ITLA CAPITAL CORP
Form 10-Q
November 09, 2005

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

FORM 10-Q

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

For the Quarterly Period Ended September 30, 2005

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 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 R No £.

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

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes £ No R.

Number of shares of common stock of the registrant: 5,715,088 outstanding as of November 3, 2005.

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ITLA CAPITAL CORPORATION
FORM 10-Q
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2005

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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, increased costs from pursuing the national expansion of our lending platform and operational challenges inherent in implementing this expansion strategy, 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 economic impact of terrorist actions on our loan originations and loan repayments, 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 2005 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”, “us” 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, 2005 (unaudited)	December 31, 2004
	(in thousands, except share data)	
Assets		
Cash and cash equivalents	$ 56,224	$ 87,580
Investment securities available for sale, at fair value	92,255	66,845
Investment securities held-to-maturity, at amortized cost	251,889	296,028
Stock in Federal Home Loan Bank	35,309	23,200
Loans, net (net of allowance for loan losses of $38,661 and $35,483 as of September 30, 2005 and December 31, 2004, respectively)	2,504,777	1,793,815
Interest receivable	14,976	10,695
Premises and equipment, net	6,774	6,645
Deferred income taxes	10,617	10,468
Goodwill	3,118	3,118
Other assets	18,930	19,677
Total assets	$ 2,994,869	$ 2,318,071
Liabilities and Shareholders' Equity		
Liabilities:		
Deposit accounts	$ 1,841,737	$ 1,432,032
Federal Home Loan Bank advances and other borrowings	843,056	584,224
Accounts payable and other liabilities	23,685	20,491
Junior subordinated debentures	86,600	86,600
Total liabilities	2,795,078	2,123,347
Commitments and contingencies		
Shareholders' equity:		
Preferred stock, 5,000,000 shares authorized, none issued	—	—
Contributed capital - common stock, $.01 par value; 20,000,000 shares authorized, 8,949,898 and 8,703,894 issued as of September 30, 2005 and December 31, 2004, respectively	77,019	69,327
Retained earnings	213,790	196,032
Accumulated other comprehensive (loss) income, net	(155)	78
	290,654	265,437
	(90,863)	(70,713)

Less treasury stock, at cost 3,537,398 and 3,154,290 shares as of September 30, 2005 and December 31, 2004, respectively				
Total shareholders' equity		199,791		194,724
Total liabilities and shareholders' equity	$	2,994,869	$	2,318,071

See accompanying notes to the unaudited consolidated financial statements.

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

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2005	2004	2005	2004
	(in thousands, except per share data)			
Interest income:				
Loans, including fees	$ 44,278	$ 28,526	$ 113,399	$ 85,386
Cash and investment securities	4,552	2,152	13,863	5,563
Total interest income	48,830	30,678	127,262	90,949
Interest expense:				
Deposit accounts	15,527	6,632	36,922	19,631
Federal Home Loan Bank advances and other borrowings	7,634	2,343	17,366	4,319
Junior subordinated debentures	1,830	1,569	5,264	4,559
Total interest expense	24,991	10,544	59,552	28,509
Net interest income before provision for loan losses	23,839	20,134	67,710	62,440
Provision for loan losses	1,500	1,100	3,750	3,450
Net interest income after provision for loan losses	22,339	19,034	63,960	58,990
Non-interest income:				
Premium on sale of loans, net	—	—	—	9,284
Late and collection fees	181	74	384	259
Other	304	(239)	590	4,731
Total non-interest income	485	(165)	974	14,274
Non-interest expense:				
Compensation and benefits	5,048	4,938	16,315	16,540
Occupancy and equipment	1,980	1,471	5,381	4,321
Other	4,945	3,472	12,576	10,860
Total general and administrative	11,973	9,881	34,272	31,721
Real estate owned expense, net	—	32	—	113
	—	—	—	1,000

Provision for losses on other real estate owned								
Gain on sale of other real estate owned, net		—		(61)		(11)		(415)
Total real estate owned expense, net		—		(29)		(11)		698
Total non-interest expense		11,973		9,852		34,261		32,419
Income before provision for income taxes		10,851		9,017		30,673		40,845
Provision for income taxes		4,583		3,519		12,915		15,933
NET INCOME	$	6,268	$	5,498	$	17,758	$	24,912
BASIC EARNINGS PER SHARE	$	1.09	$	0.91	$	3.08	$	4.04
DILUTED EARNINGS PER SHARE	$	1.06	$	0.86	$	2.96	$	3.80

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, 2005	2004
	(in thousands)	
Cash Flows From Operating Activities:		
Net Income	$ 17,758	$ 24,912
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of premises and equipment	2,025	1,510
Amortization of premium on purchased loans	2,190	1,637
Accretion of deferred loan origination fees, net of costs	(2,209)	(1,443)
Provision for loan losses	3,750	3,450
Premium on sale of RAL loans, net	—	(9,284)
Other, net	(725)	201
Increase in interest receivable	(4,281)	(36)
Decrease in other assets	4,453	3,314
Increase in accounts payable and other liabilities	3,194	4,239
Net cash provided by operating activities	26,155	28,500
Cash Flows From Investing Activities:		
Purchases of investment securities available for sale	(32,811)	(34,577)
Proceeds from maturity and calls of investment securities available for sale	6,949	23,054
Purchases of investment securities held-to-maturity	—	(200,731)
Proceeds from repayments of investment securities held-to-maturity	44,089	2,732
Purchase of stock in Federal Home Loan Bank	(11,197)	(4,457)
Purchase of loans	(621,630)	—
Origination of RAL loans	—	(12,949,433)
Proceeds from participation in RAL loans	—	12,958,717
Increase in loans, net	(93,133)	(124,240)
Proceeds from sale of other real estate owned	81	8,318
Capital expenditures, net	(2,154)	(1,994)
Net cash used in investing activities	(709,806)	(322,611)
Cash Flows From Financing Activities:		
Proceeds from exercise of employee stock options	3,908	2,319
Cash paid to acquire treasury stock	(20,150)	(20,639)
Principal payments on collateralized mortgage obligations	—	(15,868)
Net increase in deposit accounts	409,705	89,042

Net decrease in short-term borrowings		(136,000)		(31,000)
Proceeds from long-term borrowings		463,719		214,000
Repayments of long-term borrowings		(68,887)		(55,600)
Net cash provided by financing activities		652,295		182,254
Net decrease in cash and cash equivalents		(31,356)		(111,857)
Cash and cash equivalents at beginning of period		87,580		178,318
Cash and cash equivalents at end of period	$	56,224	$	66,461
Supplemental Cash Flow Information:				
Cash paid during the period for interest	$	58,709	$	28,769
Cash paid during the period for income taxes	$	8,490	$	8,835
Non-Cash Investing Transactions-				
Loans transferred to other real estate owned	$	70	$	1,855

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 the dates 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") and Imperial Capital Real Estate Investment Trust ("Imperial Capital REIT").

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, 2005 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, 2004.

NOTE 2 - ACCOUNTING FOR STOCK-BASED COMPENSATION

The Company's stock-based compensation plans are accounted for in accordance with Accounting Principles Board ("APB") Opinion No. 25 - "Accounting for Stock Issued to Employees." Under APB Opinion No. 25, no compensation expense is recognized for a stock option grant if the exercise price of the stock option at measurement date is equal to or greater than the fair market value of the common stock on the date of grant. The Company applies Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation", for disclosure purposes only. SFAS No. 123 disclosures include pro forma net income and earnings 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, 2005	2004	For the Nine Months Ended September 30, 2005	2004
	(in thousands, except per share data)			
Net income, as reported	$ 6,268	$ 5,498	$ 17,758	$ 24,912
Less: Stock-based employee compensation expense determined under the fair value method, net of tax	639	350	1,100	1,025
Pro forma net income	$ 5,629	$ 5,148	$ 16,658	$ 23,887
Earnings per share:				
Basic - as reported	$ 1.09	$ 0.91	$ 3.08	$ 4.04
Basic - pro forma	$ 0.98	$ 0.85	$ 2.89	$ 3.87
Diluted - as reported	$ 1.06	$ 0.86	$ 2.96	$ 3.80
Diluted - pro forma	$ 0.95	$ 0.80	$ 2.78	$ 3.65

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

	Weighted-Average Assumptions for Option Grants 2005	2004
Dividend Yield	0.00%	0.00%
Expected Volatility	36.34%	36.51%
Risk-Free Interest Rates	4.10%	4.16%
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.

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

	Net Income	Weighted-Average Shares Outstanding	Per Share Amount
	(in thousands, except per share data)		
For the Three Months Ended September 30, 2005			
Basic EPS	$ 6,268	5,746	$ 1.09
Effect of dilutive stock options	—	185	(0.03)

Diluted EPS	$	6,268	5,931	$	1.06
2004					
Basic EPS	$	5,498	6,054	$	0.91
Effect of dilutive stock options		—	351		(0.05)
Diluted EPS	$	5,498	6,405	$	0.86
For the Nine Months Ended September 30, 2005					
Basic EPS	$	17,758	5,769	$	3.08
Effect of dilutive stock options		—	232		(0.12)
Diluted EPS	$	17,758	6,001	$	2.96
2004					
Basic EPS	$	24,912	6,166	$	4.04
Effect of dilutive stock options		—	385		(0.24)
Diluted EPS	$	24,912	6,551	$	3.80

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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, 2005	Three Months Ended September 30, 2004	Nine Months Ended September 30, 2005	Nine Months Ended September 30, 2004
	(in thousands)			
Net Income	$ 6,268	$ 5,498	$ 17,758	$ 24,912
Other comprehensive (loss) income:				
Change in unrealized (losses) gains on investment securities available for sale, net of tax benefit (expense) of $17 and $(195) for the three months ended September 30, 2005 and 2004, and net of tax benefit (expense) of $154 and $(48) for the nine months ended September 30, 2005 and 2004, respectively.	(24)	320	(233)	78
Comprehensive Income	$ 6,244	$ 5,818	$ 17,525	$ 24,990

NOTE 5 - IMPAIRED LOANS RECEIVABLE

As of September 30, 2005 and December 31, 2004, the recorded investment in impaired loans was $41.2 million and $18.6 million, respectively. The average recorded investment in impaired loans was $32.4 million and $25.3 million, respectively, for the three and nine months ended September 30, 2005 and $19.0 million and $22.7 million, respectively, for the same periods last year. Interest income recognized on impaired loans totaled $297,000 and $609,000 for the three and nine months ended September 30, 2005 as compared to $76,000 and $313,000 for the same periods last year.

NOTE 6 - RESIDUAL INTEREST IN SECURITIZATION

The Company has recorded a residual asset in connection with a 2002 securitization of residential real estate loans, which represented the present value of future cash flows (spread and fees) that were 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. 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.

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At September 30, 2005 and December 31, 2004, 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, 2005		December 31, 2004	
	(dollars in thousands)			
Fair value of retained interest	**$**	**4,360**	**$**	**5,368**
Weighted average life (in years) - securities		**0.54**		**0.68**
Weighted average life (in years) - residual interest		**2.87**		**3.61**
Weighted average annual prepayment speed		**40.0%**		**26.5%**
Impact of 10% adverse change	$	(15)	$	(236)
Impact of 25% adverse change	$	(62)	$	(630)
Weighted average annual discount rate		**15.0%**		**15.0%**
Impact of 10% adverse change	$	(159)	$	(243)
Impact of 25% adverse change	$	(388)	$	(630)
Weighted average lifetime credit losses		**14.7%**		**25.0%**
Impact of 10% adverse change	$	(99)	$	(262)
Impact of 25% adverse change	$	(252)	$	(700)

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.

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NOTE 7 - NEW ACCOUNTING PRONOUNCEMENTS

On December 16, 2004, the Financial Accounting Standards Board ("FASB") issued SFAS No. 123 (revised 2004), "Share-Based Payment", which is a revision of SFAS No. 123. SFAS No. 123(R) supersedes APB Opinion No. 25. Generally, the approach to accounting for share-based payments in SFAS No. 123(R) is similar to the approach described in SFAS No. 123. However, SFAS No. 123(R) requires share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their grant date fair values (i.e., pro forma disclosure is no longer an alternative to financial statement recognition). SFAS No. 123(R) is effective for the Company beginning January 1, 2006. The Company plans to adopt SFAS No. 123(R) using a modified version of prospective application ("modified prospective application"). Under modified prospective application, as it is applicable to the Company, SFAS No. 123(R) applies to new awards and to awards modified, repurchased, or cancelled after January 1, 2006. Additionally, compensation cost for the portion of awards for which the requisite service has not been rendered (generally referring to non-vested awards) that are outstanding as of January 1, 2006 must be recognized as the remaining requisite service is rendered over periods after the adoption of SFAS No. 123(R). The attribution of compensation cost for those earlier awards will be based on the same method and on the same grant-date fair values previously determined for the pro forma disclosures. Management does not expect the adoption of SFAS No. 123(R) to have a material impact on the Company's consolidated results of operations or financial position. Future levels of compensation cost recognized related to stock-based compensation awards will be impacted by new awards and/or modifications, repurchases and cancellations of existing awards before and after the adoption of this standard.

In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections", which is a replacement of APB Opinion No. 20, "Accounting Changes", and SFAS No. 3, 'Reporting Accounting Changes in Interim Financial Statements". SFAS No. 154 applies to all voluntary changes in accounting principle, and changes the requirements for accounting for and reporting of a change in accounting principle. SFAS No. 154 requires retrospective application to prior periods' financial statements of a voluntary change in accounting principle unless it is impracticable. APB Opinion No. 20 previously required that most voluntary changes in accounting principle be recognized by including in net income of the period of the change the cumulative effect of changing to the new accounting principle. SFAS No. 154 will be effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. Management does not expect the adoption of SFAS No. 154 on January 1, 2006 to have a material impact on the Company's consolidated results of operations or financial position.

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 are 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.

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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 segments profits and losses disclosed below and the measurement of profits and losses in our consolidated statements of income. Accounting allocations are made in the same manner for all operating segments.

	Lending Operations	All Other	Eliminations	Consolidated
		(in thousands)		
For the three months ended September 30,				
2005				
Revenues from external customers	$ 48,709	$ 606	$ —	$ 49,315
Total interest income	48,265	565	—	48,830
Total interest expense	23,161	1,830	—	24,991
Net income	7,568	(1,300)	—	6,268
2004				
Revenues from external customers	$ 30,704	$ 362	$ —	$ 31,066
Total interest income	30,935	362	(619)	30,678
Total interest expense	9,594	1,569	(619)	10,544
Net income	7,189	(1,691)	—	5,498
For the nine months ended September 30,				
2005				
Revenues from external customers	$ 126,583	$ 1,653	$ —	$ 128,236
Total interest income	125,285	1,977	—	127,262
Total interest expense	54,288	5,264	—	59,552
Net income	21,576	(3,818)	—	17,758
2004				
Revenues from external customers	$ 105,270	$ 1,003	$ —	$ 106,273
Total interest income	91,086	1,003	(1,140)	90,949
Total interest expense	24,916	4,733	(1,140)	28,509
Net income	29,859	(4,947)	—	24,912

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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 affected our financial condition and results of operations for the three and nine months ended September 30, 2005.

Application of Critical Accounting Policies and Accounting Estimates

The accounting and reporting policies followed by us conform, in all material respects, to accounting principles generally accepted in the United States ("GAAP") and to general practices within the financial services industry. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. While we base our estimates on historical experience, current information and other factors deemed to be relevant, actual results could differ from those estimates.

We consider accounting estimates to be critical to reported financial results if (i) the accounting estimate requires management to make assumptions about matters that are highly uncertain and (ii) different estimates that management reasonably could have used for the accounting estimate in the current period, or changes in the accounting estimate that are reasonably likely to occur from period to period, could have a material impact on our financial statements. Accounting polices related to the allowance for loan losses are considered to be critical, as these policies involve considerable subjective judgment and estimation by management. We also consider accounting policies related to stock-based compensation to be critical due to the continuously evolving standards, changes to which could materially impact the way we account for stock options. Additionally, we also consider our accounting polices related to other real estate owned to be critical due to the potential significance of these activities and the estimates involved.

For additional information regarding critical accounting policies, refer to Note 1 - Organization and Summary of Significant Accounting Policies in the Notes to Consolidated Financial Statements and the sections captioned "Application of Critical Accounting Policies and Accounting Estimates" and "Allowance for Possible Loan Losses and Nonperforming Assets" in Management's Discussion and Analysis of Financial Condition and Results of Operations included in the Company's Form 10-K for the year ended December 31, 2004. There have been no significant changes in the Company's application of accounting policies since December 31, 2004.

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RESULTS OF OPERATIONS

Three Months Ended September 30, 2005 Compared to Three Months Ended September 30, 2004

Executive Summary

Consolidated net income was $6.3 million and $5.5 million for the quarters ended September 30, 2005 and 2004, respectively. Diluted EPS was $1.06 for the three months ended September 30, 2005 compared to $0.86 for the same period last year.

Net interest income before provision for loan losses increased to $23.8 million for the quarter ended September 30, 2005 compared to $20.1 million for the same period last year. The increase was primarily caused by additional interest income earned due to the growth in the average balance of our loan portfolio, and an increase in the average balance of higher yielding investment securities held-to-maturity as compared to the quarter ended September 30, 2004. The increase in interest income was partially offset by additional interest expense incurred due to the growth in the average balance of interest bearing liabilities as compared to the same period last year, deposits repricing to higher current market interest rates, and the addition of new borrowings at higher current market interest rates.

The return on average assets was 0.84% for the three months ended September 30, 2005, compared to 1.15% for the same period last year. The decrease in the return on average assets ratio was primarily due to the increase in average total assets, which increased to $3.0 billion for the three months ended September 30, 2005 as compared to $1.9 billion for the same period last year, as well as continued net interest margin compression and narrowing interest rate spreads caused by current competitive pricing pressures and a higher allocation of lower yielding multi-family loans. The return on average shareholders’ equity was 12.42% for the three months ended September 30, 2005, compared 10.86% for the same period last year.

Loan production was $382.3 million for the quarter ended September 30, 2005, compared to $231.5 million for the same period last year. During the current quarter, the Bank originated $153.4 million of commercial real estate loans, $83.0 million of small balance multi-family real estate loans, $17.4 million of entertainment finance loans, and its wholesale loan operations acquired a $128.5 million single-family residential loan portfolio. This acquisition, which met the Bank’s investment criteria, is not expected to be a recurring activity of the wholesale loan operations. Loan production for the same period last year consisted of the origination of $139.6 million of commercial real estate loans, $59.8 million of small balance multi-family real estate loans, $27.3 million of entertainment finance loans and $4.8 million of franchise loans. During the current quarter, the Company continued to deemphasize its franchise lending platform as it primarily focused on its commercial real estate and multi-family real estate loan production.

Net Interest Income and Margin

The following table presents for the three months ended September 30, 2005 and 2004, 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 September 30,					
	2005			2004		
	Average Balance	Income/ Expense	Yield/ Rate	Average Balance	Income/ Expense	Yield/ Rate
	(dollars in thousands)					
Assets						
Cash and investment securities	$ 430,410	$ 4,552	4.20%	$ 252,540	$ 2,152	3.39%
Loans receivable:						
Loans	2,480,856	43,895	7.01%	1,577,422	27,983	7.01%
Real estate loans held at REIT	26,058	383	5.83%	47,342	543	4.56%
Total loans receivable	2,506,914	44,278	7.01%	1,624,764	28,526	6.98%
Total interest earning assets	2,937,324	$ 48,830	6.60%	1,877,304	$ 30,678	6.50%
Non-interest earning assets	53,352			57,937		
Allowance for loan losses	(37,952)			(35,449)		
Total assets	$ 2,952,724			$ 1,899,792		
Liabilities and Shareholders' Equity						
Interest bearing deposit accounts:						
Interest bearing demand	$ 44,613	$ 286	2.54%	$ 85,129	$ 402	1.88%
Money market and passbook	184,428	1,476	3.18%	127,470	641	2.00%
Time certificates	1,588,757	13,765	3.44%	946,844	5,589	2.35%
Total interest bearing deposit accounts	1,817,798	15,527	3.39%	1,159,443	6,632	2.28%
FHLB advances and other borrowings	804,757	7,634	3.76%	387,792	2,343	2.40%
Junior subordinated debentures	86,600	1,830	8.38%	86,600	1,569	7.21%
Total interest bearing liabilities	2,709,155	$ 24,991	3.66%	1,633,835	$ 10,544	2.57%
Non-interest bearing demand accounts	15,671			16,286		
Other non-interest bearing liabilities	27,743			48,212		
Shareholders' equity	200,155			201,459		
Total liabilities and shareholders' equity	$ 2,952,724			$ 1,899,792		
Net interest spread *(1)*			2.94%			3.93%
Net interest income before provision for loan		$ 23,839			$ 20,134	

losses		
Net interest margin *(2)*	3.22%	4.27%

(1) Average yield on interest earning assets minus average rate paid on interest bearing liabilities.
(2) Net interest income divided by total average interest earning assets.

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.

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	For the Three Months Ended September 30, 2005 and 2004 Increase (Decrease) Due to:		
	Rate	Volume	Total
	(in thousands)		
Interest and fees earned from:			
Cash and investment securities	$ 608	$ 1,792	$ 2,400
Loans	131	15,621	15,752
Total increase in interest income	739	17,413	18,152
Interest paid on:			
Deposit accounts	4,106	4,789	8,895
FHLB advances and other borrowings	1,826	3,465	5,291
Junior subordinated debentures	261	—	261
Total increase in interest expense	6,193	8,254	14,447
Increase (decrease) in net interest income	$ (5,454)	$ 9,159	$ 3,705

Total interest income increased $18.2 million to $48.8 million during the current quarter as compared to $30.7 million for the same period last year. The increase in interest income was primarily attributable to an $882.2 million increase in the average balance of total loans receivable, a $177.9 million increase in the average balance of cash and investment securities, and an 81 basis point increase in the average yield earned on cash and investment securities.

The average balance of cash and investment securities increased to $430.4 million in the third quarter of 2005 compared to $252.5 million during the same period last year. The increase in average cash and investment securities was primarily due to an increase in the average balance of higher yielding investment securities held-to-maturity, partially offset by a decline in lower yielding short-term and overnight investments as compared to the same period last year. As a result, the average yield earned on cash and investments increased to 4.20% during the current quarter as compared to 3.39% for the same period last year.

The average aggregate balance of our loan portfolio was $2.5 billion and $1.6 billion for the three months ended September 30, 2005 and 2004, respectively. Commercial real estate and construction loans had an average aggregate balance of $801.1 million during the quarter ended September 30, 2005 compared to $709.9 million during the same period last year. Multi-family real estate loans had an average aggregate balance of $1.4 billion during the quarter ended September 30, 2005 compared to $673.4 million during the same period last year. Single-family residential loans had an average aggregate balance of $92.6 million during the quarter ended September 30, 2005 compared to $1.7 million during the same period last year. The average aggregate balance of entertainment finance loans was $84.8 million and $95.0 million during the quarters ended September 30, 2005 and 2004, respectively. The average aggregate balance of franchise loans was $129.4 million and $132.4 million during the quarters ended September 30, 2005 and 2004, respectively.

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The average yield earned on total loans increased to 7.01% in the quarter ended September 30, 2005 as compared to 6.98% in the same period last year. The increase in yield was primarily due to loans repricing to higher current interest rates, partially offset by higher yielding loans being repaid and replaced by new loan production at lower current market interest rates. A majority of our loan portfolio is comprised of adjustable rate loans indexed to six month LIBOR. Approximately 98.7% of our loan portfolio was adjustable at September 30, 2005, and approximately 35.3% of this adjustable rate portfolio consisted of loans that have an initial fixed rate of interest that will become adjustable rate loans after the conclusion of a fixed interest rate period of between three and five years. Our adjustable rate loans generally reprice on a quarterly or semi-annual basis. At September 30, 2005, approximately $1.6 billion, or 92.5%, of our adjustable loan portfolio contained interest rate floors, below which the loans' contractual interest rate may not adjust. At September 30, 2005, the weighted average floor interest rate of these loans was 6.0%. Approximately $619.1 million, or 26.9%, of these loans were at their floors at the end of the quarter.

Total interest expense increased by $14.4 million to $25.0 million during the third quarter of 2005, compared to $10.5 million for the same period last year. The increase in interest expense was primarily attributable to an increase of $1.1 billion in the average balance of interest bearing liabilities, which was caused by the increase in deposits and FHLB advances and other borrowings, and a 109 basis point increase in the rate paid on interest bearing liabilities, which was primarily caused by deposits repricing to higher current market interest rates, as well as the addition of new borrowings at higher current market interest rates.

Our average cost of funds increased to 3.66% during the three months ended September 30, 2005, compared to 2.57% for the same period last year. As discussed above, the increase in the average funding costs was primarily due to deposits repricing to higher current market interest rates, and the addition of FHLB advances and other borrowings. The average rate paid on deposit accounts was 3.39% during the three months ended September 30, 2005 as compared to 2.28% for the same period last year. The average balance of deposit accounts increased $658.4 million to $1.8 billion for the three months ended September 30, 2005 as compared to $1.2 billion for the same period last year. The average rate paid on FHLB advances and other borrowings was 3.76% during the three months ended September 30, 2005 compared to 2.40% for the same period last year. FHLB advances and other borrowings averaged $804.8 million during the current quarter, compared to $387.8 million for the same period last year.

Net interest margin decreased to 3.22% for the three months ended September 30, 2005 as compared to 4.27% for the same period last year. This decrease was primarily due to the increase in the average balance of interest bearing liabilities and the corresponding increase in our average cost of funds.

Provision for Loan Losses

Management periodically assesses the adequacy of the allowance for loan losses by reference to certain quantitative and qualitative factors that may be weighted differently at various times depending on prevailing conditions. These factors include, among other elements:

- general portfolio trends relative to asset and portfolio size;
- asset categories;
- credit and geographic concentrations;
- delinquency trends and nonaccrual loan levels;
- historical loss experience and risks associated with changes in economic, social and business conditions; and
- the underwriting standards in effect when the loan was made.

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Accordingly, the calculation of the adequacy of the allowance for loan losses is not based solely on the level of nonperforming assets. The quantitative factors, included above, are utilized by our management to identify two different risk groups (1) individual loans (loans with specifically identifiable risks); and (2) homogeneous loans (groups of loan with similar characteristics). We base the allocation for individual loans primarily on risk rating grades assigned to each of these loans as a result of our loan management and review processes. We then assign each risk-rating grade a loss ratio, which is determined based on the experience of management and our independent loan review process. We estimate losses on impaired loans based on estimated cash flows discounted at the loan's original effective interest rate or based on the underlying collateral value. Based on management's experience, we also assign loss ratios to groups of loans. These loss ratios are assigned to the various homogenous categories of the portfolio.

The qualitative factors, included above, are generally utilized to identify other risks inherent in the portfolio and to determine whether the estimated credit losses associated with the current portfolio might differ from historical loss trends. We estimate a range of exposure for each qualitative factor and evaluate the current condition and trend of each factor. Based on this evaluation, we assign a positive, negative or neutral grade to each factor to determine whether the portion of the qualitative reserve is in the high, middle or low end of the range for each factor. Because of the subjective nature of these factors and the judgments required to determine the estimated ranges, the actual losses incurred can vary significantly from the estimated amounts.

Management believes that our allowance for loan losses as of September 30, 2005 was adequate to absorb the known and inherent risks of loss in the loan portfolio at that date. While management believes the estimates and assumptions used in its determination of the adequacy of the allowance are reasonable, there can be no assurance that such estimates and assumptions will not be proven incorrect in the future, or that the actual amount of future provisions will not exceed the amount of past provisions or that any increased provisions that may be required will not adversely impact our financial condition and results of operations. In addition, the determination of the amount of the Bank's allowance for loan losses is subject to review by bank regulators, as part of the routine examination process, which may result in the establishment of additional reserves based upon their judgment of information available to them at the time of their examination.

The consolidated provision for loan losses totaled $1.5 million for the third quarter of 2005, compared to $1.1 million for the same period last year. The provision for loan losses was recorded based on an analysis of the factors referred to above. The allowance for loan losses was 1.52% of our total loan portfolio at September 30, 2005 as compared to 1.94% at December 31, 2004. The decrease in this percentage primarily reflects the decline in our overall risk profile due to a broader geographic diversification of our real estate loan portfolio resulting from the higher concentration of non-California loans and small balance multi-family loans as a percentage of our total loan portfolio. As of September 30, 2005, 39.5% of our loan portfolio secured by real estate was located outside of California, as compared to 34.6% at December 31, 2004. During the quarter ended September 30, 2005, we had net loan charge-offs of $241,000, compared to net loan change-offs of $2.3 million during the same period last year. See also - "Financial Condition - Credit Risk".

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Non-Interest Income

Non-interest income increased to $485,000 during the quarter ended September 30, 2005 as compared to $(165,000) for the same period last year. This increase was primarily attributable to a mark-to-market adjustment recorded last year related to an executive deferred compensation plan.

Non-Interest Expense

Non-interest expense totaled $12.0 million for the current quarter, compared to $9.9 million for the same period last year. The increase in non-interest expense was caused by the additional overhead expenses incurred in connection with the national expansion of our loan production platform over the same period last year. As of September 30, 2005, the Bank had 20 loan production offices outside of California and a total of 27 loan production offices operating. Our efficiency ratio (defined as recurring general and administrative expenses as a percentage of net revenue) decreased to 49.2% for the quarter ended September 30, 2005, as compared to 49.5% for the same period last year.

Nine Months Ended September 30, 2005 Compared to Nine Months Ended September 30, 2004

Executive Summary

Consolidated net income totaled $17.8 million for the nine months ended September 30, 2005 compared to $24.9 million for the same period last year. Diluted EPS was $2.96 for the nine months ended September 30, 2005, compared to $3.80 for the same period last year. This decrease was primarily caused by a decline in interest and fee income earned in connection with the Bank’s RAL program, which terminated at the conclusion of the 2004 tax season.

Despite the termination of the RAL program, net interest income before provision for loan losses increased to $67.7 million for the nine months ended September 30, 2005 compared to $62.4 million for the same period last year. This increase was due to the growth in the average balance of our loan portfolio, a decrease in the average balance of low yielding short-term and overnight investments, and an increase in the average balance of higher yielding investment securities held-to-maturity as compared to the same period last year. The decline in the average balance of short-term and overnight investment securities was a result of the termination of the RAL program, which generated a substantial level of liquidity during the quarter ended March 31, 2004. The Bank invested this additional liquidity in short-term and overnight investments, which earned a lower yield than the Bank earns on its current investment portfolio. The increase in interest income was partially offset by additional interest expense incurred due to the growth in the average balance of our interest bearing liabilities as compared to the same period last year, deposits repricing to higher current market interest rates, and the addition of new borrowings at higher current market interest rates.

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The return on average assets was 0.92% for the nine months ended September 30, 2005, compared to 1.59% for the same period last year. The return on average shareholders' equity was 12.05% for the nine months ended September 30, 2005, compared to 16.65% for the same period last year. The decrease in these ratios was primarily attributable to the absence of RAL related income during the nine months ended September 30, 2005.

Loan production was $1.3 billion for the nine months ended September 30, 2005, compared to $644.7 million for the same period last year. During the current nine month period, the Bank originated $339.8 million of commercial real estate loans, $232.5 million of small balance multi-family real estate loans, $64.4 million of entertainment finance loan, $2.4 million of franchise loans, and its wholesale loan operations acquired $493.1 million of small balance multi-family loans and a $128.5 million single-family residential loan portfolio. Loan production for the same period last year consisted of $375.7 million of commercial real estate loans, $153.7 million of small balance multi-family real estate loans, $69.2 million of entertainment finance loans and $46.1 million of franchise loans.

Net Interest Income and Margin

The following table presents, for the nine months ended September 30, 2005 and 2004, 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 Nine Months Ended September 30,					
	2005			2004		
	Average Balance	Income/ Expense	Yield/ Rate	Average Balance	Income/ Expense	Yield/ Rate
	(dollars in thousands)					
Assets						
Cash and investments	$ 430,250	$ 13,863	4.31%	$ 438,168	$ 5,563	1.70%
Loans receivable:						