EAGLE BANCORP INC
Form 10-Q
November 07, 2014
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(Mark One)

(X)	**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
	For the Quarterly Period Ended September 30, 2014
OR	
( )	**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
	For the transition period from _________ to_________

Commission File Number 0-25923

Eagle Bancorp, Inc.

(Exact name of registrant as specified in its charter)

Maryland	52-2061461
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
7830 Old Georgetown Road, Third Floor, Bethesda, Maryland	20814
(Address of principal executive offices)	(Zip Code)

(301) 986-1800

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§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 definition of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer 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

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

As of October 30, 2014, the registrant had 26,033,899 shares of Common Stock outstanding.

EAGLE BANCORP, INC.

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Item 1 – Financial Statements (Unaudited)

EAGLE BANCORP, INC.

Consolidated Balance Sheets (Unaudited)

(dollars in thousands, except per share data)

	September 30, 2014	December 31, 2013	September 30, 2013
Assets			
Cash and due from banks	$7,920	$9,577	$8,013
Federal funds sold	8,968	5,695	3,844
Interest bearing deposits with banks and other short-term investments	191,468	291,688	208,522
Investment securities available for sale, at fair value	382,468	378,133	355,830
Federal Reserve and Federal Home Loan Bank stock	10,657	11,272	11,246
Loans held for sale	41,254	42,030	39,206
Loans	3,432,548	2,945,158	2,796,840
Less allowance for credit losses	(44,954)	(40,921)	(39,687)
Loans, net	3,387,594	2,904,237	2,757,153
Premises and equipment, net	17,848	16,737	16,319
Deferred income taxes	25,803	28,949	25,982
Bank owned life insurance	40,432	39,738	29,555
Intangible assets, net	3,321	3,510	3,597
Other real estate owned	8,623	9,225	11,285
Other assets	42,825	30,712	34,376
Total Assets	$4,169,181	$3,771,503	$3,504,928
Liabilities and Shareholders' Equity			
Liabilities			
Deposits:			
Noninterest bearing demand	$1,056,559	$849,409	$898,831
Interest bearing transaction	161,886	118,580	104,004
Savings and money market	1,944,593	1,811,088	1,538,630
Time, $100,000 or more	190,137	203,706	249,594
Other time	180,675	242,631	193,000
Total deposits	3,533,850	3,225,414	2,984,059
Customer repurchase agreements	58,957	80,471	82,266
Long-term borrowings	109,300	39,300	39,300
Other liabilities	24,460	32,455	17,203
Total Liabilities	3,726,567	3,377,640	3,122,828
Shareholders' Equity			

Preferred stock, par value $.01 per share, shares authorized 1,000,000, Series B, $1,000 per share liquidation preference, shares issued and outstanding 56,600 at September 30, 2014, December 31, 2013 and September 30, 2013	56,600	56,600	56,600
Common stock, par value $.01 per share; shares authorized 50,000,000, shares issued and outstanding 26,022,307, 25,885,863 and 25,799,220 respectively	255	253	252
Warrant	946	946	946
Additional paid in capital	247,811	242,990	241,131
Retained earnings	135,490	96,393	84,534
Accumulated other comprehensive income (loss)	1,512	(3,319)	(1,363)
Total Shareholders' Equity	442,614	393,863	382,100
Total Liabilities and Shareholders' Equity	$4,169,181	$3,771,503	$3,504,928

See notes to consolidated financial statements.

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EAGLE BANCORP, INC.

Consolidated Statements of Operations (Unaudited)

(dollars in thousands, except per share data)

	Nine Months Ended September 30,		Three Months Ended September 30,	
	2014	**2013**	**2014**	**2013**
Interest Income				
Interest and fees on loans	$128,181	$109,479	$45,502	$37,457
Interest and dividends on investment securities	6,911	5,589	2,255	2,082
Interest on balances with other banks and short-term investments	379	564	125	182
Interest on federal funds sold	11	10	4	3
Total interest income	135,482	115,642	47,886	39,724
Interest Expense				
Interest on deposits	6,925	8,122	2,189	2,544
Interest on customer repurchase agreements	107	197	38	64
Interest on long-term borrowings	1,788	1,247	1,024	413
Total interest expense	8,820	9,566	3,251	3,021
Net Interest Income	126,662	106,076	44,635	36,703
Provision for Credit Losses	7,179	7,094	2,111	1,372
Net Interest Income After Provision For Credit Losses	119,483	98,982	42,524	35,331
Noninterest Income				
Service charges on deposits	3,638	3,351	1,227	1,115
Gain on sale of loans	4,686	13,355	1,822	2,938
Gain on sale of investment securities	10	23	-	-
Increase in the cash surrender value of bank owned life insurance	919	420	295	231
Other income	3,782	3,263	1,417	952
Total noninterest income	13,035	20,412	4,761	5,236
Noninterest Expense				
Salaries and employee benefits	41,565	34,722	14,942	12,187
Premises and equipment expenses	9,570	8,949	3,374	3,222
Marketing and advertising	1,421	1,167	544	426
Data processing	4,592	4,456	1,572	1,386
Legal, accounting and professional fees	2,513	2,226	740	864
FDIC insurance	1,680	1,780	573	584
Other expenses	9,035	9,755	3,398	3,004
Total noninterest expense	70,376	63,055	25,143	21,673
Income Before Income Tax Expense	62,142	56,339	22,142	18,894
Income Tax Expense	22,611	21,335	8,054	7,137
Net Income	39,531	35,004	14,088	11,757
Preferred Stock Dividends	434	425	151	142

Net Income Available to Common Shareholders	$39,097	$34,579	$13,937	$11,615
Earnings Per Common Share				
Basic	$1.50	$1.35	$0.54	$0.45
Diluted	$1.47	$1.31	$0.52	$0.44

See notes to consolidated financial statements.

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EAGLE BANCORP, INC.

Consolidated Statements of Comprehensive Income (Unaudited)

(dollars in thousands)

	Nine Months Ended September 30,		Three Months Ended September 30,	
	2014	**2013**	**2014**	**2013**
Net Income	$39,531	$35,004	$14,088	$11,757
Other comprehensive income, net of tax:				
Net unrealized gain (loss) on securities available for sale	4,837	(6,841)	(326)	(456)
Reclassification adjustment for net gains included in net income	(6)	(13)	-	-
Net change in unrealized gain (loss) on securities	4,831	(6,828)	(326)	(456)
Comprehensive Income	$44,362	$28,176	$13,762	$11,301

See notes to consolidated financial statements.

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EAGLE BANCORP, INC.

Consolidated Statements of Changes in Shareholders' Equity (Unaudited)

(dollars in thousands)

	Preferred Stock	Common Stock	Warrant	Additional Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance January 1, 2014	$ 56,600	$ 253	$ 946	$ 242,990	$ 96,393	$ (3,319)	$ 393,863
Net Income	-	-	-	-	39,531	-	39,531
Net change in other comprehensive income	-	-	-	-	-	4,831	4,831
Stock-based compensation	-	-	-	2,948	-	-	2,948
Common stock issued 122,015 shares under equity compensation plans	-	2	-	1,087	-	-	1,089
Tax benefits related to stock compensation	-	-	-	338	-	-	338
Employee stock purchase plan 14,429 shares	-	-	-	448	-	-	448
Preferred stock dividends	-	-	-	-	(434)	-	(434)
Balance September 30, 2014	**$ 56,600**	**$ 255**	**$ 946**	**$ 247,811**	**$ 135,490**	**$ 1,512**	**$ 442,614**
Balance January 1, 2013	$ 56,600	$ 226	$ 946	$ 180,593	$ 106,146	$ 5,465	$ 349,976
Net Income	-	-	-	-	35,004	-	35,004
Net change in other comprehensive income	-	-	-	-	-	(6,828)	(6,828)
10% common stock dividend 2,340,518 shares	-	23	-	56,158	(56,181)	-	-
Cash paid in lieu of fractional shares	-	-	-	-	(10)	-	(10)
Stock-based compensation	-	-	-	2,429	-	-	2,429
Common stock issued 483,595 shares under equity compensation plans	-	3	-	1,244	-	-	1,247
Tax benefit on non-qualified options exercised	-	-	-	322	-	-	322
Employee stock purchase plan 20,218 shares	-	-	-	385	-	-	385
Preferred stock dividends	-	-	-	-	(425)	-	(425)
Balance September 30, 2013	**$ 56,600**	**$ 252**	**$ 946**	**$ 241,131**	**$ 84,534**	**$ (1,363)**	**$ 382,100**

See notes to consolidated financial statements.

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EAGLE BANCORP, INC.

Consolidated Statements of Cash Flows (Unaudited)

(dollars in thousands)

	Nine Months Ended September 30,	
	2014	**2013**
Cash Flows From Operating Activities:		
Net Income	$39,531	$35,004
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for credit losses	7,179	7,094
Depreciation and amortization	3,514	3,161
Gains on sale of loans	(4,686)	(13,355)
Securities premium amortization, net	2,638	2,306
Origination of loans held for sale	(384,890)	(853,068)
Proceeds from sale of loans held for sale	390,352	1,054,140
Net increase in cash surrender value of BOLI	(919)	(420)
Decrease (increase) in deferred income taxes	3,146	(6,854)
Decrease in fair value of other real estate owned	589	-
Loss on sale of other real estate owned	138	781
Net gain on sale of investment securities	(10)	(23)
Stock-based compensation expense	2,948	2,429
Excess tax benefits from stock-based compensation	(338)	(322)
Increase in other assets	(11,150)	(3,733)
Decrease in other liabilities	(7,995)	(4,402)
Net cash provided by operating activities	40,047	222,738
Cash Flows From Investing Activities:		
Decrease (increase) in interest bearing deposits with other banks and short-term investments	26	(53)
Purchases of available for sale investment securities	(47,219)	(114,259)
Proceeds from maturities of available for sale securities	27,602	26,990
Proceeds from sale/call of available for sale securities	17,485	22,148
Purchases of Federal Reserve and Federal Home Loan Bank stock	(84)	(705)
Proceeds from redemption of federal reserve and federal home loan bank stock	699	153
Net increase in loans	(491,336)	(318,191)
Purchases of BOLI	-	(15,000)
Purchases of annuity	-	(11,184)
Proceeds from sale of other real estate owned	205	3,068
Bank premises and equipment acquired	(4,392)	(3,944)
Net cash used in investing activities	(497,014)	(410,977)
Cash Flows From Financing Activities:		
Increase in deposits	308,436	86,837
Decrease in customer repurchase agreements	(21,514)	(19,072)
Increase in long-term borrowings	70,000	-

Payment of dividends on preferred stock	(434)	(425)
Proceeds from exercise of stock options	1,089	1,247
Excess tax benefits from stock-based compensation	338	322
Payment in lieu of fractional shares	-	(10)
Proceeds from employee stock purchase plan	448	385
Net cash provided by financing activities	358,363	69,284
Net Decrease In Cash and Cash Equivalents	(98,604)	(118,955)
Cash and Cash Equivalents at Beginning of Period	306,960	339,334
Cash and Cash Equivalents at End of Period	$208,356	$220,379
Supplemental Cash Flows Information:		
Interest paid	$8,646	$10,078
Income taxes paid	$24,750	$23,945
Non-Cash Investing Activities		
Transfers from loans to other real estate owned	$330	$9,835

See notes to consolidated financial statements.

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EAGLE BANCORP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. Summary of Significant Accounting Policies

Basis of Presentation

The consolidated financial statements include the accounts of Eagle Bancorp, Inc. and its subsidiaries (the "Company"), EagleBank (the "Bank"), Eagle Commercial Ventures, LLC ("ECV"), Eagle Insurance Services, LLC, and Bethesda Leasing, LLC, with all significant intercompany transactions eliminated.

The consolidated financial statements of the Company included herein are unaudited. The consolidated financial statements reflect all adjustments, consisting of normal recurring accruals that in the opinion of management, are necessary to present fairly the results for the periods presented. The amounts as of and for the year ended December 31, 2013 were derived from audited consolidated financial statements. Certain information and note disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles ("GAAP") have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. There have been no significant changes to the Company's Accounting Policies as disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2013. The Company believes that the disclosures are adequate to make the information presented not misleading. Certain reclassifications have been made to amounts previously reported to conform to the current period presentation.

These statements should be read in conjunction with the audited consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013. Operating results for the three and nine months ended September 30, 2014 are not necessarily indicative of the results of operations to be expected for the remainder of the year, or for any other period.

Nature of Operations

The Company, through the Bank, conducts a full service community banking business, primarily in Montgomery County, Maryland, Washington, D.C., and Northern Virginia. The primary financial services offered by the Bank include real estate, commercial and consumer lending, as well as traditional deposit and repurchase agreement products. The Bank is also active in the origination and sale of residential mortgage loans and the origination of small business loans. The guaranteed portion of small business loans, guaranteed by the Small Business Administration ("SBA"), is typically sold to third party investors in a transaction apart from the loan's origination. As of September 30, 2014, the Bank offers its products and services through eighteen banking offices and various electronic capabilities, including remote deposit services and mobile banking services. Eagle Insurance Services, LLC, a subsidiary of the Bank, offers access to insurance products and services through a referral program with a third party insurance broker. Eagle Commercial Ventures, LLC, a direct subsidiary of the Company, provides subordinated financing for the acquisition, development and construction of real estate projects. These transactions involve higher levels of risk, together with commensurate higher returns. Refer to Higher Risk Lending – Revenue Recognition below.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts in the financial statements and accompanying notes. Actual results may differ from those estimates and such differences could be material to the financial statements.

Cash Flows

For purposes of reporting cash flows, cash and cash equivalents include cash and due from banks, federal funds sold, and interest bearing deposits with other banks which have an original maturity of three months or less.

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Loans Held for Sale

The Company engages in sales of residential mortgage loans and the guaranteed portion of SBA loans originated by the Bank. Loans held for sale are carried at the lower of aggregate cost or fair value. Fair value is derived from secondary market quotations for similar instruments. Gains and losses on sales of these loans are recorded as a component of noninterest income in the consolidated statements of operations.

The Company's current practice is to sell residential mortgage loans on a servicing released basis, and, therefore, it has no intangible asset recorded for the value of such servicing as of September 30, 2014, December 31, 2013 and September 30, 2013. The sale of the guaranteed portion of SBA loans on a servicing retained basis gives rise to an Excess Servicing Asset, which is computed on a loan by loan basis with the unamortized amount being included in Intangible assets in the consolidated balance sheets. This Excess Servicing Asset is being amortized on a straight-line basis (with adjustment for prepayments) as an offset to servicing fees collected and is included in Other income in the consolidated statement of operations.

The Company enters into commitments to originate residential mortgage loans whereby the interest rate on the loan is determined prior to funding (i.e. rate lock commitments). Such 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 decrease in the values of loans that would result from the exercise of the derivative loan commitments. 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 if the loan to the underlying borrower closes. 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. If the Company fails to deliver the amount of mortgages necessary to fulfill the commitment by the specified date, it is obligated to pay the investor a "pair-off" fee, based on then-current market prices, to compensate the investor for the shortfall. Such rate lock commitments on mortgage loans to be sold in the secondary market are considered to be derivatives but are effectively offset by whole loan purchase commitments from various investors. The period of time between issuance of a loan commitment to the customer and closing and sale of the loan to an investor generally ranges from 30 to 90 days under current market conditions. The Company protects itself from changes in interest rates through the use of best efforts forward delivery commitments, whereby the investor commits to purchase a loan at a price representing a premium on the day the borrower commits to an interest rate with the intent that the buyer/investor has assumed the interest rate risk on the loan. As a result, the Company is not generally exposed to losses on loans sold utilizing best efforts. Nor will it realize gains, related to rate lock commitments due to changes in interest rates. The market values of 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. Because of the high correlation between rate lock commitments and best efforts contracts, no gain or loss should occur on the rate lock commitments.

In circumstances where the Company does not deliver the whole loan to an investor, but rather elects to retain the loan in its portfolio, the loan is transferred from held for sale at fair value.

Investment Securities

The Company has no securities classified as trading, or as held to maturity. Marketable equity securities and debt securities not classified as held to maturity or trading are classified as available-for-sale. Securities available-for-sale are acquired as part of the Company’s asset/liability management strategy and may be sold in response to changes in interest rates, current market conditions, loan demand, changes in prepayment risk and other factors. Securities available-for-sale are carried at fair value, with unrealized gains or losses being reported as accumulated other comprehensive income/(loss), a separate component of shareholders’ equity, net of deferred income tax. Realized gains and losses, using the specific identification method, are included as a separate component of noninterest income in the consolidated statements of operations.

Premiums and discounts on investment securities are amortized/accreted to the earlier of call or maturity based on expected lives, which lives are adjusted based on prepayment assumptions and call optionality if any. Declines in the fair value of individual available-for-sale securities below their cost that are other-than-temporary in nature result in write-downs of the individual securities to their fair value. Factors affecting the determination of whether other-than-temporary impairment has occurred include a downgrading of the security by a rating agency, a significant deterioration in the financial condition of the issuer, or a change in management’s intent and ability to hold a security for a period of time sufficient to allow for any anticipated recovery in fair value. Management systematically evaluates investment securities for other-than-temporary declines in fair value on a quarterly basis. This analysis requires management to consider various factors, which include (1) duration and magnitude of the decline in value, (2) the financial condition of the issuer or issuers and (3) structure of the security.

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The entire amount of an impairment loss is recognized in earnings only when (1) the Company intends to sell the security, or (2) it is more likely than not that the Company will have to sell the security before recovery of its amortized cost basis, or (3) the Company does not expect to recover the entire amortized cost basis of the security. In all other situations, only the portion of the impairment loss representing the credit loss must be recognized in earnings, with the remaining portion being recognized in shareholders' equity as comprehensive income, net of deferred taxes.

Loans

Loans are stated at the principal amount outstanding, net of unamortized deferred costs and fees. Interest income on loans is accrued at the contractual rate on the principal amount outstanding. It is the Company's policy to discontinue the accrual of interest when circumstances indicate that collection is doubtful. Deferred fees and costs are being amortized on the interest method over the term of the loan.

Management considers loans impaired when, based on current information, it is probable that the Company will not collect all principal and interest payments according to contractual terms. Loans are evaluated for impairment in accordance with the Company's portfolio monitoring and ongoing risk assessment procedures. Management considers the financial condition of the borrower, cash flow of the borrower, payment status of the loan, and the value of the collateral, if any, securing the loan. Generally, impaired loans do not include large groups of smaller balance homogeneous loans such as residential real estate and consumer type loans which are evaluated collectively for impairment and are generally placed on nonaccrual when the loan becomes 90 days past due as to principal or interest. Loans specifically reviewed for impairment are not considered impaired during periods of "minimal delay" in payment (ninety days or less) provided eventual collection of all amounts due is expected. The impairment of a loan is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, or the fair value of the collateral if repayment is expected to be provided solely by the collateral. In appropriate circumstances, interest income on impaired loans may be recognized on a cash basis.

Higher Risk Lending – Revenue Recognition

The Company has occasionally made higher risk acquisition, development, and construction ("ADC") loans that entail higher risks than ADC loans made following normal underwriting practices ("higher risk loan transactions"). These higher risk loan transactions are currently made through the Company's subsidiary, ECV. This activity is limited as to individual transaction amount and total exposure amounts based on capital levels and is carefully monitored. The loans are carried on the balance sheet at amounts outstanding and meet the loan classification requirements of the Accounting Standards Executive Committee ("AcSEC") guidance reprinted from the CPA Letter, Special Supplement, dated February 10, 1986 (also referred to as Exhibit 1 to AcSEC Practice Bulletin No. 1). Additional interest earned on certain of these higher risk loan transactions (as defined in the individual loan agreements) is recognized as realized under the provisions contained in AcSEC's guidance reprinted from the CPA Letter, Special Supplement, dated

February 10, 1986 (also referred to as Exhibit 1 to AcSEC Practice Bulletin No.1) and Staff Accounting Bulletin No. 101 (Revenue Recognition in Financial Statements). Such additional interest may be included as a component of noninterest income. ECV recorded no additional interest on higher risk transactions during 2014 and 2013 (although normal interest income was recorded). ECV had five higher risk lending transactions with balances outstanding at September 30, 2014 and December 31, 2013, amounting to $6.3 million and $7.4 million, respectively.

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Allowance for Credit Losses

The allowance for credit losses represents an amount which in management's judgment, is adequate to absorb probable losses on existing loans and other extensions of credit that may become uncollectible. The adequacy of the allowance for credit losses is determined through careful and continuous review and evaluation of the loan portfolio and involves the balancing of a number of factors to establish a prudent level of allowance. Among the factors considered in evaluating the adequacy of the allowance for credit losses are lending risks associated with growth and entry into new markets, loss allocations for specific credits, the level of the allowance to nonperforming loans, historical loss experience, economic conditions, portfolio trends and credit concentrations, changes in the size and character of the loan portfolio, and management's judgment with respect to current and expected economic conditions and their impact on the existing loan portfolio. Allowances for impaired loans are generally determined based on collateral values. Loans or any portion thereof deemed uncollectible are charged against the allowance, while recoveries are credited to the allowance. Management adjusts the level of the allowance through the provision for credit losses, which is recorded as a current period operating expense. The allowance for credit losses consists of allocated and unallocated components.

The components of the allowance for credit losses represent an estimation done pursuant to Accounting Standards Codification ("ASC") Topic 450, *"Contingencies,"* or ASC Topic 310, *"Receivables."* Specific allowances are established in cases where management has identified significant conditions or circumstances related to a specific credit that management believes indicate the probability that a loss may be incurred. For potential problem credits for which specific allowance amounts have not been determined, the Company establishes allowances according to the application of credit risk factors. These factors are set by management and approved by the appropriate Board Committee to reflect its assessment of the relative level of risk inherent in each risk grade. A third component of the allowance computation, termed a nonspecific or environmental factors allowance, is based upon management's evaluation of various environmental conditions that are not directly measured in the determination of either the specific allowance or formula allowance. Such conditions include general economic and business conditions affecting key lending areas, credit quality trends (including trends in delinquencies and nonperforming loans expected to result from existing conditions), loan volumes and concentrations, specific industry conditions within portfolio categories, recent loss experience in particular loan categories, duration of the current business cycle, bank regulatory examination results, findings of outside review consultants, and management's judgment with respect to various other conditions including credit administration and management and the quality of risk identification systems. Executive management reviews these environmental conditions quarterly, and documents the rationale for all changes.

Management believes that the allowance for credit losses is adequate; however, determination of the allowance is inherently subjective and requires significant estimates. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in economic conditions. Evaluation of the potential effects of these factors on estimated losses involves a high degree of uncertainty, including the strength and timing of economic cycles and concerns over the effects of a prolonged economic downturn in the current cycle. In addition, various regulatory agencies, as an integral part of their examination process, and independent consultants engaged by the Bank periodically review the Bank's loan portfolio and allowance for credit losses. Such review may result in recognition of adjustments to the allowance based on their judgments of information available to them at the time of their examination.

Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation and amortization computed using the straight-line method for financial reporting purposes. Premises and equipment are depreciated over the useful lives of the assets, which generally range from five to seven years for furniture, fixtures and equipment, to three to five years for computer software and hardware, and to ten to forty years for buildings and building improvements. Leasehold improvements are amortized over the terms of the respective leases, which may include renewal options where management has the positive intent to exercise such options, or the estimated useful lives of the improvements, whichever is shorter. The costs of major renewals and betterments are capitalized, while the costs of ordinary maintenance and repairs are expensed as incurred. These costs are included as a component of premises and equipment expenses on the consolidated statements of operations.

Other Real Estate Owned (OREO)

Assets acquired through loan foreclosure are held for sale and are initially recorded at the lower of cost or fair value less estimated selling costs when acquired, establishing a new cost basis. The new basis is supported by appraisals that are no more than twelve months old. Costs after acquisition are generally expensed. If the fair value of the asset declines, a write-down is recorded through noninterest expense. The valuation of foreclosed assets is subjective in nature and may be adjusted in the future because of changes in market conditions or appraised values.

Goodwill and Other Intangible Assets

Goodwill and other intangible assets are subject to impairment testing at least annually, or when events or changes in circumstances indicate the assets might be impaired. Intangible assets (other than goodwill) are amortized to expense using accelerated or straight-line methods over their respective estimated useful lives. The Company's testing of potential goodwill impairment (which is performed annually) at December 31, 2013 resulted in no impairment being recorded.

Customer Repurchase Agreements

The Company enters into agreements under which it sells securities subject to an obligation to repurchase the same securities. Under these arrangements, the Company may transfer legal control over the assets but still retain effective control through an agreement that both entitles and obligates the Company to repurchase the assets. As a result, securities sold under agreements to repurchase are accounted for as collateralized financing arrangements and not as a sale and subsequent repurchase of securities. The agreements are entered into primarily as accommodations for large commercial deposit customers. The obligation to repurchase the securities is reflected as a liability in the Company's consolidated balance of sheets, while the securities underlying the securities sold under agreements to repurchase remain in the respective assets accounts and are delivered to and held as collateral by third party trustees.

Marketing and Advertising

Marketing and advertising costs are generally expensed as incurred.

Income Taxes

The Company employs the liability method of accounting for income taxes as required by ASC Topic 740, "*Income Taxes*." Under the liability method, deferred tax assets and liabilities are determined based on differences between the financial statement carrying amounts and the tax basis of existing assets and liabilities (i.e., temporary timing differences) and are measured at the enacted rates that will be in effect when these differences reverse. The Company utilizes statutory requirements for its income tax accounting, and avoids risks associated with potentially problematic tax positions that may incur challenge upon audit, where an adverse outcome is more likely than not. Therefore, no provisions are made for either uncertain tax positions nor accompanying potential tax penalties and interest for underpayments of income taxes in the Company's tax reserves. In accordance with ASC Topic 740, the Company may establish a reserve against deferred tax assets in those cases where realization is less than certain, although no such reserves exist at September 30, 2014, December 31, 2013, or September 30, 2013.

Transfer of Financial Assets

Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity. In certain cases, the recourse to the Bank to repurchase assets may exist but is deemed immaterial based on the specific facts and circumstances.

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Earnings per Common Share

Basic net income per common share is derived by dividing net income available to common shareholders by the weighted-average number of common shares outstanding during the period measured. Diluted earnings per common share is computed by dividing net income available to common shareholders by the weighted-average number of common shares outstanding during the period measured including the potential dilutive effects of common stock equivalents.

Stock-Based Compensation

In accordance with ASC Topic 718, *"Compensation,"* the Company records as compensation expense an amount equal to the amortization (over the remaining service period) of the fair value computed at the date of grant. Compensation expense on variable stock option grants (i.e. performance based grants) is recorded based on the probability of achievement of the goals underlying the performance grant. Refer to Note 9 for a description of stock-based compensation awards, activity and expense.

New Authoritative Accounting Guidance

In January 2014, the FASB issued ASU No. 2014-01, *"Accounting for Investments in Qualified Affordable Housing Projects."* ASU No. 2014-01 permits reporting entities to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Under the proportional amortization method, an entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognize the net investment performance in the income statement as a component of income tax expense. This new guidance also requires new disclosures for all investors in these projects. ASU No. 2014-01 is effective for interim and annual reporting periods beginning after December 15, 2014. Upon adoption, the guidance must be applied retrospectively to all periods presented. However, entities that use the effective yield method to account for investments in these projects before adoption may continue to do so for these pre-existing investments. The Company currently accounts for such investments using the effective yield method and plans to continue to do so for these pre-existing investments after adopting ASU No. 2014-01 on January 1, 2015. The Company expects investments made after January 1, 2015 to meet the criteria required for the proportional amortization method and plans to make such an accounting policy election. The adoption of ASU No. 2014-01 is not expected to have a material impact on the Company's consolidated financial statements.

In January 2014, the FASB issued ASU No. 2014-04, *"Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure."* The objective of this guidance is to clarify when an in substance repossession or foreclosure occurs, that is, when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan receivable should be derecognized and the real estate property recognized. ASU No. 2014-04 states that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, ASU No. 2014-04 requires interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. ASU No. 2014-04 is effective for interim and annual reporting periods beginning after December 15, 2014. The adoption of ASU No. 2014-04 is not expected to have a material impact on the Company's consolidated financial statements.

Note 2. Business Combinations

On June 9, 2014, Eagle Bancorp, Inc. and its wholly owned subsidiary bank, EagleBank, entered into an Agreement and Plan of Reorganization (the “Agreement”) with Virginia Heritage Bank (“VHB”), pursuant to which VHB will be merged with and into EagleBank, with EagleBank surviving the merger (the “Merger”).

The merger received all required regulatory approvals and was completed on October 31, 2014.

At the effective time of the Merger, each outstanding share of VHB common stock will be converted into 0.6632 shares of Company common stock and $7.50 in cash. The number of shares of Company common stock to be issued is 4,010,261 and the amount of cash paid is $45,356,539.

The Company also assumed the 15,300 shares of VHB’s preferred stock which has an aggregate liquidation preference of $15.3 million and was issued in connection with the U.S. Treasury’s Small Business Lending Fund Program.

The Company assumed the VHB stock plans. Options to purchase 448,895 shares of VHB common stock at a weighted average exercise price of $11.77 per share will be “rolled over” into options to acquire 401,497 shares of Company common stock at a weighted average exercise price of $13.17 per share.

Note 3. Cash and Due from Banks

Regulation D of the Federal Reserve Act requires that banks maintain noninterest reserve balances with the Federal Reserve Bank based principally on the type and amount of their deposits. During 2014, the Bank maintained balances at the Federal Reserve (in addition to vault cash) to meet the reserve requirements as well as balances to partially compensate for services. Late in 2008, the Federal Reserve in connection with the Emergency Economic Stabilization Act of 2008 began paying a nominal amount of interest on balances held, which interest on excess reserves was increased under provisions of the Dodd Frank Wall Street Reform and Consumer Protection Act passed in July 2010. Additionally, the Bank maintains interest-bearing balances with the Federal Home Loan Bank of Atlanta and noninterest bearing balances with six domestic correspondent banks as compensation for services they provide to the Bank.

Note 4. Investment Securities Available-for-Sale

Amortized cost and estimated fair value of securities available-for-sale are summarized as follows:

September 30, 2014 **(dollars in thousands)**	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Estimated Fair Value**
U. S. Government agency securities	$ 38,636	$ 545	$ 97	$ 39,084
Residential mortgage backed securities	227,525	1,328	3,724	225,129
Municipal bonds	113,390	4,716	250	117,856
Other equity investments	396	3	-	399
	$ 379,947	$ 6,592	$ 4,071	$ 382,468

December 31, 2013 **(dollars in thousands)**	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Estimated Fair Value**
U. S. Government agency securities	$ 46,640	$ 843	$ 148	$ 47,335
Residential mortgage backed securities	234,206	1,143	6,675	228,674
Municipal bonds	102,423	2,017	2,700	101,740
Other equity investments	396	-	12	384
	$ 383,665	$ 4,003	$ 9,535	$ 378,133

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Gross unrealized losses and fair value by length of time that the individual available-for-sale securities have been in a continuous unrealized loss position are as follows:

	Less than 12 Months		12 Months or Greater		Total	
September 30, 2014 (dollars in thousands)	**Estimated Fair Value**	**Unrealized Losses**	**Estimated Fair Value**	**Unrealized Losses**	**Estimated Fair Value**	**Unrealized Losses**
U. S. Government agency securities	$4,005	$ 16	$4,702	$ 81	$8,707	$ 97
Residential mortgage backed securities	55,857	311	96,923	3,413	152,780	3,724
Municipal bonds	3,309	3	17,952	247	21,261	250
	$63,171	$ 330	$119,577	$ 3,741	$182,748	$ 4,071

	Less than 12 Months		12 Months or Greater		Total	
December 31, 2013 (dollars in thousands)	**Estimated Fair Value**	**Unrealized Losses**	**Estimated Fair Value**	**Unrealized Losses**	**Estimated Fair Value**	**Unrealized Losses**
U. S. Government agency securities	$4,782	$ 148	$-	$ -	$4,782	$ 148
Residential mortgage backed securities	155,475	5,992	15,658	683	171,133	6,675
Municipal bonds	50,450	2,512	3,196	188	53,646	2,700
Other equity investments	-	-	165	12	165	12
	$210,707	$ 8,652	$19,019	$ 883	$229,726	$ 9,535

The unrealized losses that exist are generally the result of changes in market interest rates and interest spread relationships since original purchases. The weighted average duration of debt securities, which comprise 99.9% of total investment securities, is relatively short at 4.1 years. If quoted prices are not available, fair value is measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. The Company does not believe that the investment securities that were in an unrealized loss position as of September 30, 2014 represent an other-than-temporary impairment for the reasons noted. The Company does not intend to sell the investments and it is more likely than not that the Company will not have to sell the securities before recovery of its amortized cost basis, which may be maturity. In addition, at September 30, 2014, the Company held $10.7 million in equity securities in a combination of Federal Reserve Bank ("FRB") and Federal Home Loan Bank ("FHLB") stocks, which are required to be held for regulatory purposes and are not marketable.

The amortized cost and estimated fair value of investments available-for-sale by contractual maturity are shown in the table below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

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	September 30, 2014		December 31, 2013	
(dollars in thousands)	**Amortized Cost**	**Estimated Fair Value**	**Amortized Cost**	**Estimated Fair Value**
U. S. Government agency securities maturing:				
One year or less	$ 3,000	$ 2,981	$ 19,025	$ 19,133
After one year through five years	29,152	29,565	27,615	28,202
Five years through ten years	6,484	6,538	-	-
Residential mortgage backed securities	227,525	225,129	234,206	228,674
Municipal bonds maturing:				
One year or less	2,846	2,876	25,718	26,008
After one year through five years	46,404	48,757		
Five years through ten years	62,682			