ITLA CAPITAL CORP
Form 10-Q
November 14, 2003

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

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended September 30, 2003

OR

o 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 þ No o.

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes þ No o.

Number of shares of common stock of the registrant: 6,053,669 outstanding as of November 4, 2003.

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ITLA CAPITAL CORPORATION
FORM 10-Q
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 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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PART I FINANCIAL INFORMATION

ITLA CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	September 30, 2003 (unaudited)	December 31, 2002
	(in thousands except share amounts)	
Assets		
Cash and cash equivalents	$ 85,592	$ 160,848
Investment securities available for sale, at fair value	46,015	54,677
Stock in Federal Home Loan Bank	15,887	16,934
Loans, net (net of allowance for loan losses of $31,244 and $31,081 as of September 30, 2003 and December 31, 2002, respectively)	1,332,098	1,316,298
Real estate loans held in trust, net (net of allowance for loan losses of $1,928 as of September 30, 2003 and December 31, 2002)	85,195	121,936
Interest receivable	8,331	9,158
Other real estate owned, net	14,767	12,593
Premises and equipment, net	5,381	4,197
Deferred income taxes	13,923	13,822
Goodwill	3,118	3,118
Other assets	16,667	8,384
Total assets	$ 1,626,974	$ 1,721,965
Liabilities and Shareholders Equity		
Liabilities:		
Deposit accounts	$ 987,418	$ 1,065,911
Federal Home Loan Bank advances	317,735	338,685
Collateralized mortgage obligations	32,550	69,077
Accounts payable and other liabilities	27,987	10,006
Total liabilities	1,365,690	1,483,679
Commitments and contingencies		
Guaranteed preferred beneficial interests in the Company s junior subordinated deferrable interest debentures, net	81,797	81,595
Shareholders equity:		
Preferred stock, 5,000,000 shares authorized, none issued		
Contributed capital - common stock, $.01 par value; 20,000,000 shares authorized, 8,261,408 and 8,226,414 issued as of September 30, 2003 and December 31, 2002, respectively	59,748	58,841
Retained earnings	159,691	135,773
Accumulated other comprehensive income	126	435
	219,565	195,049
Less treasury stock, at cost 2,489,826 and 2,447,656 shares as of September 30, 2003 and December 31, 2002, respectively	(40,078)	(38,358)
Total shareholders equity	179,487	156,691

Total liabilities and shareholders equity	$1,626,974	$1,721,965

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 September 30,		For the Nine Months Ended September 30,	
	2003	2002	2003	2002
	(in thousands except per share amounts)			
Interest income:				
Loans, including fees	$24,802	$24,020	$78,877	$70,598
Real estate loans held in trust	1,407	2,458	5,036	7,960
Cash and investment securities	866	902	4,597	2,427
Total interest income	27,075	27,380	88,510	80,985
Interest expense:				
Deposit accounts	5,544	6,815	18,681	22,203
Federal Home Loan Bank advances	1,367	1,422	3,855	4,310
Collateralized mortgage obligations	204	563	885	1,852
Total interest expense	7,115	8,800	23,421	28,365
Net interest income before provision for loan losses	19,960	18,580	65,089	52,620
Provision for loan losses	750	2,700	7,100	6,125
Net interest income after provision for loan losses	19,210	15,880	57,989	46,495
Non-interest income:				
Premium on sale of loans, net			8,983	
Late and collection fees	61	38	192	157
Other	716	(92)	5,379	16
Total non-interest income	777	(54)	14,554	173
Non-interest expense:				
Compensation and benefits	4,610	3,303	14,735	9,781
Occupancy and equipment	1,236	777	3,502	2,232
Other	3,112	2,379	9,755	7,076
Total general and administrative	8,958	6,459	27,992	19,089
Real estate owned expense, net	220	71	373	325
Provision for losses on other real estate owned			370	796
Loss (gain) on sale of other real estate owned, net	389		60	(75)
Total real estate owned expense, net	609	71	803	1,046
Total non-interest expense	9,567	6,530	28,795	20,135
Income before provision for income taxes and minority interest in income of subsidiary	10,420	9,296	43,748	26,533

Minority interest in income of subsidiary	1,540	815	4,506	2,411
Income before provision for income taxes	8,880	8,481	39,242	24,122
Provision for income taxes	3,473	3,326	15,324	9,443
NET INCOME	$ 5,407	$ 5,155	$ 23,918	$ 14,679
BASIC EARNINGS PER SHARE	$ 0.90	$ 0.86	$ 3.97	$ 2.45
DILUTED EARNINGS PER SHARE	$ 0.83	$ 0.80	$ 3.69	$ 2.29

See accompanying notes to the unaudited consolidated financial statements.

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

	For the Nine Months Ended September 30,	
	2003	2002
	(in thousands)	
Cash Flows From Operating Activities:		
Net Income	$ 23,918	$ 14,679
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of premises and equipment	1,119	674
Amortization of premium on purchased loans	1,549	1,532
Amortization of original issue discount on collateralized mortgage obligations	57	136
Accretion of deferred loan origination fees, net of costs	(1,992)	(868)
Provision for loan losses	7,100	6,125
Provision for losses on other real estate owned	370	796
Loss (gain) on sales of other real estate owned	60	(75)
Decrease in interest receivable	827	2,127
Increase in other assets	(8,283)	(912)
Increase (decrease) in accounts payable and other liabilities	17,981	(2,899)
Other operating activities, net	250	(32)
Net cash provided by operating activities	42,956	21,283
Cash Flows From Investing Activities:		
Proceeds from securitization and sale of real estate loans		98,155
Decrease (increase) in loans, net	23,706	(63,527)
Net cash paid to acquire Asahi Bank of California		(14,872)
Repayment of real estate loans held in trust	35,543	28,774
Purchase of loans	(54,040)	(30,084)
Purchases of investment securities available for sale	(34,363)	(77,670)
Proceeds from the maturity and calls of investment securities available for sale	42,365	55,000
Decrease (increase) in stock in Federal Home Loan Bank	1,047	(2,990)
Proceeds from sale of other real estate owned	6,471	2,720
Other investing activities, net	(1,793)	(1,822)
Net cash provided by (used in) investing activities	18,936	(6,316)
Cash Flows From Financing Activities:		
Decrease in deposit accounts	(78,493)	(68,938)
Net (repayment of) proceeds from borrowings from the Federal Home Loan Bank	(20,950)	59,800
Repayment of Asahi repurchase agreement, net		(14,693)
Principal payments on collateralized mortgage obligations	(36,584)	(30,384)
Cash paid to acquire treasury stock	(1,720)	(2,343)
Proceeds from exercise of employee stock options	599	184
Net cash used in financing activities	(137,148)	(56,374)
Net decrease in cash and cash equivalents	(75,256)	(41,407)
Cash and cash equivalents at beginning of period	160,848	134,241
Cash and cash equivalents at end of period	$ 85,592	$ 92,834

Supplemental Cash Flow Information:		
Cash paid during the period for interest	$ 28,116	$ 28,473
Cash paid during the period for income taxes	$ 16,260	$ 10,225
Non-cash Investing Transactions:		
Loans transferred to other real estate owned	$ 9,075	$ 4,258

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 nine months ended September 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 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, Accounting for Stock-Based Compensation, 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.

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 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:

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	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2003	2002	2003	2002
	(in thousands, except per share data)			
Net income, as reported	$5,407	$5,155	$23,918	$14,679
Less: Stock-based employee compensation expense determined under the fair value method, net of tax	356	348	996	628
Pro forma net income	$5,051	$4,807	$22,922	$14,051
Earnings per share:				
Basic as reported	$ 0.90	$ 0.86	$ 3.97	$ 2.45
Basic pro forma	$ 0.84	$ 0.81	$ 3.81	$ 2.35
Diluted as reported	$ 0.83	$ 0.80	$ 3.69	$ 2.29
Diluted pro forma	$ 0.77	$ 0.75	$ 3.53	$ 2.19

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 Option Grants	
	2003	2002
Dividend Yield	0.00%	0.00%
Expected Volatility	36.24%	31.36%
Risk-Free Interest Rates	4.17%-4.34%	4.62%-4.88%
Expected Lives	Seven Years	Seven Years

NOTE 3 EARNINGS PER SHARE

Basic Earnings Per Share (Basic EPS) is computed by dividing net income 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.

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

	For the Three Months Ended September 30,			For the Nine Months Ended September 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)					
2003						
Basic EPS	$5,407	6,031	$ 0.90	$23,918	6,019	$ 3.97
Effect of dilutive stock options		517	(0.07)		471	(0.28)
Diluted EPS	$5,407	6,548	$ 0.83	$23,918	6,490	$ 3.69
2002						
Basic EPS	$5,155	5,966	$ 0.86	$14,679	5,984	$ 2.45
Effect of dilutive stock options		469	(0.06)		429	(0.16)
Diluted EPS	$5,155	6,435	$ 0.80	$14,679	6,413	$ 2.29

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NOTE 4 COMPREHENSIVE INCOME

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 September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
	(in thousands)			
Net Income	$5,407	$5,155	$23,918	$14,679
Other comprehensive (loss) income:				
Unrealized (loss) gain on investment securities available for sale, net of tax (benefit) expense of ($70) and $141 for the three months ended September 30, 2003 and 2002, and net of tax (benefit) expense of ($198) and $297 for the nine months ended September 30, 2003 and 2002, respectively.	(110)	212	(309)	445
Comprehensive income	$5,297	$5,367	$23,609	$15,124

NOTE 5 IMPAIRED LOANS RECEIVABLE

As of September 30, 2003 and December 31, 2002, the recorded investment in impaired loans and impaired real estate loans held in trust was $11.3 million and $16.0 million, respectively. The average recorded investment in impaired loans was $10.6 million for the three months ended September 30, 2003 and $7.8 million for the same period last year. The average recorded investment in impaired loans was $13.3 million for the nine months ended September 30, 2003 and $10.8 million for the same period last year. Interest income recognized on impaired loans totaled $120,000 and $377,000 for the three and nine months ended September 30, 2003 as compared to $89,000 and $169,000 for the same periods last year.

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NOTE 6 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 the Company s 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 estimated 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 estimated on a monthly basis based on a discounted cash flow analysis. These cash flows are estimated over the lives of the receivables using prepayment, default, and interest rate assumptions that management believes market participants would use for similar financial instruments.

During the nine months ended September 30, 2003, the Company recognized an other than temporary impairment of $750,000 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 September 30, 2003 and December 31, 2002, 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 are as follows:

	September 30, 2003	December 31, 2002
Dollars in thousands		
Fair value of retained interest	**$5,368**	**$5,619**
Weighted average life (in years) - securities	**0.90**	**1.49**
Weighted average life (in years) - residual interest	**4.39**	**4.70**
Weighted average annual prepayment speed	**35.0%**	**35.0%**
Impact of 10% adverse change	$ (74)	$ (23)
Impact of 25% adverse change	$ (193)	$ (59)
Weighted average annual discount rate	**15.0%**	**15.0%**
Impact of 10% adverse change	$ (306)	$ (167)
Impact of 25% adverse change	$ (737)	$ (404)
Weighted average lifetime credit losses	**3.3%**	**3.3%**
Impact of 10% adverse change	$ (163)	$ (285)
Impact of 25% adverse change	$ (407)	$ (678)

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 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.

In January 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 may be required to de-consolidate its trust subsidiaries. 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 was initially to be effective for variable interest entities acquired prior to February 1, 2003, in the quarter ended September 30, 2003. Effective October 9, 2003, the FASB agreed to defer the effective date of FIN 46 for variable interests held by public companies in all entities that were acquired prior to February 1, 2003. The deferral will require that public companies adopt the provisions of FIN 46 for periods ending after December 15, 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 would be required to 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. On October 29, 2003, the FASB agreed to defer provisions related to mandatorily redeemable financial instruments to periods beginning after December 15, 2004.

The adoption of FIN 46 and SFAS No. 150 will not have a material impact on the results of operations or the financial position of the Company but will require the restatement of certain financial ratios, such as net interest margin and efficiency ratios, for all periods presented.

NOTE 8 BUSINESS SEGMENT INFORMATION

SFAS No. 131, Disclosures About Segments of an Enterprise and Related Information, requires disclosure of segment information in a manner consistent with the management approach . The management approach is based on the way the chief operating decision-maker organizes segments within a company for making operating decisions and assessing performance.

The main factors used to identify operating segments were the specific product and business lines of the various operating segments of the Company. Operating segments are organized separately by product and service offered. We have identified one operating segment that meets the criteria of being a reportable segment in accordance with the provisions of SFAS No. 131. This reportable segment is the origination and purchase of loans, which by its legal form, is identified as operations of the Bank and Imperial Capital REIT. This segment derives the majority of its revenue by originating and purchasing loans. Other operating segments of the Company that did not meet the criteria of being a reportable segment in accordance with SFAS No. 131 have been aggregated and reported as All Other . Substantially all of the transactions from the Company s operating segments occur in the United States. The Company has no transactions with a single external customer that exceeds ten percent of the Company s consolidated revenues.

Transactions between the reportable segment of the Company and its other operating segments are made at terms which approximate arm s-length transactions and in accordance with GAAP. There is no significant difference between the measurement of the reportable segment s assets and profits and losses disclosed below and the measurement of assets and profits and losses in our consolidated balance sheets and statements of income. Accounting allocations are made in the same manner for all operating segments.

	Lending Operations	All Other	Eliminations	Consolidated
For the three months ended September 30,				
2003				
Revenues from external customers	$ 27,631	$ 221	$	$ 27,852
Total interest income	26,916	1,971	(1,812)	27,075
Total interest expense	7,308	1,554	(1,747)	7,115
Net Income	$ 6,896	$ 5,396	$ (6,885)	$ 5,407
2002				
Revenues from external customers	$ 27,021	$ 305	$	$ 27,326
Total interest income	27,059	1,351	(1,030)	27,380
Total interest expense	9,065	765	(1,030)	8,800
Net Income	$ 6,263	$ 5,126	$ (6,234)	$ 5,155
For the nine months ended September 30,				
2003				
Revenues from external customers	$102,659	$ 405	$	$103,064
Total interest income	88,316	5,343	(5,149)	88,510
Total interest expense	23,906	4,623	(5,108)	23,421
Net Income	$ 29,190	$23,885	$(29,157)	$ 23,918
2002				
Revenues from external customers	$ 80,907	$ 251	$	$ 81,158
Total interest income	80,960	3,108	(3,083)	80,985
Total interest expense	29,124	2,324	(3,083)	28,365
Net Income	$ 18,918	$14,614	$(18,853)	$ 14,679

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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 and nine months ended September 30, 2003.

RESULTS OF OPERATIONS

Three Months Ended September 30, 2003 Compared to Three Months Ended September 30, 2002

General

Consolidated net income was at $5.4 million and $5.2 million for the three months ended September 30, 2003 and 2002, respectively. Diluted EPS was $0.83 for the three months ended September 30, 2003 compared to $0.80 for the same period last year, an increase of $0.03 per diluted share. 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 net interest income from prior year was a result of the increase in the average balance of loans outstanding and the decline in average cost of funds due to our interest bearing liabilities repricing to lower current market interest rates. A significant portion of the loan portfolio is not subject to downward pricing adjustment due to interest rate floors. The resulting increase in net interest income was partially offset by a decline in the yield of the loan portfolio as higher yielding loans were repaid and replaced by new loan production at lower current market interest rates.

The return on average assets was 1.42% for the three months ended September 30, 2003 compared to 1.49% for the same period last year. The return on average shareholders equity was 12.02% for the three months ended September 30, 2003, compared to 13.64% for the same period last year.

Total loan production was $279.6 million for the three months ended September 30, 2003, consisting of the origination and/or acquisition of $230.4 million of commercial real estate loans, $21.6 million of franchise loans, and $27.6 million of film finance loans. The Bank s loan production for the same period last year was $144.7 million, consisting of originated and/or acquired commercial real estate loans.

The increase in non-interest income was primarily due to income earned in connection with the Bank s refund anticipation loan (RAL) program and its strategic relationship with Household International, Inc. (Household). Because the origination of loans under the RAL program results from the filing of individual income tax returns, transaction activity is concentrated most heavily during the tax season. This results in the Company earning most of its RAL program income in the first quarter of the year. We expect that our financial results for the remaining quarter of 2003 will not be significantly impacted by the RAL program due to the seasonal nature of the business.

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Net Interest Income and Margin

The following table presents, for the three months ended September 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.

	For the Three Months Ended September 30,					
	2003			2002		
	Average Balance	Income/ Expense	Yield/ Rate	Average Balance	Income/ Expense	Yield/ Rate
	(dollars in thousands)					
Assets						
Cash and investments	$ 110,343	$ 866	3.11%	$ 69,738	$ 902	5.13%
Loans receivable:						
Loans	1,279,054	24,802	7.69%	1,147,784	24,020	8.30%
Real estate loans held in trust	88,960	1,407	6.27%	138,906	2,458	7.02%
Total loans receivable	1,368,014	26,209	7.60%	1,286,690	26,478	8.16%
Total interest-earning assets	1,478,357	$27,075	7.27%	1,356,428	$27,380	8.01%
Non-interest-earning assets	66,405			45,321		
Allowance for loan losses	(33,456)			(30,156)		
Total assets	$1,511,306			$1,371,593		
Liabilities and Shareholders Equity						
Deposit accounts:						
Money market and passbook accounts	$ 169,417	$ 659	1.54%	$ 136,569	$ 642	1.87%
Time certificates	753,880	4,885	2.57%	754,340	6,173	3.25%
Total deposit accounts	923,297	5,544	2.38%	890,909	6,815	3.03%
Collateralized mortgage obligations	37,453					