PACWEST BANCORP
Form 10-Q
November 06, 2008

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2008

OR

o **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: 00-30747

PACWEST BANCORP

(Exact name of registrant as specified in its charter)

DELAWARE (State or other jurisdiction of incorporation or organization)	**33-0885320** (I.R.S. Employer Identification Number)
401 West "A" Street **San Diego, California** (Address of principal executive offices)	**92101** (Zip Code)

(619) 233-5588
(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 ý No o

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 ý	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

As of November 3, 2008 there were 27,200,216 shares of the registrant's common stock outstanding, excluding 957,911 shares of unvested restricted stock.

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PART I FINANCIAL INFORMATION

ITEM 1. Unaudited Condensed Consolidated Financial Statements

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

	September 30, 2008	December 31, 2007
	(Dollars in thousands, except share data)	
Assets:		
Cash and due from banks	$ 124,692	$ 99,363
Federal funds sold	5,500	2,000
Total cash and cash equivalents	130,192	101,363
Interest-bearing deposits in financial institutions	303	420
Investments:		
Federal Home Loan Bank stock, at cost	33,458	26,649
Securities available-for-sale (amortized cost of $97,809 at September 30, 2008 and $105,984 at December 31, 2007)	97,572	106,888
Total investments	131,030	133,537
Loans held for sale		63,565
Loans, net of unearned income	3,934,321	3,949,218
Less allowance for loan losses	(61,075)	(52,557)
Net loans	3,873,246	3,896,661
Premises and equipment, net	25,471	26,327
Other real estate owned, net	13,284	2,736
Accrued interest receivable	14,780	18,555
Goodwill		761,990
Core deposit and customer relationship intangibles	36,497	43,785
Cash surrender value of life insurance	69,972	67,846
Other assets	68,442	62,255
Total assets	$4,363,217	$ 5,179,040
Liabilities and Stockholders' Equity:		
Deposits:		
Noninterest-bearing	$1,218,486	$ 1,211,946
Interest-bearing	1,974,586	2,033,200
Total deposits	3,193,072	3,245,146
Accrued interest payable and other liabilities	43,115	45,054
Borrowings	620,700	612,000
Subordinated debentures	130,043	138,488
Total liabilities	3,986,930	4,040,688
Stockholders' equity:		
Preferred stock, $0.01 par value. Authorized 5,000,000 shares; none issued and outstanding		
Common stock, $0.01 par value. Authorized 50,000,000 shares; issued and outstanding 28,159,263 at September 30, 2008 and 28,002,382 at December 31, 2007 (includes 962,410 and 861,269 shares of unvested restricted stock, respectively)	282	280
Capital surplus	921,589	936,328

Retained earnings (accumulated deficit)	(545,297)	201,220
Treasury stock, 8,365 shares at September 30, 2008 and none at December 31, 2007	(150)	
Accumulated other comprehensive (loss) income unrealized (loss) gain on securities available-for-sale, net	(137)	524
Total stockholders' equity	376,287	1,138,352
Total liabilities and stockholders' equity	$4,363,217	$ 5,179,040

See "Notes to Unaudited Condensed Consolidated Financial Statements."

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS (LOSS)

	Quarter Ended			Nine Months Ended September 30,	
	9/30/08	6/30/08	9/30/07	2008	2007
	(In thousands, except per share data)				
Interest income:					
Interest and fees on loans	$ 68,712	$ 69,536	$ 85,649	$ 213,901	$ 260,875
Interest on federal funds sold	23	23	605	86	1,728
Interest on deposits in financial institutions	1	2	5	6	17
Interest on investment securities	1,808	1,861	1,268	5,370	4,006
Total interest income	70,544	71,422	87,527	219,363	266,626
Interest expense:					
Deposits	9,001	8,919	14,924	29,741	42,080
Borrowings	4,538	4,680	3,562	14,525	13,728
Subordinated debentures	2,030	2,051	2,758	6,490	8,646
Total interest expense	15,569	15,650	21,244	50,756	64,454
Net interest income before provision for credit losses	54,975	55,772	66,283	168,607	202,172
Provision for credit losses	7,500	3,500		37,000	
Net interest income after provision for credit losses	47,475	52,272	66,283	131,607	202,172
Noninterest income:					
Service charges on deposit accounts	3,165	3,205	2,877	9,594	8,544
Other commissions and fees	1,884	1,812	1,903	5,215	5,202
Gain on sale of loans, net		(572)	(323)	(303)	8,981
Gain on sale of securities, net	81			81	
Increase in cash surrender value of life insurance	632	617	597	1,836	1,840
Other income	281	339	628	1,588	2,995
Total noninterest income	6,043	5,401	5,682	18,011	27,562
Noninterest expense:					
Compensation	19,332	18,919	17,582	57,097	54,771
Occupancy	5,248	4,884	4,799	14,863	14,285
Furniture and equipment	1,073	1,046	1,258	3,258	3,746
Data processing	1,495	1,604	1,507	4,642	4,532
Other professional services	1,768	1,669	1,574	4,852	4,806
Business development	650	849	780	2,255	2,336
Communications	745	816	825	2,385	2,498
Insurance and assessments	1,025	810	468	2,375	1,259
Other real estate owned expense	1,360	164	7	1,596	66
Intangible asset amortization	2,274	2,484	2,574	7,288	7,053
Reorganization charges		258		258	1,341
Legal settlement		780		780	
Goodwill write-off		486,701		761,701	
Other	2,878	3,100	3,150	8,892	9,221
Total noninterest expense	37,848	524,084	34,524	872,242	105,914
Earnings (loss) before income taxes	15,670	(466,411)	37,441	(722,624)	123,820

Income taxes	6,119	8,103	15,245	15,062	50,553
Net earnings (loss)	$ 9,551	$ (474,514)	$ 22,196	$ (737,686)	$ 73,267
Number of outstanding shares (weighted average):					
Basic	27,191.1	27,166.8	28,899.3	27,167.8	28,884.2
Diluted	27,203.8	27,166.8	28,988.0	27,167.8	29,001.9
Earnings (loss) per share:					
Basic	$ 0.35	$ (17.47)	$ 0.77	$ (27.15)	$ 2.54
Diluted	$ 0.35	$ (17.47)	$ 0.77	$ (27.15)	$ 2.53
Dividends declared per share	$ 0.32	$ 0.32	$ 0.32	$ 0.96	$ 0.96

See "Notes to Unaudited Condensed Consolidated Financial Statements."

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

	Quarter Ended			Nine Months Ended September 30,	
	9/30/08	6/30/08	9/30/07	2008	2007
	(Dollars in thousands)				
Net earnings (loss)	$9,551	$(474,514)	$22,196	$(737,686)	$73,267
Other comprehensive income, net of related income taxes:					
Unrealized gains on securities:					
Unrealized holding gains (losses) on securities arising during the period	91	(1,193)	346	(533)	172
Reclassification of realized gains included in income	(122)			(128)	
	(31)	(1,193)	346	(661)	172
Comprehensive income (loss)	$9,520	$(475,707)	$22,542	$(738,347)	$73,439

See "Notes to Unaudited Condensed Consolidated Financial Statements."

UNAUDITED CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

	Common Stock			Retained Earnings		Accumulated Other	
	Shares	Par Value	Capital Surplus	(Accumulated Deficit)	Treasury Stock	Comprehensive Income (Loss)	Total
	(Dollars in thousands, except share data)						
Balance at December 31, 2007	28,002,382	$ 280	$ 936,328	$ 201,220	$	$ 524	$ 1,138,352
Net loss				(737,686)			(737,686)
Exercise of stock options	1,000		30				30
Tax benefits from exercise of options and vesting of restricted stock			(455)				(455)
Restricted stock awarded and earned stock compensation, net of shares forfeited	176,370	2	3,637				3,639
Restricted stock surrendered	(12,124)		(288)				(288)
Treasury stock	(8,365)				(150)		(150)
Cash dividends paid ($0.96 per share)			(17,663)	(8,831)			(26,494)
Other comprehensive income decrease in net unrealized gain on securities available-for-sale, net of tax effect of $479 thousand						(661)	(661)
Balance at September 30, 2008	28,159,263	$ 282	$ 921,589	$ (545,297)	$ (150)	$ (137)	$ 376,287

See "Notes to Unaudited Condensed Consolidated Financial Statements."

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine Months Ended September 30,	
	2008	2007
	(Dollars in thousands)	
Cash flows from operating activities:		
Net (loss) earnings	$ (737,686)	$ 73,267
Adjustments to reconcile net (loss) earnings to net cash provided by operating activities:		
Goodwill write-off	761,701	
Depreciation and amortization	11,017	11,271
Provision for credit losses	37,000	
Gain on sale of other real estate owned	(126)	
Other real estate owned valuation adjustment	1,064	
Loss (gain) on sale of loans	303	(8,981)
Loss (gain) on sale of premises and equipment	10	(433)
Gain on sale of securities	(81)	
Proceeds from sale of loans held for sale	7,868	94,459
Origination of loans held for sale	(1,665)	(16,234)
Restricted stock amortization	3,639	6,770
Deficit (excess) tax benefit from stock option exercises and restricted and performance stock vesting	455	(3,365)
Increase (decrease) in accrued and deferred income taxes, net	(3,982)	8,043
Increase in other assets	6,889	2,251
Increase in accrued interest payable and other liabilities	(557)	(8,584)
Dividends on FHLB stock	(1,210)	(1,012)
Net cash provided by operating activities	84,639	157,452
Cash flows from investing activities:		
Net cash and cash equivalents paid in acquisitions		(1,566)
Net decrease in loans	128	112,652
Proceeds from sale of loans	22,110	355,238
Net decrease in deposits in financial institutions	117	139
Securities available-for-sale:		
Sales	16,527	
Maturities	28,364	42,156
Purchases	(36,431)	(20,877)
Net (purchases) redemptions of FHLB stock	(5,599)	12,396
Proceeds from sale of other real estate owned	1,236	479
Purchases of premises and equipment, net	(3,345)	(3,662)
Proceeds from sale of premises and equipment	62	9,684
Net cash provided by investing activities	23,169	506,639
Cash flows from financing activities:		
Net increase (decrease) in deposits:		
Noninterest-bearing	6,540	(254,084)
Interest-bearing	(58,614)	10,677
Redemptions of subordinated debentures	(8,248)	(10,310)
Net repurchases of common stock	(150)	(69,016)
Net (surrenders) proceeds from exercise and vesting of stock awards	(258)	738
Deficit (excess) tax benefit from stock option exercises and restricted and performance stock vesting	(455)	3,365
Net increase (decrease) in borrowings	8,700	(224,000)
Repayment of acquired debt		(84,076)
Cash dividends paid	(26,494)	(28,540)
Net cash used in financing activities	(78,979)	(655,246)
Net increase in cash and cash equivalents	28,829	8,845
Cash and cash equivalents at beginning of period	101,363	150,910

Cash and cash equivalents at end of period	$ 130,192	$ 159,755
Supplemental disclosure of cash flow information:		
Cash paid during period for interest	$ 51,192	$ 64,750
Cash paid during period for income taxes	18,981	43,937
Transfer of loans to other real estate owned	12,104	360
Transfer from loans held-for-sale to loans	57,034	28,688
Transfer from loans to loans held-for-sale	22,085	379,692

See "Notes to Unaudited Condensed Consolidated Financial Statements."

NOTE 1 BASIS OF PRESENTATION

PacWest Bancorp, formerly known as First Community Bancorp, is a bank holding company registered under the Bank Holding Company Act of 1956, as amended. Our principal business is to serve as a holding company for our banking subsidiary. As of September 30, 2008, our sole banking subsidiary was Pacific Western Bank, which we refer to as Pacific Western or the Bank. When we say "we", "our" or the "Company", we mean the Company on a consolidated basis with the Bank. When we refer to "PacWest" or to the holding company, we are referring to the parent company on a stand-alone basis.

We have completed 19 acquisitions since May 2000 including the merger whereby the former Rancho Santa Fe National Bank and First Community Bank of the Desert became wholly-owned subsidiaries of the Company in a pooling-of-interests transaction. All other acquisitions have been accounted for using the purchase method of accounting and, accordingly, their operating results have been included in the consolidated financial statements from their respective dates of acquisition. Please see Notes 2 and 3 for more information about our acquisitions.

At a special meeting of the Company's shareholders held on April 23, 2008, the shareholders approved the reincorporation of the Company in Delaware from California and the change of the Company's name to PacWest Bancorp from First Community Bancorp. The reincorporation became effective on May 14, 2008.

In connection with the reincorporation and name change, the Company also changed its ticker symbol on the NASDAQ Global Select Market to "PACW." Other than the name change, change in ticker symbol and change in corporate domicile, the reincorporation did not result in any change in the business, physical location, management, assets, liabilities or total stockholders' equity of the Company, nor did it result in any change in location of the Company's employees, including the Company's management. Additionally, the reincorporation did not alter any shareholder's percentage ownership interest or number of shares owned in the Company.

The stockholders' equity section of the accompanying consolidated financial statements have been restated retroactively to give effect to the reincorporation. Such reclassification had no effect on the results of operations or the total amount of stockholders' equity.

(a) Basis of Presentation

The accounting and reporting policies of the Company are in accordance with U.S. generally accepted accounting principles, which we refer to as GAAP. All significant intercompany balances and transactions have been eliminated.

Our financial statements reflect all adjustments that are, in the opinion of management, necessary to present a fair statement of the results for the interim periods presented. Certain information and note disclosures normally included in consolidated financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. The interim operating results are not necessarily indicative of operating results for the full year.

(b) Use of Estimates

Management of the Company has made a number of estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period to prepare these consolidated financial statements in conformity with GAAP. Actual results could differ from those estimates. Material estimates subject to change in the near term include,

NOTE 1 BASIS OF PRESENTATION (Continued)

among other items, the allowance for credit losses, the carrying values of intangible assets and the realization of deferred tax assets.

NOTE 2 MERGER RELATED LIABILITIES

All of the acquisitions consummated after December 31, 2000 were completed using the purchase method of accounting. Accordingly, we recorded the estimated merger-related charges associated with each acquisition as a liability at closing when the related purchase price was allocated.

For each acquisition, we developed an integration plan for the Company that addressed, among other things, requirements for staffing, systems platforms, branch locations and other facilities. The established plans are evaluated regularly during the integration process and modified as required. Merger and integration expenses are summarized in the following primary categories: (i) severance and employee-related charges; (ii) system conversion and integration costs, including contract termination charges; (iii) asset write- downs, lease termination costs for abandoned space and other facilities-related costs; and (iv) other charges.

The following table presents the activity in the merger-related liability account for the nine months ended September 30, 2008:

	Severance and Employee-related	System Conversion and Integration	Asset Write-downs, Lease Terminations and Other Facilities-related	Other	Total
		(Dollars in thousands)			
Balance at December 31, 2007	$ 31	$	$ 1,337	$ 309	$ 1,677
Cash outlays	(17)		(505)	(62)	(584)
Balance at September 30, 2008	$ 14	$	$ 832	$ 247	$ 1,093

NOTE 3 GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill and intangible assets arise from purchase business combinations. The goodwill previously recorded had been assigned to our one reporting segment, banking. Goodwill and other intangible assets generated from purchase business combinations and deemed to have indefinite lives are not subject to amortization and are instead tested for impairment at least annually. As a result of the volatility in the banking industry and the effect such volatility has had on banking stocks since the beginning of 2008, including PacWest Bancorp's common stock, during both the first and second quarters we engaged an independent valuation consultant to assist us in determining whether and to what extent our goodwill asset was impaired. Based on these analyses, we wrote-off $275.0 million of goodwill in the first quarter of 2008 and wrote-off the remaining balance of our goodwill totaling $486.7 million in the second quarter of 2008. Such charges had no effect on the Company's or the Bank's cash balances or liquidity. In addition, because goodwill and other intangible assets are not included in the calculation of regulatory capital, the Company's and the Bank's well-capitalized regulatory ratios have not been affected by this non-cash expense.

The analyses compared the implied fair value of goodwill to the carrying amount of goodwill on the Company's balance sheet. Since the carrying amount of the goodwill exceeded the implied fair value of that goodwill, an impairment loss was recognized in an amount equal to that excess. The implied fair value of goodwill was determined in the same manner as goodwill recognized in a business combination would be determined. That is, the estimated fair value of the Company was allocated to all of the Company's individual assets and liabilities, including any unrecognized identifiable intangible

NOTE 3 GOODWILL AND OTHER INTANGIBLE ASSETS (Continued)

assets, as if the Company had been acquired in a business combination and the estimated fair value of the Company was the price paid to acquire it. The allocation process was performed only for purposes of determining the amount of goodwill impairment, as no assets or liabilities are written up or down, nor are any additional unrecognized identifiable intangible assets recorded as a part of this process.

The following table presents the changes in goodwill for the nine months ended September 30, 2008:

	Nine Months Ended September 30, 2008 (Dollars in thousands)
Balance as of January 1, 2008	$ 761,990
Adjustments related to 2007 acquisitions	(289)
Write-offs	(761,701)
Balance as of September 30, 2008	$

Intangible assets with definite lives are amortized over their respective estimated useful lives to their estimated residual values and reviewed for impairment annually. The estimated aggregate amortization expense related to the intangible assets is expected to be $9.4 million for 2008. The estimated aggregate amortization expense related to the intangible assets for each of the subsequent four years is $7.9 million, $7.2 million, $6.4 million, and $4.6 million.

The following table presents the changes in the gross amounts of core deposit and customer relationship intangibles and the related accumulated amortization for the nine months ended September 30, 2008 and 2007:

	Nine Months Ended September 30,	
	2008	2007
	(Dollars in thousands)	
Gross amount:		
Balance as of January 1,	$70,463	$67,773
Additions		3,032
Balance as of September 30,	70,463	70,805