

ITLA CAPITAL CORP  
Form 10-Q  
November 09, 2005

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

**FORM 10-Q**

(Mark One)

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

**For the Quarterly Period Ended 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  
(State or Other Jurisdiction of Incorporation or  
Organization)

95-4596322  
(IRS Employer Identification No.)

888 Prospect St., Suite 110, La Jolla,  
California  
(Address of Principal Executive Offices)

92037  
(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

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(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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Exhibit 31.1Exhibit 31.2Exhibit 32**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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**Table of Contents****PART I - FINANCIAL INFORMATION****ITLA CAPITAL CORPORATION AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS**

**September 30,  
2005  
(unaudited)  
(in thousands, except share data)**

**December 31,  
2004**

<b>Assets</b>			
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
<b>Total assets</b>	<b>\$</b>	<b>2,994,869</b>	<b>\$ 2,318,071</b>
<b>Liabilities and Shareholders' Equity</b>			
<b>Liabilities:</b>			
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
<b>Total liabilities</b>		<b>2,795,078</b>	<b>2,123,347</b>
<b>Commitments and contingencies</b>			
<b>Shareholders' equity:</b>			
Preferred stock, 5,000,000 shares authorized, none issued		—	—
Contributed capital - common stock, \$.01 par value; 20,000,000 shares authorized, 8,949,898 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)

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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.

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**Table of Contents****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

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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)**

	<b>For the Nine Months Ended</b>	
	<b>September 30,</b>	
	<b>2005</b>	<b>2004</b>
	<b>(in thousands)</b>	
<b>Cash Flows From Operating Activities:</b>		
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
<b>Net cash provided by operating activities</b>	<b>26,155</b>	<b>28,500</b>
<b>Cash Flows From Investing Activities:</b>		
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)
<b>Net cash used in investing activities</b>	<b>(709,806)</b>	<b>(322,611)</b>
<b>Cash Flows From Financing Activities:</b>		
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)
<b>Net increase in deposit accounts</b>	<b>409,705</b>	<b>89,042</b>

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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,		For the Nine Months Ended September 30,	
	2005	2004	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
<b>For the Three Months Ended September 30, 2005</b>			
Basic EPS	\$ 6,268	5,746	\$ 1.09
Effect of dilutive stock options	—	185	(0.03)

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Diluted EPS	\$	6,268	5,931	\$	1.06
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**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

**Table of Contents****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		Nine Months Ended	
	September 30,		September 30,	
	2005	2004	2005	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:

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

	<b>Lending Operations</b>	<b>All Other</b>	<b>Eliminations</b>	<b>Consolidated</b>
	<b>(in thousands)</b>			
<b>For the three months ended</b>				
<b>September 30,</b>				
<b>2005</b>				
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
<b>2004</b>				
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
<b>For the nine months ended</b>				
<b>September 30,</b>				
<b>2005</b>				
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
<b>2004</b>				
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 policies 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 policies 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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	<b>For the Three Months Ended September 30,</b>					
	<b>2005</b>			<b>2004</b>		
	<b>Average Balance</b>	<b>Income/ Expense</b>	<b>Yield/ Rate</b>	<b>Average Balance</b>	<b>Income/ Expense</b>	<b>Yield/ Rate</b>
	<b>(dollars in thousands)</b>					
<b>Assets</b>						
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		
<b>Liabilities and Shareholders' Equity</b>						
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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	<b>For the Three Months Ended September 30, 2005 and 2004</b>					
	<b>Increase (Decrease) Due to:</b>					
	<b>Rate</b>	<b>Volume</b>	<b>Total</b>			
	<b>(in thousands)</b>					
<b>Interest and fees earned from:</b>						
Cash and investment securities	\$	608	\$	1,792	\$	2,400
Loans		131		15,621		15,752
<b>Total increase in interest income</b>		<b>739</b>		<b>17,413</b>		<b>18,152</b>
<b>Interest paid on:</b>						
Deposit accounts		4,106		4,789		8,895
FHLB advances and other borrowings		1,826		3,465		5,291
Junior subordinated debentures		261		—		261
<b>Total increase in interest expense</b>		<b>6,193</b>		<b>8,254</b>		<b>14,447</b>
<b>Increase (decrease) in net interest income</b>	<b>\$</b>	<b>(5,454)</b>	<b>\$</b>	<b>9,159</b>	<b>\$</b>	<b>3,705</b>

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 charge-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.

	<b>For the Nine Months Ended September 30,</b>					
	<b>Average Balance</b>	<b>2005 Income/ Expense</b>	<b>Yield/ Rate</b>	<b>Average Balance</b>	<b>2004 Income/ Expense</b>	<b>Yield/ Rate</b>
<b>(dollars in thousands)</b>						
<b>Assets</b>						
Cash and investments	\$ 430,250	\$ 13,863	4.31%	\$ 438,168	\$ 5,563	1.70%
Loans receivable:						
Loans	2,119,908	112,103	7.07%	1,518,865	83,321	7.33%
Real estate loans held in trust	29,209	1,296	5.93%	54,176	2,065	5.09%
Total loans receivable	2,149,117	113,399	7.05%	1,573,041	85,386	7.25%
Total interest earning assets	2,579,367	\$ 127,262	6.60%	2,011,209	\$ 90,949	6.04%
Non-interest earning assets	49,474			110,235		
Allowance for loan losses	(36,870)			(34,970)		
Total assets	\$ 2,591,971			\$ 2,086,474		
<b>Liabilities and Shareholders' Equity</b>						
Interest bearing deposit accounts:						
Interest bearing demand	\$ 55,609	\$ 967	2.32%	\$ 72,973	\$ 1,017	1.86%
Money market and passbook	174,153	3,685	2.83%	135,228	1,776	1.75%
Time certificates	1,371,507	32,270	3.15%	971,355	16,838	2.32%

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Total interest bearing deposit accounts	1,601,269	36,922	3.08%	1,179,556	19,631	2.22%
FHLB advances and other borrowings	665,660	17,366	3.49%	226,662	4,319	2.55%
Junior subordinated debentures	86,600	5,264	8.13%	86,600	4,559	7.03%
Total interest bearing liabilities	2,353,529	\$ 59,552	3.38%	1,492,818	\$ 28,509	2.55%
Non-interest bearing demand accounts	14,884			15,359		
Other non-interest bearing liabilities	26,598			378,404		
Shareholders' equity	196,960			199,893		
Total liabilities and shareholders' equity	\$ 2,591,971			\$ 2,086,474		
Net interest spread (1)			3.22%			3.49%
Net interest income before provision for loan losses		\$ 67,710			\$ 62,440	
Net interest margin (2)			3.51%			4.15%

(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.

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

	<b>For the Nine Months Ended September 30, 2005 and 2004 Increase (Decrease) Due to:</b>		
	<b>Rate</b>	<b>Volume (in thousands)</b>	<b>Total</b>
<b>Interest and fees earned from:</b>			
Cash and investment securities	\$ 8,403	\$ (103)	\$ 8,300
Loans	(1,265)	29,278	28,013
<b>Total increase in interest income</b>	<b>7,138</b>	<b>29,175</b>	<b>36,313</b>
<b>Interest paid on:</b>			
Deposit accounts	8,992	8,299	17,291
FHLB advances and other borrowings	2,087	10,960	13,047
Junior subordinated debentures	705	—	705
<b>Total increase in interest expense</b>	<b>11,784</b>	<b>19,259</b>	<b>31,043</b>
<b>Increase (decrease) in net interest income</b>	<b>\$ (4,646)</b>	<b>\$ 9,916</b>	<b>\$ 5,270</b>

Total interest income increased \$36.3 million to \$127.3 million during the nine months ended September 30, 2005 as compared to \$90.9 million for the same period last year. The increase in interest income was primarily attributable to a \$576.1 million increase in the average balance of total loans receivable and a 261 basis point increase in the average yield earned on cash and investments.

The average balance of cash and investments decreased to \$430.3 million for the nine months ended September 30, 2005 compared to \$438.2 million during the same period last year. The decrease in average cash and investments was primarily due to a decrease in the average balance of low yielding short-term and overnight investments, partially offset by 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. As a result, the average yield earned on cash and investments increased to 4.31% during the nine months ended September 30, 2005 as compared to 1.70% for the same period last year.

The average aggregate balance of our loan portfolio was \$2.1 billion and \$1.6 billion for the nine months ended September 30, 2005 and 2004, respectively. Commercial real estate and construction loans had an average aggregate balance of \$770.5 million for the nine month period ended September 30, 2005 compared to \$671.1 million during same period last year. Multi-family real estate loans had an average aggregate balance of \$1.1 billion during the nine month period ended September 30, 2005 compared to \$666.8 million during the same period last year. Single-family residential loans had an average aggregate balance of \$31.5 million during the nine months ended September 30, 2005 compared to \$2.0 million during the same period last year. The average aggregate balance of entertainment finance loans was \$92.4 million and \$96.0 million during the nine months ended September 30, 2005 and 2004, respectively.

The average aggregate balance of franchise loans was \$134.9 million and \$121.3 million during the nine months ended September 30, 2005 and 2004, respectively.

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The average yield earned on total loans decreased to 7.05% for the nine months ended September 30, 2005 as compared to 7.25% during the same period last year. The decrease in the yield on loans was primarily due to the higher yielding loans being repaid and replaced by new loan production at lower current market interest rates, partially offset by adjustable rate loans repricing to higher current market interest rates. At September 30, 2005, a majority of our loan portfolio was comprised of adjustable rate loans indexed to the six month LIBOR.

Total interest expense increased by \$31.0 million to \$59.6 million for the nine months ended September 30, 2005, compared to \$28.5 million for the same period last year. The increase in interest expense was primarily attributable to an increase of \$860.7 million in the average balance of interest bearing liabilities, which was caused by the increase in deposits and FHLB advances and other borrowings, and a 83 basis point increase in the rate paid on interest bearing liabilities, which was primarily caused by deposits repricing to higher current market interest rates and the addition of new borrowings at higher current market interest rates.

Our average cost of funds increased to 3.38% during the nine months ended September 30, 2005, compared to 2.55% for the same period last year. The average rate paid on deposit accounts was 3.08% during the nine months ended September 30, 2005 compared to 2.22% for the same period last year. The average balance of interest bearing deposit accounts increased \$421.7 million to \$1.6 billion for the nine months ended September 30, 2005, compared to \$1.2 billion for the same period last year. The average rate paid on the FHLB advances and other borrowings was 3.49% during the nine months ended September 30, 2005 compared to 2.55% for the same period last year. FHLB advances and other borrowings averaged \$665.7 million for the nine months ended September 30, 2005, compared to \$226.7 million for the same period last year.

Net interest margin decreased to 3.51% for the nine months ended September 30, 2005 as compared to 4.15% 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, partially offset by the increase in yield earned on the average interest earning assets.

## **Provision for Loan Losses**

The consolidated provision for loan losses totaled \$3.8 million for the nine months ended September 30, 2005, compared to \$3.5 million for the same period last year. The provision for loan losses was recorded based on an analysis of the factors referred to previously. During the nine months ended September 30, 2005, we had net loan charge-offs of \$572,000, compared to net loan charge-offs of \$2.2 million for the same period last year.

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### **Non-Interest Income**

Non-interest income totaled \$1.0 million for the nine months ended September 30, 2005, compared to \$14.3 million for the same period last year. Substantially all of the non-interest income earned during the prior period was due to income earned in connection with the RAL program. During the nine months ended September 30, 2004, non-interest income consisted of fee income earned in connection with the RAL program consisting of \$9.3 million of net premiums on the sale of RAL loans and \$4.6 million of processing and administrative fees. Because the origination of loans under the RAL program resulted from the filing of individual income tax returns, transaction activity was concentrated most heavily during the tax season. This resulted in the Company earning most of its RAL program income in the first quarter of 2004.

### **Non-Interest Expense**

Non-interest expense totaled \$34.3 million for the nine months ended September 30, 2005, compared to \$32.4 million for the same period last year, and reflects the Company's continued investment in the national expansion of our loan production platform. The Company's efficiency ratio (defined as recurring general and administrative expenses as percentage of net revenue) increased to 49.9 percent for the nine months ended September 30, 2005, compared to 41.4 percent for the same period in 2004, due to the decline in net revenues earned as a result of the termination of the RAL program.

### **FINANCIAL CONDITION**

Total assets increased to \$3.0 billion at September 30, 2005 as compared to \$2.3 billion at December 31, 2004. The increase in total assets was primarily due to a \$711.0 million increase in our loan portfolio, partially offset by a \$31.4 million decrease in cash and cash equivalents and a \$44.1 million decline in investment securities held-to-maturity. The increase in the loan portfolio was primarily due to the loan production of \$1.3 billion and a decline in loan prepayment speeds experienced during the nine months ended September 30, 2005. At September 30, 2005, loans, net totaled \$2.5 billion, including approximately \$2.3 billion of real estate loans, \$89.7 million of entertainment finance loans, and \$124.8 million of franchise loans. Total deposit accounts increased to \$1.8 billion at September 30, 2005 from \$1.4 billion at December 31, 2004. FHLB advances and other borrowings increased to \$843.1 million at September 30, 2005, compared to \$584.2 million at December 31, 2004. This increase was primarily due to additional borrowings utilized to fund the growth in our loan portfolio. Management believes that a significant portion of deposits will remain with us upon maturity based on our historical experience regarding retention of deposits.



**Table of Contents****CREDIT RISK****Nonperforming Assets, Other Loans of Concern and Allowance for Loan Losses**

The following table sets forth our nonperforming assets by category and troubled debt restructurings as of the dates indicated.

	<b>September 30, 2005</b>	<b>December 31, 2004</b>
	<b>(dollars in thousands)</b>	
<b>Nonaccrual loans:</b>		
Real estate	\$ 8,858	\$ 7,057
Franchise	694	3,874
Entertainment finance	12,897	3,721
<b>Total nonaccrual loans</b>	<b>22,449</b>	<b>14,652</b>
Other real estate owned, net	—	—
<b>Total nonperforming assets</b>	<b>22,449</b>	<b>14,652</b>
Performing troubled debt restructurings	17,453	3,096
<b>Total nonperforming assets and performing troubled debt restructurings</b>	<b>\$ 39,902</b>	<b>\$ 17,748</b>
Nonaccrual loans to total loans	0.89%	0.80%
Allowance for loan losses to nonaccrual loans	172.22%	242.17%
Nonperforming assets to total assets	0.75%	0.63%

The increase in total nonperforming assets and performing troubled debt restructurings during the nine months ended September 30, 2005 was primarily attributable to the migration of a single lending relationship to nonperforming status and two lending relationships that are performing but were modified during the year as troubled debt restructurings.

As of September 30, 2005 and December 31, 2004, other loans of concern totaled \$52.1 million and \$37.1 million, respectively. Other loans of concern consist of loans with respect to which known information concerning possible credit problems with the borrowers or the cash flows of the collateral securing the respective loans has caused management to be concerned about the ability of the borrowers to comply with present loan repayment terms, which may result in the future inclusion of such loans in the nonaccrual category. The increase in other loans of concern for the nine months ended September 30, 2005 was primarily due to \$37.1 million of new other loans of concern, partially offset by \$4.4 million of loan repayments, \$2.9 million of loans being upgraded, and \$14.8 million of loans being transferred to nonperforming assets.

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The following table provides certain information with respect to our allowance for loan losses, including charge-offs, recoveries and selected ratios for the periods indicated.

	<b>For the Nine Months Ended September 30, 2005</b>	<b>For the Year Ended December 31, 2004</b>	<b>For the Nine Months Ended September 30, 2004</b>
	<b>(dollars in thousands)</b>		
Balance at beginning of period	\$ 35,483	\$ 33,401	\$ 33,401
Provision for loan losses	3,750	4,725	3,450
Charge-offs	(959)	(3,490)	(2,300)
Recoveries	387	847	132
Net (charge-offs) recoveries	(572)	(2,643)	(2,168)
Balance at end of period	\$ 38,661	\$ 35,483	\$ 34,683
Allowance for loan losses as a percentage of loans, net	1.52%	1.94%	2.09%

**Liquidity**

Liquidity refers to our ability to maintain cash flows adequate to fund operations and meet obligations and other commitments on a timely basis, including the payment of maturing deposits and the origination or purchase of new loans. We maintain a cash and investment securities portfolio designed to satisfy operating liquidity requirements while preserving capital and maximizing yield. As of September 30, 2005, we held \$56.2 million of cash and cash equivalents (consisting primarily of short-term investments with original maturities of 90 days or less) and \$92.3 million of investment securities classified as available for sale.

Short-term fixed income investments classified as cash equivalents consisted of interest bearing deposits at financial institutions, government money market funds and short-term government agency securities, while investment securities available for sale consisted primarily of fixed income instruments, which were rated "AAA", or equivalent by nationally recognized rating agencies. In addition, our liquidity position is supported by a credit facility with the Federal Home Loan Bank of San Francisco. As of September 30, 2005, we had remaining available borrowing capacity under this credit facility of \$356.3 million, net of the \$17.1 million of additional Federal Home Loan Bank stock that we would be required to purchase to support those additional borrowings. We also had available \$80.0 million of uncommitted, unsecured lines of credit with three unaffiliated financial institutions, and a \$25.0 million revolving credit facility with an unaffiliated financial institution.

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**Capital Resources**

The Company, the Bank's holding company, had Tier 1 leverage, Tier 1 risk based and total risk-based capital ratios at September 30, 2005 of 8.90%, 10.82% and 12.83%, respectively, which represents \$114.9 million, \$116.9 million and \$68.7 million, respectively, of capital in excess of the amount required to be "well capitalized." These ratios were 12.30%, 13.67% and 16.00% as of December 31, 2004, respectively.

The Bank had Tier 1 leverage, Tier 1 risk based and total risk-based capital ratios at September 30, 2005 of 8.31%, 10.11% and 11.36%, respectively, which represents \$96.0 million, \$97.9 million and \$32.5 million, respectively, of capital in excess of the amount required to be "well capitalized" for regulatory purposes. These ratios were 11.02%, 12.21% and 13.47% as of December 31, 2004, respectively.

At September 30, 2005, shareholders' equity totaled \$199.8 million, or 6.7% of total assets. Our book value per share of common stock was \$36.91 as of September 30, 2005, as compared to \$35.09 as of December 31, 2004, and \$34.62 as of September 30, 2004.

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### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

Our estimated sensitivity to interest rate risk, as measured by the estimated interest earnings sensitivity profile and the interest sensitivity gap analysis, has not materially changed from the information disclosed in our annual report on Form 10-K for the year ended December 31, 2004.

### **Item 4. Controls and Procedures**

(a) Evaluation of Disclosure Controls and Procedures: An evaluation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the "Act")) was carried out as of September 30, 2005 under the supervision and with the participation of the Company's Chief Executive Officer, Chief Financial Officer and several other members of the Company's senior management. The Company's Chief Executive Officer and Chief Financial Officer concluded that, as of September 30, 2005, the Company's disclosure controls and procedures were effective in ensuring that the information required to be disclosed by the Company in the reports it files or submits under the Act is (i) accumulated and communicated to the Company's management (including the Chief Executive Officer and Chief Financial Officer) in a timely manner, and (ii) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

(b) Changes in Internal Control over Financial Reporting: During the quarter ended September 30, 2005, no change occurred in the Company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

The Company does not expect that its disclosure controls and procedures and internal control over financial reporting will prevent all error and all fraud. A control procedure, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control procedure are met. Because of the inherent limitations in all control procedures, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any control procedure also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control procedure, misstatements due to error or fraud may occur and not be detected.

**Table of Contents****PART II - OTHER INFORMATION****Item 1. Legal Proceedings**

We are party to certain legal proceedings incidental to our business. Management believes that the outcome of such currently pending proceedings, in the aggregate, will not have a material effect on our financial condition or results of operations.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

The following table sets forth the repurchases of our common stock for the fiscal quarter ended September 30, 2005.

<b>Period</b>	<b>Total Number of Shares Purchased</b>	<b>Average Price Paid per Share</b>	<b>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</b>	<b>Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs<sup>(1)</sup></b>
July 1, 2005 to July 31, 2005	—	—	—	127,172
August 1, 2005 to August 31, 2005	60,920	54.05	60,920	66,252
September 1, 2005 to September 30, 2005	55,490	52.32	55,490	10,762
<b>Total</b>	<b>116,410</b>	<b>\$ 53.23</b>	<b>116,410</b>	<b>10,762</b>

(1) The repurchases during July, August, and September 2005 were made under the tenth extension of our stock repurchase program, which was announced on March 9, 2005. The extension authorized the repurchase of an additional 5% of the outstanding shares as of the authorization date. At September 30, 2005, 10,762 shares remained available for repurchase under the tenth extension. Subsequent to September 30, 2005, the eleventh extension to the stock repurchase program for up to 5% of ITLA Capital's outstanding shares of common stock was announced.

**Item 3 . Defaults Upon Senior Securities**

Not applicable.

**Item 4 . Submission of Matters to a Vote of Security Holders**

(a) On July 27, 2005, the Company held its Annual Meeting of Shareholders.

(b) Shareholders voted on the following matters:

(i) The election of George W. Haligowski as director for a term to expire in 2008:

<b>Votes</b>	<b>For</b>	<b>Withheld</b>
	5,837,809	607,274

(ii) The election of Hirotaka Oribe as director for a term to expire in 2008:

Votes	For	Withheld
	5,914,458	530,625

(iii) The approval of the ITLA Capital Corporation 2005 Re-Designated, Amended and Restated Employee Stock Incentive Plan:

Votes	For	Against	Withheld	Broker Non-Vote
	3,910,163	971,975	2,880	1,560,065

(iv) The approval of the ITLA Capital Corporation 2005 Re-Designated, Amended and Restated Stock Option Plan for Non-Employee Directors:

Votes	For	Against	Withheld	Broker Non-Vote
	4,132,372	749,766	2,880	1,560,065

(v) The ratification of the appointment of Ernst & Young LLP as independent auditors of the Company for the fiscal year ending December 31, 2005:

Votes	For	Against	Withheld
	6,172,371	270,812	1,900

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**Item 5 . Other Information**

None.

**Item 6 . Exhibits**

See exhibit index.

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**ITLA CAPITAL CORPORATION**

Date: November 9, 2005

/s/ George W. Haligowski  
George W. Haligowski  
Chairman of the Board, President and  
Chief Executive Officer

Date: November 9, 2005

/s/ Timothy M. Doyle  
Timothy M. Doyle  
Executive Managing Director and  
Chief Financial Officer



**Table of Contents****EXHIBIT INDEX**

<b>Regulation S-K Exhibit Number</b>	<b>Document</b>	<b>Reference to Prior Filing or Exhibit Number Attached Hereto</b>
3.1	Certificate of Incorporation	**
3.2	Bylaws, as amended	****
4	Instruments Defining the Rights of Security Holders, Including Indentures	*****
10.1	2005 Re-Designated, Amended and Restated Stock Option Plan For Nonemployee Directors	*****
10.2	2005 Re-Designated, Amended and Restated Employee Stock Incentive Plan	*****
10.3a	Nonqualified (Non-Employer Securities) Deferred Compensation Plan	*****
10.3b	Nonqualified (Employer Securities Only) Deferred Compensation Plan	*****
10.4	Supplemental Salary Savings Plan	*
10.5	Data Processing Agreement	*
10.6	Employment Agreement with George W. Haligowski	****
10.7	Form of Change of Control Agreements with Norval L. Bruce, Timothy M. Doyle, Don Nickbarg, and Scott Wallace	***
10.8	Recognition and Retention Plan	**
10.9	Voluntary Retainer Stock and Deferred Compensation Plan for Outside Directors	*****
10.10	Supplemental Executive Retirement Plan	*****
10.11	ITLA Capital Corporation Rabbi Trust Agreement	***
10.12	Salary Continuation Plan	****
10.13	Form of Incentive Stock Option Agreement under Employee Stock Incentive Plan	*****
10.14	Form of Non-Qualified Stock Option Agreement under Employee Stock Incentive Plan	*****
10.15	Form of Non-Qualified Stock Option Agreement under Stock Option Plan for Nonemployee Directors	*****
10.16	Description of Named Executive Officer Salary, Bonus and Perquisite Arrangements for 2005	*****
10.17	Description of Director Fee Arrangements	*****
11	Statement Regarding Computation of Per Share Earnings	Not Required
15	Letter Regarding Unaudited Interim Financial Information	None
18	Letter Regarding Change in Accounting Principles	None
19	Report furnished to Security Holders	None
22		None

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Published Report Regarding Matters Submitted to  
Vote of Security Holders

23.1	Consent of Experts	None
24	Power of Attorney	None
31.1	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer	31.1
31.2	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer	31.2
32	Section 1350 Certifications of Chief Executive Officer and Chief Financial Officer	32

\* Filed as an exhibit to Imperial's Registration Statement on Form S-1 (File No. 33-96518) filed with the Commission on September 1, 1995, pursuant to Section 5 of the Securities Act of 1933.

\*\* Filed as an exhibit to the Company's Registration Statement on Form S-4 (File No. 333-03551) filed with the Commission on May 10, 1996, pursuant to Section 5 of the Securities Act of 1933.

\*\*\* Filed as an exhibit to the Company's Form 10-K for the year ended December 31, 1999 (File No. 0-26960).

\*\*\*\* Filed as an exhibit to the Company's Form 10-Q for the quarter ended June 30, 2000 (File No. 0-26960).

\*\*\*\*\* Filed as an exhibit to Amendment No. Two to the Company's Registration Statement on Form S-4 (File No. 333-03551) filed with the Commission on June 19, 1996.

\*\*\*\*\* Filed as an appendix to the Company's definitive proxy materials filed on June 27, 2005.

\*\*\*\*\* Filed as an exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2003 (File No. 0-26960).

\*\*\*\*\* The Company hereby agrees to furnish the SEC, upon request, copies of the instruments defining the rights of the holders of each issue of the Company's long-term debt.

\*\*\*\*\* Filed as an exhibit to the Company's Form 10-K for the year ended December 31, 2004.

\*\*\*\*\* Filed as an exhibit to the Company's Current Report on Form 8-K filed on August 9, 2005 (File No. 0-26960).

\*\*\*\*\* Filed as an exhibit to the Company's Current Report on Form 8-K filed on November 4, 2005 (File No. 0-26960).