National Bank Holdings Corp
Form 10-Q
November 04, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2016

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: 001-35654

NATIONAL BANK HOLDINGS CORPORATION

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	27-0563799 (I.R.S. Employer Identification No.)

7800 East Orchard, Suite 300, Greenwood Village, Colorado 80111

(Address of principal executive offices) (Zip Code)

Registrant’s telephone, including area code: (720) 529-3336

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 (§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 “accelerated filer.” and “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:

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

As of November 3, 2016, the registrant had outstanding 25,963,366 shares of Class A voting common stock, each with $0.01 par value per share, excluding 804,381 shares of restricted Class A common stock issued but not yet vested.

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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, notwithstanding that such statements are not specifically identified. Any statements about our expectations, beliefs, plans, predictions, forecasts, objectives, assumptions or future events or performance are not historical facts and may be forward-looking. These statements are often, but not always, made through the use of words or phrases such as “anticipate,” “believe,” “can,” “would,” “should,” “could,” “may,” “predict,” “seek,” “potential,” “will,” “estimate,” “t “continuing,” “ongoing,” “expect,” “intend” and similar words or phrases. These statements are only predictions and involve estimates, known and unknown risks, assumptions and uncertainties. We have based these statements largely on our current expectations and projections about future events and financial trends that we believe may affect our financial condition, liquidity, results of operations, business strategy and growth prospects.

Forward-looking statements involve certain important risks, uncertainties and other factors, any of which could cause actual results to differ materially from those in such statements and, therefore, you are cautioned not to place undue reliance on such statements. Factors that could cause actual results to differ from those discussed in the forward-looking statements include, but are not limited to:

· our ability to execute our business strategy, as well as changes in our business strategy or development plans;

· business and economic conditions generally and in the financial services industry;

· economic, market, operational, liquidity, credit and interest rate risks associated with our business;

· effects of any changes in trade, monetary and fiscal policies and laws, including the interest rate policies of the Federal Reserve Board;

· changes imposed by regulatory agencies to increase our capital to a level greater than the current level required for well-capitalized financial institutions (including the impact of the joint final rules promulgated by the Federal Reserve Board, Office of the Comptroller of the Currency and the FDIC revising certain regulatory capital requirements to align with the Basel III capital standards and meet certain requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act);

· effects of inflation, as well as, interest rate, securities market and monetary supply fluctuations;

· changes in the economy or supply-demand imbalances affecting local real estate values;

- changes in consumer spending, borrowings and savings habits;
- our ability to identify potential candidates for, obtain regulatory approval for, and consummate, acquisitions of financial institutions on attractive terms, or at all;
- our ability to integrate acquisitions or consolidations and to achieve synergies, operating efficiencies and/or other expected benefits within expected time-frames, or at all, or within expected cost projections, and to preserve the goodwill of acquired financial institutions;
- our ability to realize the anticipated benefits from converted core operating systems without significant change in our client service or risk to our control environment;
- dependence on information technology and telecommunications systems of third party service providers and the risk of systems failures, interruptions or breaches of security, including those that could result in disclosure or misuse of confidential or proprietary client or other information;
- our ability to achieve organic loan and deposit growth and the composition of such growth;
- changes in sources and uses of funds, including loans, deposits and borrowings;
- increased competition in the financial services industry, nationally, regionally or locally, resulting in, among other things, lower returns;

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· the effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board and other accounting standard setters;

· the trading price of shares of the Company's stock;

· our ability to realize deferred tax assets or the need for a valuation allowance;

· continued consolidation in the financial services industry;

· our ability to maintain or increase market share and control expenses;

· costs and effects of changes in laws and regulations and of other legal and regulatory developments, including, but not limited to, changes in regulation that affect the fees that we charge, the resolution of legal proceedings or regulatory or other governmental inquiries, and the results of regulatory examinations, reviews or other inquiries; and changes in regulations that apply to us due to the conversion of our bank subsidiary to a Colorado state-chartered bank;

· technological changes;

· the timely development and acceptance of new products and services and perceived overall value of these products and services by our clients;

· changes in our management personnel and our continued ability to hire and retain qualified personnel;

· ability to implement and/or improve operational management and other internal risk controls and processes and our reporting system and procedures;

· regulatory limitations on dividends from our bank subsidiary;

· changes in estimates of future loan reserve requirements based upon the periodic review thereof under relevant regulatory and accounting requirements;

· widespread natural and other disasters, dislocations, political instability, acts of war or terrorist activities, cyberattacks or international hostilities through impacts on the economy and financial markets generally or on us or our counterparties specifically;

- impact of reputational risk on such matters as business generation and retention;

- other risks and uncertainties listed from time to time in the Company’s reports and documents filed with the Securities and Exchange Commission; and

- our success at managing the risks involved in the foregoing items.

Any forward-looking statement speaks only as of the date on which it is made, and we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which the statement is made or to reflect the occurrence of unanticipated events or circumstances, except as required by applicable law.

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PART I: FINANCIAL INFORMATION

Item 1: FINANCIAL STATEMENTS

NATIONAL BANK HOLDINGS CORPORATION AND SUBSIDIARIES

Consolidated Statements of Financial Condition (Unaudited)

(In thousands, except share and per share data)

	September 30, 2016	December 31, 2015
ASSETS		
Cash and due from banks	$ 124,977	$ 155,985
Interest bearing bank deposits	—	10,107
Cash and cash equivalents	124,977	166,092
Investment securities available-for-sale (at fair value)	968,853	1,157,246
Investment securities held-to-maturity (fair value of $360,686 and $428,585 at September 30, 2016 and December 31, 2015, respectively)	355,427	427,503
Non-marketable securities	12,373	22,529
Loans	2,822,555	2,587,673
Allowance for loan losses	(28,021)	(27,119)
Loans, net	2,794,534	2,560,554
Loans held for sale	20,341	13,292
Other real estate owned	21,200	20,814
Premises and equipment, net	96,861	103,103
Goodwill	59,630	59,630
Intangible assets, net	8,319	12,429
Other assets	143,898	140,716
Total assets	$ 4,606,413	$ 4,683,908
LIABILITIES AND SHAREHOLDERS’ EQUITY		
Liabilities:		
Deposits:		
Non-interest bearing demand deposits	$ 841,421	$ 815,054
Interest bearing demand deposits	416,153	436,745
Savings and money market	1,393,661	1,394,995
Time deposits	1,173,772	1,193,883
Total deposits	3,825,007	3,840,677
Securities sold under agreements to repurchase	113,307	136,523
Federal Home Loan Bank advances	51,359	40,000
Other liabilities	66,968	49,164
Total liabilities	4,056,641	4,066,364
Shareholders’ equity:		
Common stock, par value $0.01 per share: 400,000,000 shares authorized; 52,126,818 and 52,177,352 shares issued; 26,282,224 and	514	513

30,358,509 shares outstanding at September 30, 2016 and December 31, 2015, respectively				
Additional paid-in capital		997,665		997,926
Retained earnings		47,347		38,670
Treasury stock of 25,018,819 and 20,982,812 shares at September 30, 2016 and December 31, 2015, respectively, at cost		(504,301)		(419,660)
Accumulated other comprehensive income, net of tax		8,547		95
Total shareholders' equity		549,772		617,544
Total liabilities and shareholders' equity	$	4,606,413	$	4,683,908

See accompanying notes to the consolidated interim financial statements.

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NATIONAL BANK HOLDINGS CORPORATION AND SUBSIDIARIES

Consolidated Statements of Operations (Unaudited)

(In thousands, except share and per share data)

	For the three months ended September 30,		For the nine months ended September 30,	
	2016	2015	2016	2015
Interest and dividend income:				
Interest and fees on loans	$ 33,450	$ 32,650	$ 96,477	$ 96,797
Interest and dividends on investment securities	7,094	9,144	23,088	29,480
Dividends on non-marketable securities	160	319	581	963
Interest on interest-bearing bank deposits	60	198	644	675
Total interest and dividend income	40,764	42,311	120,790	127,915
Interest expense:				
Interest on deposits	3,479	3,424	10,305	10,274
Interest on borrowings	221	205	630	625
Total interest expense	3,700	3,629	10,935	10,899
Net interest income before provision for loan losses	37,064	38,682	109,855	117,016
Provision for loan losses	5,293	3,710	22,369	7,021
Net interest income after provision for loan losses	31,771	34,972	87,486	109,995
Non-interest income:				
Service charges	3,662	3,953	10,387	10,977
Bank card fees	2,828	2,808	8,530	8,057
Gain on sale of mortgages, net	600	628	1,608	1,574
Bank-owned life insurance income	497	421	1,378	1,217
Other non-interest income	2,354	521	5,942	2,711
OREO related write-ups and other income	1,667	183	2,190	871
Bargain purchase gain	—	1,048	—	1,048
FDIC loss-sharing related	—	(5,801)	—	(20,426)
Total non-interest income	11,608	3,761	30,035	6,029
Non-interest expense:				
Salaries and benefits	20,091	20,454	60,315	61,687
Occupancy and equipment	5,666	6,098	17,440	18,256
Telecommunications and data processing	1,487	2,933	4,599	8,573
Marketing and business development	687	1,016	1,802	3,277
FDIC deposit insurance	734	1,031	2,719	3,104
Bank card expenses	1,133	924	3,009	2,470
Professional fees	909	924	2,343	3,006
Other non-interest expense	2,198	2,831	6,265	7,566
Problem asset workout	1,172	1,821	3,104	5,435

Gain on OREO sales, net	(2,077)	(238)	(4,120)	(2,342)
Intangible asset amortization	1,370	1,359	4,110	4,031
Gain from the change in fair value of warrant liability	—	(476)	—	(358)
Banking center consolidation related expenses	—	—	—	1,089
Total non-interest expense	33,370	38,677	101,586	115,794
Income before income taxes	10,009	56	15,935	230
Income tax expense (benefit)	1,695	(1,580)	2,866	(1,311)
Net income	$ 8,314	$ 1,636	$ 13,069	$ 1,541
Income per share—basic	$ 0.30	$ 0.05	$ 0.45	$ 0.04
Income per share—diluted	$ 0.30	$ 0.05	$ 0.45	$ 0.04
Weighted average number of common shares outstanding:				
Basic	27,654,827	32,681,181	28,991,094	35,605,180
Diluted	27,898,756	32,762,516	29,111,322	35,605,701

See accompanying notes to the consolidated interim financial statements.

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NATIONAL BANK HOLDINGS CORPORATION AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income (Unaudited)

(In thousands)

	For the three months ended September 30,		For the nine months ended September 30,	
	2016	2015	2016	2015
Net income	$ 8,314	$ 1,636	$ 13,069	$ 1,541
Other comprehensive (loss) income, net of tax:				
Securities available-for-sale:				
Net unrealized (losses) gains arising during the period, net of tax benefit (expense) of $1,376 and ($2,982) for the three months ended September 30, 2016 and 2015, respectively; and net of tax expense of ($6,111) and ($2,982) for the nine months ended, September 30, 2016 and 2015, respectively	(2,242)	4,848	9,956	4,848
Less: amortization of net unrealized holding gains to income, net of tax benefit of $300 and $342 for the three months ended September 30, 2016 and 2015, respectively; and net of tax benefit of $923 and $1,120 for the nine months ended September 30, 2016 and 2015, respectively	(489)	(556)	(1,504)	(1,951)
Other comprehensive (loss) income	(2,731)	4,292	8,452	2,897
Comprehensive income	$ 5,583	$ 5,928	$ 21,521	$ 4,438

See accompanying notes to the consolidated interim financial statements.

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NATIONAL BANK HOLDINGS CORPORATION AND SUBSIDIARIES

Consolidated Statements of Changes in Shareholders' Equity (Unaudited)

Nine months ended September 30, 2016 and 2015

(In thousands, except share and per share data)

	Common stock	Additional paid-in capital	Retained earnings	Treasury stock	Accumulated other comprehensive income, net	Total
Balance, December 31, 2014	$ 512	$ 993,212	$ 40,528	$ (245,516)	$ 5,839	$ 794,575
Net income	—	—	1,541	—	—	1,541
Stock-based compensation	—	2,514	—	—	—	2,514
Issuance under equity compensation plans, including tax benefit of $8	1	(286)	—	290	—	5
Repurchase of 8,645,836 shares	—	—	—	(175,048)	—	(175,048)
Cash dividends declared ($0.15 per share)	—	—	(5,291)	—	—	(5,291)
Other comprehensive income	—	—	—	—	2,897	2,897
Balance, September 30, 2015	$ 513	$ 995,440	$ 36,778	$ (420,274)	$ 8,736	$ 621,193
Balance, December 31, 2015	$ 513	$ 997,926	$ 38,670	$ (419,660)	$ 95	$ 617,544
Net income	—	—	13,069	—	—	13,069
Stock-based compensation	—	2,692	—	—	—	2,692
Issuance of stock under equity compensation plans, including tax benefit of $39, loss on reissuance of treasury stock of $5, net	1	(2,953)	—	2,669	—	(283)
Repurchase of 4,231,874 shares	—	—	—	(87,310)	—	(87,310)
Cash dividends declared ($0.15 per share)	—	—	(4,392)	—	—	(4,392)
Other comprehensive income	—	—	—	—	8,452	8,452
Balance, September 30, 2016	$ 514	$ 997,665	$ 47,347	$ (504,301)	$ 8,547	$ 549,772

See accompanying notes to the consolidated interim financial statements.

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NATIONAL BANK HOLDINGS CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows (Unaudited)

(In thousands)

	For the nine months ended September 30, 2016	2015
Cash flows from operating activities:		
Net income	$ 13,069	$ 1,541
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Provision for loan losses	22,369	7,021
Depreciation and amortization	10,864	11,613
Current income tax receivable	3,357	(2,216)
Deferred income tax asset	6,846	(6,585)
Discount accretion, net of premium amortization on securities	2,352	3,229
Loan accretion	(27,939)	(38,073)
Gain on sale of mortgages, net	(1,608)	(1,574)
Origination of loans held for sale, net of repayments	(79,747)	(78,760)
Proceeds from sales of loans held for sale	71,113	74,234
Bank-owned life insurance income	(1,378)	(1,217)
Amortization of indemnification asset	—	20,751
Gain on the sale of other real estate owned, net	(4,120)	(2,342)
Impairment on other real estate owned	262	799
Impairment on fixed assets related to banking center consolidations	—	1,089
(Gain) loss on sale of fixed assets	(1,840)	6
Bargain purchase gain	—	(1,048)
Stock-based compensation	2,692	2,514
Decrease in due to FDIC, net	—	(3,299)
Increase in other assets	(6,892)	(2,109)
Increase (decrease) in other liabilities	17,747	(799)
Net cash provided by (used in) operating activities	27,147	(15,225)
Cash flows from investing activities:		
Purchase of FHLB stock	(1,859)	—
Proceeds from redemption of FHLB stock	7,051	493
Proceeds from redemption of FRB stock	4,964	—
Purchase of FRB stock	—	(238)
Proceeds from maturities of investment securities held-to-maturity	69,218	81,877
Proceeds from maturities of investment securities available-for-sale	207,413	242,159
Proceeds from sales of investment securities available-for-sale	—	29,748
Purchase of investment securities available-for-sale	(4,872)	—
Increase in securities purchased under agreement to resell	—	(50,000)
Net increase in loans	(239,203)	(272,019)
Sales (purchases) of premises and equipment, net	1,328	(3,623)
Purchase of bank-owned life insurance	(10,344)	—
Proceeds from sales of loans	9,231	11,702

Proceeds from sales of other real estate owned	8,227	14,260
Decrease in FDIC indemnification asset	—	176
Net cash activity from acquisitions	—	22,832
Net cash provided by investing activities	51,154	77,367
Cash flows from financing activities:		
Net decrease in deposits	(15,670)	(21,694)
(Decrease) increase in repurchase agreements	(23,216)	35,936
Advances from FHLB	71,359	—
FHLB Payoffs	(60,000)	—
Issuance of stock under purchase and equity compensation plans	(322)	(148)
Proceeds from exercise of stock options	—	160
Excess tax benefit on stock-based compensation	39	8
Payment of dividends	(4,296)	(5,179)
Repurchase of shares	(87,310)	(175,048)
Net cash used in financing activities	(119,416)	(165,965)
Decrease in cash and cash equivalents	(41,115)	(103,823)
Cash and cash equivalents at beginning of the year	166,092	256,979
Cash and cash equivalents at end of period	$ 124,977	$ 153,156
Supplemental disclosure of cash flow information during the period:		
Cash paid for interest	$ 9,336	$ 9,913
Net tax payments	$ 2,152	$ 7,467
Supplemental schedule of non-cash investing activities:		
Loans transferred to other real estate owned at fair value	$ 4,755	$ 1,143
FDIC submissions transferred to other liabilities	$ —	$ (2,644)
Loans purchased but not settled	$ 11,537	$ —

See accompanying notes to the consolidated interim financial statements.

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NATIONAL BANK HOLDINGS CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

September 30, 2016

Note 1 Basis of Presentation

National Bank Holdings Corporation ("NBHC" or the "Company") is a bank holding company that was incorporated in the State of Delaware in June 2009 with the intent to acquire and operate financial services franchises and other complementary businesses in targeted markets. The Company is headquartered immediately south of Denver, in Greenwood Village, Colorado, and its primary operations are conducted through its wholly owned subsidiary, NBH Bank (the "Bank"), a Colorado state-chartered bank and a member of the Federal Reserve System. The Company provides a variety of banking products to both commercial and consumer clients through a network of 91 banking centers located in Colorado, the greater Kansas City area and Texas, and through on-line and mobile banking products.

The accompanying interim unaudited consolidated financial statements serve to update the National Bank Holdings Corporation Annual Report on Form 10-K for the year ended December 31, 2015 and include the accounts of the Company and the Bank and its wholly owned subsidiaries. The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) and where applicable, with general practices in the banking industry or guidelines prescribed by bank regulatory agencies. However, they may not include all information and notes necessary to constitute a complete set of financial statements under GAAP applicable to annual periods and accordingly should be read in conjunction with the financial information contained in the Company's most recent Form 10-K. The unaudited consolidated financial statements reflect all adjustments which are, in the opinion of management, necessary for a fair statement of the results presented. All such adjustments are of a normal recurring nature. All significant intercompany balances and transactions have been eliminated in consolidation. Certain reclassifications of prior years' amounts are made whenever necessary to conform to current period presentation. During the first quarter of 2016, the Company updated the loan classifications in its allowance for loan losses model. Certain loan classifications within the consolidated financial statement disclosures have been updated to reflect this change. Refer to note 4 for further discussion. The prior period presentations have been reclassified to conform to the current period presentation. The results of operations for the interim period is not necessarily indicative of the results that may be expected for the full year or any other interim period. All amounts are in thousands, except share data, or as otherwise noted.

GAAP requires management to make estimates that affect the reported amounts of assets, liabilities, revenues and expenses, and disclosures of contingent assets and liabilities. By their nature, estimates are based on judgment and available information. Management has made significant estimates in certain areas, such as the amount and timing of expected cash flows from assets, the valuation of other real estate owned (“OREO”), the fair value adjustments on assets acquired and liabilities assumed, the valuation of core deposit intangible assets, the valuation of investment securities for other-than-temporary impairment (“OTTI”), the valuation of stock-based compensation, the fair values of financial instruments, the allowance for loan losses (“ALL”), and contingent liabilities. Because of the inherent uncertainties associated with any estimation process and future changes in market and economic conditions, it is possible that actual results could differ significantly from these estimates.

The Company's significant accounting policies followed in the preparation of the unaudited consolidated financial statements are disclosed in note 2 of the audited financial statements and notes for the year ended December 31, 2015 and are contained in the Company's Annual Report on Form 10-K. There have not been any significant changes to the application of significant accounting policies since December 31, 2015, with the exception of the following:

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Loans held for sale—The Company enters into commitments to originate residential mortgage loans whereby the interest rate on the loan is determined prior to funding (i.e. interest rate lock commitments). Such interest rate lock commitments on mortgage loans to be sold in the secondary market are considered to be derivatives. To protect against the price risk inherent in residential mortgage loan commitments, the Company utilizes both "best efforts" and "mandatory delivery" forward loan sale commitments to mitigate the risk of potential increases or decreases in the values of loans that would result from the change in market rates for such loans. Under a "best efforts" contract, the Company commits to deliver an individual mortgage loan of a specified principal amount and quality to an investor and the investor commits to a price that it will purchase the loan from the Company only if the loan to the underlying borrower closes. As a result, the Company is not generally exposed to gains or losses on loans sold utilizing best efforts due to changes in underlying market interest rates between the time of the rate lock and loan sale. The market value of interest rate lock commitments and best efforts contracts are not readily ascertainable with precision because rate lock commitments and best efforts contracts are not actively traded. However, because of the high correlation between rate lock commitments and best efforts contracts offsetting market value changes, no gain or loss should occur on the interest rate lock commitments. Under a "mandatory delivery" contract, the Company commits to deliver a certain principal amount of mortgage loans to an investor at a specified price on or before a specified date. This typically happens after the loan to the underlying borrower closes. The Company manages the interest rate risk on interest rate lock commitments by entering into forward sale contracts of mortgage backed securities, whereby the Company obtains the right to deliver securities to investors in the future at a specified price. Such contracts are accounted for as derivatives and are recorded at fair value as derivative assets or liabilities. They are carried on the consolidated statements of financial condition within other assets or other liabilities and changes in fair value are recorded in other non-interest income within the consolidated statements of operations. The period of time between issuance of a loan commitment to the customer and closing of the loan to an investor generally ranges from 30 - 90 days under normal market conditions. The gross gains on loan sales are recognized based on new loan commitments with adjustment for price and pair-off activity. Commission expenses on loans held for sale are recognized based on loans closed.

Income taxes —For the three and nine months ended September 30, 2016, the Company utilized the full year forecast method to calculated its interim income tax provision. For the three and nine months ended September 30, 2015, the Company utilized the discrete effective tax rate method, as allowed by Accounting Standards codification (“ASC”) 740-270-30-18, “Income Taxes-Interim Reporting,” to calculate its interim income tax provision. The discrete method is applied when the application of the estimated annual effective tax rate is impractical because it is not possible to reliably estimate the annual effective tax rate. The discrete method treats the year-to-date period as if it was the annual period and determines the income tax expense or benefit on that basis. The Company believed that, at that time, the use of this discrete method was more appropriate than the annual effective tax rate method as the estimated annual effective tax rate method was not reliable due to (1) the levels of tax-exempt income in relation to pre-tax income, (2) the impact of the warrant liability which is non-taxable and (3) the impact and variability of FDIC Indemnification amortization on pre-tax income. See further discussion in note 13.

Note 2 Recent Accounting Pronouncements

Revenue from Contracts with Customers—In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers." This update supersedes revenue recognition requirements in ASC Topic 605, Revenue Recognition, including most industry-specific revenue recognition guidance in the FASB Accounting Standards Codification. The new guidance stipulates that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance provides specific steps that entities should apply in order to achieve this principle. The amendments are effective for interim and annual periods beginning after December 15, 2017, with early application permitted for interim and annual periods beginning after December 15, 2016. ASU No. 2014-09 allows for either full retrospective or modified retrospective adoption. The Company is in the process of evaluating the impact of the ASU's adoption on the Company's consolidated financial statements. The Company has not yet selected a transition method nor has it determined the effect of the standard on its ongoing financial reporting.

Financial Instruments - Recognition and Measurement of Financial Assets and Financial Liabilities—In January 2016, the FASB issued ASU 2016-01, Financial Instruments - Recognition and Measurement of Financial Assets and Financial Liabilities (Topic 825). ASU No. 2016-01 revises the classification and measurement of investments in certain equity investments and the presentation of certain fair value changes for certain financial liabilities measured at fair value. ASU No. 2016-01 requires the change in fair value of many equity investments to be recognized in net income. ASU No. 2016-01 is effective for interim and annual periods beginning after December 15, 2017, with early adoption permitted. Adopting ASU No. 2016-01 may result in a cumulative effect adjustment to the consolidated statements of changes in shareholders’ equity as of the beginning of the year of adoption. The adoption of this ASU is not expected to have a material impact on the Company’s consolidated financial statements.

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Leases—In February 2016, the FASB issued ASU 2016-02, Leases. The guidance in ASU 2016-02 supersedes the lease recognition requirements in ASC Topic 840, Leases. The new standard establishes a right-of-use (ROU) model that requires a lessee to record a ROU asset and lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statements. The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, with early adoption permitted. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. Early adoption of the amendments in the update is permitted. The Company is in the process of evaluating the impact of the ASU's adoption on the Company's consolidated financial statements.

Improvements to Employee Share-Based Payment Accounting—In March 2016, the FASB issued ASU 2016-09, Improvements to Employee Share-Based Payment Accounting, which amends ASC Topic 718, Compensation – Stock Compensation. ASU 2016-09 simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. ASU 2016-09 is effective for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years and early adoption is permitted. The adoption of this ASU is not expected to have a material impact on the Company’s consolidated financial statements.

Financial Instruments - Credit Losses—In June 2016, the FASB issued ASU 2016-13, Measurement of Credit Losses on Financial Instruments. This update replaces the current incurred loss methodology for recognizing credit losses with a current expected credit loss model, which requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. This amendment broadens the information that an entity must consider in developing its expected credit loss estimates. Additionally, the update amends the accounting for credit losses for available-for-sale debt securities and purchased financial assets with a more-than-insignificant amount of credit deterioration since origination. This update requires enhanced disclosures to help investors and other financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of a company’s loan portfolio. The amendments in this update are effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption in fiscal years beginning after December 15, 2018 is permitted. The amendment requires the use of the modified retrospective approach for adoption. The Company is in the process of evaluating the impact of the ASU’s adoption on the Company’s consolidated financial statements.

Statement of Cash Flows—In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments. The update amends the guidance in ASC 230, Statement of Cash Flows, and clarifies how entities should classify certain cash receipts and cash payments on the statement of cash flows with the objective of reducing the existing diversity in practice related to eight specific cash flow items. The amendments in this update are effective for annual periods beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted. The Company does not expect the adoption of ASU 2016-15 to have a material impact on its financial statements.

Note 3 Investment Securities

The Company's investment securities portfolio is comprised of available-for-sale and held-to-maturity investment securities. These investment securities totaled $1.3 billion at September 30, 2016 and were comprised of $1.0 billion of available-for-sale securities and $0.3 billion of held-to-maturity securities. At December 31, 2015, investment securities totaled $1.6 billion and were comprised of $1.2 billion of available-for-sale securities and $0.4 billion of held-to-maturity securities.

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Available-for-sale

At September 30, 2016 and December 31, 2015, the Company held $1.0 billion and $1.2 billion of available-for-sale investment securities, respectively. Available-for-sale investment securities are summarized as follows as of the dates indicated:

	September 30, 2016			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Mortgage-backed securities ("MBS"):				
Residential mortgage pass-through securities issued or guaranteed by U.S. Government agencies or sponsored enterprises	$ 243,792	$ 7,446	$ —	$ 251,238
Other residential MBS issued or guaranteed by U.S. Government agencies or sponsored enterprises	714,425	3,178	(5,138)	712,465
Municipal securities	4,723	8	—	4,731
Other securities	419	—	—	419
Total	$ 963,359	$ 10,632	$ (5,138)	$ 968,853

	December 31, 2015			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Mortgage-backed securities ("MBS"):				
Residential mortgage pass-through securities issued or guaranteed by U.S. Government agencies or sponsored enterprises	$ 305,773	$ 5,721	$ (516)	$ 310,978
Other residential MBS issued or guaranteed by U.S. Government agencies or sponsored enterprises	861,321	3,638	(19,416)	845,543
Municipal securities	306	—	—	306
Other securities	419	—	—	419
Total	$ 1,167,819	$ 9,359	$ (19,932)	$ 1,157,246

At September 30, 2016 and December 31, 2015, mortgage-backed securities represented primarily all of the Company's available-for-sale investment portfolio and all mortgage-backed securities were backed by government sponsored enterprises ("GSE") collateral such as Federal Home Loan Mortgage Corporation ("FHLMC") and Federal National Mortgage Association ("FNMA"), and the government sponsored agency Government National Mortgage Association ("GNMA").

The table below summarizes the unrealized losses as of the dates shown, along with the length of the impairment period:

	September 30, 2016					
	Less than 12 months		12 months or more		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Mortgage-backed securities (“MBS”):						
Other residential MBS issued or guaranteed by U.S. Government agencies or sponsored enterprises	$ 86,999	$ (260)	$ 417,272	$ (4,878)	$ 504,271	$ (5,138)
Total	$ 86,999	$ (260)	$ 417,272	$ (4,878)	$ 504,271	$ (5,138)

	December 31, 2015					
	Less than 12 months		12 months or more		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Mortgage-backed securities (“MBS”):						
Residential mortgage pass-through securities issued or guaranteed by U.S. Government agencies or sponsored enterprises	$ 109,182	$ (516)	$ —	$ —	$ 109,182	$ (516)
Other residential MBS issued or guaranteed by U.S. Government agencies or sponsored enterprises	67,527	(404)	575,954	(19,012)	643,481	(19,416)
Total	$ 176,709	$ (920)	$ 575,954	$ (19,012)	$ 752,663	$ (19,932)

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Management evaluated all of the available-for-sale securities in an unrealized loss position and concluded that no OTTI existed at September 30, 2016 or December 31, 2015. The unrealized losses in the Company's investments issued or guaranteed by U.S. government agencies or sponsored enterprises at September 30, 2016 were caused by changes in interest rates. The portfolio included 51 securities, having an aggregate fair value of $504.3 million, which were in an unrealized loss position at September 30, 2016, compared to 66 securities, with a fair value of $752.7 million, at December 31, 2015. The Company has no intention to sell these securities before recovery of their amortized cost and believes it will not be required to sell the securities before the recovery of their amortized cost.

Certain securities are pledged as collateral for public deposits, securities sold under agreements to repurchase, and to secure borrowing capacity at the Federal Reserve Bank and Federal Home Loan Bank (“FHLB”), if needed. The fair value of available-for-sale investment securities pledged as collateral totaled $262.4 million at September 30, 2016 and $335.8 million at December 31, 2015. The decrease in pledged available-for-sale investment securities was primarily attributable to a decrease in average deposit account balances and client repurchase account balances during the nine months ended September 30, 2016. Certain investment securities may also be pledged as collateral for the line of credit at the FHLB of Topeka; at September 30, 2016 and December 31, 2015, no securities were pledged for this purpose.

Mortgage-backed securities do not have a single maturity date and actual maturities may differ from contractual maturities depending on the repayment characteristics and experience of the underlying financial instruments. The estimated weighted average life of the available-for-sale mortgage-backed securities portfolio was 3.0 years as of September 30, 2016 and 3.6 years as of December 31, 2015. This estimate is based on assumptions and actual results may differ. At September 30, 2016 and December 31, 2015, the duration of the total available-for-sale investment portfolio was 2.9 years and 3.4 years, respectively.

As of September 30, 2016, municipal securities with an amortized cost and fair value of $3.7 million were due after one year through five years, while municipal securities with an amortized cost and fair value of $1.0 million were due after five years through ten years. Other securities of $0.4 million as of September 30, 2016, have no stated contractual maturity date.

Held-to-maturity

At September 30, 2016 and December 31, 2015, the Company held $355.4 million and $427.5 million of held-to-maturity investment securities, respectively. Held-to-maturity investment securities are summarized as follows as of the dates indicated:

September 30, 2016

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Mortgage-backed securities ("MBS"):				
Residential mortgage pass-through securities issued or guaranteed by U.S. Government agencies or sponsored enterprises	$ 281,536	$ 5,312	$ —	$ 286,848
Other residential MBS issued or guaranteed by U.S. Government agencies or sponsored enterprises	73,891	313	(366)	73,838
Total investment securities held-to-maturity	$ 355,427	$ 5,625	$ (366)	$ 360,686

	December 31, 2015			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Mortgage-backed securities ("MBS"):				
Residential mortgage pass-through securities issued or guaranteed by U.S. Government agencies or sponsored enterprises	$ 340,131	$ 2,911	$ (230)	$ 342,812
Other residential MBS issued or guaranteed by U.S. Government agencies or sponsored enterprises	87,372	35	(1,634)	85,773
Total investment securities held-to-maturity	$ 427,503	$ 2,946	$ (1,864)	$ 428,585

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The table below summarizes the unrealized losses as of the dates shown, along with the length of the impairment period:

	September 30, 2016					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Mortgage-backed securities (“MBS”):						
Other residential MBS issued or guaranteed by U.S. Government agencies or sponsored enterprises	$ 5,593	$ (21)	$ 34,946	$ (345)	$ 40,539	$ (366)
Total	$ 5,593	$ (21)	$ 34,946	$ (345)	$ 40,539	$ (366)

	December 31, 2015					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Mortgage-backed securities (“MBS”):						
Residential mortgage pass-through securities issued or guaranteed by U.S. Government agencies or sponsored enterprises	$ 34,641	$ (205)	$ 853	$ (25)	$ 35,494	$ (230)
Other residential MBS issued or guaranteed by U.S. Government agencies or sponsored enterprises	28,490	(180)	45,872	(1,454)	74,362	(1,634)
Total	$ 63,131	$ (385)	$ 46,725	$ (1,479)	$ 109,856	$ (1,864)

The portfolio included five securities, having an aggregate fair value of $40.5 million, which were in an unrealized loss position at September 30, 2016, compared to twelve securities, with a fair value of $109.9 million, at December 31, 2015.

Management evaluated all of the held-to-maturity securities in an unrealized loss position and concluded that no OTTI existed at September 30, 2016 or December 31, 2015. The unrealized losses in the Company's investments issued or guaranteed by U.S. government agencies or sponsored enterprises at September 30, 2016 were caused by changes in interest rates. The Company has no intention to sell these securities before recovery of their amortized cost and believes it will not be required to sell the securities before the recovery of their amortized cost.

The carrying value of held-to-maturity investment securities pledged as collateral totaled $163.4 million and $156.5 million at September 30, 2016 and December 31, 2015, respectively.

Actual maturities of mortgage-backed securities may differ from scheduled maturities depending on the repayment characteristics and experience of the underlying financial instruments. The estimated weighted average expected life of the held-to-maturity mortgage-backed securities portfolio as of September 30, 2016 and December 31, 2015 was 3.1 years and 3.7 years, respectively. This estimate is based on assumptions and actual results may differ. The duration of the total held-to-maturity investment portfolio was 2.9 years and 3.4 years as of September 30, 2016 and December 31, 2015, respectively.

Note 4 Loans

The loan portfolio is comprised of loans originated by the Company and loans that were acquired in connection with the Company's acquisitions.

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The table below shows the loan portfolio composition including carrying value by segment of loans accounted for under ASC Topic 310-30, Receivables—Loans and Debt Securities Acquired with Deteriorated Credit Quality, and loans not accounted for under this guidance, which includes our originated loans. The carrying value of loans is net of discounts, fees and costs on loans excluded from ASC 310-30 of $6.9 million and $8.1 million as of September 30, 2016 and December 31, 2015, respectively:

	September 30, 2016			
	ASC 310-30 loans	Non 310-30 loans	Total loans	% of total
Commercial	$ 43,339	$ 1,477,267	$ 1,520,606	53.9%
Commercial real estate non-owner occupied	95,487	453,248	548,735	19.4%
Residential real estate	17,654	706,791	724,445	25.7%
Consumer	1,183	27,586	28,769	1.0%
Total	$ 157,663	$ 2,664,892	$ 2,822,555	100.0%

	December 31, 2015			
	ASC 310-30 loans	Non 310-30 loans	Total loans	% of total
Commercial	$ 57,474	$ 1,369,946	$ 1,427,420	55.2%
Commercial real estate non-owner occupied	121,173	321,712	442,885	17.1%
Residential real estate	21,452	662,550	684,002	26.4%
Consumer	2,731	30,635	33,366	1.3%
Total	$ 202,830	$ 2,384,843	$ 2,587,673	100.0%

Delinquency for loans excluded from ASC 310-30 is shown in the following tables at September 30, 2016 and December 31, 2015, respectively:

	Total Loans September 30, 2016							
	30-59 days past due	60-89 days past due	Greater than 90 days past due	Total past due	Current	Total Non 310-30 loans	Loans > 90 days past due and still accruing	Non-accrual
Loans excluded from ASC 310-30:								
Commercial:								
Commercial and industrial	$ 289	$ 7	$ 1,159	$ 1,455	$ 1,042,089	$ 1,043,544	$ 25	$ 2,129
Owner occupied commercial real estate	192	—	330	522	213,464	213,986	271	412

Agriculture	196	—	223	419	132,690	133,109	—	1,939
Energy	3,018	—	7,063	10,081	76,547	86,628	—	13,313
Total Commercial	3,695	7	8,775	12,477	1,464,790	1,477,267	296	17,793
Commercial real estate non-owner occupied:								
Construction	—	273	—	273	76,355	76,628	—	—
Acquisition/development	—	—	—	—	9,743	9,743	—	—
Multifamily	—	—	—	—	20,228	20,228	—	—
Non-owner occupied	—	—	28	28	346,621	346,649	—	68
Total commercial real estate	—	273	28	301	452,947	453,248	—	68
Residential real estate:								
Senior lien	237	265	693	1,195	651,514	652,709	131	3,745
Junior lien	306	9	24	339	53,743	54,082	—	670
Total residential real estate	543	274	717	1,534	705,257	706,791	131	4,415
Consumer	53	39	1	93	27,493	27,586	1	202
Total loans excluded from ASC 310-30	$ 4,291	$ 593	$ 9,521	$ 14,405	$ 2,650,487	$ 2,664,892	$ 428	$ 22,478

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	Total Loans December 31, 2015							
	30-59 days past due	60-89 days past due	Greater than 90 days past due	Total past due	Current	Total Non 310-30 loans	Loans > 90 days past due and still accruing	Non-accrual
Loans excluded from ASC 310-30:								
Commercial:								
Commercial and industrial	$ 2,252	$ 238	$ 49	$ 2,539	$ 890,350	$ 892,889	$ —	$ 4,830
Owner occupied commercial real estate	370	111	66	547	184,072	184,619	—	1,273
Agriculture	441	58	1,222	1,721	143,837	145,558	—	1,984
Energy	23	5,781	—	5,804	141,076	146,880	—	12,008
Total Commercial	3,086	6,188	1,337	10,611	1,359,335	1,369,946	—	20,095
Commercial real estate non-owner occupied:								
Construction	359	188	—	547	29,596	30,143	—	188
Acquisition/development	—	—	—	—	5,575	5,575	—	—
Multifamily	—	38	22	60	9,813	9,873	—	22
Non-owner occupied	2,340	182	968	3,490	272,631	276,121	—	1,013
Total commercial real estate	2,699	408	990	4,097	317,615	321,712	—	1,223
Residential real estate:								
Senior lien	1,909	911	1,481	4,301	610,192	614,493	124	3,713
Junior lien	299	237	194	730	47,327	48,057	6	584
Total residential real estate	2,208	1,148	1,675	5,031	657,519	662,550	130	4,297
Consumer	239	26	38	303	30,332	30,635	36	32
Total loans excluded from ASC 310-30	$ 8,232	$ 7,770	$ 4,040	$ 20,042	$ 2,364,801	$ 2,384,843	$ 166	$ 25,647

Loans are considered past due or delinquent when the contractual principal or interest due in accordance with the terms of the loan agreement remains unpaid after the due date of the scheduled payment. Pooled loans accounted for under ASC 310-30 that are 90 days or more past due and still accreting are generally considered to be performing and are included in loans 90 days or more past due and still accruing. Non-accrual loans include troubled debt restructurings on non-accrual status.

Non-accrual loans excluded from the scope of ASC 310-30 totaled $22.5 million at September 30, 2016, decreasing $3.2 million, or 12.4%, from $25.6 million at December 31, 2015. The change was driven by decreases of $2.7 million in the commercial and industrial sector due to charge-offs throughout the year and other net decreases of $1.8 million, offset by a net increase of $1.3 million in the energy sector at September 30, 2016.

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Credit exposure for all loans as determined by the Company's internal risk rating system was as follows as of September 30, 2016 and December 31, 2015, respectively:

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