

MidWestOne Financial Group, Inc.
Form 10-Q
August 03, 2017

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 June 30, 2017

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 001-35968

MIDWESTONE FINANCIAL GROUP, INC.
(Exact name of Registrant as specified in its charter)

Iowa 42-1206172
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)
102 South Clinton Street
Iowa City, IA 52240
(Address of principal executive offices, including zip code)
319-356-5800
(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 the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth 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
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of August 1, 2017, there were 12,218,528 shares of common stock, \$1.00 par value per share, outstanding.

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 Form 10-Q Quarterly Report
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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements.

MIDWESTONE FINANCIAL GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	June 30, 2017	December 31, 2016
(dollars in thousands, except per share amounts)	(unaudited)	
ASSETS		
Cash and due from banks	\$46,234	\$ 41,464
Interest-bearing deposits in banks	3,164	1,764
Cash and cash equivalents	49,398	43,228
Investment securities:		
Available for sale	442,958	477,518
Held to maturity (fair value of \$183,296 as of June 30, 2017 and \$164,792 as of December 31, 2016)	182,478	168,392
Loans held for sale	1,636	4,241
Loans	2,197,503	2,165,143
Allowance for loan losses	(22,510)	(21,850)
Net loans	2,174,993	2,143,293
Premises and equipment, net	74,711	75,043
Accrued interest receivable	12,606	13,871
Goodwill	64,654	64,654
Other intangible assets, net	13,518	15,171
Bank-owned life insurance	47,877	47,231
Other real estate owned	1,486	2,097
Deferred income taxes	5,482	6,523
Other assets	19,248	18,313
Total assets	\$3,091,045	\$ 3,079,575
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Non-interest-bearing demand	\$476,031	\$ 494,586
Interest-bearing checking	1,131,151	1,136,282
Savings	203,967	197,698
Certificates of deposit under \$100,000	325,847	326,832
Certificates of deposit \$100,000 and over	356,713	325,050
Total deposits	2,493,709	2,480,448
Federal funds purchased	45,319	35,684
Securities sold under agreements to repurchase	60,182	82,187
Federal Home Loan Bank borrowings	90,000	115,000
Junior subordinated notes issued to capital trusts	23,743	23,692
Long-term debt	15,000	17,500
Deferred compensation liability	5,224	5,180
Accrued interest payable	1,551	1,472
Other liabilities	13,445	12,956
Total liabilities	2,748,173	2,774,119
Shareholders' equity:		
Preferred stock, no par value; authorized 500,000 shares; no shares issued and outstanding at June 30, 2017 and December 31, 2016	\$ —	\$ —

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Common stock, \$1.00 par value; authorized 30,000,000 shares at June 30, 2017 and 15,000,000 shares at December 31, 2016; issued 12,463,481 shares at June 30, 2017 and 11,713,481 shares at December 31, 2016; outstanding 12,218,528 shares at June 30, 2017 and 11,436,360 shares at December 31, 2016	12,463	11,713
Additional paid-in capital	187,062	163,667
Treasury stock at cost, 244,953 shares as of June 30, 2017 and 277,121 shares as of December 31, 2016	(5,141	) (5,766
Retained earnings	147,015	136,975
Accumulated other comprehensive income (loss)	1,473	(1,133
Total shareholders' equity	342,872	305,456
Total liabilities and shareholders' equity	\$3,091,045	\$3,079,575
See accompanying notes to consolidated financial statements.		

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CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited) (dollars in thousands, except per share amounts)	Three Months		Six Months Ended	
	Ended June 30, 2017	2016	June 30, 2017	2016
Interest income:				
Interest and fees on loans	\$25,650	\$ 24,635	\$49,929	\$ 49,751
Interest on bank deposits	26	70	31	78
Interest on federal funds sold	1	1	1	1
Interest on investment securities:				
Taxable securities	2,590	1,912	5,308	3,836
Tax-exempt securities	1,587	1,420	3,152	2,857
Total interest income	29,854	28,038	58,421	56,523
Interest expense:				
Interest on deposits:				
Interest-bearing checking	912	776	1,710	1,536
Savings	51	60	102	166
Certificates of deposit under \$100,000	886	719	1,745	1,288
Certificates of deposit \$100,000 and over	995	719	1,912	1,358
Total interest expense on deposits	2,844	2,274	5,469	4,348
Interest on federal funds purchased	25	—	71	25
Interest on securities sold under agreements to repurchase	34	32	72	85
Interest on Federal Home Loan Bank borrowings	404	467	847	918
Interest on other borrowings	3	6	6	12
Interest on junior subordinated notes issued to capital trusts	240	196	461	393
Interest on long-term debt	113	123	223	247
Total interest expense	3,663	3,098	7,149	6,028
Net interest income	26,191	24,940	51,272	50,495
Provision for loan losses	1,240	1,171	2,281	2,236
Net interest income after provision for loan losses	24,951	23,769	48,991	48,259
Noninterest income:				
Trust, investment, and insurance fees	1,528	1,440	3,140	2,938
Service charges and fees on deposit accounts	1,257	1,283	2,540	2,541
Loan origination and servicing fees	718	855	1,520	1,474
Other service charges and fees	1,497	1,378	2,955	2,808
Bank-owned life insurance income	318	332	646	716
Gain on sale or call of available for sale securities	20	223	20	467
Gain on sale of held to maturity securities	—	—	43	—
Gain (loss) on sale of premises and equipment	8	(40)	6	(251)
Other gain	37	124	50	1,307
Total noninterest income	5,383	5,595	10,920	12,000
Noninterest expense:				
Salaries and employee benefits	11,789	13,321	23,673	25,966
Net occupancy and equipment expense	3,033	3,326	6,337	6,577
Professional fees	1,036	1,221	2,058	2,167
Data processing expense	548	809	1,259	3,382
FDIC insurance expense	352	398	719	819
Amortization of intangible assets	804	1,015	1,653	2,076

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Other operating expense	2,402	2,725	4,600	5,274
Total noninterest expense	19,964	22,815	40,299	46,261
Income before income tax expense	10,370	6,549	19,612	13,998
Income tax expense	3,136	1,794	5,665	3,699
Net income	\$7,234	\$ 4,755	\$13,947	\$ 10,299
Share and per share information:				
Ending number of shares outstanding	12,218,528	11,435,860	12,218,528	11,435,860
Average number of shares outstanding	12,200,689	11,431,252	11,855,108	11,424,122
Diluted average number of shares	12,219,238	11,453,831	11,878,315	11,448,677
Earnings per common share - basic	\$0.59	\$ 0.42	\$ 1.18	\$ 0.90
Earnings per common share - diluted	0.59	0.42	1.17	0.90
Dividends paid per common share	0.165	0.16	0.33	0.32

See accompanying notes to consolidated financial statements.

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CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(unaudited) (dollars in thousands)	Three Months		Six Months Ended	
	Ended June 30,		June 30,	
	2017	2016	2017	2016
Net income	\$7,234	\$4,755	\$13,947	\$10,299
Other comprehensive income, available for sale securities:				
Unrealized holding gains arising during period	2,745	891	4,312	3,869
Reclassification adjustment for gains included in net income	(20)	(223)	(20)	(467)
Income tax expense	(1,070)	(389)	(1,686)	(1,405)
Other comprehensive income on available for sale securities	1,655	279	2,606	1,997
Other comprehensive income, net of tax	1,655	279	2,606	1,997
Comprehensive income	\$8,889	\$5,034	\$16,553	\$12,296

See accompanying notes to consolidated financial statements.

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CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(unaudited) (dollars in thousands, except per share amounts)	Preferred Stock	Common Stock	Additional Paid-in Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance at December 31, 2015	\$ —	—\$ 11,713	\$ 163,487	\$(6,331)	\$ 123,901	\$ 3,408	\$ 296,178
Net income	—	—	—	—	10,299	—	10,299
Dividends paid on common stock (\$0.32 per share)	—	—	—	—	(3,657)	—	(3,657)
Stock options exercised (2,900 shares)	—	—	(22)	60	—	—	38
Release/lapse of restriction on RSUs (25,633 shares)	—	—	(520)	495	—	—	(25)
Stock compensation	—	—	365	—	—	—	365
Other comprehensive income, net of tax	—	—	—	—	—	1,997	1,997
Balance at June 30, 2016	\$ —	—\$ 11,713	\$ 163,310	\$(5,776)	\$ 130,543	\$ 5,405	\$ 305,195
Balance at December 31, 2016	\$ —	—\$ 11,713	\$ 163,667	\$(5,766)	\$ 136,975	\$ (1,133)	\$ 305,456
Net income	—	—	—	—	13,947	—	13,947
Issuance of common stock (750,000 shares), net of expenses of \$1,328,000	—	750	23,610	—	—	—	24,360
Dividends paid on common stock (\$0.33 per share)	—	—	—	—	(3,907)	—	(3,907)
Stock options exercised (8,250 shares)	—	—	(81)	172	—	—	91
Release/lapse of restriction on RSUs (26,875 shares)	—	—	(560)	453	—	—	(107)
Stock compensation	—	—	426	—	—	—	426
Other comprehensive income, net of tax	—	—	—	—	—	2,606	2,606
Balance at June 30, 2017	\$ —	—\$ 12,463	\$ 187,062	\$(5,141)	\$ 147,015	\$ 1,473	\$ 342,872

See accompanying notes to consolidated financial statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited) (dollars in thousands)	Six Months Ended June 30,	
	2017	2016
Cash flows from operating activities:		
Net income	\$ 13,947	\$ 10,299
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	2,281	2,236
Depreciation of premises and equipment	2,058	2,297
Amortization of other intangibles	1,653	2,076
Amortization of premiums and discounts on investment securities, net	650	916
(Gain) loss on sale of premises and equipment	(6	) 251
Deferred income taxes	(554	) (468
Excess tax benefit from share-based award activity	(91	) (13
Stock-based compensation	426	365
Net gain on sale or call of available for sale securities	(20	) (467
Net gain on sale or call of held to maturity securities	(43) —
Net gain on sale of other real estate owned	(30	) (601
Net gain on sale of loans held for sale	(799	) (993
Writedown of other real estate owned	23	—
Origination of loans held for sale	(41,284	) (47,588
Proceeds from sales of loans held for sale	44,688	46,720
Decrease in accrued interest receivable	1,265	1,565
Increase in cash surrender value of bank-owned life insurance	(646	) (716
(Increase) decrease in other assets	(935	) 342
Increase in deferred compensation liability	44	58
Increase in accrued interest payable, accounts payable, accrued expenses, and other liabilities	568	3,973
Net cash provided by operating activities	23,195	20,252
Cash flows from investing activities:		
Proceeds from sales of available for sale securities	9,999	23,384
Proceeds from maturities and calls of available for sale securities	41,162	51,873
Purchases of available for sale securities	(12,841	) (15,818
Proceeds from sales of held to maturity securities	1,153	—
Proceeds from maturities and calls of held to maturity securities	2,998	9,259
Purchase of held to maturity securities	(18,292	) (16,821
Net increase in loans	(34,188	) (17,610
Purchases of premises and equipment	(1,697	) (3,964
Proceeds from sale of other real estate owned	825	6,252
Proceeds from sale of premises and equipment	28	1,233
Proceeds of principal and earnings from bank-owned life insurance	—	430
Net cash provided by (used in) investing activities	(10,853	) 38,218
Cash flows from financing activities:		
Net increase in deposits	13,261	40
Increase (decrease) in federal funds purchased	9,635	(1,500
Decrease in securities sold under agreements to repurchase	(22,005	) (7,005
Proceeds from Federal Home Loan Bank borrowings	50,000	30,000
Repayment of Federal Home Loan Bank borrowings	(75,000) (10,000

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Proceeds from stock options exercised	1	38
Excess tax benefit from share-based award activity	91	13
Taxes paid relating to net share settlement of equity awards	(108)	(38)
Payments on long-term debt	(2,500)	(2,500)
Dividends paid	(3,907)	(3,657)
Proceeds from issuance of common stock	25,688	—
Payment of stock issuance costs	(1,328)	—
Net cash provided by (used in) financing activities	(6,172)	5,391
Net increase in cash and cash equivalents	6,170	63,861
Cash and cash equivalents at beginning of period	43,228	47,097
Cash and cash equivalents at end of period	\$49,398	\$110,958

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(unaudited) (dollars in thousands)	Six Months	
	Ended June 30,	
	2017	2016
Supplemental disclosures of cash flow information:		
Cash paid during the period for interest	\$7,070	\$5,915
Cash paid during the period for income taxes	\$5,975	\$4,225
Supplemental schedule of non-cash investing activities:		
Transfer of loans to other real estate owned	\$207	\$960
See accompanying notes to consolidated financial statements.		

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MidWestOne Financial Group, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(Unaudited)

1. Principles of Consolidation and Presentation

MidWestOne Financial Group, Inc. (the “Company,” which is also referred to herein as “we,” “our” or “us”) is an Iowa corporation incorporated in 1983, a bank holding company under the Bank Holding Company Act of 1956, as amended, and a financial holding company under the Gramm-Leach-Bliley Act of 1999. Our principal executive offices are located at 102 South Clinton Street, Iowa City, Iowa 52240.

The Company owns all of the common stock of MidWestOne Bank, an Iowa state non-member bank chartered in 1934 with its main office in Iowa City, Iowa (the “Bank”), and all of the common stock of MidWestOne Insurance Services, Inc., Oskaloosa, Iowa. We operate primarily through MidWestOne Bank, our bank subsidiary, and MidWestOne Insurance Services, Inc., our wholly-owned subsidiary that operates an insurance agency business through six offices located in central and east-central Iowa.

On May 1, 2015, the Company completed its merger with Central Bancshares, Inc. (“Central”), pursuant to which Central was merged with and into the Company. In connection with the merger, Central Bank, a Minnesota-chartered commercial bank and wholly-owned subsidiary of Central, became a wholly-owned subsidiary of the Company. On April 1, 2016, Central Bank merged with and into MidWestOne Bank.

The accompanying unaudited consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and, therefore, do not include all the information and notes necessary for complete financial statements in conformity with U.S. generally accepted accounting principles (“GAAP”). The information in this Quarterly Report on Form 10-Q is written with the presumption that the users of the interim financial statements have read or have access to the most recent Annual Report on Form 10-K of the Company, which contains the latest audited financial statements and notes thereto, together with Management’s Discussion and Analysis of Financial Condition and Results of Operations as of December 31, 2016 and for the year then ended. Management believes that the disclosures in this Form 10-Q are adequate to make the information presented not misleading. In the opinion of management, the accompanying consolidated financial statements contain all adjustments (consisting of only normal recurring accruals) necessary to present fairly the Company’s financial position as of June 30, 2017, and the results of operations and cash flows for the three and six months ended June 30, 2017 and 2016. All significant intercompany accounts and transactions have been eliminated in consolidation.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect: (1) the reported amounts of assets and liabilities, (2) the disclosure of contingent assets and liabilities at the date of the financial statements, and (3) the reported amounts of revenues and expenses during the reporting period. These estimates are based on information available to management at the time the estimates are made. Actual results could differ from those estimates. The results for the three and six months ended June 30, 2017 may not be indicative of results for the year ending December 31, 2017, or for any other period.

The Company adopted ASU 2016-09, “Improvements to Employee Share-Based Payment Accounting,” on January 1, 2017. The Company elected to account for forfeitures when they occur and recognize them in compensation cost at that time. There was no effect due to this accounting policy election on the Company’s consolidated financial statements.

The Company adopted ASU 2017-08, “Premium Amortization on Purchased Callable Debt Securities” during the second quarter of 2017. Since the Company was already amortizing premiums on callable investment securities between the date of purchase and the first call date, there was no cumulative effect adjustment necessary to the Company’s consolidated financial statements.

All significant accounting policies followed in the preparation of the quarterly financial statements are disclosed in the Annual Report on Form 10-K for the year ended December 31, 2016.

In the consolidated statements of cash flows, cash and cash equivalents include cash and due from banks, interest-bearing deposits in banks, and federal funds sold.

Certain reclassifications have been made to prior periods' consolidated financial statements to present them on a basis comparable with the current period's consolidated financial statements.

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2. Shareholders' Equity

Preferred Stock: The number of authorized shares of preferred stock for the Company is 500,000. As of June 30, 2017, none were issued or outstanding.

Common Stock: As of June 30, 2017, the number of authorized shares of common stock for the Company was 30,000,000. At the Company's 2017 annual meeting of shareholders, the Company's shareholders approved an increase in the number of authorized shares of common stock to 30,000,000, which became effective on April 21, 2017. As of June 30, 2017, 12,218,528 shares were outstanding.

On March 17, 2017, the Company entered into an underwriting agreement to offer and sell, through an underwriter, up to 750,000 newly issued shares of the Company's common stock, \$1.00 par value per share, at a public purchase price of \$34.25 per share. This included 250,000 shares of the Company's common stock granted as a 30-day option to purchase to cover over-allotments, if any. On April 6, 2017, the underwriter purchased the full amount of its over-allotment option of 250,000 shares.

On July 21, 2016, the board of directors of the Company approved a share repurchase program, allowing for the repurchase of up to \$5.0 million of stock through December 31, 2018. During the second quarter of 2017 the Company repurchased no common stock. Of the \$5.0 million of stock authorized under the repurchase plan, \$5.0 million remained available for possible future repurchases as of June 30, 2017.

3. Earnings per Share

Basic per-share amounts are computed by dividing net income (the numerator) by the weighted-average number of common shares outstanding (the denominator). Diluted per-share amounts assume issuance of all common stock issuable upon conversion or exercise of other securities, unless the effect is to reduce the loss or increase the income per common share from continuing operations.

The following table presents the computation of earnings per common share for the respective periods:

	Three Months		Six Months Ended	
	Ended June 30,		June 30,	
(dollars in thousands, except per share amounts)	2017	2016	2017	2016
Basic earnings per common share computation				
Numerator:				
Net income	\$7,234	\$ 4,755	\$13,947	\$ 10,299
Denominator:				
Weighted average shares outstanding	12,200,689	11,431,252	11,855,108	11,424,122
Basic earnings per common share	\$0.59	\$ 0.42	\$1.18	\$ 0.90
Diluted earnings per common share computation				
Numerator:				
Net income	\$7,234	\$ 4,755	\$13,947	\$ 10,299
Denominator:				
Weighted average shares outstanding, including all dilutive potential shares	12,219,238	11,453,831	11,878,315	11,448,677
Diluted earnings per common share	\$0.59	\$ 0.42	\$1.17	\$ 0.90

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4. Investment Securities

The amortized cost and fair value of investment securities available for sale, with gross unrealized gains and losses, are as follows:

	As of June 30, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
(in thousands)				
U.S. Government agencies and corporations	\$5,768	\$ 10	\$ —	\$5,778
State and political subdivisions	147,392	4,474	27	151,839
Mortgage-backed securities	53,654	490	29	54,115
Collateralized mortgage obligations	167,130	118	2,858	164,390
Corporate debt securities	64,331	326	155	64,502
Total debt securities	438,275	5,418	3,069	440,624
Other equity securities	2,263	101	30	2,334
Total	\$440,538	\$ 5,519	\$ 3,099	\$442,958

	As of December 31, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
(in thousands)				
U.S. Government agencies and corporations	\$5,895	\$ 10	\$ —	\$5,905
State and political subdivisions	162,145	3,545	418	165,272
Mortgage-backed securities	61,606	315	567	61,354
Collateralized mortgage obligations	175,506	148	4,387	171,267
Corporate debt securities	72,979	76	602	72,453
Total debt securities	478,131	4,094	5,974	476,251
Other equity securities	1,259	66	58	1,267
Total	\$479,390	\$ 4,160	\$ 6,032	\$477,518

The amortized cost and fair value of investment securities held to maturity, with gross unrealized gains and losses, are as follows: