

ISABELLA BANK CORP
Form 10-Q
August 06, 2010

Table of Contents

**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, 2010**

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:0-18415

Isabella Bank Corporation

(Exact name of registrant as specified in its charter)

Michigan

38-2830092

(State or other jurisdiction of
incorporation or organization)

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

401 N. Main St, Mt. Pleasant, MI

48858

(Address of principal executive offices)

(Zip code)

(989) 772-9471

(Registrant's telephone number, including area code)

N/A

(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 (Section 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 the definitions of "accelerated filer", "large 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

APPLICABLE ONLY TO CORPORATE ISSUERS:

Edgar Filing: ISABELLA BANK CORP - Form 10-Q

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, 7,544,191 as of July 19, 2010

ISABELLA BANK CORPORATION
QUARTERLY REPORT ON FORM 10-Q
Table of Contents

| | |
|---|-----------|
| <u>PART I</u> | 3 |
| <u>Item 1 Interim Condensed Consolidated Financial Statements (Unaudited)</u> | 3 |
| <u>Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 22 |
| <u>Item 3 Quantitative and Qualitative Disclosures about Market Risk</u> | 42 |
| <u>Item 4 Controls and Procedures</u> | 44 |
| <u>PART II</u> | 45 |
| <u>Item 1 Legal Proceedings</u> | 45 |
| <u>Item 1A Risk Factors</u> | 45 |
| <u>Item 2 Unregistered Sales of Equity Securities and Use of Proceeds</u> | 45 |
| <u>Item 6 Exhibits</u> | 45 |
| <u>SIGNATURES</u> | 46 |
| <u>EX-31.(A)</u> | |
| <u>EX-31.(B)</u> | |
| <u>EX-32</u> | |

Table of Contents**PART I FINANCIAL INFORMATION****Item 1 Interim Condensed Consolidated Financial Statements (Unaudited)****INTERIM CONDENSED CONSOLIDATED BALANCE SHEETS****(UNAUDITED)**

(Dollars in thousands)

| | June 30 2010 | December 31 2009 |
|--|---------------------|---------------------|
| ASSETS | | |
| Cash and cash equivalents | | |
| Cash and demand deposits due from banks | \$ 17,167 | \$ 17,342 |
| Interest bearing balances due from banks | 13,945 | 5,364 |
| Total cash and cash equivalents | 31,112 | 22,706 |
| Certificates of deposit held in other financial institutions | 14,199 | 7,156 |
| Trading securities | 7,223 | 13,563 |
| Investment securities available-for-sale (amortized cost of \$261,524 in 2010 and \$258,585 in 2009) | 267,942 | 259,066 |
| Mortgage loans available-for-sale | 464 | 2,281 |
| Loans | | |
| Agricultural | 70,527 | 64,845 |
| Commercial | 348,403 | 340,274 |
| Installment | 32,053 | 32,359 |
| Residential real estate mortgage | 276,068 | 285,838 |
| Total loans | 727,051 | 723,316 |
| Less allowance for loan losses | 13,018 | 12,979 |
| Net loans | 714,033 | 710,337 |
| Premises and equipment | 24,775 | 23,917 |
| Corporate owned life insurance policies | 17,116 | 16,782 |
| Accrued interest receivable | 5,312 | 5,832 |
| Acquisition intangibles and goodwill, net | 47,257 | 47,429 |
| Equity securities without readily determinable fair values | 17,763 | 17,921 |
| Other assets | 15,145 | 16,954 |
| TOTAL ASSETS | \$ 1,162,341 | \$ 1,143,944 |
| LIABILITIES AND SHAREHOLDERS EQUITY | | |
| Deposits | | |
| Noninterest bearing | \$ 101,101 | \$ 96,875 |
| NOW accounts | 128,509 | 128,111 |
| Certificates of deposit under \$100 and other savings | 403,768 | 389,644 |
| Certificates of deposit over \$100 | 191,435 | 188,022 |
| Total deposits | 824,813 | 802,652 |
| Borrowed funds (\$12,751 in 2010 and \$17,804 in 2009 at fair value) | 183,890 | 193,101 |
| Accrued interest and other liabilities | 7,359 | 7,388 |

| | | |
|---|---------------------|---------------------|
| Total liabilities | 1,016,062 | 1,003,141 |
| Shareholders' equity | | |
| Common stock - no par value 15,000,000 shares authorized; outstanding 7,545,191 (including 17,711 shares to be issued) in 2010 and 7,535,193 (including 30,626 shares to be issued) in 2009 | 133,829 | 133,443 |
| Shares to be issued for deferred compensation obligations | 4,391 | 4,507 |
| Retained earnings | 6,434 | 4,972 |
| Accumulated other comprehensive income (loss) | 1,625 | (2,119) |
| Total shareholders' equity | 146,279 | 140,803 |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | \$ 1,162,341 | \$ 1,143,944 |

See notes to interim condensed consolidated financial statements.

Table of Contents**INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY
(UNAUDITED)**

(Dollars in thousands except per share data)

| | Common Stock Shares | Common Stock | Shares to be Issued for Deferred Compensation Obligations | Retained Earnings | Accumulated Other Comprehensive (Loss) Income | Totals |
|--|---------------------------|-------------------|--|----------------------|---|-------------------|
| Balances, January 1, 2009 | 7,518,856 | \$ 133,602 | \$ 4,015 | \$ 2,428 | \$ (5,569) | \$ 134,476 |
| Comprehensive income | | | | 3,530 | (259) | 3,271 |
| Issuance of common stock | 46,778 | 1,133 | | | | 1,133 |
| Common stock issued for deferred compensation obligations | 10,067 | 274 | (144) | | | 130 |
| Share based payment awards under equity compensation plan | | | 337 | | | 337 |
| Common stock purchased for deferred compensation obligations | | (488) | | | | (488) |
| Common stock repurchased pursuant to publicly announced repurchase plan | (64,883) | (1,343) | | | | (1,343) |
| Cash dividends (\$0.25 per share) | | | | (1,884) | | (1,884) |
| Balances, June 30, 2009 | 7,510,818 | \$ 133,178 | \$ 4,208 | \$ 4,074 | \$ (5,828) | \$ 135,632 |
| Balances, January 1, 2010 | 7,535,193 | \$ 133,443 | \$ 4,507 | \$ 4,972 | \$ (2,119) | \$ 140,803 |
| Comprehensive income | | | | 4,174 | 3,744 | 7,918 |
| Issuance of common stock | 59,197 | 1,529 | | | | 1,529 |
| Common stock issued for deferred compensation obligations | 26,898 | 537 | (448) | | | 89 |
| Share based payment awards under equity | | | 332 | | | 332 |

| | | | | | | |
|--|------------------|-------------------|-----------------|-----------------|-----------------|-------------------|
| compensation plan Common stock purchased for deferred compensation obligations | | (254) | | | | (254) |
| Common stock repurchased pursuant to publicly announced repurchase plan | (76,097) | (1,426) | | | | (1,426) |
| Cash dividends (\$0.36 per share) | | | | (2,712) | | (2,712) |
| Balances, June 30, 2010 | 7,545,191 | \$ 133,829 | \$ 4,391 | \$ 6,434 | \$ 1,625 | \$ 146,279 |

See notes to interim condensed consolidated financial statements.

4

Table of Contents**INTERIM CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)**

(Dollars in thousands except per share data)

| | Three Months Ended June 30 | | Six Months Ended June 30 | |
|--|-------------------------------|---------------|-----------------------------|---------------|
| | 2010 | 2009 | 2010 | 2009 |
| Interest income | | | | |
| Loans, including fees | \$ 11,651 | \$ 12,018 | \$ 23,168 | \$ 23,916 |
| Investment securities | | | | |
| Taxable | 1,346 | 1,083 | 2,625 | 2,370 |
| Nontaxable | 1,079 | 1,179 | 2,173 | 2,342 |
| Trading account securities | 86 | 179 | 191 | 385 |
| Federal funds sold and other | 110 | 46 | 214 | 165 |
| Total interest income | 14,272 | 14,505 | 28,371 | 29,178 |
| Interest expense | | | | |
| Deposits | 2,874 | 3,465 | 5,757 | 7,092 |
| Borrowings | 1,417 | 1,561 | 2,934 | 3,162 |
| Total interest expense | 4,291 | 5,026 | 8,691 | 10,254 |
| Net interest income | 9,981 | 9,479 | 19,680 | 18,924 |
| Provision for loan losses | 1,056 | 1,535 | 2,263 | 3,007 |
| Net interest income after provision for loan losses | 8,925 | 7,944 | 17,417 | 15,917 |
| Noninterest income | | | | |
| Service charges and fees | 1,494 | 2,065 | 3,122 | 3,414 |
| Gain on sale of mortgage loans | 74 | 260 | 167 | 528 |
| Net (loss) gain on trading securities | (37) | (57) | (38) | 30 |
| Net (loss) gain on borrowings measured at fair value | (3) | 73 | 53 | 216 |
| Gain on sale of available-for-sale investment securities | | 427 | 56 | 648 |
| Other | 342 | 363 | 677 | 652 |
| Total noninterest income | 1,870 | 3,131 | 4,037 | 5,488 |
| Noninterest Expenses | | | | |
| Compensation and benefits | 4,565 | 4,720 | 9,160 | 9,396 |
| Occupancy | 557 | 548 | 1,119 | 1,077 |
| Furniture and equipment | 1,082 | 1,013 | 2,113 | 2,029 |
| FDIC insurance premiums | 313 | 415 | 619 | 1,300 |
| Other | 1,758 | 1,772 | 3,618 | 3,710 |
| Total noninterest expenses | 8,275 | 8,468 | 16,629 | 17,512 |

| | | | | |
|---|-----------------|-----------------|-----------------|-----------------|
| Income before federal income tax expense | 2,520 | 2,607 | 4,825 | 3,893 |
| Federal income tax expense | 369 | 406 | 651 | 363 |
| NET INCOME | \$ 2,151 | \$ 2,201 | \$ 4,174 | \$ 3,530 |
| Earnings per share | | | | |
| Basic | \$ 0.29 | \$ 0.29 | \$ 0.55 | \$ 0.47 |
| Diluted | \$ 0.28 | \$ 0.29 | \$ 0.54 | \$ 0.46 |
| Cash dividends per basic share | \$ 0.18 | \$ 0.13 | \$ 0.36 | \$ 0.25 |

See notes to interim condensed consolidated financial statements.

Table of Contents**INTERIM CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(UNAUDITED)**

(Dollars in thousands)

| | Three months Ended June 30 | | Six Months Ended June 30 | |
|--|-------------------------------|-----------------|-----------------------------|-----------------|
| | 2010 | 2009 | 2010 | 2009 |
| Net income | \$ 2,151 | \$ 2,201 | \$ 4,174 | \$ 3,530 |
| Unrealized gains on available-for-sale securities: | | | | |
| Unrealized holding gains (losses) arising during the period | 4,633 | (1,240) | 5,993 | (618) |
| Reclassification adjustment for net realized gains included in net income | | (427) | (56) | (648) |
| Net unrealized gains (losses) | 4,633 | (1,667) | 5,937 | (1,266) |
| Tax effect | (1,704) | 812 | (2,193) | 1,007 |
| Other comprehensive income (loss), net of tax | 2,929 | (855) | 3,744 | (259) |
| COMPREHENSIVE INCOME | \$ 5,080 | \$ 1,346 | \$ 7,918 | \$ 3,271 |

See notes to interim condensed consolidated financial statements.

Table of Contents

INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)
(Dollars in thousands)

| | Six Months Ended June 30 | |
|---|-----------------------------|---------------|
| | 2010 | 2009 |
| OPERATING ACTIVITIES | | |
| Net income | \$ 4,174 | \$ 3,530 |
| Reconciliation of net income to net cash provided by operations: | | |
| Provision for loan losses | 2,263 | 3,007 |
| Impairment of foreclosed assets | 90 | 34 |
| Depreciation | 1,235 | 1,166 |
| Amortization and impairment of originated mortgage servicing rights | 283 | 483 |
| Amortization of acquisition intangibles | 172 | 191 |
| Net amortization of available-for-sale investment securities | 442 | 364 |
| Realized gain on sale of available-for-sale investment securities | (56) | (648) |
| Net unrealized losses (gains) on trading securities | 38 | (30) |
| Net unrealized gains on borrowings measured at fair value | (53) | (216) |
| Increase in cash value of corporate owned life insurance policies | (292) | (313) |
| Realized gain on redemption of corporate owned life insurance policies | (21) | |
| Share-based payment awards under equity compensation plan | 332 | 337 |
| Net changes in operating assets and liabilities which provided (used) cash: | | |
| Trading securities | 6,302 | 5,694 |
| Mortgage loans available-for-sale | 1,817 | (1,806) |
| Accrued interest receivable | 520 | 782 |
| Other assets | (593) | (1,392) |
| Accrued interest and other liabilities | (29) | 1,660 |
| Net cash provided by operating activities | 16,624 | 12,843 |
| INVESTING ACTIVITIES | | |
| Net change in certificates of deposit held in other financial institutions | (7,043) | (4,452) |
| Activity in available-for-sale securities | | |
| Maturities, calls, and sales | 36,924 | 98,274 |
| Purchases | (40,249) | (69,339) |
| Loan principal (originations) collections, net | (7,627) | 5,764 |
| Proceeds from sales of foreclosed assets | 1,662 | 2,494 |
| Purchases of premises and equipment | (2,093) | (1,715) |
| Purchases of corporate owned life insurance policies | (175) | |
| Proceeds from the redemption of corporate owned life insurance policies | 154 | |
| Net cash (used in) provided by investing activities | (18,447) | 31,026 |
| FINANCING ACTIVITIES | | |
| Net increase (decrease) in deposits | 22,161 | (2,797) |
| Net decrease in other borrowed funds | (9,158) | (43,563) |
| Cash dividends paid on common stock | (2,712) | (1,884) |
| Proceeds from issuance of common stock | 1,081 | 989 |

| | | |
|---|------------------|------------------|
| Common stock repurchased | (889) | (1,069) |
| Common stock purchased for deferred compensation obligations | (254) | (488) |
| Net cash provided by (used in) financing activities | 10,229 | (48,812) |
| INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | 8,406 | (4,943) |
| Cash and cash equivalents at beginning of period | 22,706 | 22,979 |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | \$ 31,112 | \$ 18,036 |
| Supplemental cash flows information: | | |
| Interest paid | \$ 8,744 | \$ 10,405 |
| Federal income taxes paid | 136 | |
| Transfer of loans to foreclosed assets | 1,668 | 1,390 |
| See notes to interim condensed consolidated financial statements. | | |

Table of Contents

ISABELLA BANK CORPORATION
NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 1 BASIS OF PRESENTATION

The accompanying unaudited interim condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. Operating results for the three and six month periods ended June 30, 2010 are not necessarily indicative of the results that may be expected for the year ending December 31, 2010. For further information, refer to the consolidated financial statements and footnotes thereto included in the Corporation's annual report for the year ended December 31, 2009.

All amounts except share and per share amounts have been rounded to the nearest thousand (\$000) in this report. The accounting policies are the same as those discussed in Note 1 to the Consolidated Financial Statements included in the Corporation's annual report for the year ended December 31, 2009.

NOTE 2 RECENT ACCOUNTING PRONOUNCEMENTS

FASB ASC Topic 310, Receivables. In April 2010, ASC Topic 310 was amended by Accounting Standards Update (ASU) No. 2010-18, *Effect of a Loan Modification When the Loan Is Part of a Pool That Is Accounted for as a Single Asset (a consensus of the FASB Emerging Issues Task)*, to clarify that individual loans accounted for within pools are not to be removed from the pool solely as a result of modifications to the loan (including troubled debt restructurings). The new guidance is effective for interim and annual periods ending on or after July 15, 2010 and is not anticipated to have a significant impact on the Corporation's consolidated financial statements.

In July 2010, ASC Topic 310 was amended by ASU No. 2010-20, *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses* to provide financial statement users greater transparency about the Corporation's allowance for loan losses and the credit quality of its financing receivables. Existing disclosures are amended that will require the Corporation to provide the following disclosure about its loan portfolio on a disaggregated basis: (1) a rollforward schedule of the allowance for loan losses from the beginning of the reporting period to the end of a reporting period on a portfolio segment basis, with the ending balance further disaggregated on the basis of the impairment method, (2) for each disaggregated ending balance in item (1), the related recorded investment in loans, (3) the nonaccrual status of loans by class of loans, and (4) impaired loans by class of loans. The amendments in this update will require the Corporation to provide the following additional disclosures about its loans: (1) credit quality indicators of financing receivables at the end of the reporting period by class of loans, (2) the aging of past due loans at the end of the reporting period by class of loans, (3) the nature and extent of troubled debt restructurings that occurred during the period by class of loans and their effect on the allowance for loan losses, (4) the nature and extent of financing receivables modified within the previous 12 months that defaulted during the period by class of financing receivables and their effect on the allowance for loan losses and (5) significant purchases and sales of loans during the period disaggregated by portfolio segment. The new disclosures as of the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010. The new disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010. The new guidance is expected to significantly expand the Corporation's consolidated financial statement disclosures.

FASB ASC Topic 715, Compensation Retirement Benefits. In January 2010, ASC Topic 715 was amended by Accounting Standards Update No. 2010-06, *Improving Disclosures about Fair Value Measurements*, to change the terminology for major categories of assets to classes of assets to correspond with the amendments to ASC Topic 820 (see below). The new guidance was effective for interim and annual periods ending on or after January 1, 2010 and had no impact on the Corporation's interim