CITY NATIONAL CORP
Form 10-Q
August 09, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-Q

(Mark One)

ý QUARTERLY REPORT UNDER SECTION 13 OR 15 (d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2004

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 1-10521

CITY NATIONAL CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**95-2568550**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
City National Center **400 North Roxbury Drive, Beverly Hills, California**	**90210**
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code **(310) 888-6000**

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 ý NO o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act).

YES ý NO o

Number of shares of common stock outstanding at July 31, 2004: 49,055,585

PART 1 - FINANCIAL INFORMATON

ITEM 1. FINANCIAL STATEMENTS

CITY NATIONAL CORPORATION

CONSOLIDATED BALANCE SHEET

(Unaudited)

Dollars in thousands, except per share amounts	**June 30, 2004**	**December 31, 2003**	**June 30, 2003**
Assets			
Cash and due from banks	$ 485,208	$ 461,443	$ 451,291
Federal funds sold	595,000	240,000	650,000
Due from banks - interest bearing	76,890	405,747	30,402
Securities available-for-sale - cost $3,586,185; $3,350,632 and $2,935,401 at June 30, 2004, December 31, 2003 and June 30, 2003, respectively	3,518,757	3,365,654	2,992,686
Trading account securities	28,893	91,535	57,633
Loans	8,125,496	7,882,742	7,590,226
Less allowance for credit losses	165,117	165,986	170,927
Net loans	7,960,379	7,716,756	7,419,299
Premises and equipment, net	60,488	62,719	64,966
Deferred tax asset	127,991	65,913	50,488
Goodwill	253,736	253,824	254,627
Intangibles	44,360	47,879	48,597
Bank owned life insurance	64,012	62,799	61,554
Affordable housing investments	65,174	66,480	66,532
Other assets	187,296	171,785	200,613
Customers acceptance liability	5,716	5,708	6,145
Total assets	$ 13,473,900	$ 13,018,242	$ 12,354,833
Liabilities			
Demand deposits	$ 5,809,241	$ 5,486,668	$ 4,916,678
Interest checking deposits	861,987	840,659	689,658
Money market deposits	3,601,658	3,260,959	3,140,203
Savings deposits	199,650	208,701	211,010
Time deposits-under $100,000	191,250	199,875	210,333
Time deposits-$100,000 and over	791,133	940,201	998,924
Total deposits	11,454,919	10,937,063	10,166,806
Federal funds purchased and securities sold under repurchase agreements	94,898	111,713	167,084
Other short-term borrowings	50,125	65,135	115,125
Subordinated debt	286,896	295,723	318,282
Long-term debt	224,488	230,555	283,954
Other liabilities	101,869	127,045	126,703
Acceptances outstanding	5,716	5,708	6,145
Total liabilities	12,218,911	11,772,942	11,184,099
Minority interest in consolidated subsidiaries	27,180	26,044	26,044
Commitments and contingencies			

Shareholders Equity						
Preferred Stock authorized - 5,000,000 : none outstanding						
Common Stock-par value-$1.00; authorized - 75,000,000; Issued - 50,578,256; 50,459,716 and 50,455,363 shares at June 30, 2004, December 31, 2003 and June 30, 2003, respectively		50,578		50,460		50,455
Additional paid-in capital		408,463		401,233		404,741
Accumulated other comprehensive income (loss)		(38,418)		12,903		39,781
Retained earnings		886,367		814,591		745,017
Deferred equity compensation		(13,343)		(6,699)		(7,595)
Treasury shares, at cost - 1,268,452; 1,255,569; and 2,027,574 shares at June 30, 2004, December 31, 2003 and June 30, 2003, respectively		(65,838)		(53,232)		(87,709)
Total shareholders equity		1,227,809		1,219,256		1,144,690
Total liabilities and shareholders equity	$	13,473,900	$	13,018,242	$	12,354,833

See accompanying Notes to the Unaudited Consolidated Financial Statements.

CITY NATIONAL CORPORATION

CONSOLIDATED STATEMENT OF INCOME

(Unaudited)

In thousands, except per share amounts	For the three months ended June 30, 2004	For the three months ended June 30, 2003	For the six months ended June 30, 2004	For the six months ended June 30, 2003
Interest Income				
Loans	$ 106,448	$ 111,176	$ 212,434	$ 226,912
Securities available-for-sale	37,486	32,292	74,687	61,723
Federal funds sold and securities purchased under resale agreements	1,116	771	1,548	1,182
Due from bank - interest bearing	92	35	232	84
Trading account	36	59	74	108
Total interest income	145,178	144,333	288,975	290,009
Interest Expense				
Deposits	9,838	12,548	19,590	26,022
Subordinated debt	1,232	1,349	2,449	2,763
Other long-term debt	1,419	2,342	2,858	3,694
Federal funds purchased and securities sold under repurchase agreements	269	414	513	1,039
Other short-term borrowings	145	556	318	1,150
Total interest expense	12,903	17,209	25,728	34,668
Net interest income	132,275	127,124	263,247	255,341
Provision for credit losses		11,500		29,000
Net interest income after provision for credit losses	132,275	115,624	263,247	226,341
Non interest Income				
Trust and investment fees	16,664	12,192	32,252	18,730
Brokerage and mutual fund fees	9,367	9,313	18,093	18,255
Cash management and deposit transaction charges	10,942	10,876	22,040	21,983
International services	5,042	5,019	10,168	9,347
Bank owned life insurance	715	731	1,546	1,445
Gain on sale of loans and assets				102
Gain on sale of securities	871	1,272	1,500	2,502
Other	4,665	5,649	9,237	11,664
Total noninterest income.	48,266	45,052	94,836	84,028
Noninterest Expense				
Salaries and employee benefits	59,306	54,516	118,982	106,321
Net occupancy of premises	7,649	7,862	14,957	14,831
Professional fees	6,730	6,769	12,836	13,205
Information services	4,588	4,302	9,110	8,555
Depreciation	3,274	3,019	6,502	6,138
Marketing and advertising	3,812	3,553	7,319	6,665
Office services	2,487	2,398	4,906	4,968
Amortization of intangibles	1,760	2,227	3,519	4,203
Equipment	636	638	1,401	1,304
Other operating	5,413	6,032	10,654	10,538
Total noninterest expense	95,655	91,316	190,186	176,728
Minority interest in net income of consolidated subsidiaries	1,306	1,065	2,906	1,540

Income before income taxes	83,580	68,295	164,991	132,101
Income taxes	31,380	22,214	61,893	42,365
Net income	$ 52,200	$ 46,081	$ 103,098	$ 89,736
Net income per share, basic	$ 1.07	$ 0.95	$ 2.11	$ 1.85
Net income per share, diluted	$ 1.03	$ 0.93	$ 2.03	$ 1.80
Shares used to compute income per share, basic	48,796	48,308	48,764	48,543
Shares used to compute income per share, diluted	50,925	49,524	50,864	49,824
Dividends per share	$ 0.320	$ 0.205	$ 0.640	$ 0.410

See accompanying Notes to the Unaudited Consolidated Financial Statements.

CITY NATIONAL CORPORATION

CONSOLIDATED STATEMENT OF CASH FLOWS

(Unaudited)

Dollars in thousands	For the six months ended June 30, 2004		2003
Cash Flows From Operating Activities			
Net income	$	103,098	$	89,736
Adjustments to net income:				
Provision for credit losses				29,000
Amortization of restricted stock awards		1,265		129
Amortization of intangibles		3,519		4,203
Depreciation		6,502		6,138
Deferred income tax benefit		(62,078)		(13,434)
Gain on sales of loans and assets				(102)
Gain on sales of securities		(1,500)		(2,502)
Net decrease (increase) in other assets		(19,240)		10,399
Net decrease in trading securities		62,642		69,166
Other, net		10,319		8,980
Net cash provided by operating activities		104,527		201,713
Cash Flows From Investing Activities				
Purchase of securities		(704,411)		(1,602,880)
Sales of securities available-for-sale		61,322		111,240
Maturities and paydowns of securities		403,592		722,869
Loan principal collections (originations), net		(242,754)		380,151
Purchase of premises and equipment		(6,183)		(10,906)
Net cash for acquisitions				(39,907)
Other, net		(5)		(3)
Net cash used by investing activities.		(488,439)		(439,436)
Cash Flows From Financing Activities				
Net increase in deposits		517,856		327,108
Net decrease in federal funds purchased and securities sold under repurchase agreements		(16,815)		(99,643)
Net decrease in short-term borrowings, net of transfers from long-term debt		(15,010)		(25,000)
Repayment of long-term debt				(1,367)
Net proceeds of issuance of senior debt				221,749
Proceeds from exercise of stock options		22,937		9,015
Stock repurchases		(43,826)		(45,217)
Cash dividends paid		(31,322)		(19,914)
Net cash provided by financing activities		433,820		366,731
Net increase in cash and cash equivalents		49,908		129,008
Cash and cash equivalents at beginning of year		1,107,190		1,002,685
Cash and cash equivalents at end of period	$	1,157,098	$	1,131,693
Supplemental Disclosures of Cash Flow Information:				
Cash paid during the period for:				
Interest	$	26,142	$	31,309
Income taxes		66,500		44,000

Non-cash investing activities:		
Transfer from long-term debt to short-term borrowings	$	$ 15,000

See accompanying Notes to the Unaudited Consolidated Financial Statements.

CITY NATIONAL CORPORATION

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS EQUITY

AND COMPREHENSIVE INCOME

(Unaudited)

Dollars in thousands	Shares issued	Common stock	Additional paid-in capital	Accumulated other comprehensive income (loss)	Retained Earnings	Deferred Compensation	Treasury stock	Total shareholders equity
Balances, December 31, 2002	50,282,743	$ 50,283	$ 400,866	$ 40,400	$ 675,195	$	$ (56,785)	$ 1,109,959
Net income					89,736			89,736
Other comprehensive income net of tax								
Net unrealized gain on securities available-for-sale, net of relassification adjustment of $0.5 million of net losses included in net income				39				39
Net unrealized loss on cash flow hedges, net of reclassification of $3.1 million of net gains included in net income				(658)				(658)
Total comprehensive income								89,117
Issuance of shares for stock options		1	(5,279)				14,293	9,015
Restricted stock grants	172,620	171	7,553			(7,724)		
Amortization of restricted stock grants						129		129
Tax benefit from stock options			1,601					1,601
Cash dividends					(19,914)			(19,914)
Repurchased shares, net							(45,217)	(45,217)
Balance, June 30, 2003	50,455,363	$ 50,455	$ 404,741	$ 39,781	$ 745,017	$ (7,595)	$ (87,709)	$ 1,144,690
Balance, December 31, 2003	50,459,716	$ 50,460	$ 401,233	$ 12,903	$ 814,591	$ (6,699)	$ (53,232)	$ 1,219,256
Net income					103,098			103,098
Other comprehensive income net of tax								
Net unrealized loss on securities available-for-sale, net of relassification adjustment of $0.8 million of net gains included in net income				(47,789)				(47,789)
Net unrealized loss on cash flow hedges, net of reclassification of $2.8 million of net gains included in net income				(3,532)				(3,532)
Total comprehensive income								51,777

Issuance of shares for stock options			(8,283)				31,220	22,937
Restricted stock grants	118,540	118	7,791			(7,909)		
Amortization of restricted stock grants						1,265		1,265
Tax benefit from stock options			7,722					7,722
Cash dividends					(31,322)			(31,322)
Repurchased shares, net							(43,826)	(43,826)
Balances, June 30, 2004	50,578,256	$ 50,578	$ 408,463	$ (38,418)	$ 886,367	$ (13,343)	$ (65,838)	$ 1,227,809

See accompanying Notes to Consolidated Financial Statements.

CITY NATIONAL CORPORATION

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. City National Corporation (the Corporation) is the holding company for City National Bank (the Bank). In light of the fact that the Bank comprises substantially all of the business of the Corporation, references to the Company mean the Corporation and the Bank together.

2. The results of operations reflect the interim adjustments, all of which are of a normal recurring nature and which, in the opinion of management, are necessary for a fair presentation of the results for the interim period presented. These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements included in the Corporation s Annual Report on Form 10-K for the year ended December 31, 2003. The results for the 2004 interim periods are not necessarily indicative of the results expected for the full year.

3. Trading account securities are stated at market value. Investments not classified as trading securities are classified as securities available-for-sale and recorded at fair value. Unrealized holding gains or losses for securities available-for-sale, net of taxes are excluded from net income and are reported as other comprehensive income included as a separate component of shareholders equity.

4. Certain prior periods data have been reclassified to conform to current period presentation.

5. Reserves established as purchase price adjustments for the February 29, 2000 acquisition of The Pacific Bank N.A. and for the February 28, 2002 acquisition of Civic BanCorp of $0.6 million for exit costs relating to surplus space remain as of June 30, 2004.

6. The following table provides information about purchases by the Company during the quarter ended June 30, 2004 of equity securities that are registered by the Company pursuant to Section 12 of the Exchange Act.

Period	Total Number of Shares (or Units) Purchased	Average Price Paid per Share (or Unit)	Total number of Shares (or Units) Purchased as Part of Publicly Announced Plans	Maximum Number of Shares that May Yet Be Purchased Under the Plans

				or Programs	or Programs
04/01/04 - 04/30/04	2,752	$	60.81		1,016,900
05/01/04 - 05/31/04	7,949		60.07	7,400	1,009,500(2)
	10,701(1)	$	60.26	7,400	1,009,500

(1) We repurchased an aggregate of 7,400 shares of our common stock pursuant to a repurchase program that we publicly announced on July 15, 2003 (the Program) and we received 3,301 shares in payment of the exercise price of stock options.

(2) Our board of directors, on March 24, 2004, approved the repurchase by us of up to an aggregate of 1 million shares of our common stock pursuant to a new program to follow completion of the Program described in (1) above. Unless terminated earlier by resolution of our board of directors, the Programs will expire when we have repurchased all shares authorized for repurchase thereunder.

Basic earnings per share is based on the weighted average shares of common stock outstanding less unvested restricted shares and units. Diluted earnings per share gives effect to all dilutive potential common shares which consists of stock options and restricted shares and units that were outstanding during the period. At June 30, 2004, no stock options were antidilutive compared with 1,189,835 antidilutive stock options at June 30, 2003.

7. The Company applies APB Opinion No. 25 in accounting for stock option plans and, accordingly, no compensation cost has been recognized for its plans in the financial statements. As a practice, the Corporation s stock option grants are such that the exercise price equals the current market price of the common stock. Had the Company determined compensation cost based on the fair value at the grant date for its stock options under

SFAS No. 123 using the Black Scholes option-pricing model, the Company s proforma net income would have been reduced to the proforma amounts indicated below:

Dollars in thousands, except for per share amounts	For the three months ended June 30, 2004	For the three months ended June 30, 2003	For the six months ended June 30, 2004	For the six months ended June 30, 2003
Net income, as reported	$ 52,200	$ 46,081	$ 103,098	$ 89,736
Proforma net income	51,387	44,529	101,562	86,717
Net income per share, basic, as reported	1.07	0.95	2.11	1.85
Proforma net income per share, basic	1.05	0.92	2.08	1.79
Net income per share, diluted, as reported	1.03	0.93	2.03	1.80
Proforma net income per share, diluted	1.01	0.90	2.00	1.74
Percentage reduction in net income per share, diluted	1.94%	3.23%	1.48%	3.33%

During the latter part of the second quarter of 2003, stock-based compensation performance awards for 2002 were granted to colleagues of the Company. These performance awards for the first time included restricted stock grants with fewer stock options, which reduced the total number of shares awarded but better aligned the interests of shareholders and colleagues. The number of shares awarded was further reduced in 2004 for stock-based compensation performance awards for 2003 when the Company took into consideration changes in the value of the Company s stock price when determining share awards. The 2004 percentage reduction in net income per share, diluted is lower because a fewer number of stock options have been awarded with a portion replaced by restricted stock awards, the cost of which is charged to noninterest expense. The Company recorded $757,000 in expense for restricted stock awards in the second quarter of 2004 and $1,265,000 for the first six months of 2004 compared with $129,000 and $129,000 for the quarter and first six months of 2003. There was no expense for restricted stock awards in the first quarter of 2003 since the first grant was not until June 2003.

The Black Scholes option-pricing model requires assumptions on expected life of the options that is based upon the pattern of exercise of options granted by the Corporation in the past; volatility based on changes in the price of the Corporation s common stock during the past 10 years, measured monthly; dividend yield and risk-free investment rate. Actual dividend payments will depend upon a number of factors, including future financial results, and may differ substantially from the assumption. The risk-free investment rate is based on the yield on 10-year U.S. Treasury Notes on the grant date.

The actual value, if any, which a grantee may realize will depend upon the difference between the option exercise price and the market price of the Corporation s common stock on the date of exercise.

8. On April 1, 2003, the Corporation acquired Convergent Capital Management LLC, a privately held Chicago-based company, and substantially all of its asset management holdings, including its majority ownership interests in eight asset management firms and minority interests in two additional firms. Combined, these 10 firms manage assets of approximately $8.9 billion as of June 30, 2004. The purchase price was $49.0 million, comprised of cash and the assumption of approximately $7.5 million of debt. The acquisition resulted in $25.8 million in customer contract intangibles, which are being amortized over 20 years, and $21.5 million in goodwill.

9. As previously reported, the California Franchise Tax Board (FTB) has taken the position that certain REIT and registered investment company (RIC) tax deductions will be disallowed consistent with notices issued by the State of California that stipulate that the RIC and REIT are listed transactions under California tax shelter legislation. While management continues to believe that the tax benefits realized in previous years were appropriate, the Company deemed it prudent to participate in the statutory Voluntary Compliance Initiative-Option 2, requiring payment of all California taxes and interest on these disputed 2000 through 2002 tax benefits, and permitting the Company to claim a refund for these years while avoiding certain potential penalties. The Company retains potential exposure for assertion of an accuracy-rated penalty should the FTB prevail in its position, in addition to the risk of not being successful in its refund claims for taxes and interest. As of June 30, 2004, the Company reflected a $36.4 million net state tax receivable for the years 2000, 2001 and 2002 after giving effect to reserves for loss contingencies on the refund claims, or an equivalent of $23.7 million after giving effect to Federal tax benefits. Although management intends to aggressively pursue its claims for REIT and RIC refunds for the 2000 to 2003 tax years, no outcome can be predicted with certainty and an adverse outcome on the refund claims could result in a loss of all or a portion of the $23.7 million net state tax receivable after giving effect to Federal tax benefits.

CITY NATIONAL CORPORATION

FINANCIAL HIGHLIGHTS

(Unaudited)

Dollars in thousands, except per share amounts	At or for the three months ended June 30, 2004	March 31, 2004	June 30, 2003	Percentage change June 30, 2004 from March 31, 2004	June 30, 2003
For The Quarter					
Net income	$ 52,200	$ 50,898	$ 46,081	3%	13%
Net income per common share, diluted	1.03	1.00	0.93	3	11
Dividends, per common share	0.320	0.320	0.205	0	56
At Quarter End					
Assets	$ 13,473,900	$ 13,220,524	$ 12,354,833	2	9
Deposits	11,454,919	11,134,677	10,166,806	3	13
Loans	8,125,496	7,967,639	7,590,226	2	7
Securities	3,518,757	3,612,173	2,992,686	(3)	18
Shareholders equity	1,227,809	1,239,930	1,144,690	(1)	7
Book value per share	25.05	25.54	23.77	(2)	5
Average Balances					
Assets	$ 13,211,551	$ 12,606,754	$ 11,914,869	5	11
Deposits	11,121,541	10,533,471	9,774,905	6	14
Loans	8,053,916	7,886,333	7,793,863	2	3
Securities	3,600,997	3,462,547	2,873,831	4	25
Shareholders equity	1,230,167	1,222,017	1,131,682	1	9
Selected Ratios					
Return on average assets	1.59%	1.62%	1.55%	(2)	3
Return on average shareholders equity	17.07	16.75	16.33	2	5
Corporation s tier 1 leverage	7.69	7.61	7.17	1	7
Corporation s tier 1 risk-based capital	11.11	10.67	10.21	4	9
Corporation s total risk-based capital	14.81	14.43	14.45	3	2
Average shareholders equity to average assets	9.31	9.69	9.50	(4)	(2)
Dividend payout ratio, per share	30.06	30.71	21.51	(2)	40
Net interest margin	4.49	4.66	4.79	(4)	(6)
Efficiency ratio *	52.72	53.39	52.53	(1)	0
Asset Quality Ratios					
Nonaccrual loans to total loans	0.51%	0.54%	0.91%	(6)	(44)
Nonaccrual loans and ORE to toal loans and ORE	0.51	0.54	0.92	(6)	(45)
Allowance for credit losses to total loans	2.03	2.07	2.25	(2)	(10)
Allowance for credit losses to nonaccrual loans	394.71	386.29	246.37	2	60
		(0.05)	(0.52)	(100)	(100)

Net charge-offs to average loans - annualized	

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* The efficiency ratio is defined as noninterest expense excluding ORE expense divided by total revenue (net interest income on a tax-equivalent basis and noninterest income).

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

See Cautionary Statement for Purposes of the Safe Harbor Provisions of the Private Securities Litigation Reform Act of 1995, below relating to forward-looking statements included in this report.

RESULTS OF OPERATIONS

Critical Accounting Policies

The Company s accounting policies are fundamental to understanding management s discussion and analysis of results of operations and financial condition. The Company has identified four policies as being critical because they require management to make particularly difficult, subjective and/or complex judgments about matters that are inherently uncertain and because of the likelihood that materially different amounts would be reported under different conditions or using different assumptions. These policies relate to the accounting for securities, the allowance for credit losses, derivatives and hedging activities, and stock-based performance plans. The Company, in consultation with the Audit Committee, has reviewed and approved these critical accounting policies, which are further described in Management s Discussion and Analysis and Note 1 (Summary of Significant Accounting Policies) to the Consolidated Financial Statements in the Company s 2003 Form 10-K. There have been no material changes to the Company s accounting policies since the last reporting period.

Overview

The Corporation recorded net income of $52.2 million, or $1.03 per common share, for the second quarter of 2004, compared with net income of $46.1 million, or $0.93 per share, for the second quarter of 2003.

Highlights

Average deposits were up 14 percent with average core deposits up 18 percent for the second quarter of 2004 from the second quarter a year ago due to growth throughout the bank.

Second-quarter average loans surpassed $8.0 billion for the first time, up 3 percent from the same period last year. Period-end loan balances at June 30, 2004 of $8.1 billion increased $242.8 million, or 3 percent from $7.9 billion at December 31, 2003 net of payoffs of $98.7 million in dairy loans as a result of the Company exiting this industry as previously announced.

No provision for credit losses was recorded for the second quarter of 2004, a result of continued strong credit quality and an adequate current level of allowance for credit losses. Recoveries slightly exceeded charge-offs for the quarter. Nonaccrual loans as of June 30, 2004, were $41.8 million, down 40 percent from June 30, 2003, and down 2 percent from March 31, 2004.

Average securities for the second quarter of 2004 were up 25 percent from the same period a year ago due to deposit growth outpacing loan growth. Second-quarter average securities were up 4 percent from the first quarter of 2004 but period-end securities declined $104.1 million from March 31, 2004 to June 30, 2004.

Noninterest income for the second quarter of 2004 rose 7 percent over the same period a year ago due primarily to higher trust and investment fees.

Dollars in millions, except per share	For the three months ended June 30, 2004	2003	% Change	For the three months ended March 31, 2004	% Change
Earnings Per Share	$ 1.03	$ 0.93	11	$ 1.00	3
Net Income	52.2	46.1	13	50.9	3
Average Assets	13,211.6	11,914.9	11	12,606.8	5
Return on Average Assets	1.59%	1.55%	3	1.62%	(2)
Return on Average Equity	17.07	16.33	5	16.75	2

As previously disclosed, in 2004 the Company is continuing its practice, adopted in the fourth quarter of 2003, of not recognizing tax benefits associated with its real estate investment trusts (REITS). Second-quarter 2003 results included $2.7 million in net income, or $0.05 per share, from tax benefits of the Company s two REITS.

Outlook

As disclosed in the Company s press release on second-quarter earnings, management continues to expect the growth of net income per share for 2004 to be approximately 8 to 10 percent higher than net income per share for 2003. This is based on current economic conditions and the current outlook for the remainder of 2004, the 25 basis point increase in interest rates effective June 30, 2004, and the updated business indicators below:

Average loan growth	4 to 6 percent
Average deposit growth	7 to 10 percent
Net interest margin	4.50 to 4.70 percent
Provision for credit losses	$0 million to $10 million
Noninterest income growth	6 to 8 percent
Noninterest expense growth	6 to 8 percent
Effective tax rate	36 to 38 percent

Revenues

Revenues (net interest income plus noninterest income) for the second quarter of 2004 increased 5 percent to $180.5 million compared with $172.2 million for the second quarter of 2003 due to higher net interest income and trust and investment fees. Revenues were up 2 percent from the first quarter of 2004.

Net Interest Income

Fully taxable-equivalent net interest income for the second quarter of 2004 was $135.6 million, compared with $130.8 million for the second quarter of 2003 and $134.3 million for the first quarter of 2004. The net interest margin was 17 basis points lower than the first quarter of 2004 due primarily to investing in lower yielding, shorter term securities.

Dollars in millions	For the three months ended June 30, 2004	2003	% Change	For the three months ended March 31, 2004	% Change
Average Loans	$ 8,053.9	$ 7,793.9	3	$ 7,886.3	2
Average Securities	3,601.0	2,873.8	25	3,462.5	4
Average Deposits	11,121.5	9,774.9	14	10,533.5	6
Average Core Deposits	10,310.7	8,763.1	18	9,621.2	7
Fully Taxable-Equivalent Net Interest Income	135.6	130.8	4	134.3	1
Net Interest Margin	4.49%	4.79%	(6)	4.66%	(4)

Compared with the prior-year second-quarter averages, equity lines of credit rose 19 percent, residential mortgage loans rose 18 percent, commercial real estate mortgage loans rose 4 percent, real estate construction loans rose 15 percent, and commercial loans decreased 8 percent partially due to payoffs of dairy loans. Compared with the prior quarter, all categories increased except commercial loans.

Period-end June 30, 2004 loans increased $157.9 million from March 31, 2004, reflecting growth in residential mortgage, commercial real estate mortgage, and real estate construction loans.

Average securities increased 25 percent for the second quarter of 2004 compared with the same period for 2003 primarily due to deposit growth outpacing loan growth. Average securities were 4 percent higher than the first quarter of 2004. As of June 30, 2004, unrealized net loss on securities available-for-sale was $67.4 million. The average duration of total available-for-sale securities at June 30, 2004 was 3.8 years compared with 3.4 years at December 31, 2003 and 2.3 years at June 30, 2003. The increase in duration is attributable to an increase in long and medium term interest rates.

Average deposits during the second quarter of 2004 increased 14 percent over the same period last year and were up 6 percent from the first quarter of 2004. Average core deposits represented 93 percent of the total average deposit base for the second quarter of 2004, compared with 90 percent for the second quarter of 2003 and 91 percent for the first quarter of 2004. New clients and higher client balances maintained as deposits to pay for services contributed to the year-over-year growth of deposits.

As part of the Company s long-standing asset/liability management strategy, its plain vanilla interest rate swaps hedging loans, deposits and borrowings, with a notional value of $1.1 billion, added $8.0 million to net interest income in the second quarter of 2004, compared with $7.5 million in the second quarter of 2003 and $8.3 million in the first quarter of 2004. These amounts included $5.5 million, $5.2 million, and $6.0 million, respectively, for interest rate swaps qualifying as fair value hedges. Income from swaps qualifying as cash-flow hedges was $2.5 million for the second quarter of 2004, compared with $2.3 million for the second quarter of 2003, and $2.3 million for the first quarter of 2004. Income from existing swaps qualifying as cash-flow hedges of loans expected to be recorded in net interest income within the next 12 months is $3.4 million.

Interest recovered on nonaccrual and charged-off loans included in net interest income for the second quarter of 2004 was $0.3 million, compared with $0.4 million for the second quarter of 2003, and $0.7 million for the first quarter of 2004.

The Bank s prime rate was 4.25 percent as of June 30, 2004, an increase of 25 basis points over last year. However, the increase became effective on June 30, 2004 and did not impact 2004 second-quarter results.

The following table presents the components of net interest income on a fully taxable-equivalent basis for the three and six months ended June 30, 2004 and 2003. To compare the tax-exempt asset yields to taxable yields, amounts are adjusted to pre-tax equivalents based on the marginal corporate federal tax rate of 35 percent.

Net Interest Income Summary

	For the three months ended June 30, 2004			For the three months ended June 30, 2003		
Dollars in thousands	**Average Balance**	**Interest income/ expense (2)**	**Average interest rate**	**Average Balance**	**Interest income/ expense (2)**	**Average interest rate**
Assets						
Interest-earning assets						
Loans						
Commercial	$ 3,130,129	$ 38,954	5.01%	$ 3,402,342	$ 44,309	5.22%
Commercial real estate mortgages	1,813,126	27,456	6.09	1,736,168	29,268	6.76
Residential mortgages	2,036,426	27,414	5.41	1,733,015	26,737	6.19
Real estate construction	779,349	9,880	5.10	679,541	8,903	5.25
Equity lines of credit	203,647	2,300	4.54	170,827	2,029	4.76
Installment	91,239	1,620	7.14	71,970	1,409	7.85
Total loans(1)	8,053,916	107,624	5.37	7,793,863	112,655	5.80
Due from banks - interest bearing	42,961	92	0.86	26,954	35	0.52
Securities available-for-sale	3,568,919	39,671	4.47	2,844,001	34,440	4.86
Federal funds sold and securities purchased under resale agreements	439,402	1,116	1.02	246,559	771	1.25
Trading account securities	32,078	38	0.48	29,830	62	0.83
Total interest-earning assets	12,137,276	148,541	4.92	10,941,207	147,963	5.42
Allowance for credit losses	(167,184)			(174,270)		
Cash and due from banks	445,898			429,788		
Other nonearning assets	795,561			718,144		
Total assets	$ 13,211,551			$ 11,914,869		
Liabilities and Shareholders Equity						
Interest-bearing deposits						
Interest checking accounts	$ 824,567	174	0.08	$ 711,609	304	0.17
Money market accounts	3,648,952	6,163	0.68	3,097,697	7,257	0.94
Savings deposits	212,559	143	0.27	205,378	239	0.47
Time deposits - under $100,000	193,624	667	1.39	212,060	931	1.76
Time deposits - $100,000 and over	810,830	2,691	1.33	1,011,850	3,817	1.51
Total interest - bearing deposits	5,690,532	9,838	0.70	5,238,594	12,548	0.96
Federal funds purchased and securities sold under repurchase agreements	121,903	269	0.89	146,000	414	1.14
Other borrowings	589,991	2,796	1.91	709,391	4,247	2.40
Total interest - bearing liabilities	6,402,426	12,903	0.81	6,093,985	17,209	1.13
Noninterest - bearing deposits	5,431,009			4,536,311		
Other liabilities	147,949			152,891		
Shareholders equity	1,230,167			1,131,682		
Total liabilities and shareholders equity	$ 13,211,551			$ 11,914,869		
Net interest spread			4.11%			4.29%
Fully taxable-equivalent net interest income		$ 135,638			$ 130,754	
Net interest margin			4.49%			4.79%

(1) Includes average nonaccrual loans of $41,187 and $79,818 for 2004 and 2003, respectively.

(2) Loan income includes loan fees of $5,025 and $5,620 for 2004 and 2003, respectively.

Net Interest Income Summary

Dollars in thousands	For the six months ended June 30, 2004 Average Balance	Interest income/ expense (2)	Average interest rate	For the six months ended June 30, 2003 Average Balance	Interest income/ expense (2)	Average interest rate
Assets						
Interest-earning assets						
Loans						
Commercial	$ 3,151,138	$ 79,096	5.05%	$ 3,480,938	$ 91,499	5.30%
Commercial real estate mortgages	1,810,337	55,473	6.16	1,737,889	58,944	6.84
Residential mortgages	1,994,365	54,215	5.47	1,744,861	54,901	6.35
Real estate construction	728,914	18,451	5.09	671,791	17,743	5.33
Equity lines of credit	198,916	4,497	4.55	169,881	4,005	4.75
Installment	86,453	3,052	7.10	73,267	2,909	8.01
Total loans(1)	7,970,123	214,784	5.42	7,878,627	230,001	5.89
Due from banks - interest bearing	60,655	232	0.77	26,891	84	0.63
Securities available-for-sale	3,500,655	79,061	4.54	2,616,060	65,900	5.08
Federal funds sold and securities purchased under resale agreements	307,025	1,548	1.01	190,088	1,182	1.25
Trading account securities	31,117	77	0.50	29,610	114	0.78
Total interest-earning assets	11,869,575	295,702	5.01	10,741,276	297,281	5.58
Allowance for credit losses	(166,922)			(171,860)		
Cash and due from banks	446,559			435,402		
Other nonearning assets	759,939			694,130		
Total assets	$ 12,909,151			$ 11,698,948		
Liabilities and Shareholders Equity						
Interest-bearing deposits						
Interest checking accounts	$ 813,573	340	0.08	$ 693,311	641	0.19
Money market accounts	3,527,490	11,982	0.68	3,043,562	14,830	0.98
Savings deposits	216,136	276	0.26	201,856	501	0.50
Time deposits - under $100,000	195,642	1,378	1.42	213,865	1,941	1.83
Time deposits - $100,000 and over	861,573	5,614	1.31	1,029,504	8,109	1.59
Total interest - bearing deposits	5,614,414	19,590	0.70	5,182,098	26,022	1.01
Federal funds purchased and securities sold under repurchase agreements	116,834	513	0.88	182,556	1,039	1.15
Other borrowings	584,489	5,625	1.94	662,676	7,607	2.31
Total interest - bearing liabilities	6,315,737	25,728	0.82	6,027,330	34,668	1.16
Noninterest - bearing deposits	5,213,094			4,393,383		
Other liabilities	154,228			153,568		
Shareholders equity	1,226,092			1,124,667		
Total liabilities and shareholders equity	$ 12,909,151			$ 11,698,948		
Net interest spread			4.19%			4.42%
Fully taxable-equivalent net interest income		$ 269,974			$ 262,613	
Net interest margin			4.57%			4.93%

(1) Includes average nonaccrual loans of $41,233 and $81,428 for 2004 and 2003, respectively.

(2) Loan income includes loan fees of $10,353 and $11,048 for 2004 and 2003, respectively.

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Net interest income is impacted by the volume, mix, and rate of interest-earning assets and interest-bearing liabilities. The following table shows changes in net interest income on a fully taxable-equivalent basis between the second quarter and first six months of 2004 and the second quarter and first six months of 2003, as well as between the second quarter and first six months of 2003 and the second quarter and first six months of 2002.

Changes In Net Interest Income

	For the three months ended June 30, 2004 vs 2003			For the three months ended June 30, 2003 vs 2002		
	Increase (decrease) due to		Net	Increase (decrease) due to		Net
Dollars in thousands	**Volume**	**Rate**	**increase (decrease)**	**Volume**	**Rate**	**increase (decrease)**
Interest earned on:						
Loans	$ 3,618	$ (8,649)	$ (5,031)	$ (1,542)	$ (14,116)	$ (15,658)
Due from banks - interest bearing	27	30	57	17	(66)	(49)
Securities available-for-sale	8,179	(2,948)	5,231	11,282	(6,921)	4,361
Federal funds sold and securities purchased under resale agreements	508	(163)	345	358	(291)	67
Trading account securities	5	(29)	(24)	6	(44)	(38)
Total interest-earning assets	12,337	(11,759)	578	10,121	(21,438)	(11,317)
Interest paid on:						
Interest checking deposits	44	(174)	(130)	51	(152)	(101)
Money market deposits	1,142	(2,236)	(1,094)	2,126	(3,381)	(1,255)
Savings deposits	8	(104)	(96)	(49)	(216)	(265)
Other time deposits	(777)	(613)	(1,390)	(1,572)	(2,427)	(3,999)
Other borrowings	(707)	(889)	(1,596)	(2,018)	(90)	(2,108)
Total interest-bearing liabilities	(290)	(4,016)	(4,306)	(1,462)	(6,266)	(7,728)
	$ 12,627	$ (7,743)	$ 4,884	$ 11,583	$ (15,172)	$ (3,589)

	For the six months ended June 30, 2004 vs 2003			For the six months ended June 30, 2003 vs 2002		
	Increase (decrease) due to		Net	Increase (decrease) due to		Net
Dollars in thousands	**Volume**	**Rate**	**increase (decrease)**	**Volume**	**Rate**	**increase (decrease)**
Interest earned on:						
Loans	$ 2,739	$ (17,956)	$ (15,217)	$ 6,383	$ (26,881)	$ (20,498)
Due from banks - interest bearing	126	22	148	22	(100)	(78)
Securities	20,686	(7,525)	13,161	18,756	(12,089)	6,667
Federal funds sold and securities purchased under resale agreements	624	(258)	366	371	(400)	(29)
Trading account securities	6	(43)	(37)	(14)	(102)	(116)
Total interest-earning assets	24,181	(25,760)	(1,579)	25,518	(39,572)	(14,054)
Interest paid on:						
Interest checking deposits	105	(406)	(301)	112	(229)	(117)
Money market deposits	2,126	(4,974)	(2,848)	4,703	(6,132)	(1,429)

Savings deposits	33	(258)	(225)	(159)	(571)	(730)
Other time deposits	(1,374)	(1,684)	(3,058)	(3,289)	(5,524)	(8,813)
Other borrowings	(1,354)	(1,154)	(2,508)	(4,650)	(1,193)	(5,843)
Total interest-bearing liabilities	(464)	(8,476)	(8,940)	(3,283)	(13,649)	(16,932)
	$ 24,645	$ (17,284)	$ 7,361	$ 28,801	$ (25,923)	$ 2,878

The impact of interest rate swaps, which increases loan interest income and reduces deposit and borrowing interest expense, is included in rate changes.

Provision for Credit Losses

The Company made no provision for credit losses in the second quarter of 2004. This was attributable to the continued strong credit quality of its portfolio, low level of net charge-offs, and management s ongoing assessment of the credit quality of the portfolio, modest loan growth and an improving economic environment. Management believes the allowance for credit losses is adequate to cover risks in the portfolio at June 30, 2004. See — Allowance for Credit Losses.

Noninterest Income

Second-quarter 2004 noninterest income was 7 percent higher than the second quarter of 2003 and 4 percent higher than the first quarter of 2004 due primarily to higher trust and investment fees. As a percentage of total revenues, noninterest income was 27 percent for the second quarter of 2004, compared with 26 percent for both the second quarter of 2003 and the first quarter of 2004.

Wealth Management

Dollars in millions	At or for the three months ended June 30, 2004	2003	% Change	At or for the three months ended March 31, 2004	% Change
Trust and Investment Fee Revenue	$ 16.7	$ 12.2	37	$ 15.6	7
Brokerage and Mutual Fund Fees	9.4	9.3	1	8.7	7
Assets Under Administration	31,749.9	26,237.3	21	30,532.3	4
Assets Under Management (1)(2)	14,567.2	12,531.3	16	14,339.3	2

(1) Included above in assets under administration

(2) Excludes $3,275 and $3,591 million of assets under management for the CCM minority owned asset managers as of June 30, 2004 and March 31, 2004, respectively

Assets under management at June 30, 2004 increased from the same period last year primarily due to new business, aided by strong relative investment performance and higher market values. Trust and investment fees increased over the second quarter of 2003 primarily due to higher balances under management or administration. Increases in market values are reflected in fee income primarily on a trailing-quarter basis. Brokerage and mutual fund fees in the second quarter increased over the first quarter of 2004 due in part to fees recognized as a co-manager of the California Economic Recovery Bond and a participant in the Puerto Rico Commonwealth General Obligation Bond issues.

Other Noninterest Income

Cash management and deposit transaction fees increased 1 percent for the second quarter of 2004 over the same quarter last year. Compared with the first quarter of 2004, second-quarter 2004 cash management and deposit transaction fees decreased 1 percent due to annual fees recognized in arrears having been recorded in the first quarter of 2004.

International service fees for the second quarter of 2004 were essentially unchanged over the prior year quarter and decreased 2 percent from the first quarter of 2004 primarily due to lower import letters of credit fees.

Second-quarter 2004 other income was 17 percent lower than the second quarter of 2003 primarily due to lower loan product fees and 2 percent higher than the first quarter of 2004.

For the second quarter of 2004, $0.9 million in gains on the sale of loans, assets, and debt repurchase and gains on the sale of securities were realized, compared to $1.3 million for the second quarter of 2003 and $0.6 million for the first quarter of 2004.

Noninterest Expense

Second-quarter 2004 noninterest expense of $95.7 million was up 5 percent compared to $91.3 million for the second quarter of 2003 and up 1 percent from $94.5 million for the first quarter of 2004. The year-over-year increase primarily relates to higher staff cost including base salaries, incentives, and benefit costs including restricted stock costs. Restricted stock awards continue to replace a portion of the stock option grants that are part of the Company s equity compensation program.

For the second quarter of 2004, the efficiency ratio was 52.72 percent compared with 52.53 percent for the second quarter of 2003, and 53.39 percent for the first quarter of 2004.

Minority Interest

Minority interest consists of preferred stock dividends on the Bank s real estate investment trust subsidiaries and the minority ownership share of earnings of the Corporation s majority owned asset management firms.

Income Taxes

The second-quarter 2004 effective tax rate was 37.5 percent, compared with 36.6 percent for all of 2003. The effective tax rate reflects changes in the mix of tax rates applicable to income before tax. Quarterly comparisons with the first three quarters of 2003 were impacted by the real estate investment trust (REIT) state tax benefits which were included in net income in the first three quarters of 2003 and were reversed in the fourth quarter of 2003.

The effective tax rates differ from the applicable statutory federal tax rate due to various factors, including state taxes, tax-exempt income including interest on bank-owned life insurance, and affordable housing investments.

The Company s tax returns are being audited by the Internal Revenue Service back to 1998 and by the Franchise Tax Board of the State of California back to 1996. From time to time, there may be differences in opinions with respect to the tax treatment accorded transactions. If it becomes probable that a tax position originally taken to support amounts reported on the financial statements will not be sustained upon a challenge from a tax authority and the tax effect of this difference is reasonably estimable, such amounts will be recognized.

As previously reported, the California Franchise Tax Board (FTB) has taken the position that certain REIT and registered investment company (RIC) tax deductions will be disallowed consistent with notices issued by the State of California that stipulate that the RIC and REIT are listed transactions under California tax shelter legislation. While management continues to believe that the tax benefits realized in previous years were appropriate, the Company deemed it prudent to participate in the statutory Voluntary Compliance Initiative Option 2, requiring payment of all California taxes and interest on these disputed 2000 through 2002 tax benefits, and permitting the Company to claim a refund for these years while avoiding certain potential penalties. The Company retains potential exposure for assertion of an accuracy-rated penalty should the FTB prevail in its position, in addition to the risk of not being successful in its refund claims for taxes and interest. As of June 30, 2004, the Company reflected a $36.4 million net state tax receivable for the years 2000, 2001 and 2002 after giving effect to reserves for loss contingencies on the refund claims, or an equivalent of $23.7 million after giving effect to Federal tax benefits. Although management intends to aggressively pursue its claims for REIT and RIC refunds for the 2000 to 2003 tax years, no outcome can be predicted with certainty and an adverse outcome on the refund claims could result in a loss of all or a portion of the $23.7 million net state tax receivable after giving effect to Federal tax benefits.

BALANCE SHEET ANALYSIS

Average assets for the second quarter of 2004 were higher than the second quarter of 2003, primarily due to an increase in average securities, loans, and federal funds sold. Total assets at June 30, 2004 increased 9 percent to $13.5 billion from $12.4 billion at June 30, 2003, and increased 4 percent from $13.0 billion at December 31, 2003.

Total average interest-earning assets for the second quarter of 2004 were $12.1 billion, an increase of 11 percent over the $10.9 billion in total average interest-earning assets for the second quarter of 2003 and were 5 percent higher than the $11.6 billion in average interest-earning assets for the first quarter of 2004.

Securities

Comparative period-end security portfolio balances are presented below:

Securities Available-for-Sale

Dollars in thousands	June 30, 2004 Cost	June 30, 2004 Fair Value	December 31, 2003 Cost	December 31, 2003 Fair Value	June 30, 2003 Cost	June 30, 2003 Fair Value
U.S. Government and federal agency	$ 354,628	$ 350,169	$ 345,725	$ 348,468	$ 238,343	$ 242,288
Mortgage-backed	2,765,606	2,702,740	2,561,976	2,561,997	2,257,765	2,292,818
State and Municipal	271,568	276,178	255,355	268,041	246,751	263,121
Total debt securities	3,391,802	3,329,087	3,163,056	3,178,506	2,742,859	2,798,227
Marketable equity securities	194,383	189,670	187,576	187,148	192,542	194,459
Total securities	$ 3,586,185	$ 3,518,757	$ 3,350,632	$ 3,365,654	$ 2,935,401	$ 2,992,686

Average securities available-for-sale continued to increase primarily due to strong deposit growth. At June 30, 2004, securities available-for-sale totaled $3.5 billion, an increase of $0.5 billion compared with holdings at June 30, 2003 and an increase of $0.2 billion from December 31, 2003. At June 30, 2004, the portfolio had an unrealized net loss of $67.4 million compared with unrealized net gain of $15.0 million and $57.3 million at December 31, 2003 and June 30, 2003, respectively. The average duration of total available-for-sale securities at June 30, 2004 was 3.8 years. The 3.8 duration compares with 3.4 at December 31, 2003 and 2.3 at June 30, 2003. Duration provides a measure of fair value sensitivity to changes in interest rates. This is within the investment guidelines set by the Company s Asset/Liability Committee and the interest rate risk guidelines set by the Board of Directors. See — Asset /Liability Management for a discussion of the Company s interest rate position.

The following table provides the contractual remaining maturities and yields (taxable-equivalent basis) of debt securities within the securities portfolio as of June 30, 2004. Contractual maturities of mortgage-backed securities are substantially longer than their expected maturities due to scheduled and unscheduled principal payments. To compare the tax-exempt asset yields to taxable yields, amounts are adjusted to pre-tax equivalents based on the marginal corporate federal tax rate of 35 percent.

Debt Securities Available-for-Sale

Dollars in thousands	One year or less Amount	One year or less Yield (%)	Over 1 year thru 5 years Amount	Over 1 year thru 5 years Yield (%)	Over 5 years thru 10 years Amount	Over 5 years thru 10 years Yield (%)	Over 10 years Amount	Over 10 years Yield (%)	Total Amount	Total Yield (%)
U.S. Government and federal agency	$ 25,164	4.03	$ 323,968	3.30	$ 1,037	6.17	$		$ 350,169	3.36
Mortgage-backed	171,797	4.21			330,314	4.15	2,200,629	4.57	2,702,740	4.50
State and Municipal	5,734	6.93	109,905	6.73	90,549	6.21	69,990	6.15	276,178	6.42
Total debt securities	$ 202,695	4.26	$ 433,873	4.17	$ 421,900	4.60	$ 2,270,619	4.62	$ 3,329,087	4.54

Amortized cost	$ 204,804	$ 433,652	$ 425,924	$ 2,327,422	$ 3,391,802

Dividend income included in interest income on securities in the Unaudited Consolidated Statement of Income for the second quarter of 2004 and 2003 was $1.9 million and $2.2 million, respectively.

Loan Portfolio

A comparative period-end loan table is presented below:

Loans

Dollars in thousands	**June 30, 2004**	**December 31, 2003**	**June 30, 2003**
Commercial	$ 3,077,689	$ 3,222,444	$ 3,232,780
Commercial real estate mortgages	1,842,956	1,813,518	1,721,650
Residential mortgages	2,114,335	1,937,979	