SIERRA BANCORP
Form 10-Q
May 09, 2014

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 MARCH 31, 2014

Commission file number: 000-33063

Sierra Bancorp

(Exact name of Registrant as specified in its charter)

California	33-0937517
(State of Incorporation)	(IRS Employer Identification No)

86 North Main Street, Porterville, California 93257

(Address of principal executive offices) (Zip Code)

(559) 782-4900

(Registrant's telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

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 R 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 R 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.

Large accelerated filer £	Accelerated filer R
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 Rule 12b-2 of the Exchange Act).

Yes £ No R

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

Common stock, no par value, 14,121,139 shares outstanding as of April 30, 2014

FORM 10-Q

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PART I - FINANCIAL INFORMATION

Item 1 – Financial Statements

SIERRA BANCORP

CONSOLIDATED BALANCE SHEETS

(dollars in thousands)

	March 31, 2014 (unaudited)	December 31, 2013 (audited)
ASSETS		
Cash and due from banks	$ 45,379	$ 51,342
Interest-bearing deposits in banks	26,785	26,664
Total cash & cash equivalents	72,164	78,006
Investment securities available for sale	444,797	425,044
Loans held for sale	-	105
Loans and leases:		
Gross loans and leases	837,761	803,242
Allowance for loan and lease losses	(11,491)	(11,677)
Deferred loan and lease fees, net	1,254	1,522
Net loans and leases	827,524	793,087
Premises and equipment, net	21,153	20,393
Foreclosed assets	7,237	8,185
Goodwill	5,544	5,544
Other assets	79,902	79,885
TOTAL ASSETS	$ 1,458,321	$ 1,410,249
LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES		
Deposits:		
Non-interest bearing	$ 354,455	$ 365,997
Interest bearing	865,723	808,182
Total deposits	1,220,178	1,174,179
Federal funds purchased and repurchase agreements	5,527	5,974
Short-term borrowings	-	-
Long-term borrowings	-	-
Junior subordinated debentures	30,928	30,928
Other liabilities	17,519	17,494
TOTAL LIABILITIES	1,274,152	1,228,575
SHAREHOLDERS' EQUITY		
Common stock, no par value; 24,000,000 shares authorized; 14,179,439 and 14,217,199 shares issued and outstanding at March 31, 2014 and December 31, 2013, respectively	65,886	65,780
Additional paid in capital	2,574	2,648

Retained earnings	114,420	112,817
Accumulated other comprehensive (loss) income	1,289	429
TOTAL SHAREHOLDERS' EQUITY	184,169	181,674
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 1,458,321	$ 1,410,249

The accompanying notes are an integral part of these consolidated financial statements

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SIERRA BANCORP

CONSOLIDATED STATEMENTS OF INCOME

(dollars in thousands, except per share data, unaudited)

	For the Quarter Ended March 31, 2014	For the Quarter Ended March 31, 2013
Interest income:		
Interest and fees on loans	$ 10,351	$ 10,912
Interest on investment securities:		
Taxable	1,825	1,162
Tax-exempt	741	619
Interest on federal funds sold and interest-bearing deposits	35	28
Total interest income	12,952	12,721
Interest expense:		
Interest on deposits	558	660
Interest on short-term borrowings	5	4
Interest on long-term borrowings	-	33
Interest on mandatorily redeemable trust preferred securities	174	177
Total interest expense	737	874
Net Interest Income	12,215	11,847
Provision for loan losses	150	1,600
Net Interest Income after provision for loan losses	12,065	10,247
Non-interest income:		
Service charges on deposit accounts	1,886	2,072
Gains on investment securities available-for-sale	104	6
Other income, net	1,717	2,032
Total non-interest income	3,707	4,110
Non-interest expense:		
Salaries and employee benefits	5,985	5,920
Occupancy expense	1,505	1,551
Other	3,239	4,348
Total non-interest expenses	10,729	11,819
Income before income taxes	5,043	2,538
Provision for income taxes	1,244	204

Net Income	$ 3,799	$ 2,334
PER SHARE DATA		
Book value	$ 12.99	$ 12.43
Cash dividends	$ 0.08	$ 0.06
Earnings per share basic	$ 0.27	$ 0.17
Earnings per share diluted	$ 0.26	$ 0.16
Average shares outstanding, basic	14,228,040	14,113,502
Average shares outstanding, diluted	14,373,196	14,194,223
Total shareholder equity (in thousands)	$ 184,169	175,542
Shares outstanding	14,179,439	14,119,679
Dividends paid	$ 1,137,965	$ 846,665

The accompanying notes are an integral part of these consolidated financial statements

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SIERRA BANCORP

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(dollars in thousands, unaudited)

	For the Quarter Ended March 31, 2014	For the Quarter Ended March 31, 2013
Net Income	$ 3,799	$ 2,334
Other comprehensive income, before tax:		
Unrealized gains (losses) on securities:		
Unrealized holding gains (losses) arising during period	1,566	(85)
Less: reclassification adjustment for gains [1] included in net income	(104)	(6)
Other comprehensive income (loss), before tax	1,462	(91)
Income tax (expense) benefit related to items of other comprehensive income (loss), net of tax	(602)	37
Other comprehensive income (loss)	860	(54)
Comprehensive income	$ 4,659	$ 2,280

[1] Amounts are included in net gains on investment securities available-for-sale on the Consolidated Statements of Income in non-interest revenue. Income tax expense associated with the reclassification adjustment for the quarter ended March 31, 2014 and 2013 was $43 thousand and $3 thousand, respectively.

The accompanying notes are an integral part of these consolidated financial statements

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SIERRA BANCORP

CONSOLIDATED STATEMENTS OF CASH FLOWS

(dollars in thousands, unaudited)

	For the Quarter Ended March 31, 2014			2013		
Cash flows from operating activities:						
Net income	$	3,799		$	2,334	
Adjustments to reconcile net income to net cash provided by operating activities:						
Gain on sales of securities		(104	)		(6	)
Gain on sales of loans		(3	)		(36	)
(Gain) loss on sale on foreclosed assets		(350	)		488	
Writedowns on foreclosed assets		84			87	
Share-based compensation expense		12			93	
Provision for loan losses		150			1,600	
Depreciation		506			590	
Net amortization on securities premiums and discounts		1,614			2,096	
(Increase) decrease in unearned net loan fees		(268	)		29	
Increase in cash surrender value of life insurance policies		(325	)		(593	)
Proceeds from sales of loans portfolio		108			1,257	
Increase in loans held-for-sale		-			(1,800	)
(Increase) decrease in interest receivable		(445	)		1,057	

and other assets		
Increase (decrease) in other liabilities	25	(1,295)
Deferred income tax provision	65	4
Excess tax benefit from equity based compensation	(86)	(34)
Net cash provided by operating activities	4,782	5,871
Cash flows from investing activities:		
Maturities of securities available for sale	450	140
Proceeds from sales/calls of securities available for sale	4,215	977
Purchases of securities available for sale	(41,899)	(47,006)
Principal pay downs on securities available for sale	17,433	25,141
Net (increase) decrease in loans receivable, net	(34,444)	49,928
Purchases of premises and equipment, net	(1,266)	(94)
Proceeds from sales of foreclosed assets	1,339	3,725
Net cash (used in) provided by investing activities	(54,172)	32,811
Cash flows from financing activities:		
Increase (decrease) in deposits	45,999	(18,100)
Decrease in borrowed funds	-	(35,050)
(Decrease) increase in repurchase agreements	(447)	1,254
Cash dividends paid	(1,138)	(847)
Repurchases of common stock	(1,492)	-

Stock options exercised		540			158	
Excess tax benefit from equity based compensation		86			34	
Net cash provided by (used in) financing activities		43,548			(52,551	)
Decrease in cash and due from banks		(5,842	)		(13,869	)
Cash and cash equivalents						
Beginning of period		78,006			61,818	
End of period	$	72,164		$	47,949	

The accompanying notes are an integral part of these consolidated financial statements

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Sierra Bancorp

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2014

Note 1 – The Business of Sierra Bancorp

Sierra Bancorp (the "Company") is a California corporation headquartered in Porterville, California, and is a registered bank holding company under federal banking laws. The Company was formed to serve as the holding company for Bank of the Sierra (the "Bank"), and has been the Bank's sole shareholder since August 2001. The Company exists primarily for the purpose of holding the stock of the Bank and of such other subsidiaries it may acquire or establish. At the present time, the Company's only other subsidiaries are Sierra Statutory Trust II and Sierra Capital Trust III, which were formed in March 2004 and June 2006, respectively, solely to facilitate the issuance of capital trust pass-through securities (TRUPS). Pursuant to the Financial Accounting Standards Board's (FASB's) standard on the consolidation of variable interest entities, these trusts are not reflected on a consolidated basis in the Company's financial statements. References herein to the "Company" include Sierra Bancorp and its consolidated subsidiary, the Bank, unless the context indicates otherwise.

The Bank is a California state-chartered bank headquartered in Porterville, California, that offers a full range of retail and commercial banking services primarily to communities in the central and southern regions of the San Joaquin Valley. Our branch footprint stretches from Fresno on the north to Bakersfield on the south, and on the southern end extends east through the Tehachapi plateau and into the northwestern tip of the Mojave Desert. The Bank was incorporated in September 1977 and opened for business in January 1978, and in the ensuing years has grown to be the largest independent bank headquartered in the South San Joaquin Valley. Our growth has primarily been organic, but includes the acquisition of Sierra National Bank in 2000. We currently operate 25 full service branch offices throughout our geographic footprint, as well as an internet branch which provides the ability to open deposit accounts online. The Bank's most recent branching activity includes the relocation of our Clovis branch to a larger facility in a more convenient location in the third quarter of 2012. In addition to our full-service branches, the Bank has a real estate industries group, an agricultural credit division, an SBA lending unit, and offsite ATMs at six different non-branch locations. The Bank's deposit accounts are insured by the Federal Deposit Insurance Corporation (FDIC) up to maximum insurable amounts.

Note 2 – Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in a condensed format, and therefore do not include all of the information and footnotes required by US generally accepted accounting principles (GAAP) for complete financial statements. The information furnished in these interim statements reflects all adjustments that are, in the opinion of management, necessary for a fair statement of the results for such period. Such adjustments are of a normal recurring nature, unless otherwise disclosed in this Form 10-Q. In preparing the accompanying consolidated financial statements, management has taken subsequent events into consideration and recognized them where appropriate. The results of operations in the interim statements are not necessarily indicative of the results that may be expected for any other quarter, or for the full year. Certain amounts reported for 2013 have been reclassified to be consistent with the reporting for 2014. The interim financial information should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2013, as filed with the Securities and Exchange Commission.

Note 3 – Current Accounting Developments

In January 2014, the FASB issued Accounting Standards Update (ASU) 2014-01, *Investments—Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Qualified Affordable Housing Projects*, to provide additional flexibility with regard to accounting for investments in qualified affordable housing projects. ASU 2014-01 modifies the conditions that must be met to present the pretax impact and related tax benefits of such investments as a component of income taxes ("net" within income tax expense), to enable more investors to elect to use a "net" presentation for those investments. Investors that do not qualify for "net" presentation under the new guidance will continue to account for such investments under the equity method or cost method, which results in losses recognized in pretax income and tax benefits recognized in income taxes ("gross" presentation of investment results). For investments that qualify for the "net" presentation of investment performance, ASU 2014-01 introduces a "proportional amortization method" that can be elected to amortize the investment basis. If elected, the method is required for all eligible investments in qualified affordable housing projects. ASU 2014-01 also requires enhanced recurring disclosures for all investments in qualified affordable housing projects, regardless of the accounting method used for those investments. It is effective for interim and annual periods beginning after December 15, 2014, and early adoption is permitted. The Company currently expects to adopt ASU 2014-01 as of the first quarter of 2015. We will likely continue to account for our low-income housing tax credit investments using the equity method subsequent to our adoption of ASU 2014-01 and thus do not expect any impact on our income statement or balance sheet, but our disclosures with regard to low-income housing tax credit investments will be updated to reflect the new requirements.

In January 2014, the FASB issued ASU 2014-04, *Receivables—Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure*, to resolve diversity in practice with respect to a creditor's reclassification of a collateralized consumer mortgage loan to other real estate owned (OREO). Current US GAAP requires a loan to be reclassified to OREO upon a troubled debt restructuring that is "in substance a repossession or foreclosure", where the creditor receives "physical possession" of the debtor's assets regardless of whether formal foreclosure proceedings take place. The terms "in substance a repossession or foreclosure" and "physical possession" are not defined in US GAAP; therefore, questions have arisen about when a creditor should reclassify a collateralized mortgage loan to OREO. ASU 2014-04 requires a creditor to reclassify a collateralized consumer mortgage loan to real estate property upon obtaining legal title to the real estate collateral, or when the borrower voluntarily conveys all interest in the real estate property to the lender to satisfy the loan through a deed in lieu of foreclosure or similar legal agreement. ASU 2014-04 is effective for public business entities for interim and annual periods beginning after December 15, 2014. It will be adopted by the Company for the first quarter of 2015, and we do not expect any impact upon our financial statements or operations upon adoption.

Note 4 – Supplemental Disclosure of Cash Flow Information

During the three months ended March 31, 2014 and 2013, cash paid for interest due on interest-bearing liabilities was $777,000 and $993,000, respectively. There was no cash paid for income taxes during the three months ended March 31, 2014 and 2013. Assets totaling $125,000 and $293,000 were acquired in settlement of loans for the three months ended March 31, 2014 and March 31, 2013, respectively. We received $1.339 million in cash from the sale of foreclosed assets during the first three months of 2014 relative to $3.333 million during the first three months of 2013, which represents sales proceeds less loans extended to finance such sales.

Note 5 – Share Based Compensation

The 2007 Stock Incentive Plan (the "2007 Plan") was adopted by the Company in 2007. Our 1998 Stock Option Plan (the "1998 Plan") was concurrently terminated, although options to purchase 127,950 shares that were granted under the 1998 Plan were still outstanding as of March 31, 2014 and remain unaffected by that plan's termination. The 2007 Plan provides for the issuance of both "incentive" and "nonqualified" stock options to officers and employees, and of "nonqualified" stock options to non-employee directors of the Company. The 2007 Plan also provides for the potential issuance of restricted stock awards to these same classes of eligible participants, on such terms and conditions as are established at the discretion of the Board of Directors or the Compensation Committee. The total number of shares of the Company's authorized but unissued stock reserved for issuance pursuant to awards under the 2007 Plan was initially 1,500,000 shares, although the number remaining available for grant as of March 31, 2014 was 810,800. The dilutive impact of stock options outstanding is discussed below in Note 6, Earnings per Share. No restricted stock awards have been issued by the Company.

Pursuant to FASB's standards on stock compensation, the value of each option granted is reflected in our income statement as employee compensation or directors' expense by amortizing the value over the vesting period of such option or by expensing it as of the grant date for immediately vested options. The Company is utilizing the Black-Scholes model to value stock options, and the "multiple option" approach is used to allocate the resulting valuation to actual expense. Under the multiple option approach an employee's options for each vesting period are separately valued and amortized, which appears to be the preferred method for option grants with graded vesting. A pre-tax charge of $12,000 was reflected in the Company's income statement during the first quarter of 2014 and $93,000 was charged during the first quarter of 2013, as expense related to stock options.

<u>Note 6 – Earnings per Share</u>

The computation of earnings per share, as presented in the Consolidated Statements of Income, is based on the weighted average number of shares outstanding during each period. There were 14,228,040 weighted average shares outstanding during the first quarter of 2014, and 14,113,502 during the first quarter of 2013.

Diluted earnings per share include the effect of the potential issuance of common shares, which for the Company is limited to shares that would be issued on the exercise of “in-the-money” stock options. The dilutive effect of options outstanding was calculated using the treasury stock method, excluding anti-dilutive shares and adjusting for unamortized expense and windfall tax benefits. For the first quarter of 2014 the dilutive effect of options outstanding calculated under the treasury stock method totaled 145,156, which was added to basic weighted average shares outstanding for purposes of calculating diluted earnings per share. Likewise, for the first quarter of 2013 shares totaling 80,721 were added to basic weighted average shares outstanding in order to calculate diluted earnings per share.

Note 7 – Comprehensive Income

As presented in the Consolidated Statements of Comprehensive Income, comprehensive income includes net income and other comprehensive income. The Company’s only source of other comprehensive income is unrealized gains and losses on available-for-sale investment securities. Gains or losses on investment securities that were realized and included in net income of the current period, which had previously been included in other comprehensive income as unrealized holding gains or losses in the period in which they arose, are considered to be reclassification adjustments that are excluded from other comprehensive income in the current period.

Note 8 – Financial Instruments with Off-Balance-Sheet Risk

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business, in order to meet the financing needs of its customers. Those financial instruments consist of unused commitments to extend credit and standby letters of credit. They involve, to varying degrees, elements of risk in excess of the amount recognized in the balance sheet. The Company’s exposure to credit loss in the event of nonperformance by counterparties for commitments to extend credit and letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and issuing letters of credit as it does for originating loans included on the balance sheet. The following financial instruments represent off-balance-sheet credit risk (dollars in thousands):

	March 31, 2014	December 31, 2013
Commitments to extend credit	$ 425,048	$ 420,707
Standby letters of credit	$ 8,724	$ 8,703
Commercial letters of credit	$ 8,069	$ 8,070

Commitments to extend credit consist primarily of the unused or unfunded portions of the following: home equity lines of credit; commercial real estate construction loans, where disbursements are made over the course of construction; commercial revolving lines of credit; mortgage warehouse lines of credit; unsecured personal lines of credit; and formalized (disclosed) deposit account overdraft lines. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many commitments are expected to expire without being drawn upon, the unused portions of committed amounts do not necessarily represent future cash requirements.

Standby letters of credit are generally unsecured and are issued by the Company to guarantee the performance of a customer to a third party, while commercial letters of credit represent the Company's commitment to pay a third party on behalf of a customer upon fulfillment of contractual requirements. The credit risk involved in issuing letters of credit is essentially the same as the risk involved in extending loans to customers.

The Company is also utilizing a $78 million letter of credit issued by the Federal Home Loan Bank on the Company's behalf as security for certain deposits. The letter of credit is backed by specific loans which are pledged to the Federal Home Loan Bank by the Company.

Note 9 – Fair Value Disclosures and Reporting, the Fair Value Option and Fair Value Measurements

FASB's standards on financial instruments, and on fair value measurements and disclosures, require all entities to disclose in their financial statement footnotes the estimated fair values of financial instruments for which it is practicable to estimate fair values. In addition to disclosure requirements, FASB's standard on investments requires that our debt securities, which are classified as available for sale, and our equity securities that have readily determinable fair values, be measured and reported at fair value in our statement of financial position. Certain impaired loans are also reported at fair value, as explained in greater detail below, and foreclosed assets are carried at the lower of cost or fair value. FASB's standard on financial instruments permits companies to report certain other financial assets and liabilities at fair value, but we have not elected the fair value option for any additional financial assets or liabilities.