

ITLA CAPITAL CORP  
Form 10-Q  
August 14, 2003

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

**FORM 10-Q**

(Mark One)

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

For the Quarterly Period Ended June 30, 2003

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 0-26960

**ITLA CAPITAL CORPORATION**

(Exact Name of Registrant as Specified in its Charter)

Delaware

95-4596322

(State or Other Jurisdiction of Incorporation  
or Organization)

(IRS Employer Identification No.)

888 Prospect St., Suite 110, La Jolla, California

92037

(Address of Principal Executive Offices)

(Zip Code)

(858) 551-0511

(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Sections 12, 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 is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes  No  .

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Number of shares of common stock of the Registrant: 6,081,591 outstanding as of August 8, 2003.

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FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2003  
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**Forward Looking Statements**

Safe Harbor statement under the Private Securities Litigation Reform Act of 1995: This Form 10-Q contains forward-looking statements that are subject to risks and uncertainties, including, but not limited to, changes in economic conditions in our market areas, changes in policies by regulatory agencies, the impact of competitive loan products, loan demand risks, the quality or composition of our loan or investment portfolios, fluctuations in interest rates and changes in the relative differences between short and long term interest rates, levels of nonperforming assets and operating results, the impact of terrorist actions and other risks detailed from time to time in our filings with the Securities and Exchange Commission. We caution readers not to place undue reliance on forward-looking statements. We do not undertake and specifically disclaim any obligation to revise any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements. These risks could cause our actual results for 2003 and beyond to differ materially from those expressed in any forward-looking statements by, or on behalf of, us.

As used throughout this report, the terms "we", "our", "ITLA Capital" or the "Company" refer to ITLA Capital Corporation and its consolidated subsidiaries.

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**ITLA CAPITAL CORPORATION AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS**

	<u>June 30, 2003 (unaudited)</u>	<u>December 31, 2002</u>
<b>(in thousands except share amounts)</b>		
<b>Assets</b>		
Cash and cash equivalents	\$ 133,139	\$ 160,848
Investment securities available for sale, at fair value	41,135	54,677
Stock in Federal Home Loan Bank	12,392	16,934
Loans, net (net of allowance for loan losses of \$31,590 and \$31,081 as of June 30, 2003 and December 31, 2002, respectively)	1,217,150	1,316,298
Real estate loans held in trust (net of allowance for loan losses of \$1,928 as of June 30, 2003 and December 31, 2002, respectively)	96,109	121,936
Interest receivable	7,796	9,158
Other real estate owned, net	16,885	12,593
Premises and equipment, net	5,189	4,197
Deferred income taxes	13,848	13,822
Goodwill	3,118	3,118
Other assets	16,735	8,384
	<u>                    </u>	<u>                    </u>
Total assets	<u>\$ 1,563,496</u>	<u>\$ 1,721,965</u>
<b>Liabilities and Shareholders' Equity</b>		
<b>Liabilities:</b>		
Deposit accounts	\$ 973,039	\$ 1,065,911
Federal Home Loan Bank advances	247,835	338,685
Collateralized mortgage obligations	43,419	69,077
Accounts payable and other liabilities	42,049	10,006
	<u>                    </u>	<u>                    </u>
Total liabilities	<u>1,306,342</u>	<u>1,483,679</u>
<b>Commitments and contingencies</b>		
Guaranteed preferred beneficial interests in the Company's junior subordinated deferrable interest debentures, net		
81,731	81,595	
<b>Shareholders' equity:</b>		
Preferred stock, 5,000,000 shares authorized, none issued		
Contributed capital - common stock, \$.01 par value; 20,000,000 shares authorized, 8,240,579 and 8,226,414 issued as of June 30, 2003 and December 31, 2002, respectively		
59,261	58,841	
Retained earnings		

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154,284 135,773  
Accumulated other  
comprehensive income  
236 435

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213,781 195,049  
Less treasury stock, at cost  
2,447,656 shares as of June 30,  
2003 and December 31, 2002,  
respectively  
(38,358) (38,358)

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Total shareholders' equity  
175,423 156,691

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Total liabilities and shareholders  
equity  
\$1,563,496 \$1,721,965

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See accompanying notes to the unaudited consolidated financial statements.

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**ITLA CAPITAL CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF INCOME**  
(Unaudited)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2003	2002	2003	2002
(in thousands except per share amounts)				
<b>Interest income:</b>				
Loans, including fees	\$25,461	\$23,062	\$54,075	\$46,578
Real estate loans held in trust	1,456	2,662	3,629	5,502
Cash and investment securities	994	846	3,731	1,525
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Total interest income	27,911	26,570	61,435	53,605
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
<b>Interest expense:</b>				
Deposit accounts	6,289	7,095	13,137	15,388
Federal Home Loan Bank advances	1,293	1,350	2,488	2,888
Collateralized mortgage obligations	291	631	681	1,289
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Total interest expense	7,873	9,076	16,306	19,565
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Net interest income before provision for loan losses	20,038	17,494	45,129	34,040
Provision for loan losses	1,850	2,100	6,350	3,425
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Net interest income after provision for loan losses	18,188	15,394	38,779	30,615
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
<b>Non-interest income:</b>				
Premium on sale of loans, net	265		8,983	
Late and collection fees	64	47	131	119
Other	912	55	4,664	108
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Total non-interest income	1,241	102	13,778	227
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
<b>Non-interest expense:</b>				
Compensation and benefits	4,773	3,159	10,125	6,478
Occupancy and equipment	1,055	738	2,131	1,455
FDIC assessment	42	42	80	84
Other	3,047	2,373	6,701	4,613
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Total general and administrative	8,917	6,312	19,037	12,630
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Real estate owned expense, net	11	168	153	254
Provision for losses on other real estate owned	40	283	370	796
Loss (gain) on sale of other real estate owned, net		57	(329)	(75)
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Total real estate owned expense, net	51	508	194	975
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Total non-interest expense	8,968	6,820	19,231	13,605
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>



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Income before provision for income taxes and minority interest in income of subsidiary	10,461	8,676	33,326	17,237
Minority interest in income of subsidiary	1,446	797	2,966	1,596
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Income before provision for income taxes	9,015	7,879	30,360	15,641
Provision for income taxes	3,525	3,074	11,849	6,117
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
NET INCOME	\$ 5,490	\$ 4,805	\$18,511	\$ 9,524
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
BASIC EARNINGS PER SHARE	\$ 0.91	\$ 0.80	\$ 3.08	\$ 1.59
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
DILUTED EARNINGS PER SHARE	\$ 0.85	\$ 0.75	\$ 2.86	\$ 1.49
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>

See accompanying notes to the unaudited consolidated financial statements.

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**ITLA CAPITAL CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(Unaudited)**

	<b>For the Six Months Ended June 30,</b>	
	<b>2003</b>	<b>2002</b>
	<b>(in thousands)</b>	
<b>Cash Flows From Operating Activities:</b>		
Net Income	\$ 18,511	\$ 9,524
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of premises and equipment	742	444
Amortization of premium on purchased loans	1,355	216
Amortization of original issue discount and deferred debt issuance cost on CMOs	151	97
Accretion of deferred loan origination fees, net of costs	(1,506)	(418)
Provision for loan losses	6,350	3,425
Provision for losses on other real estate owned	370	796
Gain on sales of other real estate owned	(329)	(75)
Decrease in interest receivable	1,362	2,217
Increase in other assets	(8,351)	(1,711)
Increase (decrease) in accounts payable and other liabilities	32,043	(976)
Other operating activities, net	250	(32)
	50,948	13,507
<b>Cash Flows From Investing Activities:</b>		
Proceeds from securitization and sale of real estate loans		98,155
Decrease (increase) in loans, net	88,022	(24,524)
Net cash paid to acquire Asahi Bank of California		(14,872)
Repayment of real estate loans held in trust	24,985	19,148
Purchase of loans	(3,259)	(15,791)
Purchases of investment securities available for sale	(20,210)	(23,418)
Proceeds from the maturity and calls of investment securities available for sale	33,277	15,000
Decrease (increase) in stock in Federal Home Loan Bank	4,542	(1,545)
Proceeds from sale of other real estate owned	4,695	2,730
Other investing activities, net	(1,392)	(749)
	130,660	54,134
<b>Cash Flows From Financing Activities:</b>		
Decrease in deposit accounts	(92,872)	(94,049)
Net (repayment of) proceeds from borrowings from the Federal Home Loan Bank	(90,850)	30,900
Repayment of Asahi repurchase agreement, net		(14,693)
Principal payments on collateralized mortgage obligations	(25,809)	(20,371)
Cash paid to acquire treasury stock		(1,911)
Proceeds from exercise of employee stock options	214	132
	(209,317)	(99,992)
Net decrease in cash and cash equivalents	(27,709)	(32,351)
Cash and cash equivalents at beginning of period	160,848	134,241
	\$ 133,139	\$ 101,890

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Supplemental Cash Flow Information:

Cash paid during the period for interest	\$ 16,975	\$ 19,767
Cash paid during the period for income taxes	\$ 12,410	\$ 7,725
Non-cash Investing Transactions:		
Loans transferred to other real estate owned	\$ 9,028	\$ 548

See accompanying notes to the unaudited consolidated financial statements.

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**ITLA CAPITAL CORPORATION AND SUBSIDIARIES**  
**NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1 - BASIS OF PRESENTATION**

The unaudited consolidated financial statements of ITLA Capital Corporation (the Company) included herein reflect all normal recurring adjustments which are, in the opinion of management, necessary to present fairly the results of operations and financial position of the Company, as of and for the interim periods indicated. The unaudited consolidated financial statements include the accounts of ITLA Capital Corporation and its wholly-owned subsidiaries, Imperial Capital Bank (the Bank), Imperial Capital Real Estate Investment Trust (Imperial Capital REIT), ITLA Capital Statutory Trust I (Trust I), ITLA Capital Statutory Trust II (Trust II), ITLA Capital Statutory Trust III (Trust III), ITLA Capital Statutory Trust IV (Trust IV), and ITLA Capital Statutory Trust V (Trust V). All intercompany transactions and balances have been eliminated. Certain information and disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to the rules and regulations of the U.S. Securities and Exchange Commission. Certain amounts in prior periods have been reclassified to conform to the presentation in the current period. The results of operations for the three and six months ended June 30, 2003 are not necessarily indicative of the results of operations for the remainder of the year.

These unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in our annual report on Form 10-K for the year ended December 31, 2002.

**NOTE 2 - EARNINGS PER SHARE**

Basic Earnings Per Share (Basic EPS) is computed by dividing income available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted Earnings Per Share (Diluted EPS) reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock which shared in the Company's earnings.

The following is a reconciliation of the calculation of Basic EPS and Diluted EPS:

	For the Three Months Ended June 30,			For the Six Months Ended June 30,		
	Net Income	Weighted- Average Shares Outstanding	Per Share Amount	Net Income	Weighted- Average Shares Outstanding	Per Share Amount
(in thousands, except per share data)						
<b>2003</b>						
Basic EPS	\$5,490	6,016	\$ 0.91	\$18,511	6,013	\$ 3.08
Effect of dilutive stock options		476	(0.06)		453	(0.22)
Diluted EPS	\$5,490	6,492	\$ 0.85	\$18,511	6,466	\$ 2.86
<b>2002</b>						
Basic EPS	\$4,805	5,979	\$ 0.80	\$ 9,524	5,995	\$ 1.59
Effect of dilutive stock options		465	(0.05)		406	(0.10)
Diluted EPS	\$4,805	6,444	\$ 0.75	\$ 9,524	6,401	\$ 1.49

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Comprehensive income, which encompasses net income and the net change in unrealized gains (losses) on investment securities available for sale, is presented below:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
	(in thousands)			
Net Income	\$ 5,490	\$ 4,805	\$ 18,511	\$ 9,524
Other comprehensive (loss) income:				
Unrealized (loss) gain on investment securities available for sale, net of tax (benefit) expense of (\$51) and \$20 for the three months ended June 30, 2003 and 2002, and net of tax (benefit) expense of (\$127) and \$155 for the six months ended June 30, 2003 and 2002, respectively.	(79)	102	(199)	233
Comprehensive income	\$ 5,411	\$ 4,907	\$ 18,312	\$ 9,757

**NOTE 4 - IMPAIRED LOANS RECEIVABLE**

As of June 30, 2003 and December 31, 2002, the recorded investment in impaired loans and impaired real estate loans held in trust was \$9.2 million and \$16.0 million, respectively. The average recorded investment in impaired loans was \$12.1 million for the three months ended June 30, 2003 and \$9.1 million for the same period last year. The average recorded investment in impaired loans was \$14.6 million for the six months ended June 30, 2003 and \$11.8 million for the same period last year. Interest income recognized on impaired loans totaled \$116,000 and \$257,000 for the three and six months ended June 30, 2003 as compared to \$35,000 and \$79,000 for the same periods last year.

**NOTE 5 - RESIDUAL INTEREST IN SECURITIZATION**

During the first quarter of 2002, the Company formed a limited liability company to issue \$86.3 million of asset-backed notes in a securitization of substantially all of its residential loan portfolio. The Company recognized a gain of \$3.7 million on the securitization of these loans, which was included in other non-interest income within the consolidated statement of income. Concurrent with recognizing such gain on sale, the Company recorded a residual interest of \$5.6 million, which represented the present value of future cash flows (spread and fees) that are anticipated to be received over the life of the loans. The residual interest is recorded on the consolidated balance sheet in Investment securities available for sale, at fair value. The value of the residual interest is subject to substantial credit, prepayment, and interest rate risk on the sold residential loans. In accordance with the provisions of Statement of Financial Accounting Standards (SFAS) No. 115, Accounting for Certain Investments in Debt and Equity Securities, the residual interest is classified as available-for-sale and, as such, recorded at fair value with the resultant changes in fair value recorded as accumulated unrealized gain or loss in a separate component of shareholders' equity entitled accumulated other comprehensive income or loss, until realized. Fair value is determined on a monthly basis based on a discounted cash flow analysis. These cash flows are projected over the lives of the receivables using prepayment, default, and interest rate assumptions that management believes market participants would use for similar financial instruments.

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During the six months ended June 30, 2003, the Company recognized an other than temporary impairment of \$500,000 in connection with its residual interest. Impairments that are deemed to be other than temporary are charged to income, as other expense. In evaluating impairments as other than temporary the Company considers credit risk, as well as the magnitude and trend of default rates and prepayment speeds of the underlying residential loans.

At June 30, 2003, key economic assumptions and the sensitivity of the current fair value of the residual interest based on projected cash flows to immediate adverse changes in those assumptions is as follows:

	<b>June 30, 2003</b>
<b>Dollars in thousands, except percentages</b>	
<b>Fair value of retained interest</b>	<b>\$5,368</b>
<b>Weighted average life (in years)</b>	<b>1.22</b>
<b>Weighted average annual prepayment speed</b>	<b>35.0%</b>
Impact of 10% adverse change	\$ (93)
Impact of 25% adverse change	\$ (225)
<b>Weighted average annual discount rate</b>	<b>15.0%</b>
Impact of 10% adverse change	\$ (359)
Impact of 25% adverse change	\$ (857)
<b>Weighted average lifetime credit losses</b>	<b>3.3%</b>
Impact of 10% adverse change	\$ (152)
Impact of 25% adverse change	\$ (380)

These sensitivities are hypothetical and should be used with caution. As the figures indicate, changes in the fair value of the residual interest are based on a variation in assumptions and generally cannot be extrapolated because the relationship of the change in assumption to the change in fair value may not be linear. Also, in the above table, the effect of a variation in a particular assumption on the fair value of the residual interest is calculated without changing any other assumption; in reality, changes in one factor may result in changes in another (for example, increases in market interest rates may result in lower prepayments but increased credit losses), which might magnify or counteract the sensitivities, and depending on the severity of such changes, the results of operations may be materially affected.

**NOTE 6 ACCOUNTING FOR STOCK-BASED COMPENSATION**

In December 2002, the Financial Accounting Standards Board ( FASB ) issued SFAS No. 148, Accounting for Stock-Based Compensation, to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS No. 148 amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The transition guidance and annual disclosure provisions are effective for fiscal years ending after December 15, 2002. The interim disclosure provisions are effective for financial reports containing financial statements for interim periods beginning after December 15, 2002. The Company adopted the provisions of SFAS No. 148 effective in the first quarter of 2003.

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The Company has stock-based compensation plans. These plans are accounted for under APB Opinion No. 25, Accounting for Stock Issued to Employees, and accordingly, no compensation costs have been recognized in the accompanying unaudited consolidated statements of income. The Company applies SFAS No. 123, Accounting for Stock-Based Compensation for disclosure purposes only. SFAS No. 123 disclosures include pro forma net income and earning per share as if the fair value-based method of accounting had been used. If compensation had been determined based on SFAS No. 123, the Company's pro forma net income and pro forma per share data would be as follows:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2003	2002	2003	2002
	(in thousands, except per share data)			
Net income, as reported	\$ 5,490	\$ 4,805	\$ 18,511	\$ 9,524
Less: Stock-based employee compensation expense determined under the fair value method, net of tax	348	190	631	327
Pro forma net income	\$ 5,142	\$ 4,615	\$ 17,880	\$ 9,197
Earnings per share:				
Basic as reported	\$ 0.91	\$ 0.80	\$ 3.08	\$ 1.59
Basic pro forma	0.85	0.77	2.97	1.53
Diluted as reported	0.85	0.75	2.86	1.49
Diluted pro forma	0.79	0.72	2.77	1.44

The fair value of each option grant was estimated on the date of grant using an option pricing model with the following weighted-average assumptions for option grants:

	Weighted-Average Assumptions for Options Grants	
	2003	2002
Dividend Yield	0.00%	0.00%
Expected Volatility	34.47%	29.38%
Risk-Free Interest Rates	4.17%	4.79%-4.88%
Expected Lives	Seven Years	Seven Years

**NOTE 7 NEW ACCOUNTING PRONOUNCEMENTS**

In November 2002, FASB issued FASB Interpretation No. 45 ( FIN 45 ), Guarantor's Accounting and Disclosure Requirement for Guarantees, Including Indirect Guarantees of Indebtedness of Others. FIN 45 elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The initial recognition and measurement provisions for FIN 45 are applicable on a prospective basis to guarantees issued or modified after December 31, 2002. The disclosure requirements of FIN 45 are effective for financial statements of interim or annual periods ending after December 15, 2002, and were included in the Company's financial statements for the year ended December 31, 2002. Implementation of the provisions of FIN 45 did not have an impact on the Company's financial statements.

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In January of 2003, FASB issued FIN 46, an interpretation of Accounting Research Bulletin No. 51, Consolidated Financial Statements. FIN 46 establishes the criteria used to identify variable interest entities and to determine whether or not to consolidate a variable interest entity. Under the criteria established by FIN 46, the Company believes it will be required to de-consolidate its trust subsidiaries, however, management is still evaluating this interpretation. The result will be to recognize investments in its trust subsidiaries in other assets, to report the amount of subordinated debentures issued by the Company to its trust subsidiaries in the liability section of the Company's consolidated balance sheets, and to recognize the interest expense in the subordinated debentures in the consolidated statements of income. Prior to FIN 46, the Company consolidated its trust subsidiaries and reported trust preferred securities in the mezzanine section of the Company's consolidated balance sheets and recognized the proportionate share of income attributable to the preferred shareholders as minority interest in income of subsidiary in the consolidated statements of income. This interpretation was effective immediately for variable interest entities created after January 31, 2003 and in the first fiscal year or interim period beginning after June 15, 2003, for variable interest entities in which a variable interest was acquired prior to February 1, 2003.

On May 15, 2003, FASB issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity. SFAS No. 150 modifies the accounting for certain financial instruments that issuers could account for as equity. Under SFAS No. 150, those instruments with characteristics of both liabilities and equity must be classified as liabilities in the consolidated balance sheets, with the corresponding payments to holders of the instruments recognized as interest expense.

The reporting requirements of SFAS No. 150 are effective July 1, 2003. As a result of this new standard, should the adoption of FIN 46 not otherwise require de-consolidation of the trusts, the Company will reclassify its trust preferred securities, presented on the consolidated balance sheets as Guaranteed preferred beneficial interest in the Company's junior subordinated deferrable interest debentures, net, to liabilities and recognize the related expense within the consolidated statements of income as interest expense rather than minority interest in income of subsidiary.

The adoption of FIN 46 and SFAS No. 150 will have no impact on the results of operations or the financial position of the Company but will require the restatement of certain financial ratios for all periods presented such as net interest margin and efficiency ratios, beginning in the third quarter of 2003.



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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion and analysis is intended to identify the major factors that influenced the financial condition and results of operations for the three months ended June 30, 2003.

**RESULTS OF OPERATIONS**

**Three Months Ended June 30, 2003 Compared to Three Months Ended June 30, 2002**

**General**

Consolidated net income was at \$5.5 million and \$4.8 million for the three months ended June 30, 2003 and 2002, respectively. The increase in net income was primarily due to increases in net interest income and non-interest income, partially offset by increases in non-interest expense and minority interest in income of subsidiary. The increase in non-interest income was primarily due to the Bank's refund anticipation loan (RAL) program and its strategic relationship with Household International, Inc. (Household). Diluted EPS was \$0.85 for the three months ended June 30, 2003 compared to \$0.75 for the same period last year, an increase of \$0.10 per diluted share.

The return on average assets was 1.38% for the three months ended June 30, 2003 compared to 1.46% for the same period last year. The return on average shareholders' equity was 12.68% for the three months ended June 30, 2003, compared to 13.31% for the same period last year.

Total loan production was \$144.0 million for the three months ended June 30, 2003, consisting of the origination of \$124.4 million of commercial real estate loans, \$10.5 million of franchise loans, and \$9.1 million of film finance loans. Loan production during the same period last year totaled \$127.2 million, consisting of the origination and/or purchase of \$121.2 million of commercial real estate loans and \$6.0 million of acquired franchise loans.

Substantially all RAL loans originated during the quarter were sold to Household. At June 30, 2003, the Company held \$1.1 million in RAL participation interests. Because the RAL program relates to the filing of income tax returns, transaction activity is concentrated during the tax season. This results in the Company earning most of its RAL program income in the first quarter of the year. The Company expects that its financial results for the remaining quarters of 2003 will not be significantly impacted by the RAL program due to the seasonal nature of the business.

**Net Interest Income and Margin**

The following table presents, for the three months ended June 30, 2003 and 2002, our condensed average balance sheet information, together with interest income and yields earned on average interest-earning assets and interest expense and rates paid on average interest-bearing liabilities. Average balances are computed using daily average balances. Nonaccrual loans are included in loans receivable.

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For the Three Months Ended June 30,

	2003			2002		
	Average Balance	Income/Expense	Yield/Rate	Average Balance	Income/Expense	Yield/Rate
(dollars in thousands)						
<b>Assets</b>						
Cash and investments	\$ 203,187	\$ 994	1.96%	\$ 66,610	\$ 846	5.09%
Loans receivable:						
Loans	1,266,690	25,461	8.06%	1,094,054	23,062	8.45%
Real estate loans held in trust	107,146	1,456	5.45%	149,000	2,662	7.17%
	<u>1,373,836</u>	<u>26,917</u>	<u>7.86%</u>	<u>1,243,054</u>	<u>25,724</u>	<u>8.30%</u>
Total loans receivable						
Total interest-earning assets	1,577,023	\$ 27,911	7.10%	1,309,664	\$ 26,570	8.14%
		<u>          </u>	<u>          </u>		<u>          </u>	<u>          </u>
Non-interest-earning assets	64,702			42,374		
Allowance for loan losses	(32,887)			(29,169)		
	<u>          </u>			<u>          </u>		
Total assets	\$ 1,608,838			\$ 1,322,869		
	<u>          </u>			<u>          </u>		
<b>Liabilities and Shareholders</b>						
<b>Equity</b>						
Deposit accounts:						
Money market and passbook accounts	\$ 168,276	\$ 620	1.48%	\$ 142,849	\$ 691	1.94%
Time certificates	844,830	5,669	2.69%	739,216	6,404	3.47%
	<u>1,013,106</u>	<u>6,289</u>	<u>2.49%</u>	<u>882,065</u>	<u>7,095</u>	<u>3.23%</u>
Total deposit accounts						
Collateralized mortgage obligations	55,988	291	2.08%	93,673	631	2.70%
FHLB advances	168,698	1,293	3.07%	168,755	1,350	3.21%
	<u>1,237,792</u>	<u>\$ 7,873</u>	<u>2.55%</u>	<u>1,144,493</u>	<u>\$ 9,076</u>	<u>3.18%</u>
Total interest-bearing liabilities						
		<u>          </u>	<u>          </u>		<u>          </u>	<u>          </u>
Non-interest-bearing liabilities	115,689			5,467		
Trust preferred securities	81,698			28,154		
Shareholders' equity	173,659			144,755		
	<u>          </u>			<u>          </u>		
Total liabilities and shareholders' equity	\$ 1,608,838			\$ 1,322,869		
	<u>          </u>			<u>          </u>		
Net interest spread			4.55%			4.96%
			<u>          </u>			<u>          </u>
Net interest income before provision for loan losses		\$ 20,038			\$ 17,494	
		<u>          </u>			<u>          </u>	
Net interest margin			5.10%			5.36%
			<u>          </u>			<u>          </u>



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The following table sets forth a summary of the changes in interest income and interest expense resulting from changes in average interest-earning asset and interest-bearing liability balances and changes in average interest rates. The change in interest due to both volume and rate has been allocated to change due to volume and rate in proportion to the relationship of absolute dollar amounts of each.

	<b>For the Three Months Ended June 30, 2003 and 2002 Increase (Decrease) Due to:</b>		
	<b>Rate</b>	<b>Volume</b>	<b>Total</b>
	<b>(In thousands)</b>		
Interest and fees earned from:			
Cash and investment securities	\$(490)	\$ 638	\$