

CITY NATIONAL CORP  
Form 10-Q  
November 14, 2003

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D. C. 20549

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**FORM 10-Q**

(Mark One)

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

For the quarterly period ended September 30, 2003

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 1-10521

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**CITY NATIONAL CORPORATION**

(Exact name of registrant as specified in its charter)

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**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**95-2568550**  
(I.R.S. Employer  
Identification No.)

**City National Center**  
**400 North Roxbury Drive, Beverly Hills, California 90210**  
(Address of principal executive offices) (Zip Code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES

NO

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

YES

NO

Number of shares of common stock outstanding at October 31, 2003: 48,953,252

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## PART 1 - FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

**CITY NATIONAL CORPORATION**  
**CONSOLIDATED BALANCE SHEET**

(Unaudited)

Dollars in thousands, except per share amounts	September 30, 2003	December 31, 2002	September 30, 2002
<b>Assets</b>			
Cash and due from banks	\$ 497,392	\$ 497,273	\$ 480,884
Federal funds sold	717,200	460,000	268,000
Securities available-for-sale - cost \$3,381,676; \$2,169,444 and \$1,925,814 at September 30, 2003, December 31, 2002 and September 30, 2002, respectively	3,409,374	2,226,656	1,979,439
Trading account securities	92,024	172,211	66,581
Loans	7,542,147	7,999,470	7,966,801
Less allowance for credit losses	166,209	164,502	159,173
Net loans	7,375,938	7,834,968	7,807,628
Premises and equipment, net	64,403	61,208	59,990
Deferred tax asset	68,404	36,578	25,177
Goodwill	251,038	229,834	229,658
Intangibles	46,233	27,007	28,983
Bank owned life insurance	62,324	60,119	59,583
Affordable housing investments	65,609	68,848	53,688
Other assets	172,672	186,766	204,896
Customers acceptance liability	7,917	8,924	9,260
Total assets	\$ 12,830,528	\$ 11,870,392	\$ 11,273,767
<b>Liabilities</b>			
Demand deposits	\$ 5,365,335	\$ 4,764,234	\$ 4,200,997
Interest checking deposits	729,892	692,261	627,765
Money market deposits	3,303,615	2,929,501	2,757,585
Savings deposits	212,688	198,288	219,968
Time deposits-under \$100,000	205,625	218,447	221,601
Time deposits-\$100,000 and over	968,546	1,036,967	1,098,806
Total deposits	10,785,701	9,839,698	9,126,722
Federal funds purchased and securities sold under repurchase agreements	103,346	266,727	231,389
Other short-term borrowings	15,125	125,125	294,125
Subordinated debt	299,898	303,795	301,917
Long-term debt	282,159	68,682	68,897

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Other liabilities	126,539	126,303	102,137
Acceptances outstanding	7,917	8,924	9,260
<b>Total liabilities</b>	<b>11,620,685</b>	<b>10,739,254</b>	<b>10,134,447</b>
<b>Minority interest in consolidated subsidiaries</b>	<b>26,044</b>	<b>21,179</b>	<b>13,465</b>
<b>Commitments and contingencies</b>			
<b>Shareholders Equity</b>			
Preferred Stock authorized - 5,000,000 : none outstanding			
Common Stock-par value-\$1.00; authorized - 75,000,000; Issued - 50,454,249; 50,282,743 and 50,275,643 shares at September 30, 2003, December 31, 2002 and September 30, 2002, respectively			
	50,454	50,283	50,276
Additional paid-in capital	401,612	400,866	400,994
Accumulated other comprehensive income	21,446	40,400	39,122
Retained earnings	783,902	675,195	640,563
Deferred equity compensation	(7,158)		
Treasury shares, at cost - 1,545,450; 1,299,312; and 112,338 shares at September 30, 2003, December, 31, 2002 and September 30, 2002, respectively			
	(66,457)	(56,785)	(5,100)
<b>Total shareholders equity</b>	<b>1,183,799</b>	<b>1,109,959</b>	<b>1,125,855</b>
<b>Total liabilities and shareholders equity</b>	<b>\$ 12,830,528</b>	<b>\$ 11,870,392</b>	<b>\$ 11,273,767</b>

See accompanying Notes to the Unaudited Consolidated Financial Statements.

## CITY NATIONAL CORPORATION

## CONSOLIDATED STATEMENT OF INCOME AND COMPREHENSIVE INCOME

(Unaudited)

In thousands, except per share amounts	For the three months ended September 30,		For the nine months ended September 30,	
	2003	2002	2003	2002
<b>Interest Income</b>				
Loans	\$ 107,515	\$ 127,682	\$ 334,427	\$ 375,004
Securities available-for-sale	33,162	26,235	94,885	81,186
Federal funds sold and securities purchased under resale agreements	1,511	540	2,693	1,751
Trading account	173	159	365	544
Total interest income	142,361	154,616	432,370	458,485
<b>Interest Expense</b>				
Deposits	10,045	17,766	36,067	54,877
Subordinated debt	1,232	1,711	3,995	5,629
Other long-term debt	1,788	807	5,482	3,037
Federal funds purchased and securities sold under repurchase agreements	292	845	1,331	2,430
Other short-term borrowings	343	1,963	1,493	8,719
Total interest expense	13,700	23,092	48,368	74,692
Net interest income	128,661	131,524	384,002	383,793
Provision for credit losses		20,500	29,000	49,500
Net interest income after provision for credit losses	128,661	111,024	355,002	334,293
<b>Noninterest Income</b>				
Trust fees and investment fee revenue	23,412	15,287	60,397	45,297
Cash management and deposit transaction charges	10,661	9,929	32,238	30,323
International services	4,845	4,747	14,192	13,257
Bank owned life insurance	747	737	2,192	2,129
Gain (loss) on sale of loans and assets	16	(3,756)	118	(757)
Gain on sale of securities	36	1,206	2,538	2,078
Other	5,551	6,028	17,621	16,532
Total noninterest income	45,268	34,178	129,296	108,859
<b>Noninterest Expense</b>				
Salaries and employee benefits	55,261	49,109	161,582	146,221
Net occupancy of premises	8,142	6,837	22,973	19,512
Professional fees	6,821	5,418	20,026	15,829
Information services	4,749	4,200	13,304	13,221
Depreciation	3,315	3,268	9,453	9,996
Marketing and advertising	3,060	3,259	9,725	9,358

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Office services	2,504	2,231	7,472	7,060
Amortization of intangibles	2,365	1,976	6,568	5,547
Equipment	528	599	1,832	1,870
Other operating	5,588	5,258	16,126	15,116
Total noninterest expense	92,333	82,155	269,061	243,730
<b>Minority interest in net income of consolidated subsidiaries</b>	1,717	217	3,257	374
Income before income taxes	79,879	62,830	211,980	199,048
Income taxes	27,376	14,145	69,741	60,367
<b>Net income</b>	<b>52,503</b>	<b>48,685</b>	<b>142,239</b>	<b>138,681</b>
Other comprehensive income				
Unrealized gain (loss) on securities available-for-sale	(29,393)	22,600	(31,828)	50,843
Unrealized gain (loss) on cash flow hedges	(1,191)	1,593	(706)	(342)
Less reclassification adjustment for gain included in net income	1,055	988	169	1,413
Income taxes (benefit)	(13,304)	9,756	(13,749)	20,640
Other comprehensive income (loss)	(18,335)	13,449	(18,954)	28,448
Comprehensive income	\$ 34,168	\$ 62,134	\$ 123,285	\$ 167,129
Net income per share, basic	\$ 1.08	\$ 0.97	\$ 2.93	\$ 2.80
Net income per share, diluted	\$ 1.05	\$ 0.94	\$ 2.85	\$ 2.69
Shares used to compute income per share, basic	48,537	50,107	48,541	49,587
Shares used to compute income per share, diluted	50,177	51,899	49,942	51,595
Dividends per share	\$ 0.280	\$ 0.195	\$ 0.690	\$ 0.585

See accompanying Notes to the Unaudited Consolidated Financial Statements.

**CITY NATIONAL CORPORATION**  
**CONSOLIDATED STATEMENT OF CASH FLOWS**

(Unaudited)

Dollars in thousands	For the nine months ended September 30,	
	2003	2002
<b>Cash Flows From Operating Activities</b>		
Net income	\$ 142,239	\$ 138,681
Adjustments to net income:		
Provision for credit losses	29,000	49,500
Amortization of intangibles	6,568	5,547
Depreciation	9,453	9,996
Deferred income tax (benefit)	(18,065)	31,693
(Gain) loss on sales of loans and assets	(118)	757
Gain on sales of securities	(2,538)	(2,078)
Net decrease (increase) in other assets	20,554	(46,128)
Net decrease in trading securities	80,187	11,685
Other, net	1,623	(5,419)
Net cash provided by operating activities	268,903	194,234
<b>Cash Flows From Investing Activities</b>		
Purchase of securities	(2,588,462)	(688,468)
Sales of securities available-for-sale	188,525	164,205
Maturities and paydowns of securities	1,181,395	440,974
Sales of loans	11,744	12,531
Loan principal collections (originations), net	432,375	(486,057)
Purchase of premises and equipment	(14,628)	(6,715)
Net cash from (for) acquisitions	(39,907)	35,633
Other, net	(2)	4
Net cash used by investing activities	(828,960)	(527,893)
<b>Cash Flows From Financing Activities</b>		
Net increase in deposits	946,003	557,057
Net (decrease) increase in federal funds purchased and securities sold under repurchase agreements	(163,381)	59,858
Net decrease in short-term borrowings, net of transfers from long-term debt	(125,000)	(246,000)
Repayment of long-term debt	(6,575)	
Net proceeds of issuance of senior debt	221,749	
Proceeds from exercise of stock options	23,728	24,088
Stock repurchases	(45,616)	(6,629)
Cash dividends paid	(33,532)	(28,849)
Net cash provided by financing activities	817,376	359,525

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Net increase in cash and cash equivalents	257,319	25,866
Cash and cash equivalents at beginning of year	957,273	723,018
Cash and cash equivalents at end of period	\$ 1,214,592	\$ 748,884

**Supplemental Disclosures of Cash Flow Information:**

Cash paid during the period for:

Interest	\$ 52,643	\$ 51,029
Income taxes	64,000	43,500

Non-cash investing activities:

Transfer from loans to foreclosed assets	\$	\$ 1,664
Transfer from long-term debt to short-term borrowings	15,000	125,000

See accompanying Notes to the Unaudited Consolidated Financial Statements.



**CITY NATIONAL CORPORATION**  
**CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY**  
**(Unaudited)**

Dollars in thousands	For the nine months ended September 30,	
	2003	2002
<b>Common Stock</b>		
Balance, beginning of period	\$ 50,283	\$ 48,150
Stock issued for acquisitions		1,208
Stock options exercised		918
Restricted stock and units issued	171	
Balance, end of period	50,454	50,276
<b>Additional paid-in capital</b>		
Balance, beginning of period	400,866	301,022
Tax benefit from stock options	5,465	9,552
Stock options exercised	(12,216)	21,642
Restricted stock and units issued	7,497	
Excess of market value of shares issued for acquisitions over historical cost		68,778
Balance, end of period	401,612	400,994
<b>Accumulated other comprehensive income (loss)</b>		
Balance, beginning of period	40,400	10,674
Other comprehensive income (loss) net of income taxes	(18,954)	28,448
Balance, end of period	21,446	39,122
<b>Retained earnings</b>		
Balance, beginning of period	675,195	530,731
Net income	142,239	138,681
Dividends paid	(33,532)	(28,849)
Balance, end of period	783,902	640,563
<b>Deferred equity compensation</b>		
Balance, beginning of period		
Restricted stock and units issued	(7,668)	
Amortization of restricted stock awards	510	
Balance, end of period	(7,158)	
<b>Treasury shares</b>		
Balance, beginning of period	(56,785)	
Purchase of shares	(45,616)	(6,629)
Issuance of shares for stock options	35,944	1,529

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Balance, end of period	(66,457)	(5,100)
Total shareholders' equity	\$ 1,183,799	\$ 1,125,855

See accompanying Notes to the Unaudited Consolidated Financial Statements.

**CITY NATIONAL CORPORATION**

**NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

1. City National Corporation (the Corporation ) is the holding company for City National Bank (the Bank ). In light of the fact that the Bank comprises substantially all of the business of the Corporation, references to the Company mean the Corporation and the Bank together.
2. The results of operations reflect the interim adjustments, all of which are of a normal recurring nature and which, in the opinion of management, are necessary for a fair presentation of the results for the interim period presented. These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements included in the Corporation s Annual Report on Form 10-K for the year ended December 31, 2002. The results for the 2003 interim periods are not necessarily indicative of the results expected for the full year.
3. Trading account securities are stated at market value. Investments not classified as trading securities are classified as securities available-for-sale and recorded at fair value. Unrealized holding gains or losses for securities available-for-sale, net of taxes are excluded from net income and are reported as other comprehensive income included as a separate component of shareholders equity.
4. Certain prior periods data have been reclassified to conform to current period presentation.
5. Reserves established as a purchase price adjustment for the February 29, 2000 acquisition of The Pacific Bank N.A. of \$0.9 million for exit costs relating to surplus space remain as of September 30, 2003. Reserves established as a purchase price adjustment for the February 28, 2002 acquisition of Civic BanCorp of \$0.6 million for exit costs relating to surplus space remain as of September 30, 2003.
6. On February 13, 2003, the Corporation issued \$225 million of 5.125 percent Senior Notes due 2013 in a private placement. A like amount of exchange notes were subsequently registered pursuant to the Securities Act of 1933 in April 2003 and 100 percent of the Senior Notes were exchanged for the registered notes in an exchange offering with the Senior Notes which closed on May 29, 2003.

7. On January 22, 2003, the Board of Directors authorized a 1 million-share stock buyback program. No shares were repurchased during the third quarter of 2003. A total number of 750,100 shares have been repurchased under this program at an average price of \$42.47 per share leaving 249,900 shares available for repurchase. Shares will be repurchased on a selective basis from time to time in open market transactions. The shares purchased under the buyback programs may be reissued for acquisitions, upon the exercise of stock options, or for other general corporate purposes. There were 1,545,450 treasury shares at September 30, 2003.

On July 15, 2003, the Board of Directors authorized the repurchase of 500,000 additional shares of City National Corporation stock, following completion of the Company's current buyback initiative.

Basic earnings per share is based on the weighted average shares of common stock outstanding less unvested restricted shares and units. Diluted earnings per share gives effect to all dilutive potential common shares which consists of stock options and restricted shares and units that were outstanding during the period. At September 30, 2003, 50,950 stock options were antidilutive.

8. The Company applies APB Opinion No. 25 in accounting for stock option plans and, accordingly, no compensation cost has been recognized for its plans in the financial statements. As a practice, the Corporation's stock option grants are such that the exercise price equals the current market price of the common stock. Had the Company determined compensation cost based on the fair value at the grant date for its stock options under SFAS No. 123 using the Black Scholes option-pricing model, the Company's proforma net income would have been reduced to the proforma amounts indicated below:

Dollars in thousands, except for per share amounts	For the three months ended September 30,		For the nine months ended September 30,	
	2003	2002	2003	2002
Net income, as reported	\$ 52,503	\$ 48,685	\$ 142,239	\$ 138,681
Proforma net income	50,807	46,143	137,524	131,057
Net income per share, basic, as reported	1.08	0.97	2.93	2.80
Proforma net income per share, basic	1.05	0.92	2.83	2.64
Net income per share, diluted, as reported	1.05	0.94	2.85	2.69
Proforma net income per share, diluted	1.01	0.89	2.75	2.54
Percentage reduction in net income per share, diluted	3.81%	5.32%	3.51%	5.58%

During the latter part of the second quarter of 2003, stock-based compensation performance awards for 2002 were granted to colleagues of the Company. These performance awards for the first time included restricted stock grants with fewer stock options, which reduced the total number of shares awarded but better aligned the interests of shareholders and colleagues. The Company recorded \$381,000 in expense for restricted stock awards in the third quarter of 2003 and \$510,000 for the first nine months of 2003 out of the original \$7,668,000 grant.

9. In January 2003, the Financial Accounting Standards Board (FASB) issued Interpretation No. 46 (FIN 46), Consolidation of Variable Interest Entities. The recognition and measurement provisions of this Interpretation are effective for newly created VIEs formed after January 31, 2003. On October 9, 2003, the FASB issued FIN 46-6 which delayed the recognition and measurement provisions of FIN 46 for existing VIEs to the first interim or annual reporting period ending after December 15, 2003. The Company adopted the disclosure provisions of FIN 46 effective December 31, 2002. The Company adopted the recognition and measurement provisions of FIN 46 for newly formed VIEs effective February 1, 2003, which did not have a material effect on the Company's financial statements. The Company intends to adopt the recognition and measurement provisions of FIN 46 for existing VIEs on December 31, 2003. The Company does not expect that the adoption of FIN 46 will have a material effect on the Company's financial statements.

10. On April 1, 2003, the Corporation acquired Convergent Capital Management LLC, a privately held Chicago-based company, and substantially all of its asset management holdings, including its majority ownership interests in eight asset management firms and minority interests in two additional firms. Combined, these 10 firms manage assets of approximately \$7.3 billion as of September 30, 2003. The purchase price was \$49.0 million, comprised of cash and the assumption of approximately \$7.5 million of debt. The acquisition preliminarily resulted in \$25.8 million in customer contract intangibles, which is being amortized over 20 years, and \$21.5 million in goodwill.

## CITY NATIONAL CORPORATION

## FINANCIAL HIGHLIGHTS

(Unaudited)

Dollars in thousands, except per share amounts	At or for the three months ended			Percentage change	
	September 30, 2003	June 30, 2003	September 30, 2002	September 30, 2003 from June 30, 2003	September 30, 2002
<b>For The Quarter</b>					
Net income	\$ 52,503	\$ 46,081	\$ 48,685	14%	8%
Net income per common share, basic	1.08	0.95	0.97	14	11
Net income per common share, diluted	1.05	0.93	0.94	13	12
Dividends, per common share	0.280	0.205	0.195	37	44
<b>At Quarter End</b>					
Assets	\$ 12,830,528	\$ 12,354,833	\$ 11,273,767	4	14
Deposits	10,785,701	10,166,806	9,126,722	6	18
Loans	7,542,147	7,590,226	7,966,801	(1)	(5)
Securities	3,501,398	3,080,721	2,046,020	14	71
Shareholders equity	1,183,799	1,144,690	1,125,855	3	5
Book value per share	24.29	23.77	22.44	2	8
<b>Average Balances</b>					
Assets	\$ 12,418,660	\$ 11,914,869	\$ 10,964,142	4	13
Deposits	10,320,828	9,774,905	8,772,826	6	18
Loans	7,558,799	7,793,863	7,958,258	(3)	(5)
Securities	3,247,019	2,900,785	1,936,582	12	68
Shareholders equity	1,139,440	1,131,682	1,094,381	1	4
<b>Selected Ratios</b>					
Return on average assets	1.68%	1.55%	1.76%	8	(5)
Return on average shareholders equity	18.28	16.33	17.65	12	4
Corporation's tier 1 leverage	7.37	7.17	7.88	3	(6)
Corporation's tier 1 risk-based capital	10.76	10.21	10.16	5	6
Corporation's total risk-based capital	14.94	14.45	14.61	3	2
Dividend payout ratio, per share	25.94	21.51	20.03	21	30
Net interest margin	4.61	4.79	5.35	(4)	(14)
Efficiency ratio *	52.92	52.53	48.65	1	9
<b>Asset Quality Ratios</b>					
Nonaccrual loans to total loans	0.72%	0.91%	0.63%	(21)	14
Nonaccrual loans and ORE to total loans and ORE	0.72	0.92	0.64	(22)	13

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Allowance for credit losses to total loans	2.20	2.25	2.00	(2)	10
Allowance for credit losses to non accrual loans	304.08	246.37	317.25	23	(4)
Net charge-offs to average loans - annualized	(0.25)	(0.52)	(0.95)	(52)	(74)

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

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

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

**RESULTS OF OPERATIONS**





*Critical Accounting Policies*

The Company's accounting policies are fundamental to understanding management's discussion and analysis of results of operations and financial condition. The Company has identified four policies as being critical because they require management to make particularly difficult, subjective and/or complex judgments about matters that are inherently uncertain and because of the likelihood that materially different amounts would be reported under different conditions or using different assumptions. These policies relate to the accounting for securities, the allowance for credit losses, derivatives and hedging activities and stock based performance plans. The Company, in consultation with the Audit Committee, has reviewed and approved these critical accounting policies, which are further described in Management's Discussion and Analysis and Note 1 (Summary of Significant Accounting Policies) to Financial Statements in the Company's 2002 Form 10-K.

*Overview*

The Corporation recorded net income of \$52.5 million, or \$1.05 per common share, for the third quarter of 2003, compared with net income of \$48.7 million, or \$0.94 per share, for the third quarter of 2002 on fewer common shares outstanding this year.

For the first nine months of 2003, City National Corporation recorded net income of \$142.2 million, or \$2.85 per share, compared with net income of \$138.7 million, or \$2.69 per share, reported for the first nine months of 2002.

**HIGHLIGHTS**

In light of improved credit quality, no provision for credit losses was recorded in the third quarter of 2003 compared with \$20.5 million in the prior year as nonaccrual loans declined 21 percent; selected higher-risk credits were paid, charged off or sold; charge-offs were lower and recoveries were higher than expected; and loans declined by 1 percent from the end of the prior quarter. The year-to-date provision for credit losses was \$29.0 million compared with \$49.5 million for the first nine months of 2002. The allowance for credit losses to total loans was 2.20 percent at September 30, 2003.

Average core deposits for the first nine months were up 23 percent from the same period last year. Third-quarter average core deposits were up 23 percent from a year ago and 6 percent from the prior quarter.

Average securities for the first nine months were up 46 percent from the same period last year due to significantly higher deposit balances and modest loan demand. The average duration of total available-for-sale securities at September 30, 2003 was 3.2 years. Average loans for the first nine months were essentially unchanged from the same period last year and period-end loan balances were down \$48.1 million from the last quarter.

Net interest income for the first nine months of 2003 increased slightly over the first nine months of 2002, but was 2 percent lower in the third quarter compared with the same period last year. This decline is consistent with the

18-basis-point compression in the net interest margin to 4.61 percent during the third quarter of 2003.

Noninterest income excluding gains on sale of loans, assets and securities rose 18 percent for the first nine months over the same period last year. This continued increase was primarily due to the acquisition of Convergent Capital Management ( CCM ) on April 1, 2003. Third-quarter noninterest income, excluding gains on the sale of loans, assets and securities, was 23 percent higher than the third quarter of 2002 and 3 percent higher than the second quarter of 2003.

Exposure to syndicated non-relationship commercial and purchased media and telecommunication loans declined 40 percent from June 30, 2003 to \$31.2 million at September 30, 2003 out of a total loan portfolio of \$7.5 billion.

Dollars in millions, except per share	For the three months ended September 30,			For the three months ended June 30, 2003	For the nine months ended September 30,		
	2003	2002	% Change		2003	2002	% Change
Earnings Per Share	\$ 1.05	\$ 0.94	12	\$ 0.93	\$ 2.85	\$ 2.69	6
Net Income	52.5	48.7	8	46.1	142.2	138.7	3
Average Assets	12,418.7	10,964.1	13	11,914.9	11,941.5	10,749.8	11
Return on Average Assets	1.68%	1.76%	(5)	1.55%	1.59%	1.72%	(8)
Return on Average Equity	18.28	17.65	4	16.33	16.83	18.01	(7)

Return on average assets for the third quarter and the first nine months of 2003 declined compared with the same periods last year due to an increase in average assets, primarily lower-yielding securities. The lower return on average shareholders' equity for the first nine months was due primarily to a higher level of shareholders' equity from retained net income and from the exercise of stock options, net of treasury share repurchases.

## Outlook



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Consistent with its October 15, 2003 third quarter earnings release, management currently expects net income per diluted common share for 2003 to be approximately 8 to 10 percent higher than net income per diluted common share for 2002 based on the business indicators below:

Average loan growth	flat to 2 percent
Average deposit growth	13 to 16 percent
Net interest margin	4.75 to 4.85 percent
Provision for credit losses	\$29 million to \$35 million
Noninterest income growth	18 to 21 percent
Noninterest expense growth	9 to 12 percent
Effective tax rate	32 to 34 percent

### *Revenues*

Revenues (net interest income plus noninterest income) for the first nine months of 2003, increased 4 percent to \$513.3 million compared with \$492.7 million for the first nine months of 2002, primarily due to the acquisition of CCM. Third-quarter revenues increased 5 percent to \$173.9 million from \$165.7 million in the third quarter of 2002. Revenues increased 1 percent from the second quarter of 2003.

### *Net Interest Income*

Fully taxable-equivalent net interest income for the first nine months of 2003 was \$395.0 million compared with \$394.9 million for the first nine months of 2002. Net interest income for the third quarter of 2003 was \$132.4 million on a fully taxable-equivalent basis, a 2 percent decrease from \$135.2 million in the third quarter of 2002 due to lower interest rates and lower commercial loan demand.

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Dollars in millions	For the three months ended September 30,			For the three months ended June 30, 2003	For the nine months ended September 30,		
	2003	2002	% Change		2003	2002	% Change
Average Loans	\$ 7,558.8	\$ 7,958.3	(5)	\$ 7,793.9	\$ 7,770.8	\$ 7,772.7	0
Average Securities	3,247.0	1,936.6	68	2,900.8	2,866.2	1,963.7	46
Average Deposits	10,320.8	8,772.8	18	9,774.9	9,826.7	8,422.3	17
Average Core Deposits	9,323.5	7,565.7	23	8,763.1	8,808.0	7,138.6	23
Fully Taxable-Equivalent Net Interest Income	132.4	135.2	(2)	130.8	395.0	394.9	0
Net Interest Margin	4.61%	5.35%	(14)	4.79%	4.82%	5.35%	(10)

Average loans for the first nine months of 2003 were just slightly lower than the same period last year. However, average loans for the third quarter of 2003 declined 5 percent compared with the same period last year and 3 percent from the prior quarter, due to continued modest loan demand. Compared with the first nine months of 2002 averages, commercial loans decreased 5 percent, residential first mortgage loans rose 3 percent, real estate mortgage loans rose 5 percent, and real estate construction loans rose 5 percent. Compared with the prior-year third-quarter averages, commercial loans declined 11 percent, residential first mortgage loans rose 1 percent, real estate mortgage loans declined 1 percent, and real estate construction loans declined 3 percent due to payoffs on completed construction projects. Compared with the prior quarter, average residential first mortgage loans and installment loans increased while all other loan categories decreased.

Period-end September 30, 2003 loans declined \$48.1 million from June 30, 2003, representing a slowing in the decline in the total loan portfolio and the modest growth seen in certain areas, compared with the \$242.6 million decline between June 30, 2003 and March 31, 2003.

Average securities, principally with low current yields and short maturities, for the first nine months and third quarter of 2003 increased 46 percent and 68 percent over the same periods last year due to higher deposit balances and modest loan demand. As of September 30, 2003, unrealized gains on securities available-for-sale were \$27.7 million. In addition, the average duration of total available-for-sale securities at September 30, 2003 was 3.2 years compared to 2.3 years at June 30, 2003, consistent with our expectations given the change in interest rates from June to September.

Average deposits continued to increase over the prior-year periods as well as from the prior quarter. Average core deposits represented 90 percent of the total average deposit base for the third quarter of 2003, compared with 86 percent for the third quarter of 2002 and 90 percent for the second quarter of 2003. New clients and higher client balances maintained as deposits to pay for services contributed to the continued growth of deposits.

The net interest margin narrowed due to prepayment and refinancing activity and low interest rates.

As part of the Company's long-standing asset liability management strategy, its plain vanilla interest rate swaps hedging loans, deposits and borrowings, with a notional value of \$1,051.4 million, added \$8.1 million to net interest income in the third quarter of 2003. That compared with \$8.2 million in the third quarter of 2002 and \$7.5 million for the second quarter of 2003. These net interest income amounts included \$5.8 million, \$3.7 million and \$5.2 million, respectively, for interest swaps qualifying as fair-value hedges. Income from swaps qualifying as cash-flow hedges was \$2.3 million for the third quarter of 2003, compared with \$4.5 million for the third quarter of 2002 and \$2.3 million for the second quarter of 2003. For the first nine months of 2003, interest rate swaps added \$23.1 million to net interest income, compared with

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\$24.6 million for the first nine months of 2002. These amounts included \$15.5 million and \$10.6 million, respectively, for interest swaps qualifying as fair value hedges. Income from existing swaps qualifying as cash flow hedges of loans expected to be recorded in net interest income within the next 12 months is \$7.8 million.

Interest recovered on nonaccrual and charged-off loans included in net interest income for the first nine months of 2003 was \$2.3 million compared with \$1.4 million for the first nine months of 2002. Interest income



recovered was \$1.3 million for the third quarter of 2003, compared with \$0.4 million for the third quarter of 2002 and \$0.4 million for the second quarter of 2003, respectively.

The Bank's prime rate was 4.00 percent as of September 30, 2003, compared with 4.75 percent a year earlier.

The following tables present the components of net interest income on a fully taxable-equivalent basis for the three and nine months ended September 30, 2003 and 2002. To compare the tax-exempt asset yields to taxable yields, amounts are adjusted to pre-tax equivalents based on the marginal corporate federal tax rate of 35 percent.

## Net Interest Income Summary

Dollars in thousands	For the three months ended September 30, 2003			For the three months ended September 30, 2002		
	Average Balance	Interest income/ expense (2)	Average interest rate	Average Balance	Interest income/ expense (2)	Average interest rate
<b>Assets</b>						
Interest-earning assets						
Loans						
Commercial	\$ 3,191,405	\$ 42,658	5.30%	\$ 3,598,795	\$ 54,422	6.00%
Real estate mortgages	1,890,996	30,582	6.42	1,900,612	34,481	7.20
Residential first mortgages	1,754,877	26,383	5.96	1,733,693	29,454	6.74
Real estate construction	634,300	7,925	4.96	651,174	9,254	5.64
Installment	87,221	1,579	7.18	73,984	1,602	8.59
Total loans (1)	7,558,799	109,127	5.73	7,958,258	129,213	6.44
Securities available-for-sale	3,146,971	35,268	4.45	1,882,231	28,350	5.98
Federal funds sold and securities purchased under resale agreements	584,552	1,511	1.03	120,279	540	1.78
Trading account securities	100,048	175	0.69	54,351	163	1.19
Total interest-earning assets	11,390,370	146,081	5.09	10,015,119	158,266	6.27
Allowance for credit losses	(173,822)			(160,026)		
Cash and due from banks	438,968			440,226		
Other nonearning assets	763,144			668,823		
Total assets	\$ 12,418,660			\$ 10,964,142		
<b>Liabilities and Shareholders Equity</b>						
Interest-bearing deposits						
Interest checking accounts	\$ 750,513	292	0.15	\$ 626,469	408	0.26
Money market accounts	3,289,234	5,541	0.67	2,680,730	9,128	1.35
Savings deposits	211,623	71	0.13	221,227	441	0.79
Time deposits - under \$100,000	207,362	819	1.57	223,853	1,277	2.26
Time deposits - \$100,000 and over	997,287	3,322	1.32	1,207,127	6,512	2.14
Total interest - bearing deposits	5,456,019	10,045	0.73	4,959,406	17,766	1.42
Federal funds purchased and securities sold under repurchase agreements	132,731	292	0.87	211,321	845	1.59
Other borrowings	660,830	3,363	2.02	750,319	4,481	2.37
Total interest - bearing liabilities	6,249,580	13,700	0.87	5,921,046	23,092	1.55
Noninterest - bearing deposits	4,864,809			3,813,420		