OCEANFIRST FINANCIAL CORP
Form 10-Q
May 09, 2014
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2014

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

For the transition period from__________ to __________

Commission file number 001-11713

OceanFirst Financial Corp.

(Exact name of registrant as specified in its charter)

Delaware	**22-3412577**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
975 Hooper Avenue, Toms River, NJ	**08753**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code: (732) 240-4500

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 x NO ¨.

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES x NO ¨.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer	¨	Accelerated Filer	x
Non-accelerated Filer	¨	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 x.

As of May 2, 2014 there were 17,337,872 shares of the Registrant s Common Stock, par value $.01 per share, outstanding.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

FINANCIAL SUMMARY	At or for the Quarter Ended		
(dollars in thousands, except per share amounts)	March 31, 2014	December 31, 2013	March 31, 2013
SELECTED FINANCIAL CONDITION DATA:			
Total assets	$ 2,281,711	$ 2,249,711	$ 2,303,711
Loans receivable, net	1,570,969	1,541,460	1,501,362
Deposits	1,720,131	1,746,763	1,740,294
Stockholders equity	216,190	214,350	219,554
SELECTED OPERATING DATA:			
Net interest income	18,065	18,251	17,189
Provision for loan losses	530	200	1,100
Other income	3,998	4,283	3,409
Operating expenses	14,263	19,611(2)	12,665
Net income	4,707	1,939(2)	4,436
Diluted earnings per share	0.28	0.11(2)	0.26
SELECTED FINANCIAL RATIOS:			
Stockholders equity per common share	12.45	12.33	12.43
Cash dividend per share	0.12	0.12	0.12
Stockholders equity to total assets	9.47%	9.53%	9.53%
Return on average assets (1)	0.83	0.34(2)	0.77
Return on average stockholders equity (1)	8.72	3.64(2)	8.06
Average interest rate spread	3.31	3.33	3.08
Net interest margin	3.36	3.38	3.16
Operating expenses to average assets (1)	2.52	3.43(2)	2.21
Efficiency ratio	64.65	87.03(2)	61.49
ASSET QUALITY:			
Non-performing loans	$ 45,321	$ 45,360	$ 47,437
Non-performing assets	49,778	49,705	50,250
Allowance for loan losses as a percent of total loans receivable	1.31%	1.33%	1.34%
Allowance for loan losses as a percent of total non-performing loans	46.19	46.14	43.20
Non-performing loans as a percent of total loans receivable	2.83	2.88	3.11
Non-performing assets as a percent of total assets	2.18	2.21	2.18
Wealth Management			
Assets under administration	$ 216,508	$ 216,114	$ 176,824

(1) Ratios are annualized

(2) Operating results and financial ratios for the fourth quarter of 2013 include non-recurring expenses relating to the prepayment of Federal Home Loan Bank advances at a cost of $4.3 million and the consolidation of two branches into newer, in-market facilities at a cost of $579,000. The total after-tax cost was $3.1 million.

Summary

OceanFirst Financial Corp. is the holding company for OceanFirst Bank (the Bank), a community bank serving Ocean and Monmouth Counties in New Jersey. The term the Company refers to OceanFirst Financial Corp., OceanFirst Bank and all of the Bank s subsidiaries on a consolidated basis. The Company s results of operations are primarily dependent on net interest income, which is the difference between the interest income earned on interest-earning assets, such as loans and investments, and the interest expense on interest-bearing liabilities, such as deposits and borrowings. The Company also generates non-interest income such as income from bankcard services, wealth management services, deposit accounts, the sale of investment products, loan originations, loan servicing, loan sales, and other fees. The Company s operating expenses primarily consist of compensation and employee benefits, occupancy and equipment, marketing, federal deposit insurance, data processing and general and administrative expenses. The Company s results of operations are also significantly affected by general economic and competitive conditions, particularly changes in market interest rates, government policies and actions of regulatory agencies.

Interest-earning assets, both loans and securities, are generally priced against longer-term indices, while interest-bearing liabilities, primarily deposits and borrowings, are generally priced against shorter-term indices. The Company s net interest margin has expanded over the past year as the Company has succeeded in growing commercial loans resulting in a shift in asset mix from lower-yielding short-term investments and securities into higher-yielding loans. The net interest margin also benefited from the prepayment of $159.0 million of Federal Home Loan Bank (FHLB) advances in the fourth quarter of 2013 and from the rising interest rate environment in 2013 which steepened the yield curve, slowed loan refinance activity and improved yields on newly originated loans and investments. Based upon current economic conditions, the Federal Reserve has indicated that it anticipates that short-term interest rates will remain at current levels for a considerable time, especially if projected inflation continues to run below the 2% longer-run goal, and provided that longer-term inflation expectations remain well-anchored. Additionally, the Federal Reserve recently decided to taper its monthly bond buying program, with further reductions expected throughout 2014. The increase in longer-term rates and related reduction in loan refinance activity has caused a decrease in the Company s loan sale volume and therefore lower income from the net gain on the sale of loans.

In addition to the interest rate environment, the Company s results are affected by economic conditions. Recent economic indicators point to some improvement in the economy, which expanded modestly in 2013 and into 2014. Labor market conditions also improved as the national and local unemployment rate in the first quarter of 2014 has improved over prior year levels. Despite these signs, the pace of economic recovery remains weak.

Highlights of the Company s financial results for the three months ended March 31, 2014 were as follows:

Total assets increased to $2.282 billion at March 31, 2014, from $2.250 billion at December 31, 2013. Loans receivable, net increased $29.5 million at March 31, 2014, as compared to December 31, 2013 primarily due to growth in commercial loans of $27.5 million and in residential construction loans, net of loans in process, which increased $5.8 million.

Net income for the three months ended March 31, 2014 was $4.7 million, or $0.28 per diluted share, as compared to net income of $4.4 million, or $0.26 per diluted share for the corresponding prior year period. The prior year period was adversely impacted by a provision of $975,000 added to the reserve for repurchased loans and loss sharing obligations as compared to no provision in the current period. The three months ended March 31, 2014 benefited from higher net interest income and lower provision for loan losses offset by lower gain on sale of loans (excluding the provision for repurchased loans) and higher operating expenses. Diluted earnings per share for the three months ended March 31, 2014 also benefited from a reduction in shares outstanding.

Net interest income for the three months ended March 31, 2014 increased to $18.1 million, as compared to $17.2 million in the same prior year period, reflecting a higher net interest margin partly offset by lower interest-earning assets. The net interest margin increased to 3.36% for the three months ended March 31, 2014, as compared to 3.16% for the corresponding prior year period.

The provision for loan losses was $530,000 for the three months ended March 31, 2014, as compared to $1.1 million in the same prior year period primarily due to a reduction in net charge-offs.

Other income increased to $4.0 million for the three months ended March 31, 2014 as compared to $3.4 million in the same prior year period. Excluding the $975,000 provision for repurchased loans, the gain on sale of loans decreased $669,000 due to a reduction in loans sold and a decrease in the gain on sale margin. Operating expenses increased $1.6 million primarily due to personnel additions in revenue producing areas and higher marketing costs related to a promotional campaign to attract retail checking accounts and incent bankcard usage.

The Company remains well-capitalized with a tangible common equity ratio of 9.47%.

Return on average stockholders equity was 8.72% for the three months ended March 31, 2014, as compared to 8.06% for the corresponding prior year period.

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Analysis of Net Interest Income

Net interest income represents the difference between income on interest-earning assets and expense on interest-bearing liabilities. Net interest income depends upon the relative amounts of interest-earning assets and interest-bearing liabilities and the interest rate earned or paid on them.

The following table sets forth certain information relating to the Company for the three months ended March 31, 2014 and 2013. The yields and costs are derived by dividing income or expense by the average balance of assets or liabilities, respectively, for the periods shown except where noted otherwise. Average balances are derived from average daily balances. The yields and costs include certain fees which are considered adjustments to yields.

	FOR THE THREE MONTHS ENDED MARCH 31,					
	2014			2013		
	AVERAGE BALANCE	INTEREST	AVERAGE YIELD/ COST	AVERAGE BALANCE	INTEREST	AVERAGE YIELD/ COST
	(dollars in thousands)					
Assets						
Interest-earning assets:						
Interest-earning deposits and short-term investments	$ 29,332	$ 6	0.08%	$ 85,951	$ 26	0.12%
Securities (1) and FHLB stock	562,350	2,493	1.77	565,197	2,362	1.67
Loans receivable, net (2)	1,557,281	17,246	4.43	1,524,156	17,664	4.64
Total interest-earning assets	2,148,963	19,745	3.68	2,175,304	20,052	3.69
Non-interest-earning assets	115,855			118,148		
Total assets	$ 2,264,818			$ 2,293,452		
Liabilities and Stockholders Equity						
Interest-bearing liabilities:						
Transaction deposits	$ 1,322,358	363	0.11	$ 1,330,639	563	0.17
Time deposits	215,710	733	1.36	221,200	762	1.38
Total	1,538,068	1,096	0.29	1,551,839	1,325	0.34
Borrowed funds	283,256	584	0.82	319,645	1,538	1.92
Total interest-bearing liabilities	1,821,324	1,680	0.37	1,871,484	2,863	0.61
Non-interest-bearing deposits	210,867			185,066		
Non-interest-bearing liabilities	16,690			16,845		
Total liabilities	2,048,881			2,073,395		
Stockholders equity	215,937			220,057		

Total liabilities and stockholders equity	$ 2,264,818		$ 2,293,452	
Net interest income	$ 18,065		$ 17,189	
Net interest rate spread (3)		3.31%		3.08%
Net interest margin (4)		3.36%		3.16%

(1) Amounts are recorded at average amortized cost.
(2) Amount is net of deferred loan fees, undisbursed loan funds, discounts and premiums and estimated loss allowances and includes loans held for sale and non-performing loans.
(3) Net interest rate spread represents the difference between the yield on interest-earning assets and the cost of interest-bearing liabilities.
(4) Net interest margin represents net interest income divided by average interest-earning assets.

Comparison of Financial Condition at March 31, 2014 and December 31, 2013

Total assets increased by $32.0 million to $2.282 billion at March 31, 2014, from $2.250 billion at December 31, 2013. Securities, in the aggregate, decreased by $4.1 million, to $535.4 million at March 31, 2014, as compared to $539.4 million at December 31, 2013. Loans receivable, net, increased by $29.5 million, an annualized growth rate of 7.7%, to $1.571 billion at March 31, 2014 from $1.541 billion at December 31, 2013, primarily due to growth in commercial loans of $27.5 million and in residential construction loans, net of loans in process, which increased $5.8 million. The growth in commercial loans was primarily due to the successful recruitment of several experienced commercial lenders within the past year.

Deposits decreased by $26.6 million, to $1.720 billion at March 31, 2014, from $1.747 billion at December 31, 2013, despite strong growth in retail and business checking accounts. To fund loan growth and deposit outflows, FHLB advances increased $57.3 million, to $232.3 million at March 31, 2014, from $175.0 million at December 31, 2013.

Stockholders equity increased to $216.2 million at March 31, 2014, as compared to $214.4 million at December 31, 2013. Net income for the period was offset by the repurchase of 88,000 shares of common stock for $1.5 million (average cost per share of $17.29) and the cash dividends on common stock of $2.0 million. At March 31, 2014, there were 213,766 shares available for repurchase under the stock repurchase program adopted in the fourth quarter of 2012.

Comparison of Operating Results for the Three months Ended March 31, 2014 and March 31, 2013

General

Net income for the three months ended March 31, 2014 was $4.7 million, or $0.28 per diluted share, as compared to net income of $4.4 million, or $0.26 per diluted share for the corresponding prior year period. The prior year period was adversely impacted by a provision of $975,000 added to the reserve for repurchased loans and loss sharing obligations as compared to no provision in the current period. The three months ended March 31, 2014 benefited from higher net interest income and lower provision for loan losses offset by lower gain on sale of loans (excluding the provision for repurchased loans) and higher operating expenses. Diluted earnings per share for the three months ended March 31, 2014 also benefited from a reduction in shares outstanding.

Interest Income

Interest income for the three months ended March 31, 2014 was $19.7 million, as compared to $20.1 million for the three months ended March 31, 2013. The yield on interest-earning assets declined to 3.68% for the three months ended March 31, 2014, as compared to 3.69% same prior year period. Average interest-earning assets decreased by $26.3 million for the three months ended March 31, 2014, as compared to the same prior year period. Despite the one basis point decline, the asset yield benefited from a shift in the mix of interest-earning assets as average loans receivable, net increased $33.1 million while average interest-earning deposits and short-term investments decreased $56.6 million, as compared to the same prior year period.

Interest Expense

Interest expense for the three months ended March 31, 2014 was $1.7 million as compared to $2.9 million for the three months ended March 31, 2013. The cost of interest-bearing liabilities decreased to 0.37% for the three months ended March 31, 2014, as compared to 0.61% in the same prior year period. The decrease was partly due to the prepayment of $159.0 million of FHLB advances with a weighted average cost of 2.31% in the fourth quarter of 2013. Average interest-bearing liabilities decreased by $50.2 million for the three months ended March 31, 2014, as compared to the same prior year period due to a decline in average borrowed funds of $36.4 million. Additionally, interest-bearing funding was partly replaced by an increase of $25.8 million in average non-interest bearing deposits for the three months ended March 31, 2014, as compared to the same prior year period.

Net Interest Income

Net interest income for the three months ended March 31, 2014 increased to $18.1 million, as compared to $17.2 million in the same prior year period, reflecting a higher net interest margin partly offset by lower interest-earning assets. The net interest margin increased to 3.36% for the three months ended March 31, 2014, from 3.16% in the same prior year period primarily due to a reduction in the cost of average interest-bearing liabilities.

Provision for Loan Losses

For the three months ended March 31, 2014, the provision for loan losses was $530,000, as compared to $1.1 million for the corresponding prior year period. The decrease for the three months ended March 31, 2014 was primarily due to a reduction of $590,000 in net charge-offs, as compared to the same prior year period. Non-performing loans decreased $39,000 at March 31, 2014, as compared to December 31, 2013, and by $2.1 million, as compared to March 31, 2013.

Other Income

For the three months ended March 31, 2014, other income increased to $4.0 million as compared to $3.4 million in the same prior year period. For the three months ended March 31, 2014, wealth management revenue increased $113,000, as compared to the same prior year period, partly due to an increase in assets under administration to $216.5 million at March 31, 2014 from $176.8 million at March 31, 2013. Fees and service charges increased $144,000, as compared to the same prior year period due to higher retail and commercial checking account fees. For the three months ended March 31, 2014, the net gain on the sale of loans amounted to $132,000, as compared to a loss of $174,000 in the same prior year period. The net loss on the sale of loans for the three months ended March 31, 2013 was adversely impacted by a provision of $975,000 added to the reserve for repurchased loans and loss sharing obligations, as compared to no provision in the current quarter. The prior year provision was related to loans sold to the FHLB as part of its Mortgage Partnership Finance program. Excluding the provision for repurchased loans, the gain on sale of loans was adversely impacted by a decrease in the gain-on-sale margin and a reduction in loans sold to $10.3 million for the quarter ended March 31, 2014, as compared to $36.8 million for the corresponding prior year quarter, as increasing longer-term interest rates reduced one-to-four family refinance activity.

Operating Expenses

Operating expenses amounted to $14.3 million for the three months ended March 31, 2014, as compared to $12.7 million in the same prior year period. Compensation and employee benefits expense increased $1.1 million for the three months ended March 31, 2014, as compared to the same prior year period primarily due to personnel additions in revenue producing areas. Marketing expenses increased $282,000, as compared to the same prior year period, primarily due to a promotional campaign to attract retail checking accounts and incent bankcard usage. The promotion resulted in the acquisition of 1,200 new checking relationships in the first quarter. Occupancy expenses for the three months ended March 31, 2014 include $180,000 in snow removal costs, a $130,000 increase over the same prior year period.

Provision for Income Taxes

The provision for income taxes was $2.6 million for the quarter ended March 31, 2014, as compared to $2.4 million for the same prior year period. The effective tax rate was 35.3% for the quarter ended March 31, 2014, as compared to 35.1% in the same prior year period.

Liquidity and Capital Resources

The Company s primary sources of funds are deposits, principal and interest payments on loans and mortgage-backed securities, proceeds from the sale of loans, FHLB and other borrowings and, to a lesser extent, investment maturities. While scheduled amortization of loans is a predictable source of funds, deposit flows and mortgage prepayments are greatly influenced by interest rates, economic conditions and competition. The Company has other sources of liquidity if a need for additional funds arises, including various lines of credit.

At March 31, 2014 the Company had $92.3 million in outstanding overnight borrowings from the FHLB compared to $35.0 million in outstanding at December 31, 2013. The Company periodically utilizes overnight borrowings to fund short-term liquidity needs. The Company had total FHLB borrowings, including the overnight borrowings, of $232.3 million and $175.0 million, respectively, at March 31, 2014 and December 31, 2013.

The Company s cash needs for the three months ended March 31, 2014 were primarily satisfied by principal payments on loans and mortgage-backed securities, proceeds from the sale of mortgage loans held for sale, proceeds from maturities of investment securities and increased total borrowings. The cash was principally utilized for loan originations, the purchase of investment and mortgage-backed securities and to fund deposit outflows. The Company s cash needs for the three months ended March 31, 2013 were primarily satisfied by principal payments on loans and mortgage-backed securities, proceeds from the sale of mortgage loans held for sale, proceeds from maturities of investment securities available for sale, deposit growth and short-term borrowings. The cash was principally utilized for loan originations and the purchase of investment and mortgage-backed securities.

In the normal course of business, the Company routinely enters into various off-balance-sheet commitments. At March 31, 2014, outstanding undrawn lines of credit totaled $287.3 million; outstanding commitments to originate loans totaled $83.4 million; and outstanding commitments to sell loans totaled $20.5 million. The Company expects to have sufficient funds available to meet current commitments arising in the normal course of business.

Time deposits scheduled to mature in one year or less totaled $127.3 million at March 31, 2014. Based upon historical experience management estimates that a significant portion of such deposits will remain with the Company.

The Company has a detailed contingency funding plan and comprehensive reporting of funding trends on a monthly and quarterly basis which is reviewed by management. Management also monitors cash on a daily basis to determine the liquidity needs of the Bank. Additionally, management performs multiple liquidity stress test scenarios on a quarterly basis. The Bank continues to maintain significant liquidity under all stress scenarios.

Under the Company s stock repurchase program, shares of OceanFirst Financial Corp. common stock may be purchased in the open market and through other privately-negotiated transactions, from time-to-time, depending on market conditions. The repurchased shares are held as treasury stock for general corporate purposes. For the three months ended March 31, 2014, the Company repurchased 88,000 shares of common stock at a total cost of $1.5 million, compared with repurchases of 254,340 shares at a cost of $3.6 million for the three months ended March 31, 2013. At March 31, 2014, there were 213,766 shares remaining to be repurchased under the existing stock repurchase program.

Cash dividends on common stock declared and paid during the first three months of 2014 were $2.0 million, as compared to $2.1 million in the same prior year period. On April 23, 2014, the Board of Directors declared a quarterly cash dividend of twelve cents ($0.12) per common share. The dividend is payable on May 16, 2014 to stockholders of record at the close of business on May 5, 2014.

The primary sources of liquidity specifically available to OceanFirst Financial Corp., the holding company of OceanFirst Bank, are capital distributions from the banking subsidiary and the issuance of preferred and common stock and long-term debt. In December 2013, as part of its capital plan, the Company submitted notice to the Federal Reserve Bank of Philadelphia requesting

a total payment of $16.0 million in dividends from the Bank to the Holding Company over the next four quarters (including the fourth quarter of 2013). The Federal Reserve did not object to the payments, although it reserved the right to revoke the approval at any time if a safety and soundness concern arises throughout the period. For the three months ended March 31, 2014, the Company received a dividend payment of $4.0 million from the Bank and $8.0 million remained to be paid over the next two quarters. The Company s ability to continue to pay dividends will be largely dependent upon capital distributions from the Bank, which may be adversely affected by capital constraints imposed by the applicable regulations. The Company cannot predict whether the Bank will be permitted under applicable regulations to pay a dividend to the Company. If the Bank is unable to pay dividends to the Company, the Company may not have the liquidity necessary to pay a dividend in the future or pay a dividend at the same rate as historically paid, or be able to meet current debt obligations. At March 31, 2014, OceanFirst Financial Corp. held $16.9 million in cash and $9.1 million in investment securities available-for-sale.

As of March 31, 2014, the Bank exceeded all regulatory capital requirements as follows (in thousands):

	Actual		Required	
	Amount	Ratio	Amount	Ratio
Tangible	$ 219,094	9.59%	$ 34,270	1.50%
Tier 1 leverage	219,094	9.59	91,386	4.00
Tier 1 risk-based	219,094	14.58	60,111	4.00
Total risk-based	237,906	15.83	120,221	8.00

The Bank is considered a well-capitalized institution under the Prompt Corrective Action Regulations.

In July 2013 the Federal Deposit Insurance Corporation and the other federal bank regulatory agencies issued a final rule that will revise their leverage and risk-based capital requirements and the method for calculating risk-weighted assets to make them consistent with agreements that were reached by the Basel Committee on Banking Supervision and certain provisions of the Dodd-Frank Act. Among other things, the rule establishes a new common equity Tier 1 minimum capital requirement (4.5% of risk-weighted assets), increases the minimum Tier 1 capital to risk-based assets requirement (from 4% to 6% of risk-weighted assets) and assigns a higher risk weight (150%) to exposures that are more than 90 days past due or are on non-accrual status and to certain commercial real estate facilities that finance the acquisition, development or construction of real property. The final rule also requires unrealized gains and losses on certain available-for-sale securities holdings to be included for purposes of calculating regulatory capital unless a one-time opt-out is exercised. Additional constraints will also be imposed on the inclusion in regulatory capital of mortgage-servicing assets, deferred tax assets and minority interests. The rule limits a banking organization s capital distributions and certain discretionary bonus payments if the banking organization does not hold a capital conservation buffer consisting of 2.5% of common equity Tier 1 capital to risk-weighted assets in addition to the amount necessary to meet its minimum risk-based capital requirements. The final rule becomes effective for the Bank on January 1, 2015. The capital conservation buffer requirement will be phased in beginning January 1, 2016 and ending January 1, 2019, when the full capital conservation buffer requirement will be effective.

At March 31, 2014, the Company maintained tangible common equity of $216.2 million, for a tangible common equity to assets ratio of 9.47%.

Off-Balance-Sheet Arrangements and Contractual Obligations

In the normal course of operations, the Company engages in a variety of financial transactions that, in accordance with generally accepted accounting principles, are not recorded in the financial statements. These transactions involve, to

varying degrees, elements of credit, interest rate and liquidity risk. Such transactions are used for general corporate purposes or for customer needs. Corporate purpose transactions are used to help manage credit, interest rate and liquidity risk or to optimize capital. Customer transactions are used to manage customers requests for funding. These financial instruments and commitments include undrawn lines of credit and commitments to extend credit. The Company also has outstanding commitments to sell loans amounting to $20.5 million.

The following table shows the contractual obligations of the Company by expected payment period as of March 31, 2014 (in thousands):

Contractual Obligation	Total	Less than one year	1-3 years	3-5 years	More than 5 years
Debt Obligations					