OLD SECOND BANCORP INC
Form DEFA14A
July 22, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of
the Securities Exchange Act of 1934 (Amendment No.)

Filed by the Registrant x

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Check the appropriate box:

o	Preliminary Proxy Statement
o	**Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
o	Definitive Proxy Statement
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o	Soliciting Material Pursuant to §240.14a-12

Old Second Bancorp, Inc.
(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

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Old Second Bancorp, Inc. issued the following press release on July 22, 2010 announcing its earnings for the second fiscal quarter ended June 30, 2010:

Old Second Bancorp, Inc. **For Immediate Release**
(Nasdaq: OSBC) **July 22, 2010**

Contact: **J. Douglas Cheatham**
Chief Financial Officer
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Old Second Bancorp, Inc. Announces Second Quarter Results

AURORA, Illinois Old Second Bancorp, Inc. (the Company or Old Second) (Nasdaq: OSBC) today announced results of operations for the second quarter of 2010.

Summary

- The net loss available to common stockholders declined to $24.5 million, or $1.75 per share, in the second quarter of 2010, compared to a net loss of $59.7 million, or $4.29 per share, in the second quarter of 2009. The net loss decreased primarily because of a goodwill impairment charge that was recognized in the second quarter of 2009.

- Core earnings, defined as pre-tax earnings excluding the impact of other real estate owned and the provision for loan losses (and also excluding the one-time goodwill impairment charge recognized in the second quarter of 2009), were $11.4 million, or $0.82 per core diluted share, in the second quarter of 2010, as compared to $11.7 million, or $0.84 per core diluted share, in the second quarter of 2009.

- Tax-equivalent net interest margin improved to 3.70% in the first half of 2010, compared to 3.39% in the first half of 2009.

- The ratio of loan loss reserves to total loans increased to 4.26% at June 30, 2010, compared to 3.41% at March 31, 2010 and 3.37% at June 30, 2009, due to the second quarter of 2010 provision exceeding net charge-offs of $30.5 million by $14.1 million.

- The provision for loan losses declined 6.1% to $44.6 million in the second quarter of 2010 from the $47.5 million provision recognized in the second quarter of 2009.

- Savings and transaction deposits increased $64.9 million, or 5.2%, to $1.319 billion as of June 30, 2010, compared to $1.254 billion as of June 30, 2009. The Company continued to exhibit a low level of reliance on brokered deposits, which comprised only 2.31% of total deposits and was generally limited to customer participation in the CDARS program as of June 30, 2010. Furthermore, the Company did not have any internet deposits as of June 30, 2010.

- Total nonperforming loans increased to $242.9 million at June 30, 2010 from $192.7 million at March 31, 2010. A majority of this increase was attributable to a $44.9 million increase in nonperforming commercial real estate loans, which included a single $16.1 million credit secured by several special purpose, owner-occupied properties.

- In the second quarter of 2010, the Company engaged a nationally recognized financial services consulting firm to conduct an independent credit review of the Bank s credit risk ratings and regulatory classifications, loss content, loss recognition and the accuracy of accrual/nonaccrual status. The outside firm reviewed approximately 43% of the Bank s loan portfolio, including a high percentage of its adversely classified loans. The Company believes that the consulting firm s conclusions corroborate the Bank s overall loan grading methodology and the Bank s conclusions regarding the appropriateness of the methodology that it employs for establishing its allowance for loan and lease losses.

• Also in the second quarter of 2010, the Company adopted a multi-faceted capital strategy designed to improve its capital position in light of the continuing challenging economic environment. In furtherance of such strategy, the Company commenced an offer to exchange a portion of the $31.6 million outstanding liquidation amount of the 7.80% Capital Securities issued by Old Second Capital Trust I for newly issued shares of common stock of the Company. The exchange offer is scheduled to expire on August 2, 2010, subject to the Company s right to extend the expiration date, or terminate the exchange offer, in its discretion.

In announcing these results, the Company s Chairman and CEO, William Skoglund, stated, The ongoing weakness in the financial system and economy, particularly as it relates to credit costs associated with the real estate markets in the market areas that we serve, continues to directly affect borrowers ability to repay their loans, which has resulted in a continued increase in the level of our nonperforming loans. However, we are encouraged by the continued strength of our core operations, particularly our ability to attract more core deposits while also continuing to increase our net interest margin. We believe that this exemplifies the strength of the Old Second franchise in our market areas.

Mr. Skoglund continued, Our board of directors and management team, as significant stockholders of the Company, share in the disappointment of our stockholders regarding the recent downward pressure on the Company s stock price. We remain focused on the need to implement strategies that are targeted to improve asset quality in this difficult economic environment and to successfully execute on our previously announced capital plan. We are devoting significant time and resources to implementing these strategies and our capital plan. We believe our current capital levels and the continued strength of our core operations affords us the time to thoroughly explore a variety of capital strategies that will best maximize stockholder value.

Ongoing Capital Initiatives

On June 22, 2010, the Company announced the commencement of an offer to exchange a portion of the $31.6 million outstanding liquidation amount of the 7.80% Capital Securities (the Capital Securities) issued by Old Second Capital Trust I for newly issued shares of common stock of the Company. The exchange offer will expire on August 2, 2010, unless the Company extends the expiration date or terminates the exchange offer. This offer to exchange is the first component of a contemplated multi-faceted capital strategy designed to strengthen the Company s capital position.

The Company has called a special meeting of stockholders scheduled to be held on August 2, 2010, at which the Company will seek stockholder approval to issue up to 6,000,000 shares of its common stock, in the aggregate, in the exchange offer and in a possible separate private exchange of its common stock for capital securities held by certain holders of Old Second Capital Trust II (discussed below). If the Company s stockholders do not approve the issuance of up to 6,000,000 shares, the Company will be limited to issuing no more than 2,750,000 shares of its common stock in the exchange offer and the potential separate private exchange transaction to comply with Nasdaq listing rules.

The Company believes that the consummation of the Capital Securities for common stock exchange offer will have several positive effects on its overall financial condition, as it will result in the recognition of a net gain due to the indebtedness represented by the Capital Securities being redeemed at a price below its face amount, reduce the Company s indebtedness and associated interest expense and increase its Tier 1 common and tangible common equity ratios by issuing common stock in exchange for a type of Tier 1 capital that is not considered common equity. The magnitude of these positive effects will depend on the amount of Capital Securities exchanged.

As noted above, the exchange offer is the first component of a contemplated multi-faceted capital strategy adopted by the Company. The current status of the other components of the capital strategy, which the Company also announced on June 22, 2010, are as follows:

- **Exchange of Series B Preferred Stock for Trust Preferred Securities** The United States Senate passed the financial regulatory reform bill, H.R. 4173, on July 15, 2010 and President Obama signed the bill into law on July 21, 2010. The final bill includes a provision allowing trust preferred securities issued in an exchange for preferred stock issued under the Capital Purchase Program of the Troubled Asset Recovery Program that is completed before October 2010 to qualify as Tier 1 capital. Accordingly, the Company is continuing to pursue the proposed exchange of its $73.0 million of Fixed Rate Cumulative Perpetual Preferred Stock, Series B (the Series B Preferred Stock) issued under the Capital Purchase Program of the Troubled Asset Recovery Program for a like amount of fixed rate trust preferred securities. However, there remains uncertainty as to whether the U.S. Department of the Treasury generally will approve pending applications for such exchanges in light of the new legislation, or whether the Treasury will approve the Company s application specifically. The Company believes that the exchange of some or all of its Series B Preferred Stock for trust preferred securities is an important factor that will enhance the probability of the successful completion of other components of its capital plan.

- **Proposed Exchange of Capital Securities of Old Second Capital Trust II** If the Company does not issue the maximum 6,000,000 shares in the exchange offer, it may enter into separate negotiations with a limited number of holders of the Floating Rate Capital Securities of Old Second Capital Trust II regarding the potential exchange of such securities for newly issued shares of the Company s common stock or securities convertible into newly issued shares of common stock. The Company does not have any definitive plans, understandings, agreements or commitments with such holders.

- **Issue Additional Common Stock** Due to conditions in the capital markets during June and July and the significant decline in the trading price of the Company s common stock since the Company filed a shelf registration statement in mid-May, the Company does not have any definitive plans, understandings, agreements or commitments to issue additional shares of its common stock in a public or private offering and, as a result of these continuing conditions, there is no guarantee that the Company will be able to pursue a public or private common stock offering this year.

As previously discussed in the Company s public filings, the Company has agreed with the Office of the Comptroller of the Currency (the OCC) to maintain the regulatory capital ratios of Old Second National Bank (the Bank) at levels in excess of the general minimums required to be considered well capitalized under OCC regulations. Specifically, the Bank s board of directors agreed to meet by December 31, 2009, and thereafter maintain, a Tier 1 capital ratio of at least 8.75% and a total risk-based capital ratio of at least 11.25%. The Bank achieved these heightened regulatory capital ratios by December 31, 2009 and remained in compliance with them as of March 31, 2010. However, because of the net loss incurred during the second quarter of 2010, the Bank s Tier 1 capital ratio declined to 7.76% and its total risk-based capital ratio declined to 10.73%. Accordingly, the Bank was not in compliance with the heightened capital ratios as of June 30, 2010. The Company does not anticipate that its operations will be materially impacted in the near term by the fact that the Bank s regulatory capital ratios have fallen below the heightened levels that it has agreed to maintain. It is unknown at this time what actions, if any, the OCC or other bank regulatory agencies may take in connection with the Bank not achieving these agreed-upon capital ratios.

The Company is focused on pursuing its capital strategy, as outlined above, and considering any other reasonable alternatives for improving the Company s and the Bank s capital positions, particularly in light of the Bank falling below the heightened minimum capital ratios as of June 30, 2010. As noted above, the Company believes that the current exchange offer of the Capital Securities for shares of its common stock as well as the exchange of some or all of its Series B Preferred Stock for trust preferred securities are important components of its capital plan. Accordingly, if the Company is unable to consummate either or both of these exchanges, it may need to reevaluate its capital plan and develop alternative strategies to improve the Company s and the Bank s capital positions.

Independent Third-Party Credit Review

In connection with the Company s overall capital planning, in April 2010, the Company engaged a nationally recognized financial services consulting firm to conduct an independent credit review of the Bank s credit risk ratings and regulatory classifications, loss content, loss recognition and the accuracy of accrual/nonaccrual status. The outside firm also reviewed the Bank s methodology and supporting documentation for establishing its allowance for loan and lease losses for adequacy and appropriateness, but it was not engaged to perform an analysis of the adequacy of the balance of the Bank s allowance for loan and lease losses.

The scope of the outside firm s review included: (i) all classified, criticized and nonperforming loans and foreclosed assets with an outstanding balance in excess of $1 million; (ii) a sample of nonclassified, pass-rated credits with an outstanding balance in excess of $1 million; and (iii) a random sample of classified, criticized and nonperforming loans and foreclosed assets with an outstanding balance of less than $1 million. The sample was drawn from all loan types, including commercial real estate, construction and development, commercial and industrial, multifamily, agricultural, consumer first mortgages and home equity lines of credit. In total, this firm reviewed 501 loans with total outstanding balances of $820.6 million, or approximately 43% of the Bank s total loan portfolio as of June 30, 2010.

The outside firm completed its review in early May 2010 and discussed its findings with the Company s management team and prepared a final written report. As noted above, the outside firm was not engaged to, and did not, evaluate the adequacy of the balance of the Company s allowance for loan and lease losses. However, the Company believes that the consulting firm s conclusions corroborate the Bank s overall loan grading methodology and the Bank s conclusions regarding the appropriateness of the methodology that it employs for establishing its allowance for loan and lease losses.

Net Interest Income

Net interest income decreased $2.9 million, from $43.9 million in the first half of 2009, to $41.0 million in the first half of 2010. Average earning assets decreased $424.1 million, or 15.7%, from June 30, 2009 to June 30, 2010, as management continued to emphasize asset quality and new loan originations continued to be limited. The comparative $272.7 million decrease in year to date average loans was primarily due to the combined effect of a general decrease in demand from qualified borrowers in the Bank s market area as well as charge-off activity. Management also continued to reduce securities available for sale in the second quarter of 2010. At the same time, management significantly reduced both borrowings and deposits that had previously provided funding for those assets. The decrease in average interest bearing deposits was due to management s continued emphasis upon relationship banking versus customers who sought a single transaction for which no other depositor product or service would be utilized. As a result, average interest bearing liabilities decreased $355.3 million, or 15.1%, during the same period. The net interest margin (tax-equivalent basis), expressed as a percentage of average earning assets, increased from 3.39% in the first half of 2009 to 3.70% in the first half of 2010. The average tax-equivalent yield on earning assets decreased from 5.24% in the first half of 2009 to 4.96%, or 28 basis points, in the first half of 2010. At the same time, however, the cost of funds on interest bearing liabilities decreased from 2.20% to 1.52%, or 68 basis points. The decrease in the level of average earning assets in 2010 contributed to decreased interest income as did the higher level of nonaccrual loans. At the same time, the general decrease in interest rates lowered interest expense to a greater degree than it reduced interest income and provided an offsetting effect to the continued balance sheet deleveraging strategy.

Net interest income decreased $1.7 million from $21.7 million in the second quarter of 2009 to $20.0 million in the second quarter of 2010. The decrease in average earning assets on a quarterly comparative basis was $370.2 million, or 14.0%, from June 30, 2009 to June 30, 2010 due in part to the lack of demand from qualified borrowers as well as charge-off activity in the quarter. Average interest bearing liabilities decreased $288.2 million, or 12.7%, during the same period. The net interest margin (tax-equivalent basis), expressed as a percentage of average earning assets, increased from 3.42% in the second quarter of 2009 to

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3.61% in the second quarter of 2010. The average tax-equivalent yield on earning assets decreased from 5.20% in the second quarter of 2009 to 4.83% in the second quarter of 2010, or 37 basis points. The cost of interest-bearing liabilities also decreased from 2.15% to 1.47%, or 68 basis points, in the same period. Consistent with the year to date margin trend, the continued higher level of nonaccrual loans combined with the repricing of interest bearing assets and liabilities in a lower interest rate environment decreased interest income to a greater degree than it decreased interest expense.

Asset Quality

In the first half of 2010, the Company recorded a $63.8 million provision for loan losses, which included an addition of $44.6 million in the second quarter. In the first half of 2009, the provision for loan losses was $56.9 million, which included an addition of $47.5 million in the second quarter. Provisions for loan losses are made to provide for probable and estimable losses inherent in the loan portfolio. Nonperforming loans increased to $242.9 million at June 30, 2010 from $189.7 million at December 31, 2009, and $178.6 million at June 30, 2009. Charge-offs, net of recoveries, totaled $47.4 million and $23.6 million in the first six months of 2010 and 2009, respectively. Net charge-offs totaled $30.5 million in the second quarter of 2010 and $19.2 million in the second quarter of 2009. The distribution of the Company s gross charge-off activity for the periods indicated is detailed in the first table below and the distribution of the Company s remaining nonperforming loans and related specific allocations at June 30, 2010 are included in the table following.

Loan Charge-offs, Gross (in thousands)	**Three Months Ended June 30, 2010**	**Three Months Ended June 30, 2009**	**Year to Date June 30, 2010**	**Year to Date June 30, 2009**
Real Estate-Construction				
Homebuilder	$ 3,759	$ 6,444	$ 10,534	$ 6,801
Land	5,285	2,899	6,094	6,215
Commercial Speculative	2,763	6,110	6,498	6,110
All Other	3	222	218	276
Total Real Estate - Construction	11,810	15,675	23,344	19,402
Real Estate-Residential				
Investor	7,167	1,235	7,782	1,289
Owner Occupied	733	49	2,051	127
Revolving and Junior Liens	170	204	505	365
Total Real Estate-Residential	8,070	1,488	10,338	1,781
Real Estate-Commercial, Nonfarm				
Owner general purpose	2,705	1	3,211	24
Owner special purpose	1,697	113	1,775	113
Non owner gen purpose	2,666	132	2,862	252
Non owner special purpose	2,694		2,925	
Strip malls	1,128	96	3,653	312
Total Real Estate - Commercial, Nonfarm	10,890	342	14,426	701
Real Estate-Commercial, Farm				
Commercial and Industrial	327	1,717	1,558	1,763
Other	136	131	233	233
	$ 31,233	$ 19,353	$ 49,899	$ 23,880