

ENTERPRISE FINANCIAL SERVICES CORP
Form 10-Q
October 31, 2014

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 September 30, 2014.

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 001-15373

ENTERPRISE FINANCIAL SERVICES CORP

Incorporated in the State of Delaware
I.R.S. Employer Identification # 43-1706259
Address: 150 North Meramec
Clayton, MO 63105
Telephone: (314) 725-5500

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, 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 website, 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. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

(Do not check if a 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

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As of October 29, 2014, the Registrant had 19,785,022 shares of outstanding common stock, \$0.01 par value.

This document is also available through our website at <http://www.enterprisebank.com>.

ENTERPRISE FINANCIAL SERVICES CORP AND SUBSIDIARIES
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PART 1 – ITEM 1 – FINANCIAL STATEMENTS

ENTERPRISE FINANCIAL SERVICES CORP AND SUBSIDIARIES

Condensed Consolidated Balance Sheets (Unaudited)

(In thousands, except share and per share data)

	September 30, 2014	December 31, 2013
Assets		
Cash and due from banks	\$54,113	\$19,573
Federal funds sold	36	76
Interest-bearing deposits (including \$980 and \$990 pledged as collateral)	69,663	190,920
Total cash and cash equivalents	123,812	210,569
Interest-bearing deposits greater than 90 days	5,300	5,300
Securities available for sale	456,584	434,587
Loans held for sale	4,899	1,834
Portfolio loans	2,294,905	2,137,313
Less: Allowance for loan losses	28,800	27,289
Portfolio loans, net	2,266,105	2,110,024
Purchase credit impaired loans, net of the allowance for loan losses (\$15,544 and \$15,438, respectively)	98,318	125,100
Total loans, net	2,364,423	2,235,124
Other real estate not covered under FDIC loss share	2,261	7,576
Other real estate covered under FDIC loss share	8,826	15,676
Other investments, at cost	15,291	12,605
Fixed assets, net	18,054	18,180
Accrued interest receivable	7,526	7,303
State tax credits, held for sale, including \$15,131 and \$16,491 carried at fair value, respectively	45,631	48,457
FDIC loss share receivable	22,039	34,319
Goodwill	30,334	30,334
Intangible assets, net	4,453	5,418
Other assets	100,157	102,915
Total assets	\$3,209,590	\$3,170,197
Liabilities and Shareholders' Equity		
Demand deposits	\$695,804	\$653,686
Interest-bearing transaction accounts	438,205	219,802
Money market accounts	736,840	948,884
Savings	80,521	79,666
Certificates of deposit:		
\$100 and over	426,593	475,544
Other	131,801	157,371
Total deposits	2,509,764	2,534,953
Subordinated debentures	56,807	62,581
Federal Home Loan Bank advances	120,000	50,000
Other borrowings	181,122	203,831
Notes payable	6,000	10,500
Accrued interest payable	854	957
Other liabilities	26,289	27,670
Total liabilities	2,900,836	2,890,492
Shareholders' equity:		

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Preferred stock, \$0.01 par value; 5,000,000 shares authorized; 0 shares issued and outstanding	—	—
Common stock, \$0.01 par value; 30,000,000 shares authorized; 19,861,022 and 19,399,709 shares issued, respectively	199	194
Treasury stock, at cost; 76,000 shares	(1,743	) (1,743)
Additional paid in capital	207,079	200,258
Retained earnings	103,452	85,376
Accumulated other comprehensive loss	(233	) (4,380)
Total shareholders' equity	308,754	279,705
Total liabilities and shareholders' equity	\$3,209,590	\$3,170,197
See accompanying notes to condensed consolidated financial statements.		

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ENTERPRISE FINANCIAL SERVICES CORP AND SUBSIDIARIES

Condensed Consolidated Statements of Operations (Unaudited)

	Three months ended		Nine months ended	
	September 30,		September 30,	
(In thousands, except per share data)	2014	2013	2014	2013
Interest income:				
Interest and fees on loans	\$28,395	\$34,396	\$89,582	\$109,330
Interest on debt securities:				
Taxable	2,190	2,043	6,545	6,210
Nontaxable	298	301	896	907
Interest on interest-bearing deposits	43	37	145	130
Dividends on equity securities	110	106	201	277
Total interest income	31,036	36,883	97,369	116,854
Interest expense:				
Interest-bearing transaction accounts	163	99	385	360
Money market accounts	653	714	2,095	2,348
Savings	52	56	151	171
Certificates of deposit:				
\$100 and over	1,335	1,326	3,997	4,207
Other	406	439	1,249	1,385
Subordinated debentures	306	679	1,016	2,580
Federal Home Loan Bank advances	490	757	1,345	2,221
Notes payable and other borrowings	187	239	579	801
Total interest expense	3,592	4,309	10,817	14,073
Net interest income	27,444	32,574	86,552	102,781
Provision for portfolio loan losses	66	(652)	2,441	(3,094)
Provision for purchase credit impaired loan losses	(1,877)	2,811	957	2,789
Net interest income after provision for loan losses	29,255	30,415	83,154	103,086
Noninterest income:				
Wealth Management revenue	1,754	1,698	5,191	5,419
Service charges on deposit accounts	1,812	1,768	5,317	5,025
Other service charges and fee income	849	722	2,188	2,030
Gain on sale of other real estate	114	472	1,514	1,562
Gain on state tax credits, net	156	308	860	1,214
Gain on sale of investment securities	—	611	—	1,295
Change in FDIC loss share receivable	(2,374)	(2,849)	(7,526)	(13,647)
Miscellaneous income	2,141	986	4,235	2,055
Total noninterest income	4,452	3,716	11,779	4,953
Noninterest expense:				
Employee compensation and benefits	11,913	10,777	35,882	33,006
Occupancy	1,683	1,689	4,998	5,298
Data processing	1,045	1,143	3,296	3,000
FDIC and other insurance	710	900	2,170	2,592
Loan legal and other real estate expense	811	1,247	2,985	3,355
Professional fees	710	1,041	2,569	3,394
FDIC clawback	1,028	62	1,060	815
Other	3,221	4,149	9,708	10,979
Total noninterest expense	21,121	21,008	62,668	62,439

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Income before income tax expense	12,586	13,123	32,265	45,600
Income tax expense	4,388	4,713	11,059	16,117
Net income	\$8,198	\$8,410	\$21,206	\$29,483

Earnings per common share

Basic	\$0.41	\$0.45	\$1.07	\$1.61
Diluted	0.41	0.44	1.07	1.55

See accompanying notes to condensed consolidated financial statements.

ENTERPRISE FINANCIAL SERVICES CORP AND SUBSIDIARIES
Condensed Consolidated Statements of Comprehensive Income (Unaudited)

(in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Net income	\$8,198	\$8,410	\$21,206	\$29,483
Other comprehensive income (loss), net of tax:				
Unrealized gain/(loss) on investment securities available for sale arising during the period, net of income tax expense/(benefit) for three months of \$(505), and \$598, and for nine months of \$2,574 and (\$5,716), respectively.	(812	) 939	4,147	(8,981)
Less reclassification adjustment for realized gains on sale of securities available for sale included in net income, net of income tax expense for three months of \$0, and \$238, and for the nine months of \$0, and \$505, respectively.	—	(373	) —	(790)
Total other comprehensive income (loss)	(812	) 566	4,147	(9,771)
Total comprehensive income	\$7,386	\$8,976	\$25,353	\$19,712

See accompanying notes to condensed consolidated financial statements.

ENTERPRISE FINANCIAL SERVICES CORP AND SUBSIDIARIES
Condensed Consolidated Statements of Shareholders' Equity (Unaudited)

(in thousands, except per share data)	Preferred Stock	Common Stock	Treasury Stock	Additional paid in capital	Retained earnings	Accumulated other comprehensive income (loss)	Total shareholders' equity
Balance January 1, 2014	\$ —	\$ 194	\$(1,743)	\$200,258	\$85,376	\$ (4,380)	\$ 279,705
Net income	—	—	—	—	21,206	—	21,206
Other comprehensive income	—	—	—	—	—	4,147	4,147
Cash dividends paid on common shares, \$0.105 per share	—	—	—	—	(3,130)	—	(3,130)
Issuance under equity compensation plans, 173,461 shares	—	2	—	(484)	—	—	(482)
Trust preferred securities conversion 287,852 shares	—	3	—	4,999	—	—	5,002
Share-based compensation	—	—	—	2,205	—	—	2,205
Excess tax benefit related to equity compensation plans	—	—	—	101	—	—	101
Balance September 30, 2014	\$ —	\$ 199	\$(1,743)	\$207,079	\$103,452	\$ (233)	\$ 308,754

(in thousands, except per share data)	Preferred Stock	Common Stock	Treasury Stock	Additional paid in capital	Retained earnings	Accumulated other comprehensive income (loss)	Total shareholders' equity
Balance January 1, 2013	\$ —	\$ 181	\$(1,743)	\$173,299	\$56,218	\$ 7,790	\$ 235,745
Net income	—	—	—	—	29,483	—	29,483
Other comprehensive loss	—	—	—	—	—	(9,771)	(9,771)
Cash dividends paid on common shares, \$0.1575 per share	—	—	—	—	(2,924)	—	(2,924)
Repurchase of common stock warrants	—	—	—	(1,006)	—	—	(1,006)
Issuance under equity compensation plans, 87,743 shares	—	1	—	2,550	—	—	2,551
Trust preferred securities conversion, 1,176,470 shares	—	12	—	20,431	—	—	20,443
Share-based compensation	—	—	—	3,136	—	—	3,136
Excess tax benefit related to equity compensation plans	—	—	—	83	—	—	83
Balance September 30, 2013	\$ —	\$ 194	\$(1,743)	\$198,493	\$82,777	\$ (1,981)	\$ 277,740

See accompanying notes to condensed consolidated financial statements.

ENTERPRISE FINANCIAL SERVICES CORP AND SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows (Unaudited)

(in thousands)	Nine months ended September 30,	
	2014	2013
Cash flows from operating activities:		
Net income	\$21,206	\$29,483
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation	1,681	1,936
Provision for loan losses	3,398	(305)
Deferred income taxes	6,458	180
Net amortization of debt securities	2,885	4,579
Amortization of intangible assets	965	1,540
Gain on sale of investment securities	—	(1,295)
Mortgage loans originated for sale	(52,475)	(64,463)
Proceeds from mortgage loans sold	49,811	70,884
Gain on sale of other real estate	(1,514)	(1,562)
Gain on state tax credits, net	(860)	(1,214)
Excess tax benefit of share-based compensation	(101)	—
Share-based compensation	2,205	3,136
Valuation adjustment on other real estate	618	962
Net accretion of loan discount and indemnification asset	731	(13,853)
Changes in:		
Accrued interest receivable	(223)	) 600
Accrued interest payable	(103)	) (397)
Prepaid FDIC insurance	—	2,607
Other assets	(2,984)	) (21,322)
Other liabilities	(1,381)	) 516
Net cash provided by operating activities	30,317	12,012
Cash flows from investing activities:		
Net (increase) decrease in loans	(133,782)	) 36,955
Net cash proceeds received from FDIC loss share receivable	6,487	9,654
Proceeds from the sale of debt and equity securities, available for sale	—	159,604
Proceeds from the maturity of debt and equity securities, available for sale	35,503	69,017
Proceeds from the redemption of other investments	18,637	26,695
Proceeds from the sale of state tax credits held for sale	4,099	8,126
Proceeds from the sale of other real estate	14,435	15,303
Payments for the purchase/origination of:		
Available for sale debt and equity securities	(53,664)	) (60,732)
Other investments	(21,324)	) (28,143)
Bank owned life insurance	—	(20,000)
State tax credits held for sale	—	(1,365)
Fixed assets	(1,556)	) (1,122)
Net cash (used in) provided by investing activities	(131,165)	) 213,992
Cash flows from financing activities:		
Net increase/(decrease) in noninterest-bearing deposit accounts	42,118	(67,242)
Net decrease in interest-bearing deposit accounts	(67,307)	) (143,691)
Proceeds from Federal Home Loan Bank advances	799,600	743,000
Repayments of Federal Home Loan Bank advances	(729,600)) (703,000)
Repayments of notes payable	(4,500)) (900)

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Repayments of subordinated debentures	—	(2,000)
Net decrease in other borrowings	(22,709)	(66,005)
Cash dividends paid on common stock	(3,130	)	(2,924)
Excess tax benefit of share-based compensation	101	83	
Payments for the repurchase of common stock warrants	—	(1,006)
Employee stock issuances, net	(482	)	2,551)
Net cash provided by (used in) financing activities	14,091	(241,134)
Net decrease in cash and cash equivalents	(86,757	)	(15,130)
Cash and cash equivalents, beginning of period	210,569	116,370	
Cash and cash equivalents, end of period	\$123,812	\$101,240	
Supplemental disclosures of cash flow information:			
Cash paid during the period for:			
Interest	\$10,920	\$14,470	
Income taxes	8,998	24,348	
Noncash transactions:			
Transfer to other real estate owned in settlement of loans	7,468	21,116	
Sales of other real estate financed	5,102	5,564	
Issuance of common stock from Trust Preferred Securities conversion	5,002	20,443	
See accompanying notes to condensed consolidated financial statements.			

ENTERPRISE FINANCIAL SERVICES CORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies used by Enterprise Financial Services Corp (the “Company” or “Enterprise”) in the preparation of the condensed consolidated financial statements are summarized below:

Business and Consolidation

Enterprise is a financial holding company that provides a full range of banking and wealth management services to individuals and corporate customers located in the St. Louis, Kansas City and Phoenix metropolitan markets through its banking subsidiary, Enterprise Bank & Trust (the “Bank”).

Operating results for the three and nine months ended September 30, 2014 are not necessarily indicative of the results that may be expected for any other interim period or for the year ending December 31, 2014. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2013.

Basis of Financial Statement Presentation

The condensed consolidated financial statements of the Company and its subsidiaries have been prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. The condensed consolidated financial statements include the accounts of the Company and its subsidiaries, all of which are wholly owned. All intercompany accounts and transactions have been eliminated. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included.

NOTE 2 - EARNINGS PER SHARE

Basic earnings per common share data is calculated by dividing net income available to common shareholders by the weighted average number of common shares outstanding during the period. Common shares outstanding include common stock and restricted stock awards where recipients have satisfied the vesting terms. Diluted earnings per common share gives effect to all dilutive potential common shares outstanding during the period using the treasury stock method and the if-converted method for convertible trust preferred securities.

The following table presents a summary of per common share data and amounts for the periods indicated.

(in thousands, except per share data)	Three months ended		Nine months ended	
	September 30,		September 30,	
	2014	2013	2014	2013
Net income as reported	\$8,198	\$8,410	\$21,206	\$29,483
Impact of assumed conversions				
Interest on 9% convertible trust preferred securities, net of income tax	—	217	66	926
Net income available to common shareholders and assumed conversions	\$8,198	\$8,627	\$21,272	\$30,409
Weighted average common shares outstanding	19,838	18,779	19,729	18,288
Incremental shares from assumed conversions of convertible trust preferred securities	—	851	76	1,241
Additional dilutive common stock equivalents	142	200	165	153
Weighted average diluted common shares outstanding	19,980	19,830	19,970	19,682
Basic earnings per common share:	\$0.41	\$0.45	\$1.07	\$1.61
Diluted earnings per common share:	\$0.41	\$0.44	\$1.07	\$1.55

For the three months ended September 30, 2014 and 2013, the amount of common stock equivalents excluded from the earnings per share calculations because their effect was anti-dilutive was 289,286, and 474,267 common stock equivalents, respectively. For the nine months ended September 30, 2014 and 2013, the amount of common stock equivalents excluded from the earnings per share calculations because their effect was anti-dilutive was 289,407, and 488,318 common stock equivalents (including 9,497 common stock warrants), respectively.

NOTE 3 - INVESTMENTS

The following table presents the amortized cost, gross unrealized gains and losses and fair value of securities available-for-sale:

(in thousands)	September 30, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale securities:				
Obligations of U.S. Government-sponsored enterprises	\$91,823	\$638	\$(189)	) \$92,272
Obligations of states and political subdivisions	49,064	1,576	(699)	) 49,941
Agency mortgage-backed securities	315,951	3,099	(4,679)	) 314,371
	\$456,838	\$5,313	\$(5,567)	) \$456,584
(in thousands)	December 31, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale securities:				
Obligations of U.S. Government-sponsored enterprises	\$93,218	\$700	\$(388)	) \$93,530
Obligations of states and political subdivisions	49,721	983	(1,761)	) 48,943
Agency mortgage-backed securities	298,623	2,675	(9,184)	) 292,114
	\$441,562	\$4,358	\$(11,333)	) \$434,587

At September 30, 2014, and December 31, 2013, there were no holdings of securities of any one issuer in an amount greater than 10% of shareholders' equity, other than the U.S. government agencies and sponsored enterprises. The residential mortgage-backed securities are all issued by U.S. government sponsored enterprises. Available for sale securities having a fair value of \$255.9 million and \$270.1 million at September 30, 2014, and December 31, 2013, respectively, were pledged as collateral to secure deposits of public institutions and for other purposes as required by law or contract provisions.

The amortized cost and estimated fair value of debt securities classified as available for sale at September 30, 2014, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. The weighted average life of the mortgage-backed securities is approximately 5 years.

(in thousands)	Amortized Cost	Estimated Fair Value
Due in one year or less	\$3,181	\$3,227
Due after one year through five years	109,044	110,116
Due after five years through ten years	21,833	22,352
Due after ten years	6,829	6,518
Mortgage-backed securities	315,951	314,371
	\$456,838	\$456,584

The following table represents a summary of available-for-sale investment securities that had an unrealized loss:

(in thousands)	September 30, 2014					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Obligations of U.S. Government-sponsored enterprises	\$5,454	\$7	\$24,813	\$182	\$30,267	\$189
Obligations of states and political subdivisions	\$1,092	\$18	\$14,143	\$681	\$15,235	\$699
Agency mortgage-backed securities	29,404	139	136,333	4,540	165,737	4,679
	\$35,950	\$164	\$175,289	\$5,403	\$211,239	\$5,567
(in thousands)	December 31, 2013					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Obligations of U.S. Government-sponsored enterprises	\$30,221	\$388	\$—	\$—	\$30,221	\$388
Obligations of states and political subdivisions	17,141	952	7,168	809	24,309	1,761
Agency mortgage-backed securities	159,999	7,338	21,437	1,846	181,436	9,184
	\$207,361	\$8,678	\$28,605	\$2,655	\$235,966	\$11,333

The unrealized losses at both September 30, 2014, and December 31, 2013, were primarily attributable to changes in market interest rates since the securities were purchased. Management systematically evaluates investment securities for other-than-temporary declines in fair value on a quarterly basis. This analysis requires management to consider various factors, which include (1) the present value of the cash flows expected to be collected compared to the amortized cost of the security, (2) duration and magnitude of the decline in value, (3) the financial condition of the issuer or issuers, (4) structure of the security and (5) the intent to sell the security or whether it is more likely than not that the Company would be required to sell the security before its anticipated recovery in market value. At September 30, 2014, management performed its quarterly analysis of all securities with an unrealized loss and concluded no individual securities were other-than-temporarily impaired.

The gross gains and gross losses realized from sales of available-for-sale investment securities were as follows:

(in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Gross gains realized	\$—	\$611	\$—	\$1,477
Gross losses realized	—	—	—	(182)
Proceeds from sales	—	36,710	—	159,604

NOTE 4 - PORTFOLIO LOANS

Below is a summary of Portfolio loans by category at September 30, 2014, and December 31, 2013:

(in thousands)	September 30, 2014	December 31, 2013
Real Estate Loans:		
Construction and land development	\$ 123,888	\$ 117,032
Commercial real estate - Investor owned	391,791	437,688
Commercial real estate - Owner occupied	366,724	341,631
Residential real estate	187,594	158,527
Total real estate loans	\$ 1,069,997	\$ 1,054,878
Commercial and industrial	1,172,015	1,041,576
Consumer and other	51,816	39,838
Portfolio loans	\$ 2,293,828	\$ 2,136,292
Unearned loan costs, net	1,077	1,021
Portfolio loans, including unearned loan costs	\$ 2,294,905	\$ 2,137,313

The Company grants commercial, real estate, and consumer loans primarily in the St. Louis, Kansas City and Phoenix metropolitan areas. The Company has a diversified loan portfolio, with no particular concentration of credit in any one economic sector; however, a substantial portion of the portfolio is concentrated in and secured by real estate. The ability of the Company's borrowers to honor their contractual obligations is partially dependent upon the local economy and its effect on the real estate market.

A summary of the year-to-date activity in the allowance for loan losses and the recorded investment in Portfolio loans by class and category based on impairment