

COMMERCIAL FEDERAL CORP

Form 10-Q

May 15, 2003

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the Quarterly period ended March 31, 2003

OR

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

Commission file number 1-11515

COMMERCIAL FEDERAL CORPORATION

(Exact name of registrant as specified in its charter)

Nebraska
(State or other jurisdiction of

incorporation or organization)

47-0658852
(I. R. S. Employer

Identification Number)

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13220 California Street, Omaha, Nebraska
(Address of principal executive offices)

68154
(Zip Code)

(402) 554-9200

(Registrant's telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

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 ☒ NO ☐

Indicate by check mark whether the registrant is an accelerated filer as defined in rule 12b-2 of the Securities Exchange Act of 1934. YES ☒ NO ☐

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

<u>Title of Each Class</u>	<u>Outstanding at May 8, 2003</u>
Common Stock, Par Value \$.01 Per Share	44,230,176

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	March 31,	December 31,
(Dollars in Thousands)	2003	2002
	(Unaudited)	(Audited)
ASSETS		
Cash (including short-term investments of \$842 and \$505)	\$ 223,129	\$ 200,581
Investment securities available for sale, at fair value	1,271,810	1,296,050
Mortgage-backed securities available for sale, at fair value	1,588,715	1,632,622
Loans held for sale, net	1,013,067	868,569
Loans receivable, net of allowances of \$108,857 and \$106,148	7,808,986	7,703,016
Federal Home Loan Bank stock	264,028	283,193
Foreclosed real estate	41,316	40,008
Premises and equipment, net	143,904	148,374
Bank owned life insurance	232,262	228,958
Other assets	557,290	495,014
Core value of deposits, net of accumulated amortization of \$62,817 and \$61,268	20,816	22,365
Goodwill	162,717	162,717
Total Assets	\$ 13,328,040	\$ 13,081,467
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Deposits	\$ 6,740,117	\$ 6,439,041
Advances from Federal Home Loan Bank	4,770,335	4,848,997
Other borrowings	569,943	603,306
Other liabilities	489,290	433,602
Total Liabilities	12,569,685	12,324,946
Commitments and Contingencies		
Stockholders' Equity:		
Preferred stock, \$.01 par value; 10,000,000 shares authorized; none issued		
Common stock, \$.01 par value; 120,000,000 shares authorized; 44,808,282 and 45,270,360 shares issued and outstanding	448	453
Additional paid-in capital	51,837	61,712
Retained earnings	816,909	797,778
Accumulated other comprehensive loss, net	(110,839)	(103,422)

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Total Stockholders	Equity	758,355	756,521
Total Liabilities and Stockholders	Equity	\$ 13,328,040	\$ 13,081,467

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents**COMMERCIAL FEDERAL CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENT OF OPERATIONS****(Unaudited)**

(Dollars in Thousands Except Per Share Data)

Three Months Ended

March 31,

2003

2002

Interest Income:

Loans receivable	\$ 142,351	\$ 152,039
Mortgage-backed securities	16,447	26,858
Investment securities	17,576	19,119

Total interest income

176,374 198,016

Interest Expense:

Deposits	39,614	48,804
Advances from Federal Home Loan Bank	56,920	58,894
Other borrowings	5,012	5,735

Total interest expense

101,546 113,433

Net Interest Income

74,828 84,583

Provision for Loan Losses

(7,146) (6,589)

Net Interest Income After Provision for Loan Losses

67,682 77,994

Other Income (Loss):

Retail fees and charges	13,503	12,408
Loan servicing fees, net of amortization	(1,025)	2,836
Mortgage servicing rights valuation adjustment	(13,528)	529
Gain (loss) on sales of securities and changes in fair values of derivatives, net	19,000	(4,843)
Gain on sales of loans	5,480	3,439
Bank owned life insurance	3,304	3,345
Other operating income	5,656	7,876

Total other income

32,390 25,590

Other Expense:

General and administrative expenses		
Compensation and benefits	30,813	28,495
Occupancy and equipment	10,436	9,326
Data processing	4,675	4,434
Advertising	4,130	2,915
Communication	3,414	3,056
Item processing	3,469	3,461
Outside services	2,391	3,638
Foreclosed real estate, net	1,381	1,442
Other operating expenses	5,923	5,799

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Total general and administrative expenses	66,632	62,566
Amortization of core value of deposits	1,549	1,633
Total other expense	68,181	64,199
Income Before Income Taxes	31,891	39,385
Provision for Income Taxes	8,760	11,402
Net Income	\$ 23,131	\$ 27,983

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COMMERCIAL FEDERAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF OPERATIONS (Continued)

(Unaudited)

(Dollars in Thousands Except Per Share Data)	Three Months Ended	
	March 31,	
	2003	2002
Weighted Average Number of Common Shares Outstanding Used in Basic Earnings Per Share Calculation	45,092,714	45,355,667
Add Assumed Exercise of Outstanding Stock Options as Adjustments for Dilutive Securities	328,646	555,035
Weighted Average Number of Common Shares Outstanding Used in Diluted Earnings Per Share Calculation	45,421,360	45,910,702
Basic Earnings Per Common Share	\$.51	\$.62
Diluted Earnings Per Common Share	\$.51	\$.61
Dividends Declared Per Common Share	\$.09	\$.08

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents**COMMERCIAL FEDERAL CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME****(Unaudited)**

(Dollars in Thousands)	Three Months Ended	
	March 31,	
	2003	2002
Net Income	\$ 23,131	\$ 27,983
Other Comprehensive Income (Loss):		
Unrealized holding losses on securities available for sale	(2,447)	(29,894)
Fair value adjustment on interest rate swap agreements	11,603	31,987
Fair value change on interest only strips	(1,024)	(144)
Reclassification of net losses (gains) included in net income pertaining to:		
Securities sold	(20,271)	3,149
Amortization of fair value adjustments on interest rate swap agreements	509	509
Other Comprehensive Income (Loss) Before Income Taxes	(11,630)	5,607
Income Tax Provision (Benefit)	(4,213)	1,765
Other Comprehensive Income (Loss)	(7,417)	3,842
Comprehensive Income	\$ 15,714	\$ 31,825

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents**COMMERCIAL FEDERAL CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENT OF CASH FLOWS****(Unaudited)**

(Dollars in Thousands)	Three Months Ended	
	March 31,	
	2003	2002
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 23,131	\$ 27,983
Adjustments to reconcile net income to net cash provided (used) by operating activities:		
Amortization of core value of deposits	1,549	1,633
Depreciation and amortization	4,994	4,495
Amortization of deferred discounts and fees, net of premiums	9,882	2,486
Amortization of mortgage servicing rights	12,062	6,668
Valuation adjustment of mortgage servicing rights	13,528	(529)
Provision for losses on loans	7,146	6,589
Gain on sales of real estate and loans, net	(5,441)	(3,386)
Gain on sales of securities and changes in fair values of derivatives, net	(19,000)	4,843
Proceeds from sales of loans	1,256,144	624,553
Origination of loans for resale	(447,480)	(233,006)
Purchases of loans for resale	(1,055,862)	(544,340)
Increase in bank owned life insurance, net	(3,304)	(3,352)
Decrease in interest receivable	8,207	2,032
Increase (decrease) in interest payable and other liabilities, net	74,095	(38,480)
Other items, net	(82,755)	(36,179)
Total adjustments	(226,235)	(205,973)
Net cash used by operating activities	(203,104)	(177,990)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of loans	(283,056)	(112,336)
Repayment of loans, net of originations	259,197	366,781
Proceeds from sales of mortgage-backed securities available for sale		18,147
Principal repayments of mortgage-backed securities available for sale	252,988	276,835
Purchases of mortgage-backed securities available for sale	(214,805)	(306,092)
Maturities and principal repayments of investment securities available for sale	6,418	8,490
Proceeds from sales of investment securities available for sale	240,485	122,838
Purchases of investment securities available for sale	(220,650)	(88,576)
Purchase of mortgage servicing rights	(6,758)	
Purchases of Federal Home Loan Bank stock		(2,942)
Proceeds from sales of Federal Home Loan Bank stock	19,165	6,334
Proceeds from sales of real estate	4,697	13,093
Payments to acquire real estate	(184)	(9,490)

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Dispositions (purchases) of premises and equipment, net	(524)	1,035
Other items, net	1,074	(2,731)
Net cash provided by investing activities	58,047	291,386

Table of Contents**COMMERCIAL FEDERAL CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENT OF CASH FLOWS (Continued)****(Unaudited)**

(Dollars in Thousands)	Three Months Ended	
	March 31,	
	2003	2002
CASH FLOWS FROM FINANCING ACTIVITIES		
Increase (decrease) in deposits	\$ 301,076	\$ (114,042)
Proceeds from Federal Home Loan Bank advances	143,975	
Repayments of Federal Home Loan Bank advances	(225,000)	(37,025)
Proceeds from securities sold under agreements to repurchase	3,544	108,075
Repayments of securities sold under agreements to repurchase	(3,350)	(8,118)
Repayments of other borrowings	(33,557)	(79,761)
Purchases of interest rate swap and swaption agreements	(4,782)	(18,175)
Payments of cash dividends on common stock	(4,067)	(3,671)
Repurchases of common stock	(10,274)	(19,474)
Issuance of common stock	40	1,727
Net cash provided (used) by financing activities	167,605	(170,464)
CASH AND CASH EQUIVALENTS		
Increase (decrease) in net cash position	22,548	(57,068)
Balance, beginning of year	200,581	206,765
Balance, end of period	\$ 223,129	\$ 149,697
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid during the period for:		
Interest expense	\$ 98,820	\$ 111,784
Income taxes, net	18,086	12,654
Non-cash investing and financing activities:		
Loans exchanged for mortgage-backed securities	7,009	
Loans transferred to real estate	7,498	2,496

See accompanying Notes to Condensed Consolidated Financial Statements.

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COMMERCIAL FEDERAL CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

AS OF AND FOR THE THREE MONTHS ENDED MARCH 31, 2003

(Unaudited)

(Columnar Dollars in Footnotes are in Thousands Except Per Share Amounts)

A. BASIS OF CONSOLIDATION AND PRESENTATION:

The unaudited condensed consolidated financial statements are prepared on an accrual basis and include the accounts of Commercial Federal Corporation (the Corporation), its wholly-owned subsidiary, Commercial Federal Bank, a Federal Savings Bank (the Bank), and all majority-owned subsidiaries of the Corporation and Bank. All significant intercompany balances and transactions have been eliminated. Certain amounts in the prior year periods have been reclassified for comparative purposes including real estate held for investment totaling \$11,474,000 at December 31, 2002, reclassified from Real Estate to Other Assets in the Consolidated Statement of Financial Condition.

The accompanying interim condensed consolidated financial statements have not been audited by independent auditors. In the opinion of management, all adjustments considered necessary to fairly present the financial statements have been included. The consolidated financial statements should be read in conjunction with the audited financial statements and notes thereto included in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2002. The results of operations for the three months ended March 31, 2003, are not necessarily indicative of the results which may be expected for the entire calendar year 2003.

B. STOCK-BASED COMPENSATION:

The Corporation applies APB Opinion No. 25 Accounting for Stock Issued to Employees, and related Interpretations in accounting for its stock option plans. No compensation cost was recognized for stock options granted, as all stock options granted had an exercise price equal to the market value of the underlying common stock on the date of grant. The effect on the Corporation's net income and earnings per share is presented in the following table as if compensation cost was determined based on the fair value at the grant dates for stock options awarded pursuant to the provisions of Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation.

	Three Months Ended	
	March 31,	
	2003	2002
Net income as reported	\$ 23,131	\$ 27,983

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Deduct total stock-based employee compensation expense determined under the fair value based method for all awards, net of related tax effects

	1,421	1,328
	<u> </u>	<u> </u>
Pro forma net income	\$ 21,710	\$ 26,655
<hr/>		
Earnings per share:		
Basic		
As reported	\$.51	\$.62
Pro forma	.48	.59
Diluted		
As reported	\$.51	\$.61
Pro forma	.48	.59
<hr/>		

The fair value of each option grant was estimated on the date of grant using the Black-Scholes option-pricing model. The Black-Scholes option-pricing model calculates the fair value of stock options awarded based on subjective assumptions. Changes to these assumptions can materially affect the fair value calculation by the model. Therefore, management does not consider these fair value amounts to be a true reflection of the amount of stock based compensation for the Corporation.

Table of Contents**C. MORTGAGE BANKING ACTIVITIES:**

The Corporation services real estate loans for investors that are not included in the accompanying condensed consolidated financial statements. Mortgage servicing rights are established based on the cost of acquiring the right to service mortgage loans or the allocated fair value of servicing rights retained on loans originated by the Bank and subsequently sold in the secondary market. Mortgage servicing rights are included in the Consolidated Statement of Financial Condition under the caption Other Assets. The activity of mortgage servicing rights for the periods indicated and the ending balances of mortgage servicing rights and the respective fair values at the periods ended are summarized as follows:

	Three Months Ended	
	March 31,	
	2003	2002
Beginning balance	\$ 88,353	\$ 114,146
Mortgage servicing rights retained through loan sales	16,753	9,614
Purchase of mortgage servicing rights	6,758	
Amortization expense	(12,062)	(6,668)
Balance before valuation adjustments	99,802	117,092
Valuation adjustments	(13,528)	529
Ending balance	\$ 86,274	\$ 117,621
Fair value at the periods ended	\$ 86,274	\$ 124,841

The Corporation is exposed to interest rate risk relating to the potential decrease in the value of mortgage servicing rights due to increased prepayments on mortgage servicing loans resulting from declining interest rates. As part of its overall strategy to manage the level of exposure to the risk of interest rates adversely affecting the value of mortgage servicing rights, the Corporation uses interest rate floor agreements to protect the fair value of the mortgage servicing rights. These derivatives do not qualify as hedges under Statement of Financial Accounting Standards No. 133 (SFAS No. 133), and therefore, receive a no hedging designation. The fair value gains of the interest rate floor agreements totaled \$10,468,000 and \$1,692,000, respectively, at March 31, 2003 and 2002.

The following compares the key assumptions used in measuring the fair values of mortgage servicing rights at the periods presented:

March 31, 2003		March 31, 2002
Conventional	Governmental	Conventional