

1ST SOURCE CORP
Form 10-Q
July 21, 2011
[Table of Contents](#)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2011

OR

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

For the transition period from _____ to _____

Commission file number 0-6233

Edgar Filing: 1ST SOURCE CORP - Form 10-Q

(Exact name of registrant as specified in its charter)

INDIANA

(State or other jurisdiction of incorporation or organization)

35-1068133

(I.R.S. Employer Identification No.)

**100 North Michigan Street
South Bend, IN**

(Address of principle executive offices)

46614

(Zip Code)

(574) 235-2000

(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 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 the 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 Exchange 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 Rule 12b-2 of the Exchange Act). Yes No

Edgar Filing: 1ST SOURCE CORP - Form 10-Q

Number of shares of common stock outstanding as of July 15, 2011 24,213,142 shares

Table of Contents

TABLE OF CONTENTS

	Page
PART I. FINANCIAL INFORMATION	
<u>Item 1.</u>	<u>Financial Statements (Unaudited)</u>
	<u>Consolidated statements of financial condition June 30, 2011 and December 31, 2010</u> 3
	<u>Consolidated statements of income three and six months ended June 30, 2011 and 2010</u> 4
	<u>Consolidated statements of shareholders' equity six months ended June 30, 2011 and 2010</u> 5
	<u>Consolidated statements of cash flows six months ended June 30, 2011 and 2010</u> 6
	<u>Notes to the Consolidated Financial Statements</u> 7
<u>Item 2.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> 29
<u>Item 3.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u> 39
<u>Item 4.</u>	<u>Controls and Procedures</u> 39
PART II. OTHER INFORMATION	
<u>Item 1.</u>	<u>Legal Proceedings</u> 39
<u>Item 1A.</u>	<u>Risk Factors</u> 39
<u>Item 2.</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u> 40
<u>Item 3.</u>	<u>Defaults Upon Senior Securities</u> 40
<u>Item 4.</u>	<u>(Removed and reserved)</u> 40
<u>Item 5.</u>	<u>Other Information</u> 40
<u>Item 6.</u>	<u>Exhibits</u> 40
<u>SIGNATURES</u>	41
CERTIFICATIONS	
<u>Exhibit 31.1</u>	
<u>Exhibit 31.2</u>	
<u>Exhibit 32.1</u>	
<u>Exhibit 32.2</u>	

Table of Contents**1st SOURCE CORPORATION****CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION****(Unaudited - Dollars in thousands)**

	June 30, 2011	December 31, 2010
ASSETS		
Cash and due from banks	\$ 59,249	\$ 62,313
Federal funds sold and interest bearing deposits with other banks	100	34,559
Investment securities available-for-sale (amortized cost of \$878,401 and \$952,101 at June 30, 2011 and December 31, 2010, respectively)	902,742	969,018
Other investments	18,974	21,343
Trading account securities	143	138
Mortgages held for sale	7,805	32,599
Loans and leases - net of unearned discount		
Commercial and agricultural loans	551,820	530,228
Auto, light truck and environmental equipment	473,925	396,500
Medium and heavy duty truck	155,423	162,824
Aircraft financing	607,567	614,357
Construction equipment financing	274,968	285,634
Commercial real estate	568,226	594,729
Residential real estate	390,389	390,951
Consumer loans	95,839	95,400
Total loans and leases	3,118,157	3,070,623
Reserve for loan and lease losses	(85,010)	(86,874)
Net loans and leases	3,033,147	2,983,749
Equipment owned under operating leases, net	77,102	78,138
Net premises and equipment	36,885	33,881
Goodwill and intangible assets	88,325	88,955
Accrued income and other assets	130,479	140,588
Total assets	\$ 4,354,951	\$ 4,445,281
LIABILITIES		
Deposits:		
Noninterest bearing	\$ 516,189	\$ 524,564
Interest bearing	3,007,127	3,098,181
Total deposits	3,523,316	3,622,745
Short-term borrowings:		
Federal funds purchased and securities sold under agreements to repurchase	108,799	136,028
Other short-term borrowings	21,324	19,961
Total short-term borrowings	130,123	155,989
Long-term debt and mandatorily redeemable securities	36,785	24,816
Subordinated notes	89,692	89,692
Accrued expenses and other liabilities	69,441	65,656
Total liabilities	3,849,357	3,958,898
SHAREHOLDERS EQUITY		
Preferred stock; no par value		
Authorized 10,000,000 shares; none issued or outstanding		
Common stock; no par value		
Authorized 40,000,000 shares; issued 25,643,506 at June 30, 2011 and December 31, 2010	346,535	350,282
Retained earnings	175,374	157,875

Edgar Filing: 1ST SOURCE CORP - Form 10-Q

Cost of common stock in treasury (1,431,804 shares at June 30, 2011 and 1,470,696 shares at December 31, 2010)	(31,437)	(32,284)
Accumulated other comprehensive income	15,122	10,510
Total shareholders' equity	505,594	486,383
Total liabilities and shareholders' equity	\$ 4,354,951	\$ 4,445,281

The accompanying notes are a part of the consolidated financial statements.

Table of Contents

1st SOURCE CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

(Unaudited - Dollars in thousands, except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Interest income:				
Loans and leases	\$ 41,710	\$ 43,099	\$ 83,009	\$ 85,369
Investment securities, taxable	4,912	5,279	9,394	10,680
Investment securities, tax-exempt	1,004	1,422	2,190	2,889
Other	247	250	490	524
Total interest income	47,873	50,050	95,083	99,462
Interest expense:				
Deposits	8,162	11,573	16,517	23,978
Short-term borrowings	74	206	163	394
Subordinated notes	1,648	1,647	3,295	3,294
Long-term debt and mandatorily redeemable securities	405	375	664	645
Total interest expense	10,289	13,801	20,639	28,311
Net interest income	37,584	36,249	74,444	71,151
Provision for loan and lease losses	67	5,798	2,265	10,186
Net interest income after provision for loan and lease losses	37,517	30,451	72,179	60,965
Noninterest income:				
Trust fees	4,411	4,062	8,403	7,807
Service charges on deposit accounts	4,638	5,275	8,874	9,895
Mortgage banking income	835	425	1,279	1,202
Insurance commissions	1,062	1,061	2,204	2,526
Equipment rental income	6,009	6,672	12,047	13,417
Other income	3,327	3,012	6,298	5,701
Investment securities and other investment gains	1,142	95	1,272	976
Total noninterest income	21,424	20,602	40,377	41,524
Noninterest expense:				
Salaries and employee benefits	19,135	18,848	37,773	37,658
Net occupancy expense	2,051	1,939	4,371	4,426
Furniture and equipment expense	3,561	3,196	6,910	5,996
Depreciation - leased equipment	4,795	5,304	9,600	10,668
Professional fees	1,080	1,418	2,176	2,932
Supplies and communication	1,316	1,338	2,710	2,707
FDIC and other insurance	958	1,667	2,634	3,341
Business development and marketing expense	864	880	1,486	1,447
Loan and lease collection and repossession expense	1,500	3,267	2,824	4,373
Other expense	683	1,792	3,935	3,211
Total noninterest expense	35,943	39,649	74,419	76,759
Income before income taxes	22,998	11,404	38,137	25,730

Edgar Filing: 1ST SOURCE CORP - Form 10-Q

Income tax expense	8,133	3,609	12,664	8,256
Net income	14,865	7,795	25,473	17,474
Preferred stock dividends and discount accretion		(1,717)		(3,428)
Net income available to common shareholders	\$ 14,865	\$ 6,078	\$ 25,473	\$ 14,046
Per common share				
Basic net income per common share	\$ 0.61	\$ 0.25	\$ 1.04	\$ 0.57
Diluted net income per common share	\$ 0.61	\$ 0.25	\$ 1.04	\$ 0.57
Dividends	\$ 0.16	\$ 0.15	\$ 0.32	\$ 0.30
Basic weighted average common shares outstanding	24,254,334	24,284,519	24,262,803	24,247,586
Diluted weighted average common shares outstanding	24,263,596	24,292,491	24,271,527	24,254,098

The accompanying notes are a part of the consolidated financial statements.

Table of Contents**1st SOURCE CORPORATION****CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY****(Unaudited - Dollars in thousands, except per share amounts)**

	Total	Preferred Stock	Common Stock	Retained Earnings	Cost of Common Stock in Treasury	Accumulated Other Comprehensive Income (Loss), Net
Balance at January 1, 2010	\$ 570,320	\$ 104,930	\$ 350,269	\$ 142,407	\$ (32,380)	\$ 5,094
Comprehensive Income, net of tax:						
Net Income	17,474			17,474		
Change in unrealized appreciation of available-for-sale securities, net of tax	9,411					9,411
Reclassification adjustment for gains included in net income, net of tax	(174)					(174)
Total Comprehensive Income	26,711					
Issuance of 188,470 common shares under stock based compensation awards, including related tax effects	2,884			628	2,256	
Cost of 21,471 shares of common stock acquired for treasury	(362)				(362)	
Preferred stock discount accretion		653		(653)		
Preferred stock dividend (paid and/or accrued)	(2,775)			(2,775)		
Common stock dividend (\$0.30 per share)	(7,282)			(7,282)		
Stock based compensation	6		6			
Balance at June 30, 2010	\$ 589,502	\$ 105,583	\$ 350,275	\$ 149,799	\$ (30,486)	\$ 14,331
Balance at January 1, 2011	\$ 486,383	\$	\$ 350,282	\$ 157,875	\$ (32,284)	\$ 10,510
Comprehensive Income, net of tax:						
Net Income	25,473			25,473		
Change in unrealized appreciation of available-for-sale securities, net of tax	5,457					5,457
Reclassification adjustment for gains included in net income, net of tax	(845)					(845)
Total Comprehensive Income	30,085					
Issuance of 148,291 common shares under stock based compensation awards, including related tax effects	2,818			(168)	2,986	
Cost of 109,399 shares of common stock acquired for treasury	(2,139)				(2,139)	
Repurchase of common stock warrant	(3,750)		(3,750)			

Edgar Filing: 1ST SOURCE CORP - Form 10-Q

Common stock dividend (\$0.32 per share)		(7,806)				(7,806)						
Stock based compensation		3			3							
Balance at June 30, 2011	\$	505,594	\$		\$	346,535	\$	175,374	\$	(31,437)	\$	15,122

The accompanying notes are a part of the consolidated financial statements.

Table of Contents**1st SOURCE CORPORATION****CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited - Dollars in thousands)**

	Six Months Ended June 30,	
	2011	2010
Operating activities:		
Net income	\$ 25,473	\$ 17,474
Adjustments to reconcile net income to net cash provided (used) by operating activities:		
Provision for loan and lease losses	2,265	10,186
Depreciation of premises and equipment	1,780	2,156
Depreciation of equipment owned and leased to others	9,600	10,668
Amortization of investment security premiums and accretion of discounts, net	965	795
Amortization of mortgage servicing rights	1,458	1,461
Mortgage servicing asset impairment	16	970
Deferred income taxes	(755)	8,637
Investment securities and other investment gains	(1,272)	(976)
Originations/purchases of loans held for sale, net of principal collected	(40,963)	(138,692)
Proceeds from the sales of loans held for sale	66,258	107,651
Net gain on sale of loans held for sale	(500)	(1,394)
Change in trading account securities	(5)	12
Change in interest receivable	918	1,255
Change in interest payable	2,462	3,238
Change in other assets	8,347	(3,482)
Change in other liabilities	(734)	(6,355)
Other	2,620	387
Net change in operating activities	77,933	13,991
Investing activities:		
Proceeds from sales of investment securities	126,805	71,917
Proceeds from maturities of investment securities	107,843	215,792
Purchases of investment securities	(160,641)	(303,604)
Net change in other investments	2,370	2,056
Loans sold or participated to others	11,010	9,886
Net change in loans and leases	(62,674)	(58,893)
Net change in equipment owned under operating leases	(8,564)	(4,952)
Purchases of premises and equipment	(5,589)	(1,041)
Net change in investing activities	10,560	(68,839)
Financing activities:		
Net change in demand deposits, NOW accounts and savings accounts	(108,064)	44,177
Net change in certificates of deposit	8,635	(87,055)
Net change in short-term borrowings	(25,866)	(8,336)
Proceeds from issuance of long-term debt	10,554	10,346
Payments on long-term debt	(256)	(289)
Net proceeds from issuance of treasury stock	2,818	2,884
Acquisition of treasury stock	(2,139)	(362)
Repurchase of common stock warrant	(3,750)	
Cash dividends paid on preferred stock		(2,775)
Cash dividends paid on common stock	(7,948)	(7,408)
Net change in financing activities	(126,016)	(48,818)

Edgar Filing: 1ST SOURCE CORP - Form 10-Q

Net change in cash and cash equivalents	(37,523)	(103,666)
Cash and cash equivalents, beginning of year	96,872	210,102
Cash and cash equivalents, end of period	\$ 59,349	\$ 106,436
<u>Non-cash transactions:</u>		
Loans transferred to other real estate and repossessed assets	\$ 6,721	\$ 10,939
Common stock matching contribution to KSOP plan	2,420	2,545

The accompanying notes are a part of the consolidated financial statements.

Table of Contents

1ST SOURCE CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. Basis of Presentation

The accompanying unaudited consolidated financial statements reflect all adjustments (all of which are normal and recurring in nature) which are, in the opinion of management, necessary for a fair presentation of the consolidated financial position, the results of operations, changes in shareholders' equity, and cash flows for the periods presented. These unaudited consolidated financial statements have been prepared according to the rules and regulations of the Securities and Exchange Commission (SEC) and, therefore, certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles (GAAP) have been omitted. The Notes to the Consolidated Financial Statements appearing in 1st Source Corporation's Annual Report on Form 10-K (2010 Annual Report), which include descriptions of significant accounting policies, should be read in conjunction with these interim financial statements. The balance sheet at December 31, 2010 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. Certain amounts in the prior period consolidated financial statements have been reclassified to conform with the current year presentation.

Cash Flow For purposes of the consolidated statements of cash flow, we consider cash and due from banks, federal funds sold and interest bearing deposits with other banks with original maturities of three months or less as cash and cash equivalents.

Note 2. Recent Accounting Pronouncements

Comprehensive Income: In June 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-05 *Comprehensive Income (Topic 220) Presentation of Comprehensive Income*. ASU 2011-05 requires that all nonowner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. ASU 2011-05 is effective retrospectively for fiscal years, and interim periods within those years, beginning after December 15, 2011. We are assessing the impact of ASU 2011-05 on our comprehensive income presentation.

Fair Value Measurements: In May 2011, the FASB issued ASU No. 2011-04 *Fair Value Measurement (Topic 820) - Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*. ASU 2011-04 changes the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. Consequently, the amendments in this update result in common fair value measurement and disclosure requirements in U.S. GAAP and IFRSs (International Financial Reporting Standards). ASU 2011-04 is effective prospectively during interim and annual periods beginning on or after December 15, 2011. Early application by public entities is not permitted. We are assessing the impact of ASU 2011-04 on our fair value disclosures.

Edgar Filing: 1ST SOURCE CORP - Form 10-Q

Transfers and Servicing: In April 2011, the FASB issued ASU No. 2011-03 *Transfers and Servicing (Topic 860) - Reconsideration of Effective Control for Repurchase Agreement*. ASU 2011-03 removes from the assessment of effective control the criterion relating to the transferor's ability to repurchase or redeem financial assets on substantially the agreed terms, even in the event of default by the transferee. ASU 2011-03 is effective for the first interim or annual period beginning on or after December 15, 2011. The guidance should

Table of Contents

be applied prospectively to transactions or modifications of existing transactions that occur on or after the effective date. Early adoption is not permitted. We are assessing the impact of ASU 2011-03 on our financial condition, results of operations, and disclosures.

Receivables: In April 2011, the FASB issued ASU No. 2011-02 *Receivables (Topic 310) - A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring*. ASU 2011-02 clarifies whether loan modifications constitute troubled debt restructuring. In evaluating whether a restructuring constitutes a troubled debt restructuring, a creditor must separately conclude that both of the following exist: (a) the restructuring constitutes a concession; and (b) the debtor is experiencing financial difficulties. ASU 2011-02 is effective for the first interim and annual period beginning on or after June 15, 2011, and should be applied retrospectively to the beginning of the annual period of adoption. We are assessing the impact of ASU 2011-02 on our financial condition, results of operations, and disclosures.

Business Combinations: In December 2010, the FASB issued ASU No. 2010-29 *Business Combinations (Topic 805) - Disclosure of Supplementary Pro Forma Information for Business Combinations*. If a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. ASU 2010-29 also expands the supplementary pro forma disclosures. ASU 2010-29 was effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. ASU 2010-29 will only affect us if there are future business combinations.

Intangibles - Goodwill and Other: In December 2010, the FASB issued ASU No. 2010-28 *Intangibles - Goodwill and Other (Topic 350) - When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts*. ASU 2010-28 affects all entities that have recognized goodwill and have one or more reporting units whose carrying amount for purposes of performing Step 1 of the goodwill impairment test is zero or negative. ASU 2010-28 was effective for fiscal years and interim periods within those years, beginning after December 15, 2010. ASU 2010-28 did not have an impact on our financial condition, results of operations, or disclosures.

Table of Contents**Note 3. Investment Securities**

Investment securities available-for-sale were as follows:

(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
June 30, 2011				
U.S. Treasury and Federal agencies securities	\$ 376,304	\$ 6,998	\$ (127)	\$ 383,175
U.S. States and political subdivisions securities	112,900	5,310	(786)	117,424
Mortgage-backed securities Federal agencies	339,583	9,898	(225)	349,256
Corporate debt securities	40,563	181	(70)	40,674
Foreign government and other securities	6,705	44	(54)	6,695
Total debt securities	876,055	22,431	(1,262)	897,224
Marketable equity securities	2,346	3,176	(4)	5,518
Total investment securities available-for-sale	\$ 878,401	\$ 25,607	\$ (1,266)	