

STERLING FINANCIAL CORP /WA/
Form 424B3
July 27, 2011

Filed Pursuant to Rule 424(B)(3)
Registration Statement No. 333-169579

PROSPECTUS SUPPLEMENT
(To Prospectus dated November 16, 2010)

STERLING FINANCIAL CORPORATION

RECENT DEVELOPMENTS

We have attached to this prospectus supplement our Current Report on Form 8-K filed with the Securities and Exchange Commission on July 27, 2011.

July 27, 2011

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 8-K

CURRENT REPORT

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

Date of Report (Date of earliest event reported): July 27, 2011

STERLING FINANCIAL CORPORATION
(Exact name of registrant as specified in its charter)

Washington (State or other jurisdiction of incorporation or organization)	001-34696 (Commission File Number)	91-1572822 (I.R.S. Employer Identification No.)
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111 North Wall Street, Spokane, Washington 99201
(Address of principal executive offices) (Zip Code)

(509) 458-3711
(Registrant's telephone number, including area code)

Not Applicable
(Former Name or Former Address, if Changed Since Last Report)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

- Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)
 - Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)
 - Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))
 - Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))
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INFORMATION TO BE INCLUDED IN THE REPORT

Item Results of Operations and Financial Condition.
2.02.

On July 27, 2011, Sterling Financial Corporation ("Sterling") issued a press release regarding its financial results for the quarter ended June 30, 2011. A copy of the press release is included as Exhibit 99.1 to this report. The information included in the press release is considered to be "furnished" under the Securities Exchange Act of 1934. Sterling will include final financial statements and additional analyses for the period ended June 30, 2011, as part of its quarterly report on Form 10-Q covering that period.

Item Financial Statements and Exhibits.
9.01.

(d) The following exhibit is being furnished herewith:

Exhibit No.	Exhibit Description
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99.1	Press release text of Sterling Financial Corporation dated July 27, 2011.
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S I G N A T U R E

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

STERLING FINANCIAL CORPORATION
(Registrant)

July 27, 2011
Date

By: /s/ Patrick J. Rusnak
Patrick J. Rusnak
Chief Financial Officer

EXHIBIT INDEX

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Exhibit 99.1

Sterling Financial Corporation of Spokane, Wash. Reports Second-Quarter 2011 Earnings and Operating Results

SPOKANE, Wash.--(BUSINESS WIRE)--July 27, 2011--Sterling Financial Corporation (NASDAQ:STSA), the bank holding company of Sterling Savings Bank, today announced results for the quarter ended June 30, 2011. For the quarter, Sterling recorded net income attributable to common shareholders of \$7.6 million, or \$0.12 per common share, compared to \$5.4 million, or \$0.09 per common share, for the first quarter of 2011, and compared to a net loss of \$58.2 million, or \$73.91 per common share, for the second quarter of 2010 (per share amount adjusted for a 1-for-66 reverse stock split in November 2010).

Following are selected financial highlights for the second quarter of 2011:

- Loan originations were \$883.0 million, a 41 percent increase over the linked quarter.
- Retail transaction, savings and MMDA account balances increased by \$81.7 million, or 3 percent, for the quarter.
- Net interest margin expanded to 3.31 percent, improving 9 basis points for the quarter.
- Nonperforming assets declined by \$131.3 million, or 21 percent, for the quarter.

Greg Seibly, Sterling's president and chief executive officer, noted, "Sterling's earnings growth for the quarter was a result of net interest margin expansion and growth of non-interest income. The margin expansion was a function of growth of the loan portfolio and the success of our deposit strategy, which reduced the cost of deposits by 10 basis points for the quarter. The loan growth was a result of higher loan production, which outpaced the significant reduction in nonperforming assets. Our production teams are continuing to generate momentum as we enter the second half of the year."

Balance Sheet Management

Seibly continued, "During the second quarter, we made additional progress improving our mix of deposits by increasing checking account balances and reducing our reliance on CDs, while growing our loan portfolio in multifamily and commercial banking. Additionally, we repositioned a portion of the securities portfolio to manage interest rate risk and to prepare for funding of anticipated future loan growth."

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	June 30, 2011		March 31, 2011		June 30, 2010		Annual % Change
	Amount	% of Loans	Amount	% of Loans	Amount	% of Loans	
	(in thousands)						
Total assets	\$9,241,595		\$9,352,469		\$9,737,781		-5%
Investments and MBS	2,496,056		2,820,772		1,955,890		28%
Loans receivable:							
Residential real estate	712,638	13%	719,458	13%	778,196	12%	-8%
Multifamily real estate	811,917	14%	638,250	12%	460,393	7%	76%
Commercial real estate	1,324,058	24%	1,348,646	24%	1,367,122	21%	-3%
Construction	308,273	6%	396,300	7%	958,825	15%	-68%
Consumer	703,675	13%	715,206	13%	827,123	13%	-15%
Commercial banking	1,741,819	30%	1,738,794	31%	2,018,871	32%	-14%
Gross loans receivable	\$5,602,380	100%	\$5,556,654	100%	\$6,410,530	100%	-13%

Loan originations were \$883.0 million for the second quarter of 2011, up \$254.6 million, or 41 percent from the linked quarter. Growth in loan originations came primarily within the multifamily portfolio, with multifamily originations expanding by \$97.3 million, or 81 percent for the quarter. Other notable growth was achieved in commercial banking, with originations increasing by \$74.8 million, or 138 percent, and in residential real estate, with originations increasing by \$96.2 million, or 25 percent. These originations outpaced the continued runoff of construction loans, which contracted by \$88.0 million, or 22 percent, during the quarter.

	June 30, 2011	March 31, 2011	June 30, 2010	Annual % Change
	(in thousands)			
Deposits:				
Retail:				
Transaction	\$ 1,572,771	\$ 1,507,489	\$ 1,465,691	7%
Savings and MMDA	1,710,527	1,694,139	1,508,272	13%
Time deposits	2,279,025	2,499,546	3,122,547	-27%
Total retail	5,562,323	5,701,174	6,096,510	-9%
Public	561,651	691,527	683,528	-18%
Brokered	480,024	331,726	460,731	4%
Total deposits	\$ 6,603,998	\$ 6,724,427	\$ 7,240,769	-9%
Net loans to deposits	82%	79%	85%	-3%
				Annual Basis Point Change
Funding costs:				
Cost of deposits	0.91%	1.01%	1.36%	(45)
Total funding liabilities	1.31%	1.39%	1.71%	(40)

Sterling's total deposits were \$6.60 billion at June 30, 2011, down from \$6.72 billion at March 31, 2011, and down from \$7.24 billion at June 30, 2010. The decrease during the second quarter of 2011 reflects the expected reduction in retail CDs, as Sterling allowed certain higher-rate CDs to run off, improving the deposit mix and reducing funding costs. This run-off was partially offset by an increase in retail transaction, savings and MMDA accounts, which increased by \$81.7 million over the linked quarter. Total funding costs declined to 1.31 percent for the second quarter of 2011, compared to 1.39 percent for the linked quarter and 1.71 percent for the same period a year ago.

At June 30, 2011, Sterling had total shareholders' equity of \$807.6 million, compared to \$774.5 million at March 31, 2011, and \$193.1 million at June 30, 2010. Sterling's ratio of shareholders' equity to total assets was 8.7 percent at June 30, 2011, compared to 8.3 percent at March 31, 2011. The tier 1 leverage ratio increased to 10.9 percent at June 30, 2011, from 10.6 percent at March 31, 2011, and tangible common equity to tangible assets increased to 8.6 percent at June 30, 2011, from 8.1 percent at March 31, 2011.

Operating Results

Net Interest Income

Sterling reported net interest income of \$74.8 million for the quarter ended June 30, 2011, compared to \$73.7 million in the linked quarter and \$73.1 million for the same period a year ago.

	June 30, 2011	Three Months Ended March 31, 2011 (in thousands)	June 30, 2010
Net interest income	\$ 74,807	\$ 73,743	\$ 73,095
Net interest margin (tax equivalent)	3.31%	3.22%	2.88%

Improvements in both net interest income and net interest margin during the quarter, as compared to the linked quarter, primarily reflect the decline in nonperforming assets, reduced deposit costs, and the increase in loan balances. The reversal of interest income from nonperforming loans reduced the net interest margin by 42 basis points for the second quarter of 2011, compared to 53 basis points for the linked quarter and 80 basis points for the same period a year ago.

Non-interest Income

For the second quarter of 2011, non-interest income was \$34.3 million, compared to \$30.0 million for the linked quarter and \$41.2 million for the same period a year ago. For the quarter ended June 30, 2011, fees and service charges income contributed \$12.9 million to non-interest income, compared to \$12.6 million in the linked quarter and \$14.2 million in the same period a year ago. The reduction in fees and service charges income from last year is primarily related to lower non-sufficient funds (NSF) fees and financial services commission income.

Income from mortgage banking operations for the second quarter of 2011 totaled \$10.8 million, up from \$10.3 million for the linked quarter, and down from \$11.7 million from the same period a year ago, when the federal government was offering incentives to homebuyers. The table below presents residential loan originations and sales for the periods indicated.

	June 30, 2011	Three Months Ended March 31, 2011 (in thousands)	June 30, 2010	Annual % Change
Loan originations - residential real estate for sale	\$457,123	\$363,118	\$606,706	-25%
Loan sales - residential	398,120	498,310	660,310	-40%
				Annual Basis Point Change
Margin - residential loan sales	2.21%	2.48%	2.22%	(1)

For the quarter ended June 30, 2011, Sterling recorded a gain on sales of securities of \$8.3 million, compared to \$6.0 million for the linked quarter and \$15.3 million for the same period a year ago.

Non-interest Expense

Non-interest expense was \$91.6 million for the second quarter of 2011, compared to \$88.3 million in the linked quarter and \$97.3 million for the same period a year ago. The increase compared to the linked quarter was primarily the result of higher expenses related to other real estate owned (OREO), which increased by \$3.1 million. The \$5.7 million reduction of non-interest expense compared to the second quarter of last year primarily reflects lower Federal Deposit Insurance Corporation (FDIC) deposit insurance premiums.

During the second quarter of 2011, Sterling successfully completed the conversion to a new core operating system that is expected to support future growth and reduce associated operating expenses. In connection with the core conversion, Sterling incurred \$2.3 million of non-recurring implementation expenses during the second quarter of 2011, compared to \$1.5 million during the first quarter of 2011.

Income Taxes

During the second quarter of 2011, Sterling did not recognize any federal or state tax expense, as the income tax expense for the quarter was offset by a reduction in the deferred tax valuation allowance.

Sterling uses an estimate of future earnings and an evaluation of its loss carryback ability and tax planning strategies to determine whether it is more likely than not that it will realize the benefit of its net deferred tax asset. Sterling determined that it did not meet the required threshold as of June 30, 2011, and accordingly, a full valuation reserve was provided against the deferred tax asset. As of June 30, 2011, the reserved deferred tax asset was approximately \$350 million, including approximately \$279 million of net operating loss carry-forwards.

With regard to the deferred tax asset, the benefits of Sterling's accumulated tax losses would be reduced in the event of an "ownership change," as determined under Section 382 of the Internal Revenue Code. In order to preserve the benefits of these tax losses, during 2010, Sterling's shareholders approved a protective amendment to the restated articles of incorporation and Sterling's board adopted a tax preservation rights plan, both of which restrict certain stock transfers that would result in investors acquiring more than 4.95 percent of Sterling's total outstanding common stock.

Credit Quality

For the second quarter of 2011, Sterling reported a provision for credit losses of \$10.0 million, compared to \$10.0 million for the linked quarter and \$70.8 million for the same period a year ago. Net charge-offs for the second quarter of 2011 were \$33.4 million, compared to \$24.1 million for the linked quarter, and \$101.8 million for the same period a year ago. The loan loss allowance at June 30, 2011 was \$212.1 million, or 3.79 percent, of total loans, compared to \$232.9 million, or 4.19 percent, of total loans at March 31, 2011.

The reduction in the allowance as a percent of total loans was warranted by the continued improvement in asset quality metrics during the quarter. At June 30, 2011, classified assets were \$603.8 million, a reduction of \$208.1 million, or 26 percent, from March 31, 2011, and down \$782.8 million, or 56 percent, from June 30, 2010. These reductions were a result of improved risk ratings, sales of OREO, and net charge-offs. Nonperforming assets were \$497.5 million at June 30, 2011, compared to \$628.8 million at March 31, 2011, and \$1.02 billion at June 30, 2010, representing reductions of 21 percent and 51 percent, respectively. At June 30, 2011, nonperforming assets as a percentage of total assets were 5.38 percent, compared to 6.72 percent at March 31, 2011, and 10.47 percent at June 30, 2010.

At the end of the second quarter of 2011, OREO, which is included in nonperforming assets, was \$101.4 million, down 33 percent from \$151.8 million at March 31, 2011. During the second quarter of 2011, Sterling sold 253 properties with a carrying value of \$76.5 million.

Seibly commented, "We continue to experience favorable reductions in nonperforming assets and expect significant additional resolutions during the remainder of the year. Our asset quality metrics are the best we have reported in the last two years."

The following table presents an analysis of Sterling's nonperforming assets by loan category and geographic region as of the dates indicated.

Nonperforming Asset
Analysis

	June 30, 2011		March 31, 2011		June 30, 2010	
Residential construction			(in thousands)			
Puget Sound	\$21,121	4%	\$35,617	6%	\$ 128,742	13%
Portland, OR	21,014	4%	35,594	6%	82,717	8%
Vancouver, WA	1,829	0%	7,697	1%	14,969	1%
Northern California	5,387	1%	5,555	1%	22,628	2%
Southern California	1,652	0%	3,558	1%	6,761	1%
Bend, OR	993	0%	1,199	0%	13,878	1%
Boise, ID	535	0%	1,034	0%	10,746	1%
Other	12,641	3%	21,830	3%		