

INDEPENDENT BANK CORP /MI/

Form 10-Q

May 07, 2007

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**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, 2007
Commission file number 0-7818
INDEPENDENT BANK CORPORATION
(Exact name of registrant as specified in its charter)**

Michigan

38-2032782

(State or jurisdiction of
Incorporation or Organization)

(I.R.S. Employer Identification
Number)

230 West Main Street, P.O. Box 491, Ionia, Michigan 48846

(Address of principal executive offices)

(616) 527-9450

(Registrant's telephone number, including area code)

NONE

Former name, address and fiscal year, if changed since last report.

Indicate by check mark whether the registrant (1) has filed all documents and reports required to be filed by Sections 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 is a large accelerated filer, an accelerated filer or non-accelerated filer.

Large accelerated filer ☐ Accelerated filer ☒ Non-accelerated filer ☐

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

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

Common stock, par value \$1

22,584,455

Class

Outstanding at May 7, 2007

INDEPENDENT BANK CORPORATION AND SUBSIDIARIES
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Any statements in this document that are not historical facts are forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. Words such as expect, believe, intend, estimate, project, may and similar expressions are intended to identify forward-looking statements. These forward-looking statements are predicated on management's beliefs and assumptions based on information known to Independent Bank Corporation's management as of the date of this document and do not purport to speak as of any other date. Forward-looking statements may include descriptions of plans and objectives of Independent Bank Corporation's management for future or past operations, products or services, and forecasts of the Company's revenue, earnings or other measures of economic performance, including statements of profitability, business segments and subsidiaries, and estimates of credit quality trends. Such statements reflect the view of Independent Bank Corporation's management as of this date with respect to future events and are not guarantees of future performance; involve assumptions and are subject to substantial risks and uncertainties, such as the changes in Independent Bank Corporation's plans, objectives, expectations and intentions. Should one or more of these risks materialize or should underlying beliefs or assumptions prove incorrect, the Company's actual results could differ materially from those discussed. Factors that could cause or contribute to such differences are changes in interest rates, changes in the accounting treatment of any particular item, the results of regulatory examinations, changes in industries where the Company has a concentration of loans, changes in the level of fee income, changes in general economic conditions and related credit and market conditions, and the impact of regulatory responses to any of the foregoing. Forward-looking statements speak only as of the date they are made. Independent Bank Corporation does not undertake to update forward-looking statements to reflect facts, circumstances, assumptions or events that occur after the date the forward-looking statements are made. For any forward-looking statements made in this document, Independent Bank Corporation claims the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995.

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Item 1.INDEPENDENT BANK CORPORATION AND SUBSIDIARIES
Consolidated Statements of Financial Condition

	March 31, 2007	December 31, 2006
	(unaudited)	
	(in thousands)	
Assets		
Cash and due from banks	\$ 67,209	\$ 73,142
Federal funds sold and other overnight investments	94,661	
	Cash and cash equivalents	161,870
		73,142
Securities available for sale	430,949	434,785
Federal Home Loan Bank stock, at cost	14,326	14,325
Loans held for sale	33,959	31,846
Loans		
Commercial	1,081,502	1,083,921
Real estate mortgage	858,288	865,522
Installment	354,705	350,273
Finance receivables	189,852	183,679
	Total Loans	2,484,347
Allowance for loan losses	(30,908)	2,483,395
		(26,879)
	Net Loans	2,453,439
Property and equipment, net	72,230	2,456,516
Bank owned life insurance	41,557	67,992
Goodwill	66,735	41,109
Other intangibles	18,065	48,709
Assets of discontinued operations	339	7,854
Accrued income and other assets	62,102	189,432
		64,188
	Total Assets	\$ 3,355,571
		\$ 3,429,898
Liabilities and Shareholders Equity		
Deposits		
Non-interest bearing	\$ 318,238	\$ 282,632
Savings and NOW	1,033,586	875,541
Time	1,551,708	1,444,618
	Total Deposits	2,903,532
Federal funds purchased		2,602,791
Other borrowings	60,436	84,081
Subordinated debentures	64,197	163,681
Financed premiums payable	34,861	64,197
Liabilities of discontinued operations		32,767
		183,676

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Accrued expenses and other liabilities	40,728	40,538
Total Liabilities	3,103,754	3,171,731
Shareholders' Equity		
Preferred stock, no par value 200,000 shares authorized; none outstanding		
Common stock, \$1.00 par value 40,000,000 shares authorized; issued and outstanding: 22,584,455 shares at March 31, 2007 and 22,864,587 shares at December 31, 2006	22,584	22,865
Capital surplus	194,902	200,241
Retained earnings	30,924	31,420
Accumulated other comprehensive income	3,407	3,641
Total Shareholders' Equity	251,817	258,167
Total Liabilities and Shareholders' Equity	\$ 3,355,571	\$ 3,429,898

See notes to interim consolidated financial statements

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INDEPENDENT BANK CORPORATION AND SUBSIDIARIES
Consolidated Statements of Operations

	Three Months Ended March 31,	
	2007	2006
	(unaudited)	
	(in thousands, except per share amounts)	
Interest Income		
Interest and fees on loans	\$ 49,953	\$ 46,046
Securities available for sale		
Taxable	2,477	2,848
Tax-exempt	2,600	2,869
Other investments	314	223
Total Interest Income	55,344	51,986
Interest Expense		
Deposits	22,408	15,927
Other borrowings	3,304	4,324
Total Interest Expense	25,712	20,251
Net Interest Income	29,632	31,735
Provision for loan losses	8,139	1,386
Net Interest Income After Provision for Loan Losses	21,493	30,349
Non-interest Income		
Service charges on deposit accounts	4,888	4,468
Mepco litigation settlement		2,800
Net gains on assets		
Real estate mortgage loans	1,081	1,026
Securities	79	
VISA check card interchange income	950	791
Real estate mortgage loan servicing	527	653
Title insurance fees	414	442
Other income	2,731	2,358
Total Non-interest Income	10,670	12,538
Non-interest Expense		
Compensation and employee benefits	13,968	13,541
Occupancy, net	2,614	2,687
Furniture, fixtures and equipment	1,900	1,783
Data processing	1,438	1,342

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Advertising	1,152	987
Branch acquisition and conversion costs	422	
Goodwill impairment	343	
Other expenses	6,129	5,898
Total Non-interest Expense	27,966	26,238
Income From Continuing Operations Before Income Tax	4,197	16,649
Income tax expense	305	3,593
Income From Continuing Operations	3,892	13,056
Discontinued operations, net of tax	351	(713)
Net Income	\$ 4,243	\$ 12,343
Income Per Share From Continuing Operations		
Basic	\$.17	\$.57
Diluted	.17	.56
Net Income Per Share		
Basic	.19	.54
Diluted	.18	.53
Dividends Per Common Share		
Declared	\$.21	\$.19
Paid	.20	.18
See notes to interim consolidated financial statements		

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INDEPENDENT BANK CORPORATION AND SUBSIDIARIES
Consolidated Statements of Cash Flows

	Three months ended March 31,	
	2007	2006
	(unaudited)	
	(in thousands)	
Net Income	\$ 4,243	\$ 12,343
Adjustments to Reconcile Net Income to Net Cash from Operating Activities		
Proceeds from sales of loans held for sale	70,293	61,273
Disbursements for loans held for sale	(71,325)	(61,321)
Provision for loan losses	8,288	1,586
Depreciation and amortization of premiums and accretion of discounts on securities and loans	(2,584)	(2,696)
Net gains on sales of real estate mortgage loans	(1,081)	(1,026)
Net gains on securities	(79)	
Goodwill impairment	343	
Deferred loan fees	(82)	(53)
Increase (decrease) in accrued income and other assets	813	(3,039)
Decrease in accrued expenses and other liabilities	(4,776)	(6,433)
	(190)	(11,709)
Net Cash from Operating Activities	4,053	634
Cash Flow from (used in) Investing Activities		
Proceeds from the sale of securities available for sale	6,367	
Proceeds from the maturity of securities available for sale	8,790	2,622
Principal payments received on securities available for sale	8,094	9,530
Purchases of securities available for sale	(19,000)	(400)
(Increase) decrease portfolio loans originated, net of principal payments	4,135	(54,542)
Acquisition of business offices, less cash received	210,053	
Proceeds from sale of insurance premium finance business	175,901	
Capital expenditures	(2,642)	(4,579)
Net Cash from (used in) Investing Activities	391,698	(47,369)
Cash Flow from (used in) Financing Activities		
Net increase (decrease) in total deposits	(107,505)	51,622
Net increase (decrease) in short-term borrowings	(169,823)	21,093
Proceeds from Federal Home Loan Bank advances	32,000	700
Payments of Federal Home Loan Bank advances	(49,003)	(25,261)
Repayment of long-term debt	(500)	(500)
Net increase (decrease) in financed premiums payable	(1,854)	6,765
Dividends paid	(4,584)	(4,188)
Repurchase of common stock	(5,989)	(9,178)

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Proceeds from issuance of common stock	68	213
Net Cash from (used in) Financing Activities	(307,190)	41,266
Net Increase (Decrease) in Cash and Cash Equivalents	88,561	(5,469)
Change in cash and cash equivalents of discontinued operations	167	30
Cash and Cash Equivalents at Beginning of Period	73,142	67,522
Cash and Cash Equivalents at End of Period	\$ 161,870	\$ 62,083
Cash paid during the period for		
Interest	\$ 28,502	\$ 22,470
Income taxes	4	63
Transfer of loans to other real estate	1,059	565
See notes to interim consolidated financial statements		

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INDEPENDENT BANK CORPORATION AND SUBSIDIARIES
Consolidated Statements of Shareholders' Equity

	Three months ended March 31,	
	2007	2006
	(unaudited)	
	(in thousands)	
Balance at beginning of period	\$ 258,167	\$ 248,259
Net income	4,243	12,343
Cash dividends declared	(4,739)	(4,128)
Issuance of common stock	369	1,771
Repurchase of common stock	(5,989)	(9,178)
Net change in accumulated other comprehensive income, net of related tax effect	(234)	(300)
Balance at end of period	\$ 251,817	\$ 248,767

See notes to interim consolidated financial statements.

Table of Contents**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

(unaudited)

1. In our opinion, the accompanying unaudited consolidated financial statements contain all the adjustments necessary to present fairly our consolidated financial condition as of March 31, 2007 and December 31, 2006, and the results of operations for the three-month periods ended March 31, 2007 and 2006. Certain reclassifications have been made in the prior year financial statements to conform to the current year presentation. Our critical accounting policies include the assessment for other than temporary impairment on investment securities, the determination of the allowance for loan losses, the valuation of derivative financial instruments, the valuation of originated mortgage servicing rights, the valuation of deferred tax assets and the valuation of goodwill. Refer to our 2006 Annual Report on Form 10-K for a disclosure of our accounting policies.

2. Our assessment of the allowance for loan losses is based on an evaluation of the loan portfolio, recent loss experience, current economic conditions and other pertinent factors. Loans on non-accrual status, past due more than 90 days, or restructured amounted to \$48.1 million at March 31, 2007, and \$39.2 million at December 31, 2006. (See Management's Discussion and Analysis of Financial Condition and Results of Operations).

3. Comprehensive income for the three-month periods ended March 31 follows:

	Three months ended March 31,	
	2007	2006
	(in thousands)	
Net income	\$ 4,243	\$ 12,343
Net change in unrealized gain on securities available for sale, net of related tax effect	390	(428)
Net change in unrealized gain (loss) on derivative instruments, net of related tax effect	(523)	213
Reclassification adjustment for accretion on settled derivative financial instruments	(101)	(85)
Comprehensive income	\$ 4,009	\$ 12,043

The net change in unrealized gain on securities available for sale reflect net gains and losses reclassified into earnings as follows:

	Three months ended March 31,	
	2007	2006
	(in thousands)	
Gain (loss) reclassified into earnings	\$ 79	\$
Federal income tax expense (benefit) as a result of the reclassification of these amounts from comprehensive income	28	

4. Our reportable segments are based upon legal entities. We have five reportable segments: Independent Bank (IB), Independent Bank West Michigan (IBWM), Independent Bank South Michigan (IBSM), Independent Bank East Michigan (IBEM) and Mepco Finance Corporation (Mepco). We evaluate performance based principally on net income of the respective reportable segments.

Table of Contents**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (continued)**

(unaudited)

A summary of selected financial information for our reportable segments as of or for the three-month periods ended March 31, follows:

As of or for the three months ended March 31,

	IB	IBWM	IBSM	IBEM	Mepco	Other ⁽¹⁾	Elimination	Total
	(in thousands)							
2007								
Total assets	\$ 1,103,707	\$ 772,973	\$ 568,275	\$ 710,977	\$ 214,776	\$ 339,617	\$ (354,754)	\$ 3,355,571
Interest income	16,946	13,592	8,082	11,682	5,198	5	(161)	55,344
Net interest income	8,938	8,206	4,111	6,714	3,268	(1,563)	(42)	29,632
Provision for loan losses	1,063	2,455	1,816	2,676	129			8,139
Income (loss) from continuing operations before income tax	2,792	2,399	(50)	(165)	1,388	(2,226)	59	4,197
Discontinued operations, net of tax					351			351
Net income (loss)	2,194	1,789	228	119	1,220	(1,321)	14	4,243
2006								
Total assets	\$ 1,029,276	\$ 727,604	\$ 490,211	\$ 724,119	\$ 432,301	\$ 346,789	\$ (347,526)	\$ 3,402,774
Interest income	15,771	12,301	7,490	11,284	5,307	5	(172)	51,986
Net interest income	9,901	8,383	4,448	7,296	3,261	(1,512)	(42)	31,735
Provision for loan losses	340	232	542	218	54			1,386
Income (loss) from continuing operations before income tax	4,706	4,736	1,963	2,520	1,724	979	21	16,649
Discontinued operations, net of tax					(713)			(713)
Net income (loss)	3,603	3,326	1,579	1,899	355	1,605	(24)	12,343

(1)

Includes items relating to the Registrant and certain insignificant operations. 2006 net income includes \$2.8 million of non-interest income related to the settlement of litigation involving the former owners of Mepco. This amount is not taxable.

Table of Contents**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (continued)**
(unaudited)

5. Basic income per share is based on weighted average common shares outstanding during the period. Diluted income per share includes the dilutive effect of additional potential common shares to be issued upon the exercise of stock options and stock units for a deferred compensation plan for non-employee directors.

A reconciliation of basic and diluted earnings per share for the three-month periods ended March 31 follows:

	Three months ended March 31,	
	2007	2006
	(in thousands, except per share amounts)	
Income from continuing operations	\$ 3,892	\$ 13,056
Net income	\$ 4,243	\$ 12,343
Shares outstanding	22,829	22,938
Effect of stock options	257	340
Stock units for deferred compensation plan for non-employee directors	58	52
Shares outstanding for calculation of diluted earnings per share	23,144	23,330
Income per share from continuing operations		
Basic	\$.17	\$.57
Diluted	.17	.56
Net income per share		
Basic	.19	.54
Diluted	.18	.53

Weighted average stock options outstanding that were anti-dilutive totaled 0.8 million and 0.5 million for the three-months ended March 31, 2007 and 2006, respectively.

Per share data has been restated for a 5% stock dividend in 2006.

6. Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities, (SFAS #133) which was subsequently amended by SFAS #138, requires companies to record derivatives on the balance sheet as assets and liabilities measured at their fair value. The accounting for increases and decreases in the value of derivatives depends upon the use of derivatives and whether the derivatives qualify for hedge accounting.

Table of Contents**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (continued)**

(unaudited)

Our derivative financial instruments according to the type of hedge in which they are designated under SFAS #133 follows:

	Notional Amount	March 31, 2007 Average Maturity (years) (dollars in thousands)	Fair Value
Fair Value Hedge pay variable interest-rate swap agreements	\$450,159	2.7	\$(3,112)
Cash Flow Hedge			
Pay fixed interest-rate swap agreements	\$ 54,500	2.2	\$ 900
Interest-rate cap agreements	225,500	2.0	945
	\$280,000	2.0	\$ 1,845