

CITY NATIONAL CORP  
Form 10-Q  
August 14, 2003

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D. C. 20549

---

**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 June 30, 2003**

or

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

**For the transition period from            to**

**Commission File Number 1-10521**

---

**CITY NATIONAL CORPORATION**

(Exact name of registrant as specified in its charter)

Edgar Filing: CITY NATIONAL CORP - Form 10-Q

**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 July 31, 2003: **48,482,668**

---

## PART 1 - FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

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

(Unaudited)

| Dollars in thousands, except per share amounts  | June 30,<br>2003 | December 31,<br>2002 | June 30,<br>2002 |
|---|------------------|----------------------|------------------|
| <b>Assets</b>   |                  |                      |                  |
| Cash and due from banks   | \$ 451,291       | \$ 497,273           | \$ 442,343       |
| Federal funds sold  | 650,000          | 460,000              | 165,000          |
| Securities available-for-sale - cost \$2,935,401; \$2,169,444 and \$1,886,817 at June 30, 2003, December 31, 2002 and June 30, 2002, respectively | 2,992,686        | 2,226,656            | 1,919,985        |
| Trading account securities  | 88,035           | 172,211              | 68,832           |
| Loans   | 7,590,226        | 7,999,470            | 7,854,530        |
| Less allowance for credit losses  | 170,927          | 164,502              | 157,647          |
| Net loans   | 7,419,299        | 7,834,968            | 7,696,883        |
| Premises and equipment, net   | 64,966           | 61,208               | 60,016           |
| Deferred tax asset  | 50,488           | 36,578               | 39,186           |
| Goodwill  | 254,627          | 229,834              | 230,161          |
| Intangibles   | 48,597           | 27,007               | 30,959           |
| Bank owned life insurance   | 61,554           | 60,119               | 60,505           |
| Affordable housing investments  | 66,532           | 68,848               | 55,761           |
| Other assets  | 200,613          | 186,766              | 201,393          |
| Customers acceptance liability  | 6,145            | 8,924                | 11,396           |
| Total assets  | \$ 12,354,833    | \$ 11,870,392        | \$ 10,982,420    |
| <b>Liabilities</b>  |                  |                      |                  |
| Demand deposits   | \$ 4,916,678     | \$ 4,764,234         | \$ 3,973,435     |
| Interest checking deposits  | 689,658          | 692,261              | 610,217          |
| Money market deposits   | 3,140,203        | 2,929,501            | 2,472,224        |
| Savings deposits  | 211,010          | 198,288              | 222,241          |
| Time deposits-under \$100,000   | 210,333          | 218,447              | 226,116          |
| Time deposits-\$100,000 and over  | 998,924          | 1,036,967            | 1,292,934        |
| Total deposits  | 10,166,806       | 9,839,698            | 8,797,167        |
| Federal funds purchased and securities sold under repurchase agreements   | 167,084          | 266,727              | 110,665          |
| Other short-term borrowings   | 115,125          | 125,125              | 421,125          |
| Subordinated debt   | 318,282          | 303,795              | 282,043          |
| Long-term debt  | 283,954          | 68,682               | 169,144          |

Edgar Filing: CITY NATIONAL CORP - Form 10-Q

|   |                      |                      |                      |
|---|----------------------|----------------------|----------------------|
| Other liabilities   | 126,703              | 126,303              | 110,804              |
| Acceptances outstanding   | 6,145                | 8,924                | 11,396               |
| <b>Total liabilities</b>  | <b>11,184,099</b>    | <b>10,739,254</b>    | <b>9,902,344</b>     |
| <b>Minority interest in consolidated subsidiaries</b>   | <b>26,044</b>        | <b>21,179</b>        | <b>6,738</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 - 50,455,363; 50,282,743 and 50,122,921 shares at June 30, 2003, December 31, 2002 and June 30, 2002, respectively | 50,455               | 50,283               | 50,123               |
| Additional paid-in capital  | 404,741              | 400,866              | 396,058              |
| Accumulated other comprehensive income  | 39,781               | 40,400               | 25,673               |
| Retained earnings   | 745,017              | 675,195              | 601,484              |
| Deferred equity compensation  | (7,595)              |                      |                      |
| Treasury shares, at cost - 2,027,574; 1,299,312; and 0 shares at June 30, 2003, December, 31, 2002 and June 30, 2002, respectively  | (87,709)             | (56,785)             |                      |
| <b>Total shareholders equity</b>  | <b>1,144,690</b>     | <b>1,109,959</b>     | <b>1,073,338</b>     |
| <b>Total liabilities and shareholders equity</b>  | <b>\$ 12,354,833</b> | <b>\$ 11,870,392</b> | <b>\$ 10,982,420</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<br>June 30, |            | For the six months ended<br>June 30, |            |
|---|--|------------|--------------------------------------|------------|
|   | 2003                                   | 2002       | 2003                                 | 2002       |
| <b>Interest Income</b>  |  |            |                                      |            |
| Loans   | \$ 111,176                             | \$ 126,704 | \$ 226,912                           | \$ 247,322 |
| Securities available-for-sale   | 32,292                                 | 27,923     | 61,723                               | 54,951     |
| Federal funds sold and securities purchased under resale agreements     | 771                                    | 704        | 1,182                                | 1,211      |
| Trading account   | 94                                     | 180        | 192                                  | 385        |
| Total interest income   | 144,333                                | 155,511    | 290,009                              | 303,869    |
| <b>Interest Expense</b>   |  |            |                                      |            |
| Deposits  | 12,548                                 | 18,168     | 26,022                               | 37,111     |
| Subordinated debt   | 1,349                                  | 1,732      | 2,763                                | 3,927      |
| Other long-term debt  | 2,342                                  | 1,080      | 3,694                                | 2,221      |
| Federal funds purchased and securities sold under repurchase agreements | 414                                    | 805        | 1,039                                | 1,585      |
| Other short-term borrowings   | 556                                    | 3,152      | 1,150                                | 6,756      |
| Total interest expense  | 17,209                                 | 24,937     | 34,668                               | 51,600     |
| Net interest income   | 127,124                                | 130,574    | 255,341                              | 252,269    |
| Provision for credit losses   | 11,500                                 | 18,000     | 29,000                               | 29,000     |
| Net interest income after provision for credit losses                   | 115,624                                | 112,574    | 226,341                              | 223,269    |
| <b>Noninterest Income</b>   |  |            |                                      |            |
| Trust fees and investment fee revenue                                   | 21,505                                 | 15,736     | 36,985                               | 30,010     |
| Cash management and deposit transaction charges                         | 10,660                                 | 10,025     | 21,577                               | 20,394     |
| International services  | 5,019                                  | 4,719      | 9,347                                | 8,510      |
| Bank owned life insurance   | 731                                    | 719        | 1,445                                | 1,392      |
| Gain on sale of loans and assets  |  | 1,320      | 102                                  | 2,999      |
| Gain on sale of securities  | 1,272                                  | 184        | 2,502                                | 872        |
| Other   | 5,865                                  | 6,035      | 12,070                               | 10,504     |
| Total noninterest income  | 45,052                                 | 38,738     | 84,028                               | 74,681     |
| <b>Noninterest Expense</b>  |  |            |                                      |            |
| Salaries and employee benefits  | 54,516                                 | 49,642     | 106,321                              | 97,112     |
| Net occupancy of premises   | 7,862                                  | 6,495      | 14,831                               | 12,675     |
| Professional  | 6,769                                  | 5,182      | 13,205                               | 10,411     |
| Information services  | 4,302                                  | 4,661      | 8,555                                | 9,021      |
| Depreciation  | 3,019                                  | 3,336      | 6,138                                | 6,728      |
| Marketing and advertising   | 3,553                                  | 3,311      | 6,665                                | 6,099      |
| Office services   | 2,398                                  | 2,731      | 4,968                                | 4,829      |
| Amortization of intangibles   | 2,227                                  | 2,056      | 4,203                                | 3,571      |

Edgar Filing: CITY NATIONAL CORP - Form 10-Q

|   |           |           |           |            |
|---|-----------|-----------|-----------|------------|
| Equipment   | 638       | 789       | 1,304     | 1,271      |
| Other operating   | 6,032     | 4,671     | 10,538    | 9,858      |
| Total noninterest expense   | 91,316    | 82,874    | 176,728   | 161,575    |
| <b>Minority interest in net income of consolidated subsidiaries</b>     | 1,065     | 85        | 1,540     | 157        |
| Income before income taxes  | 68,295    | 68,353    | 132,101   | 136,218    |
| Income taxes  | 22,214    | 22,593    | 42,365    | 46,222     |
| <b>Net income</b>   | 46,081    | 45,760    | 89,736    | 89,996     |
| Other comprehensive income  |           |           |           |            |
| Unrealized gain (loss) on securities available-for-sale                 | 414       | 38,496    | (2,434)   | 28,244     |
| Unrealized gain (loss) on cash flow hedges                              | (43)      | 1,342     | 485       | (1,935)    |
| Less reclassification adjustment for (gain) loss included in net income | (3,341)   | 232       | (886)     | 425        |
| Income taxes (benefit)  | 1,562     | 16,652    | (444)     | 10,885     |
| Other comprehensive gain (loss)   | 2,150     | 22,954    | (619)     | 14,999     |
| Comprehensive income  | \$ 48,231 | \$ 68,714 | \$ 89,117 | \$ 104,995 |
| Net income per share, basic   | \$ 0.95   | \$ 0.92   | \$ 1.85   | \$ 1.82    |
| Net income per share, diluted   | \$ 0.93   | \$ 0.88   | \$ 1.80   | \$ 1.75    |
| Shares used to compute income per share, basic                          | 48,308    | 49,963    | 48,543    | 49,327     |
| Shares used to compute income per share, diluted                        | 49,524    | 52,083    | 49,824    | 51,443     |
| Dividends per share   | \$ 0.205  | \$ 0.195  | \$ 0.410  | \$ 0.390   |

See accompanying Notes to the Unaudited Consolidated Financial Statements.

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

(Unaudited)

| Dollars in thousands  | For the six months ended<br>June 30, |           |
|---|--------------------------------------|-----------|
|   | 2003                                 | 2002      |
| <b>Cash Flows From Operating Activities</b>   |                                      |           |
| Net income  | \$ 89,736                            | \$ 89,996 |
| Adjustments to net income:  |                                      |           |
| Provision for credit losses   | 29,000                               | 29,000    |
| Amortization of intangibles   | 4,203                                | 3,571     |
| Depreciation  | 6,138                                | 6,728     |
| Deferred income tax benefit   | (13,434)                             | (7,929)   |
| Gain on sales of loans and assets   | (102)                                | (2,999)   |
| Gain on sales of securities   | (2,502)                              | (872)     |
| Net decrease (increase) in other assets   | 10,399                               | (24,889)  |
| Net decrease in trading securities  | 84,176                               | 9,434     |
| Other, net  | 9,108                                | (893)     |
| Net cash provided by operating activities   | 216,722                              | 101,147   |
| <b>Cash Flows From Investing Activities</b>   |                                      |           |
| Purchase of securities  | (1,602,880)                          | (450,710) |
| Sales of securities available-for-sale  | 111,240                              | 88,529    |
| Maturities and paydowns of securities   | 722,869                              | 318,116   |
| Loan principal collections (originations), net  | 380,151                              | (353,518) |
| Purchase of premises and equipment  | (10,906)                             | (2,455)   |
| Net cash from (for) acquisitions  | (39,907)                             | 35,633    |
| Other, net  | (3)                                  | 3         |
| Net cash used by investing activities   | (439,436)                            | (364,402) |
| <b>Cash Flows From Financing Activities</b>   |                                      |           |
| Net increase in deposits  | 327,108                              | 227,502   |
| Net decrease in federal funds purchased and securities sold under repurchase agreements | (99,643)                             | (60,866)  |
| Net decrease in short-term borrowings, net of transfers from long-term debt             | (25,000)                             | (19,000)  |
| Repayment of long-term debt   | (1,367)                              |           |
| Net proceeds of issuance of senior debt   | 221,749                              |           |
| Proceeds from exercise of stock options   | 9,016                                | 19,187    |
| Stock repurchases   | (45,217)                             |           |
| Cash dividends paid   | (19,914)                             | (19,243)  |

Edgar Filing: CITY NATIONAL CORP - Form 10-Q

|  |              |            |
|--|--------------|------------|
| Net cash provided by financing activities            | 366,732      | 147,580    |
| Net increase (decrease) in cash and cash equivalents | 144,018      | (115,675)  |
| Cash and cash equivalents at beginning of year       | 957,273      | 723,018    |
| Cash and cash equivalents at end of period           | \$ 1,101,291 | \$ 607,343 |

**Supplemental Disclosures of Cash Flow Information:**

Cash paid during the period for:

|              |           |           |
|--------------|-----------|-----------|
| Interest     | \$ 31,309 | \$ 51,029 |
| Income taxes | 44,000    | 28,500    |

Non-cash investing activities:

|   |        |        |
|---|--------|--------|
| Transfer from loans to foreclosed assets              | \$     | \$ 530 |
| Transfer from long-term debt to short-term borrowings | 15,000 | 25,000 |

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 six months ended<br>June 30, |           |
|---|--------------------------------------|-----------|
|   | 2003                                 | 2002      |
| <b>Common Stock</b>   |                                      |           |
| Balance, beginning of period  | \$ 50,283                            | \$ 48,150 |
| Stock issued for acquisitions   |                                      | 1,208     |
| Stock options exercised   | 2                                    | 765       |
| Restricted stock and units issued   | 170                                  |           |
| Balance, end of period  | 50,455                               | 50,123    |
| <b>Additional paid-in capital</b>   |                                      |           |
| Balance, beginning of period  | 400,866                              | 301,022   |
| Tax benefit from stock options  | 1,601                                | 7,836     |
| Stock options exercised   | (5,279)                              | 18,422    |
| Restricted stock and units issued   | 7,553                                |           |
| Excess of market value of shares issued for acquisitions over historical cost |                                      | 68,778    |
| Balance, end of period  | 404,741                              | 396,058   |
| <b>Accumulated other comprehensive income</b>                                 |                                      |           |
| Balance, beginning of period  | 40,400                               | 10,674    |
| Other comprehensive income (loss) net of income taxes                         | (619)                                | 14,999    |
| Balance, end of period  | 39,781                               | 25,673    |
| <b>Retained earnings</b>  |                                      |           |
| Balance, beginning of period  | 675,195                              | 530,731   |
| Net income  | 89,736                               | 89,996    |
| Dividends paid  | (19,914)                             | (19,243)  |
| Balance, end of period  | 745,017                              | 601,484   |
| <b>Deferred equity compensation</b>   |                                      |           |
| Balance, beginning of period  |                                      |           |
| Unamortized cost of restricted stock and units                                | (7,595)                              |           |
| Balance, end of period  | (7,595)                              |           |
| <b>Treasury shares</b>  |                                      |           |
| Balance, beginning of period  | (56,785)                             |           |
| Purchase of shares  | (45,217)                             |           |
| Issuance of shares for stock options  | 14,293                               |           |
| Balance, end of period  | (87,709)                             |           |

Edgar Filing: CITY NATIONAL CORP - Form 10-Q

|                           |    |           |    |           |
|---------------------------|----|-----------|----|-----------|
| Total shareholders equity | \$ | 1,144,690 | \$ | 1,073,338 |
|---------------------------|----|-----------|----|-----------|

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 June 30, 2003. Reserves established as a purchase price adjustment for the February 28, 2002 acquisition of Civic BanCorp of \$0.8 million for exit costs relating to surplus space remain as of June 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. During the second quarter of 2003, 537,300 shares were repurchased under this program at an average price of \$41.64 per share. 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 2,027,574 treasury shares at June 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 June 30, 2003, 1,189,835 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<br>June 30, |           | For the six months ended<br>June 30, |           |
|--|--|-----------|--------------------------------------|-----------|
|  | 2003                                   | 2002      | 2003                                 | 2002      |
| Net income, as reported                                  | \$ 46,081                              | \$ 45,760 | \$ 89,736                            | \$ 89,996 |
| Proforma net income                                      | 44,529                                 | 43,219    | 86,717                               | 84,914    |
| Net income per share, basic, as reported                 | 0.95                                   | 0.92      | 1.85                                 | 1.82      |
| Proforma net income per share, basic                     | 0.92                                   | 0.86      | 1.79                                 | 1.72      |
| Net income per share, diluted, as reported               | 0.93                                   | 0.88      | 1.80                                 | 1.75      |
| Proforma net income per share, diluted                   | 0.90                                   | 0.83      | 1.74                                 | 1.65      |
| Percentage reduction in net income per share,<br>diluted | 3.32%                                  | 5.68%     | 3.33%                                | 5.71%     |

During the latter part of the quarter, 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 \$129,000 in expense for restricted stock awards in the second quarter, and going forward expects to expense \$387,000 quarterly for this stock award.

9. In January 2003, the FASB issued Interpretation No. 46, Consolidation of Variable Interest Entities. Interpretation 46 clarifies the application of Accounting Research Bulletin No. 51, Consolidated Financial Statements, to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. The recognition and measurement provisions of Interpretation 46 are effective for newly created variable interest entities formed after January 31, 2003, and for existing variable interest entities, on the first interim or annual reporting period beginning after June 15, 2003. The Company will adopt the provisions of Interpretation 46 for existing variable interest entities on July 1, 2003, which are not expected to have a material effect on the Company's financial statements.

In April 2003, the FASB issued Statement No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities. Statement 149 amends and clarifies accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under Statement 133. In particular, this Statement clarifies under what circumstances a contract with an initial net investment meets the characteristic of a derivative and when a derivative contains a financing component that warrants special reporting in the statement of cash flows. This Statement is generally effective for contracts entered into or modified after June 30, 2003 and is not expected to have a material impact on the Company's financial statements.

In May 2003, the FASB issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity (SFAS No. 150). SFAS No. 150 requires issuers to classify as liabilities (or assets in some circumstances) three classes of freestanding financial instruments that embody obligations for the issuer. Generally, SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. SFAS No. 150 is to be implemented by reporting the cumulative effect of a change in an accounting principle for financial instruments created before May 15, 2003 and still existing at the beginning of the interim period of adoption. The adoption of SFAS No. 150 is not expected to have a material effect on the Company's financial statements, as the preferred securities of our subsidiary trusts will continue to be reported as a liability on the consolidated statements of financial condition.

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 \$6.9 billion as of June 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 \$25.1 million in goodwill.

11. On July 15, 2003, the Board of Directors approved a 37 percent increase in the Company's quarterly common stock cash dividend. The new quarterly dividend of \$0.28 per share is up from the \$0.205 per share previously paid.

## CITY NATIONAL CORPORATION

## FINANCIAL HIGHLIGHTS

(Unaudited)

| Dollars in thousands, except per share amounts  | At or for the three months ended |                   |                  | Percentage change<br>June 30, 2003 from |                  |
|---|----------------------------------|-------------------|------------------|---|------------------|
|   | June 30,<br>2003                 | March 31,<br>2003 | June 30,<br>2002 | March 31,<br>2003                       | June 30,<br>2002 |
| <b>For The Quarter</b>                          |                                  |                   |                  |   |                  |
| Net income                                      | \$ 46,081                        | \$ 43,655         | \$ 45,760        | 6%                                      | 1%               |
| Net income per common share, basic              | 0.95                             | 0.89              | 0.92             | 7                                       | 3                |
| Net income per common share, diluted            | 0.93                             | 0.87              | 0.88             | 7                                       | 6                |
| Dividends, per common share                     | 0.205                            | 0.205             | 0.195            | 0                                       | 5                |
| <b>At Quarter End</b>                           |                                  |                   |                  |   |                  |
| Assets  | \$ 12,354,833                    | \$ 12,012,472     | \$ 10,982,420    | 3                                       | 12               |
| Deposits  | 10,166,806                       | 9,863,846         | 8,797,167        | 3                                       | 16               |
| Loans   | 7,590,226                        | 7,832,823         | 7,854,530        | (3)                                     | (3)              |
| Securities                                      | 2,992,686                        | 2,531,809         | 1,919,985        | 18                                      | 56               |
| Shareholders equity                             | 1,144,690                        | 1,121,689         | 1,073,338        | 2                                       | 7                |
| Book value per share                            | 23.77                            | 23.09             | 21.41            | 3                                       | 11               |
| <b>Average Balances</b>                         |                                  |                   |                  |   |                  |
| Assets  | \$ 11,914,869                    | \$ 11,480,626     | \$ 10,934,265    | 4                                       | 9                |
| Deposits  | 9,774,905                        | 9,373,839         | 8,551,230        | 4                                       | 14               |
| Loans   | 7,793,863                        | 7,964,338         | 7,889,005        | (2)                                     | (1)              |
| Securities                                      | 2,900,785                        | 2,441,796         | 2,029,742        | 19                                      | 43               |
| Shareholders equity                             | 1,131,682                        | 1,117,573         | 1,047,042        | 1                                       | 8                |
| <b>Selected Ratios</b>                          |                                  |                   |                  |   |                  |
| Return on average assets                        | 1.55%                            | 1.54%             | 1.68%            | 1                                       | (8)              |
| Return on average shareholders equity           | 16.33                            | 15.84             | 17.53            | 3                                       | (7)              |
| Corporation's tier 1 leverage                   | 7.17                             | 7.65              | 7.44             | (6)                                     | (4)              |
| Corporation's tier 1 risk-based capital         | 10.21                            | 10.30             | 9.74             | (1)                                     | 5                |
| Corporation's total risk-based capital          | 14.45                            | 14.46             | 14.24            | 0                                       | 1                |
| Dividend payout ratio, per share                | 21.51                            | 22.91             | 21.34            | (6)                                     | 1                |
| Net interest margin                             | 4.79                             | 5.07              | 5.35             | (6)                                     | (10)             |
| Efficiency ratio *                              | 52.53                            | 50.28             | 47.95            | 4                                       | 10               |
| <b>Asset Quality Ratios</b>                     |                                  |                   |                  |   |                  |
| Nonaccrual loans to total loans                 | 0.91%                            | 1.27%             | 0.82%            | (28)                                    | 11               |
| Nonaccrual loans and ORE to total loans and ORE | 0.92                             | 1.28              | 0.83             | (28)                                    | 11               |
| Allowance for credit losses to total loans      | 2.25                             | 2.16              | 2.01             | 4                                       | 12               |

Edgar Filing: CITY NATIONAL CORP - Form 10-Q

|   |        |        |        |      |      |
|---|--------|--------|--------|------|------|
| Allowance for credit losses to non accrual<br>loans | 246.37 | 169.93 | 244.67 | 45   | 1    |
| Net charge-offs to average loans - annualized       | (0.52) | (0.64) | (0.81) | (19) | (36) |

---

\* 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 \$46.1 million, or \$0.93 per common share, for the second quarter of 2003, compared with net income of \$45.8 million, or \$0.88 per share, for the second quarter of 2002 on fewer common shares outstanding this year.

For the first half of 2003, City National Corporation recorded net income of \$89.7 million, or \$1.80 per share, compared with net income of \$90.0 million, or \$1.75 per share, reported for the first half of 2002.

**HIGHLIGHTS**

Average core deposits for the second quarter were up 21 percent from a year ago, up 5 percent from the prior quarter and up 23 percent for the first six months from the same period last year.

Average loans for the first six months were up 3 percent from the same period last year. However, average loans for the second quarter declined 1 percent from a year ago and were 2 percent lower than the prior quarter. These declines reflect the continued slow demand for commercial loans and the Company's continuing attention to credit quality.

Net interest income for the first half of 2003 increased 1 percent over the first half of 2002 but fell 3 percent in the second quarter compared with the year ago quarter. This decline is consistent with the compression in the net interest margin to 4.79 percent during the period.

Nonaccrual loans fell by \$30.4 million, or 30 percent, from March 31, 2003 to \$69.4 million, contributing to a lower provision for credit losses of \$11.5 million for the second quarter of 2003.

Exposure to syndicated non-relationship commercial and purchased media and telecommunication loans declined 40 percent from March 31, 2003 to \$52.2 million at June 30, 2003.

Fueled by the acquisition of Convergent Capital Management ( CCM ) in April 2003, noninterest income continued to increase. It rose 16 percent over both the second quarter of 2002 and the first quarter of this year. For the first six months, noninterest income was up 13 percent from the same period last year.

Edgar Filing: CITY NATIONAL CORP - Form 10-Q

| \$ in millions,<br>except per share | For the three months ended<br>June 30, |          |     | %<br>Change | For the three<br>months ended<br>March 31, 2003 | For the six months ended<br>June 30, |      |  | %<br>Change |
|-------------------------------------|--|----------|-----|-------------|---|--------------------------------------|------|--|-------------|
|                                     | 2003                                   | 2002     |     |             |   | 2003                                 | 2002 |  |             |
| Earnings Per Share                  | \$ 0.93                                | \$ 0.88  | 6   | \$ 0.87     | \$ 1.80   | \$ 1.75                              | 3    |  |             |
| Net Income                          | 46.1                                   | 45.8     | 1   | 43.7        | 89.7  | 90.0                                 | (0)  |  |             |
| Average Assets                      | 11,914.9                               | 10,934.3 | 9   | 11,480.6    | 11,698.9  | 10,640.8                             | 10   |  |             |
| Return on Average<br>Assets         | 1.55%                                  | 1.68%    | (8) | 1.54%       | 1.55%   | 1.71%                                | (9)  |  |             |
| Return on Average<br>Equity         | 16.33                                  | 17.53    | (7) | 15.84       | 16.09   | 18.21                                | (12) |  |             |

Return on average assets for the second quarter and the first six months of 2003 declined due to an increase in average assets, primarily lower-yielding securities. The lower return on average shareholders' equity was due primarily to a higher level of shareholders' equity from retained net income, issuance of restricted shares to colleagues, and from the exercise of stock options, net of treasury share repurchases.

Outlook

Consistent with its July 15, 2003 second quarter earnings release, management currently expects net income per diluted common share for 2003 to be approximately 4 to 6 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 10 to 13 percent

Net interest margin 4.75 to 4.90 percent

Provision for credit losses \$50 million to \$65 million

Noninterest income growth 18 to 21 percent

Noninterest expense growth 9 to 12 percent

Effective tax rate 31 to 33 percent

Revenues

Revenues (net interest income plus noninterest income) increased 2 percent to \$172.2 million in the second quarter of 2003 from \$169.3 million in the second quarter of 2002 and increased 3 percent from the first quarter of 2003 due in part to the acquisition of CCM in April 2003. For the first half of 2003, revenues increased 4 percent to \$339.4 million compared with \$327.0 million for the first half of 2002.

*Net Interest Income*

Net interest income for the second quarter of 2003 was \$130.8 million on a fully taxable-equivalent basis, a 3 percent decrease from \$134.3 million in the second quarter of 2002 due to lower interest rates and lower commercial loan demand. Fully taxable-equivalent net interest income for the first six months of 2003 was \$262.6 million compared with \$259.7 million for the first six months of 2002.

| \$ in millions                                     | For the three months ended<br>June 30, |            |             | For the three<br>months ended<br>March 31, 2003 | For the six months ended<br>June 30, |            |             |
|--|--|------------|-------------|---|--------------------------------------|------------|-------------|
|  | 2003                                   | 2002       | %<br>Change |   | 2003                                 | 2002       | %<br>Change |
| Average Loans                                      | \$ 7,793.9                             | \$ 7,889.0 | (1)         | \$ 7,964.3                                      | \$ 7,878.6                           | \$ 7,678.4 | 3           |
| Average Securities                                 | 2,900.8                                | 2,029.7    | 43          | 2,441.8   | 2,672.6                              | 1,977.4    | 35          |
| Average Deposits                                   | 9,774.9                                | 8,551.2    | 14          | 9,373.8   | 9,575.5                              | 8,244.1    | 16          |
| Average Core Deposits                              | 8,763.1                                | 7,238.8    | 21          | 8,326.5   | 8,546.0                              | 6,921.5    | 23          |
| Fully<br>Taxable-Equivalent Net<br>Interest Income | 130.8                                  | 134.3      | (3)         | 131.9   | 262.6                                | 259.7      | 1           |
| Net Interest Margin                                | 4.79%                                  | 5.35%      | (10)        | 5.07%   | 4.93%                                | 5.35%      | (8)         |

Second-quarter and year-to-date 2003 average deposits continued to increase over the prior-year periods as well as from the prior quarter.

Average loans for the second quarter of 2003 declined compared with the same period last year and the prior quarter due to economic uncertainties and the emphasis on credit quality. However, average loans for the first six months of 2003 increased over the same period last year.

The net interest margin narrowed due to a flattening yield curve, mortgage prepayment activity and low interest rates.

Compared with the prior-year second-quarter averages, commercial loans declined 8 percent, residential first mortgage loans rose 1 percent, real estate mortgage loans rose 6 percent, and real estate construction loans rose 9 percent. Compared with the prior quarter, average real estate construction loans increased while all other loan categories fell. Compared with the first six months of 2002, commercial loans decreased 2 percent, residential first mortgage loans rose 4 percent, real estate mortgage loans rose 9 percent, and real estate construction loans rose 9 percent.

Average securities, principally with lower yields and shorter durations, continued to increase as deposits grew strongly. As of June 30, 2003 unrealized gains on securities available-for-sale were \$57.3 million.

During the second quarter of 2003, average core deposits — which include all deposits except time deposits of \$100,000 or more — rose to \$8.8 billion, an increase of 21 percent over the \$7.2 billion reported for the second quarter of 2002. They rose 5 percent over the first quarter of 2003. For the first half of 2003, average core deposits increased 23 percent over the same period last year. Average core deposits represented 90 percent of the total average deposit base for the second quarter of 2003, compared with 85 percent for the second quarter of 2002 and 89 percent for the first quarter of 2003. For the first half of 2003, average core deposits were 89 percent of total average deposits compared with 84 percent for the first half of 2002. New clients, additional trust and escrow deposits and higher client balances maintained as deposits to pay for services contributed to the continued growth of deposits.

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

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 \$976.4 million, added \$7.5 million to net interest income in the second quarter of 2003. That compared with \$8.5 million in the second quarter of 2002 and \$7.5 million for the first quarter of 2003. These amounts included \$5.2 million, \$3.7 million and \$4.5 million, respectively, for interest swaps qualifying as fair-value hedges. Income from swaps qualifying as cash-flow hedges was \$2.3 million for the second quarter of 2003, compared with \$4.8 million for the second quarter of 2002 and \$3.0 million for the first quarter of 2003. For the first half of 2003, interest rate swaps added \$15.0 million to net interest income, compared with \$16.4 million for the first half of 2002. These amounts include \$9.7 million and \$6.9 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 \$8.5 million.

Interest income recovered on nonaccrual and charged-off loans included above was \$0.4 million for the second quarter of 2003, compared with \$0.6 million for the second quarter of 2002 and \$0.6 million for the first quarter of 2003, respectively.

The following tables present the components of net interest income on a fully taxable-equivalent basis for the three and six months ended June 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<br>June 30, 2003 |                                    |                             | For the three months ended<br>June 30, 2002 |                                    |                             |
|---|---|------------------------------------|-----------------------------|---|------------------------------------|-----------------------------|
|   | Average<br>Balance                          | Interest<br>income/<br>expense (2) | Average<br>interest<br>rate | Average<br>Balance                          | Interest<br>income/<br>expense (2) | Average<br>interest<br>rate |
| <b>Assets</b>   |   |                                    |                             |   |                                    |                             |
| Interest-earning assets   |   |                                    |                             |   |                                    |                             |
| Loans   |   |                                    |                             |   |                                    |                             |
| Commercial  | \$ 3,402,342                                | \$ 44,309                          | 5.22%                       | \$ 3,687,873                                | \$ 55,856                          | 6.07%                       |
| Real estate mortgages   | 1,906,995                                   | 31,297                             | 6.58                        | 1,791,314                                   | 32,651                             | 7.31                        |
| Residential first mortgages   | 1,733,015                                   | 26,737                             | 6.19                        | 1,718,680                                   | 29,468                             | 6.88                        |
| Real estate construction  | 679,541                                     | 8,903                              | 5.25                        | 622,223                                     | 8,780                              | 5.66                        |
| Installment   | 71,970                                      | 1,409                              | 7.85                        | 68,915                                      | 1,558                              | 9.07                        |
| Total loans (1)   | 7,793,863                                   | 112,655                            | 5.80                        | 7,889,005                                   | 128,313                            | 6.52                        |
| Securities available-for-sale   | 2,844,001                                   | 34,440                             | 4.86                        | 1,980,089                                   | 30,079                             | 6.09                        |
| Federal funds sold and securities purchased under resale agreements     | 246,559                                     | 771                                | 1.25                        | 149,255                                     | 704                                | 1.89                        |
| Trading account securities  | 56,784                                      | 97                                 | 0.69                        | 49,653                                      | 184                                | 1.49                        |
| Total interest-earning assets   | 10,941,207                                  | 147,963                            | 5.42                        | 10,068,002                                  | 159,280                            | 6.35                        |
| Allowance for credit losses   | (174,270)                                   |                                    |                             | (160,779)                                   |                                    |                             |
| Cash and due from banks   | 429,788                                     |                                    |                             | 414,851                                     |                                    |                             |
| Other nonearning assets   | 718,144                                     |                                    |                             | 612,191                                     |                                    |                             |
| Total assets  | \$ 11,914,869                               |                                    |                             | \$ 10,934,265                               |                                    |                             |
| <b>Liabilities and Shareholders Equity</b>                              |   |                                    |                             |   |                                    |                             |
| Interest-bearing deposits   |   |                                    |                             |   |                                    |                             |
| Interest checking accounts  | \$ 711,609                                  | 304                                | 0.17                        | \$ 627,118                                  | 405                                | 0.26                        |
| Money market accounts   | 3,097,697                                   | 7,257                              | 0.94                        | 2,388,757                                   | 8,512                              | 1.43                        |
| Savings deposits  | 205,378                                     | 239                                | 0.47                        | 229,726                                     | 504                                | 0.88                        |
| Time deposits - under \$100,000   | 212,060                                     | 931                                | 1.76                        | 226,137                                     | 1,339                              | 2.37                        |
| Time deposits - \$100,000 and over                                      | 1,011,850                                   | 3,817                              | 1.51                        | 1,312,423                                   | 7,408                              | 2.26                        |
| Total interest - bearing deposits                                       | 5,238,594                                   | 12,548                             | 0.96                        | 4,784,161                                   | 18,168                             | 1.52                        |
| Federal funds purchased and securities sold under repurchase agreements |   |                                    |                             |   |                                    |                             |
|   | 146,000                                     | 414                                | 1.14                        | 201,489                                     | 805                                | 1.60                        |
| Other borrowings  | 709,391                                     | 4,247                              | 2.40                        | 1,021,421                                   | 5,964                              | 2.34                        |
| Total interest - bearing liabilities                                    | 6,093,985                                   | 17,209                             | 1.13                        | 6,007,071                                   | 24,937                             | 1.67                        |
| Noninterest - bearing deposits  | 4,536,311                                   |                                    |                             | 3,767,069                                   |                                    |                             |
| Other liabilities   | 152,891                                     |                                    |                             | 113,083                                     |                                    |                             |
| Shareholders equity   | 1,131,682                                   |                                    |                             | 1,047,042                                   |                                    |                             |
|   | \$ 11,914,869                               |                                    |                             | \$ 10,934,265                               |                                    |                             |

Edgar Filing: CITY NATIONAL CORP - Form 10-Q

Total liabilities and  
shareholders' equity

|   |    |         |    |         |
|---|----|---------|----|---------|
| Net interest spread                             |    | 4.29%   |    | 4.68%   |
| Fully taxable-equivalent net<br>interest income | \$ | 130,754 | \$ | 134,343 |
| Net interest margin                             |    | 4.79%   |    | 5.35%   |

---

(1) Includes average nonaccrual loans of \$79,818 and \$58,210 for 2003 and 2002, respectively.

(2) Loan income includes loan fees of \$5,620 and \$5,574 for 2003 and 2002, respectively.

## Net Interest Income Summary

| Dollars in thousands  | For the six months ended<br>June 30, 2003 |                                    |                             | For the six months ended<br>June 30, 2002 |                                    |                             |
|---|---|------------------------------------|-----------------------------|---|------------------------------------|-----------------------------|
|   | Average<br>Balance                        | Interest<br>income/<br>expense (2) | Average<br>interest<br>rate | Average<br>Balance                        | Interest<br>income/<br>expense (2) | Average<br>interest<br>rate |
| <b>Assets</b>   |   |                                    |                             |   |                                    |                             |
| Interest-earning assets   |   |                                    |                             |   |                                    |                             |
| Loans   |   |                                    |                             |   |                                    |                             |
| Commercial  | \$ 3,480,938                              | \$ 91,499                          | 5.30%                       | \$ 3,560,880                              | \$ 108,865                         | 6.17%                       |
| Real estate mortgages   | 1,907,770                                 | 62,949                             | 6.65                        | 1,754,779                                 | 63,548                             | 7.30                        |
| Residential first mortgages   | 1,744,861                                 | 54,901                             | 6.35                        | 1,676,088                                 | 57,747                             | 6.95                        |
| Real estate construction  | 671,791                                   | 17,743                             | 5.33                        | 616,582                                   | 17,174                             | 5.62                        |
| Installment   | 73,267                                    | 2,909                              | 8.01                        | 70,059                                    | 3,165                              | 9.11                        |
| Total loans (1)   | 7,878,627                                 | 230,001                            | 5.89                        | 7,678,388                                 | 250,499                            | 6.58                        |
| Securities available-for-sale   | 2,616,060                                 | 65,900                             | 5.08                        | 1,922,114                                 | 59,233                             | 6.21                        |
| Federal funds sold and securities purchased under resale agreements     | 190,088                                   | 1,182                              | 1.25                        | 139,530                                   | 1,211                              | 1.75                        |
| Trading account securities  | 56,501                                    | 198                                | 0.71                        | 55,319                                    | 392                                | 1.43                        |
| Total interest-earning assets   | 10,741,276                                | 297,281                            | 5.58                        | 9,795,351                                 | 311,335                            | 6.41                        |
| Allowance for credit losses   | (171,860)                                 |                                    |                             | (155,494)                                 |                                    |                             |
| Cash and due from banks   | 435,402                                   |                                    |                             | 419,075                                   |                                    |                             |
| Other nonearning assets   | 694,130                                   |                                    |                             | 581,894                                   |                                    |                             |
| Total assets  | \$ 11,698,948                             |                                    |                             | \$ 10,640,826                             |                                    |                             |
| <b>Liabilities and Shareholders Equity</b>                              |   |                                    |                             |   |                                    |                             |
| Interest-bearing deposits   |   |                                    |                             |   |                                    |                             |
| Interest checking accounts  | \$ 693,311                                | 641                                | 0.19                        | \$ 596,087                                | 758                                | 0.26                        |
| Money market accounts   | 3,043,562                                 | 14,830                             | 0.98                        | 2,261,972                                 | 16,259                             | 1.45                        |
| Savings deposits  | 201,856                                   | 501                                | 0.50                        | 236,291                                   | 1,231                              | 1.05                        |
| Time deposits - under \$100,000   | 213,865                                   | 1,941                              | 1.83                        | 230,197                                   | 2,937                              | 2.57                        |
| Time deposits - \$100,000 and over                                      | 1,029,504                                 | 8,109                              | 1.59                        | 1,322,541                                 | 15,926                             | 2.43                        |
| Total interest - bearing deposits                                       | 5,182,098                                 | 26,022                             | 1.01                        | 4,647,088                                 | 37,111                             | 1.61                        |
| Federal funds purchased and securities sold under repurchase agreements | 182,556                                   | 1,039                              | 1.15                        | 201,352                                   | 1,585                              | 1.59                        |
| Other borrowings  | 662,676                                   | 7,607                              | 2.31                        | 1,088,880                                 | 12,904                             | 2.39                        |
| Total interest - bearing liabilities                                    | 6,027,330                                 | 34,668                             | 1.16                        | 5,937,320                                 | 51,600                             | 1.75                        |
| Noninterest - bearing deposits  | 4,393,383                                 |                                    |                             | 3,596,974                                 |                                    |                             |
| Other liabilities   | 153,568                                   |                                    |                             | 109,842                                   |                                    |                             |
| Shareholders equity   | 1,124,667                                 |                                    |                             | 996,690                                   |                                    |                             |
|   | \$ 11,698,948                             |                                    |                             | \$ 10,640,826                             |                                    |                             |



Edgar Filing: CITY NATIONAL CORP - Form 10-Q

Total liabilities and  
shareholders' equity

|   |    |         |    |         |
|---|----|---------|----|---------|
| Net interest spread                             |    | 4.42%   |    | 4.66%   |
| Fully taxable-equivalent net<br>interest income | \$ | 262,613 | \$ | 259,735 |
| Net interest margin                             |    | 4.93%   |    | 5.35%   |

---

(1) Includes average nonaccrual loans of \$81,428 and \$50,901 for 2003 and 2002, respectively.

(2) Loan income includes loan fees of \$11,048 and \$11,891 for 2003 and 2002, respectively.

Edgar Filing: CITY NATIONAL CORP - Form 10-Q

Net interest income is impacted by the volume, mix and rate of interest-earning assets and interest-bearing liabilities. The following table shows changes in net interest income on a fully taxable-equivalent basis between the second quarter and the first six months of 2003 and the second quarter and the first six months of 2002, as well as between the second quarter and the first six months of 2002 and the second quarter and the first six months of 2001.

**Changes In Net Interest Income**

| Dollars in thousands  | For the three months ended June 30,<br>2003 vs 2002 |             |                               | For the three months ended June 30,<br>2002 vs 2001 |             |                               |
|---|---|-------------|-------------------------------|---|-------------|-------------------------------|
|   | Increase (decrease)<br>due to                       |             | Net<br>increase<br>(decrease) | Increase (decrease)<br>due to                       |             | Net<br>increase<br>(decrease) |
|   | Volume  | Rate        |                               | Volume  | Rate        |                               |
| <b>Interest earned on:</b>  |   |             |                               |   |             |                               |
| Loans   | \$ (1,542)  | \$ (14,116) | \$ (15,658)                   | \$ 24,465   | \$ (26,972) | \$ (2,507)                    |
| Securities available-for-sale                                       | 11,282  | (6,921)     | 4,361                         | 5,697   | (3,114)     | 2,583                         |
| Federal funds sold and securities purchased under resale agreements | 358   | (291)       | 67                            | 494   | (658)       | (164)                         |
| Trading account securities  | 23  | (110)       | (87)                          | (164)   | (310)       | (474)                         |
| Total interest-earning assets                                       | 10,121  | (21,438)    | (11,317)                      | 30,492  | (31,054)    | (562)                         |
| <b>Interest paid on:</b>  |   |             |                               |   |             |                               |
| Interest checking deposits  | 51  | (152)       | (101)                         | 42  | (122)       | (80)                          |
| Money market deposits   | 2,126   | (3,381)     | (1,255)                       | 5,234   | (9,365)     | (4,131)                       |
| Savings deposits  | (49)  | (216)       | (265)                         | (120)   | (1,382)     | (1,502)                       |
| Other time deposits   | (1,572)   | (2,427)     | (3,999)                       | (2,002)   | (10,789)    | (12,791)                      |
| Other borrowings  | (2,018)   | (90)        | (2,108)                       | (404)   | (7,596)     | (8,000)                       |
| Total interest-bearing liabilities                                  | (1,462)   | (6,266)     | (7,728)                       | 2,750   | (29,254)    | (26,504)                      |
|   | \$ 11,583   | \$ (15,172) | \$ (3,589)                    | \$ 27,742   | \$ (1,800)  | \$ 25,942                     |

| Dollars in thousands  | For the six months ended June 30,<br>2003 vs 2002 |             |                               | For the six months ended June 30,<br>2002 vs 2001 |             |                               |
|---|---|-------------|-------------------------------|---|-------------|-------------------------------|
|   | Increase (decrease)<br>due to                     |             | Net<br>increase<br>(decrease) | Increase (decrease)<br>due to                     |             | Net<br>increase<br>(decrease) |
|   | Volume  | Rate        |                               | Volume  | Rate        |                               |
| <b>Interest earned on:</b>  |   |             |                               |   |             |                               |
| Loans   | \$ 6,383  | \$ (26,881) | \$ (20,498)                   | \$ 43,159   | \$ (63,875) | \$ (20,716)                   |
| Securities  | 18,756  | (12,089)    | 6,667                         | 11,637  | (5,611)     | 6,026                         |
| Federal funds sold and securities purchased under resale agreements | 371   | (400)       | (29)                          | 1,120   | (1,380)     | (260)                         |
| Trading account securities  | 8   | (202)       | (194)                         | (220)   | (753)       | (973)                         |
| Total interest-earning assets                                       | 25,518  | (39,572)    | (14,054)                      | 55,696  | (71,619)    | (15,923)                      |

Edgar Filing: CITY NATIONAL CORP - Form 10-Q

Interest paid on:

|                                    |           |             |          |           |            |           |
|------------------------------------|-----------|-------------|----------|-----------|------------|-----------|
| Interest checking deposits         | 112       | (229)       | (117)    | 50        | (474)      | (424)     |
| Money market deposits              | 4,703     | (6,132)     | (1,429)  | 10,236    | (17,905)   | (7,669)   |
| Savings deposits                   | (159)     | (571)       | (730)    | (162)     | (2,758)    | (2,920)   |
| Other time deposits                | (3,289)   | (5,524)     | (8,813)  | (6,171)   | (24,279)   | (30,450)  |
| Other borrowings                   | (4,650)   | (1,193)     | (5,843)  | 1,308     | (18,961)   | (17,653)  |
| Total interest-bearing liabilities | (3,283)   | (13,649)    | (16,932) | 5,261     | (64,377)   | (59,116)  |
|                                    | \$ 28,801 | \$ (25,923) | \$ 2,878 | \$ 50,435 | \$ (7,242) | \$ 43,193 |

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

*Provision for Credit Losses*

The Company recorded a provision for credit losses of \$11.5 million for the second quarter of 2003, compared with \$18.0 million for the same period in 2002. The provision for credit losses in the first quarter of 2003 was \$17.5 million. The provision for credit losses primarily reflects declining nonaccrual loan levels, charge-offs, management's ongoing assessment of the credit quality of the portfolio and the economic environment, most notably in Northern California and in California's dairy industry. The Company's dairy portfolio contained \$150 million in outstanding loan balances as of June 30, 2003. All of these dairy loans are performing. Management believes the allowance for credit losses is adequate to cover risks in the portfolio at June 30, 2003. See — Allowance for Credit Losses.

*Noninterest Income*

The Company continues to emphasize growth in noninterest income through both the development of its existing business as well as from acquisitions. Noninterest income increased 16 percent to \$45.1 million for the second quarter of 2003, compared with \$38.7 million for the second quarter of 2002, primarily attributable to the acquisition of CCM. Noninterest income increased 16 percent over the first quarter of 2003. For the first half of 2003, noninterest income increased 13 percent to \$84.0 million compared with \$74.7 million for the first half of 2002.

Noninterest income as a percentage of total revenues for the second quarter and first half of 2003 was 26 percent and 25 percent, respectively, compared with 23 percent for the second quarter and first half of 2002 and 23 percent for the first quarter of 2003.

*Trust and Investment Fee Revenue*

| \$ in millions                   | At or for the<br>three months ended<br>June 30, |          |    | %<br>Change | For the<br>six months ended<br>June 30,               |         |      | %<br>Change |
|----------------------------------|---|----------|----|-------------|---|---------|------|-------------|
|                                  | 2003  | 2002     |    |             | At or for the three<br>months ended<br>March 31, 2003 | 2003    | 2002 |             |
| Trust and Investment Fee Revenue | \$ 21.5   | \$ 15.7  | 37 | \$ 15.5     | \$ 37.0   | \$ 30.0 | 23   |             |
| Assets Under Administration      | 26,237.3  | 18,271.1 | 44 | 19,840.8    |   |         |      |             |
| Assets Under Management (1)(2)   | 12,531.3  | 6,906.2  | 81 | 6,978.0     |   |         |      |             |

(1) Included above in assets under administration

(2) June 30, 2003 does not include an additional \$1,896 million of assets under management for the CCM minority owned asset managers

Assets under management at June 30, 2003 increased primarily due to the CCM acquisition in April 2003. New business in all other categories, aided by strong relative investment performance and higher market values, also contributed to the increase. The year-over-prior-year revenue increase for both second quarter and first six months of 2003 was driven by higher balances under administration partially attributable to the acquisition of CCM. Increases in market values are reflected in fee income primarily on a trailing quarter basis.

*Other Noninterest Income*

Cash management and deposit transaction fees for both the second quarter and first half of 2003 increased 6 percent over the same periods last year. Strong growth in deposits and higher sales of cash management products contributed to this growth. Cash management and deposit transaction fees for the second quarter of 2003 were slightly lower than they were in the first quarter when prior-year annual fees were recognized.

International services fees for the second quarter 2003 were up 6 percent over the same period last year and increased 16 percent from the first quarter of 2003. For the first half of 2003, international services fees were 10 percent higher than the first half of 2002. Higher foreign exchange fueled the year-over-year and prior quarter revenue growth while trade-finance revenue was down from 2002.

Gains on the sale of loans and other assets and gains on the sale of securities for the second quarter of 2003 amounted to \$1.3 million compared with \$1.5 million for the second quarter of 2002 and \$1.3 million for the first quarter of 2003. For the first half of 2003, \$2.6 million in gains were realized compared with \$3.9 million in gains for the first half of 2002.

#### *Noninterest Expense*

Noninterest expense was \$91.3 million in the second quarter of 2003, up 10 percent from \$82.9 million for the second quarter of 2002 and 7 percent from \$85.4 million for the first quarter of 2003. Expenses grew primarily because of the addition of CCM and to a lesser extent were due to the Company's continued modest expansion, principally in New York.

During the quarter, 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 \$129,000 in expense for restricted stock awards in the second quarter, and going forward expects to expense \$387,000 quarterly for this stock award.

Noninterest expense for the first half of 2003 increased 9 percent to \$176.7 million compared with \$161.6 million for the first half of 2002.

The Company's efficiency ratio for the second quarter of 2003 was 52.53 percent, compared with 47.95 percent for the second quarter of 2002 and 50.28 percent for the first quarter of 2003. The higher efficiency ratio is impacted by the acquisition of CCM. For the first half of 2003, the efficiency ratio was 51.42 percent compared with 47.95 percent for the first half of 2002.

#### *Minority Interest*

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

#### *Income Taxes*

## Edgar Filing: CITY NATIONAL CORP - Form 10-Q

The first-half 2003 effective tax rate was 32.1 percent, compared with 30.1 percent for all of 2002. The higher effective tax rate over the prior year reflects the absence of certain tax benefits recorded in the second half of 2002.

The effective tax rates differ from the applicable statutory federal tax rate due to various factors, including state taxes and the impact of the Company's real estate investment trust subsidiaries on state taxes, tax-exempt income including interest on bank-owned life insurance, and affordable housing investments.

The Company's tax returns are being audited by the Internal Revenue Service back to 1998 and by the Franchise Tax Board of the State of California back to 1996. From time to time, there may be differences in opinions with the respect to tax treatment accorded transactions. When, and if, such differences occur and become probable and estimable, such amounts will be recognized.

**BALANCE SHEET ANALYSIS**

Average assets reached \$11.9 billion for the second quarter of 2003, an increase of 9 percent over the \$10.9 billion in average assets for the second quarter of 2002 and 4 percent over the \$11.5 billion in average assets for the first quarter of 2003. For the first half of 2003, average assets were \$11.7 billion, 10 percent higher than the \$10.6 billion in average assets for the first half of 2002. Total assets at June 30, 2003 increased 12 percent to \$12.4 billion from \$11.0 billion at June 30, 2002. Total assets at December 31, 2002 were \$11.9 billion.

Total average interest-earning assets were \$10.9 billion for the second quarter of 2003, an increase of 9 percent over the \$10.1 billion in average interest-earning assets for the second quarter of 2002 and 4 percent higher than the \$10.5 billion in average interest-earning assets for the first quarter of 2003. For the first half of 2003, total average interest-earning assets were \$10.7 billion, and increase of 10 percent over the \$9.8 billion in total average interest-earning assets for the first half of 2002.

*Securities*

Comparative period-end security portfolio balances are presented below:

**Securities Available-for-Sale**

| Dollars in thousands               | June 30,<br>2003 |              | December 31,<br>2002 |              | June 30,<br>2002 |              |
|------------------------------------|------------------|--------------|----------------------|--------------|------------------|--------------|
|                                    | Cost             | Fair Value   | Cost                 | Fair Value   | Cost             | Fair Value   |
| U.S. Government and federal agency | \$ 238,343       | \$ 242,288   | \$ 317,183           | \$ 324,223   | \$ 320,348       | \$ 326,968   |
| Mortgage-backed                    | 2,257,765        | 2,292,818    | 1,448,673            | 1,491,489    | 1,121,904        | 1,146,818    |
| State and Municipal                | 246,751          | 263,121      | 224,013              | 236,591      | 218,921          | 227,204      |
| Other                              |                  |              | 5,451                | 4,600        | 31,899           | 31,872       |
| Total debt securities              | 2,742,859        | 2,798,227    | 1,995,320            | 2,056,903    | 1,693,072        | 1,732,862    |
| Marketable equities securities     | 192,542          | 194,459      | 174,124              | 169,753      | 193,745          | 187,123      |
| Total securities                   | \$ 2,935,401     | \$ 2,992,686 | \$ 2,169,444         | \$ 2,226,656 | \$ 1,886,817     | \$ 1,919,985 |

Average securities available-for-sale continued to increase primarily due to strong deposit growth. At June 30, 2003, securities available-for-sale totaled \$3.0 billion, an increase of \$1,072.7 million compared with holdings at June 30, 2002 and an increase of \$766.0 million from December 31, 2002. At June 30, 2003 the portfolio had an unrealized net gain of \$57.3 million compared with \$57.2 million and \$33.2 million at December 31, 2002 and June 30, 2002, respectively. The average duration of total available-for-sale securities at June 30, 2003 was 2.3 years. Duration provides a measure of fair value sensitivity to changes in interest rates. For example, a one percent increase in rates such as occurred in July would result in a decrease in fair value of total debt securities of about \$65 million. The 2.3 duration compares with 2.1 at December 31, 2002 and 2.9 at June 30, 2002. This is within the investment guidelines set by ALCO and the interest rate risk guidelines set by the Board of Directors. See — Asset /Liability Management for a discussion of the Company's interest rate position.



The following table provides the contractual remaining maturities and yields (taxable-equivalent basis) of debt securities within the securities portfolio as of June 30, 2003. Contractual maturities of mortgage-backed securities are substantially longer than their expected maturities due to scheduled and unscheduled principal payments. To compare the tax-exempt asset yields to taxable yields, amounts are adjusted to pre-tax equivalents based on the marginal corporate federal tax rate of 35 percent.

## Debt Securities Available-for-Sale

| Dollars in thousands               | One year or less |           | Over 1 year thru 5 years |           | Over 5 years thru 10 years |           | Over 10 years |           | Total        |           |
|------------------------------------|------------------|-----------|--------------------------|-----------|----------------------------|-----------|---------------|-----------|--------------|-----------|
|                                    | Amount           | Yield (%) | Amount                   | Yield (%) | Amount                     | Yield (%) | Amount        | Yield (%) | Amount       | Yield (%) |
| U.S. Government and federal agency | \$ 17,967        | 1.99      | \$ 210,978               | 3.64      | \$ 13,343                  | 6.21      | \$            |           | \$ 242,288   | 3.66      |
| Mortgage-backed                    |                  |           |                          |           | 4,462                      | 6.83      | 2,288,356     | 4.83      | 2,292,818    | 4.83      |
| State and Municipal                | 10,843           | 6.96      | 92,325                   | 6.55      | 110,793                    | 6.64      | 49,160        | 6.23      | 263,121      | 6.55      |
| Total debt securities              | \$ 28,810        | 3.86      | \$ 303,303               | 4.52      | \$ 128,598                 | 6.60      | \$ 2,337,516  | 4.86      | \$ 2,798,227 | 4.89      |
| Amortized cost                     | \$ 28,541        |           | \$ 293,415               |           | \$ 119,769                 |           | \$ 2,301,134  |           | \$ 2,742,859 |           |

Dividend income included in interest income on securities in the Unaudited Consolidated Statement of Income and Comprehensive Income for the second quarters of 2003 and 2002 was \$2.2 million and \$2.4 million and \$4.1 million and \$5.1 million for the first half of 2003 and 2002, respectively.

*Loan Portfolio*

A comparative period-end loan table is presented below:

## Loans

| Dollars in thousands             | June 30, 2003 | December 31, 2002 | June 30, 2002 |
|----------------------------------|---------------|-------------------|---------------|
| Commercial                       | \$ 3,232,780  | \$ 3,609,053      | \$ 3,552,800  |
| Residential first mortgages      | 1,736,442     | 1,738,909         | 1,730,589     |
| Real estate mortgages            | 1,895,964     | 1,934,409         | 1,866,086     |
| Real estate construction         | 653,063       | 640,861           | 635,218       |
| Installment                      | 71,977        | 76,238            | 69,837        |
| Total loans, gross               | 7,590,226     | 7,999,470         | 7,854,530     |
| Less allowance for credit losses | 170,927       | 164,502           | 157,647       |
| Total loans, net                 | \$ 7,419,299  | \$ 7,834,968      | \$ 7,696,883  |

Total loans at June 30, 2003 were 3 percent lower than total loans at June 30, 2002 and March 31, 2003. At June 30, 2003, the Company's loan portfolio included approximately \$1.0 billion of loans to borrowers located in Northern California, including approximately \$600 million of loans managed in Northern California offices. In addition, the portfolio included \$52.2 million of syndicated non-relationship commercial loans

Edgar Filing: CITY NATIONAL CORP - Form 10-Q

and purchased media and telecommunication loans, down from \$87.1 million at March 31, 2003.

Following is a breakdown of the syndicated non-relationship commercial loans and purchased media and telecommunication loans as of June 30, 2003:

| Dollars in thousands    | Number | Commitments | Outstanding | Percentage |
|-------------------------|--------|-------------|-------------|------------|
| Commercial              | 10     | \$ 37,341   | \$ 27,224   | 52%        |
| Telecommunications      | 4      | 16,115      | 6,835       | 13         |
| Publishing              | 2      | 11,932      | 4,947       | 9          |
| Television Broadcasting | 1      | 5,000       | 4,917       | 10         |
| Wireless                | 2      | 14,064      | 8,309       | 16         |
|                         | 19     | \$ 84,452   | \$ 52,232   | 100%       |

The above loan portfolio balances exclude one available-for-sale loan which is carried in other assets.

The following table presents information concerning nonaccrual loans, ORE, and restructured loans. Bank policy requires that a loan be placed on nonaccrual status if (1) either principal or interest payments are 90 days past due, unless the loan is both well secured and in process of collection, (2) full collection of interest or principal becomes uncertain, regardless of the time period involved or (3) regulators' ratings of credits suggest that the loan be placed on nonaccrual.

### Nonaccrual Loans, ORE and Restructured Loans

| Dollars in thousands   | June 30,<br>2003 | December 31,<br>2002 | June 30,<br>2002 |
|--|------------------|----------------------|------------------|
| Nonaccrual loans:  |                  |                      |                  |
| Commercial   | \$ 55,638        | \$ 52,890            | \$ 49,249        |
| Real estate  | 13,739           | 17,992               | 12,703           |
| Installment  |                  | 475                  | 2,480            |
| Total  | 69,377(1)        | 71,357               | 64,432           |
| ORE  | 173              | 670                  | 460              |
| Total nonaccrual loans and ORE   | \$ 69,550        | \$ 72,027            | \$ 64,892        |
|  |                  |                      |                  |
| Total non accrual loans as a percentage of total loans                 | 0.91%            | 0.89%                | 0.82%            |
| Total non accrual loans and ORE as a percentage of total loans and ORE | 0.92             | 0.90                 | 0.83             |
| Allowance for credit losses to total loans                             | 2.25             | 2.06                 | 2.01             |
| Allowance for credit losses to nonaccrual loans                        | 246.37           | 230.53               | 244.67           |
|  |                  |                      |                  |
| Loans past due 90 days or more on accrual status:                      |                  |                      |                  |
| Commercial   | \$ 5,225         | \$ 5,854             | \$ 1,517         |
| Real estate  | 628              | 104                  | 589              |
| Installment  |                  | 198                  | 1,151            |
| Total  | \$ 5,853         | \$ 6,156             | \$ 3,257         |

(1) Balance does not include a \$3,625 loan held-for-sale in other assets as of June 30, 2003 which would have been classified as nonperforming had it been included in loans. The loan was sold on July 1, 2003 at its June 30, 2003 carrying value.

Nonaccrual loans fell this quarter from the \$99.7 million at March 31, 2003 primarily due to payoffs and sales. Approximately 40 percent of the nonperforming assets were loans to Northern California clients as of June 30, 2003. Approximately 20 percent were three syndicated non-relationship commercial and purchased media and telecommunication loans totaling \$14.7 million, which compared with nine loans totaling \$34.0 million at March 31, 2003. The remaining 40 percent were loans to other borrowers.

At June 30, 2003, nonaccrual loans included \$68.6 million of impaired loans which had an allowance for credit losses of \$10.7 million allocated to them. At March 31, 2003, nonaccrual loans included \$99.7 million of impaired loans which had an allowance of \$22.3 million allocated to them. The Company considers a loan to be impaired when it is probable that it will be unable to collect all amounts due according to the

## Edgar Filing: CITY NATIONAL CORP - Form 10-Q

contractual terms of the loan agreement. Once a loan is determined to be impaired, the impairment is measured based on the present value of the expected future cash flows discounted at the loan's effective interest rate, except that as a practical expedient, the impairment is measured by using the loan's observable market price or the fair value of the collateral if the loan is collateral dependent. Impairment on loans less than \$500,000 is measured using historical loss factors, which approximates the discounted cash flows method.

When the measurement of the impaired loan is less than the recorded amount of the loan, an impairment is recognized by creating a valuation allowance with a corresponding charge to the allowance for credit losses or by adjusting an existing valuation allowance for the impaired loan with a corresponding charge or credit to the allowance for credit losses.

The Company's policy is to record cash receipts on impaired loans first as reductions in principal and then as interest income.

The following table summarizes the changes in nonaccrual loans for the three and six months ended June 30, 2003 and 2002.

#### Changes in Nonaccrual Loans

| Dollars in thousands                                 | For the three months ended<br>June 30, |           | For the six months ended<br>June 30, |           |
|--|--|-----------|--------------------------------------|-----------|
|  | 2003                                   | 2002      | 2003                                 | 2002      |
| Balance, beginning of period                         | \$ 99,738                              | \$ 50,136 | \$ 71,357                            | \$ 38,563 |
| Additions from acquisitions                          |  |           |                                      | 3,510     |
| Loans placed on nonaccrual                           | 18,905                                 | 31,262    | 71,647                               | 52,927    |
| Charge-offs  | (12,266)                               | (11,444)  | (22,783)                             | (19,646)  |
| Loans returned to accrual status                     |  | (60)      |                                      | (1,219)   |
| Repayments (including interest applied to principal) | (37,000)                               | (5,462)   | (50,844)                             | (9,172)   |
| Transferred to ORE                                   |  |           |                                      | (531)     |
| Balance, end of period                               | \$ 69,377                              | \$ 64,432 | \$ 69,377                            | \$ 64,432 |

In addition to loans disclosed above as nonaccrual or restructured, management has also identified \$17.8 million of credits to 17 borrowers where the ability to comply with the present loan payment terms in the future is questionable. However, the inability of the borrower to comply with repayment terms was not sufficiently probable to place the loan on nonaccrual status at June 30, 2003. Estimated potential losses from these potential problem loans have been provided for in determining the adequacy of the allowance for credit losses at June 30, 2003.

Management's classification of credits as nonaccrual, restructured or problems does not necessarily indicate that the principal is uncollectable in whole or in part.

#### *Allowance for Credit Losses*

The allowance for credit losses at June 30, 2003 totaled \$170.9 million, or 2.25 percent of outstanding loans. This compares with an allowance of \$157.6 million, or 2.01 percent at June 30, 2002 and an allowance of \$169.5 million, or 2.16 percent at March 31, 2003. The allowance for credit losses as a percentage of nonaccrual loans was 246 percent at June 30, 2003, compared with 245 percent at June 30, 2002 and 170 percent

## Edgar Filing: CITY NATIONAL CORP - Form 10-Q

at March 31, 2003. Management believes the allowance for credit losses is adequate to cover risks in the portfolio at June 30, 2003.

Net charge-offs for the second quarter of 2003 were \$10.1 million, including \$4.8 million relating to the Company's syndicated non-relationship commercial and purchased media and telecommunication loan portfolio. This compares with \$16.0 million and \$9.7 million, respectively, for the second quarter of 2002. For the first half of 2003, net charge-offs were \$22.6 million, compared with \$23.0 million in the same period last year. As an annualized percentage of average loans, net charge-offs were 0.52 percent, 0.81 percent and 0.64 percent for the second quarters of 2003 and 2002 and the first quarter of 2003, respectively.

The allowance for credit losses is maintained at a level that management deems appropriate based on a thorough analysis of numerous factors, including levels of net charge-offs and nonaccrual loans and

changes in the loan portfolio. Credit quality will be influenced by underlying trends in the economy, particularly in California, and other factors that may be beyond management's control. No assurances can be given that the Company will not sustain credit losses, in any particular period, that are sizable in relation to the allowance for credit losses. Based on known information available to it at the date of this report, management believes the allowance for credit losses is adequate to cover risks inherent in the portfolio at June 30, 2003. Subsequent evaluation of the loan portfolio, in light of factors then prevailing, will dictate the level of provisions required to maintain the adequacy of the allowance for credit losses.

The table below summarizes the changes in the allowance for credit losses for the three and six months ended June 30, 2003 and 2002.

### Changes in Allowance for Credit Losses

| Dollars in thousands   | For the three months ended<br>June 30, |              | For the six months ended<br>June 30, |              |
|--|--|--------------|--------------------------------------|--------------|
|  | 2003                                   | 2002         | 2003                                 | 2002         |
| Loans outstanding  | \$ 7,590,226                           | \$ 7,854,530 | \$ 7,590,226                         | \$ 7,854,530 |
| Average amount of loans outstanding                            | \$ 7,793,863                           | \$ 7,889,005 | \$ 7,878,627                         | \$ 7,678,388 |
| Balance of allowance for credit losses, beginning of period    | \$ 169,480                             | \$ 155,657   | \$ 164,502                           | \$ 142,862   |
| Loans charged off:   |  |              |                                      |              |
| Commercial   | (14,151)                               | (15,999)     | (27,438)                             | (24,383)     |
| Real estate and other  | (60)                                   | (1,862)      | (1,655)                              | (2,774)      |
| Total loans charged off  | (14,211)                               | (17,861)     | (29,093)                             | (27,157)     |
| Less recoveries of loans previously charged off:               |  |              |                                      |              |
| Commercial   | 3,749                                  | 1,009        | 6,017                                | 2,036        |
| Real estate and other  | 409                                    | 842          | 501                                  | 2,119        |
| Total recoveries   | 4,158                                  | 1,851        | 6,518                                | 4,155        |
| Net loans charged off  | (10,053)                               | (16,010)     | (22,575)                             | (23,002)     |
| Additions to allowance charged to operating expense            | 11,500                                 | 18,000       | 29,000                               | 29,000       |
| Additions to allowance from acquisition                        |  |              |                                      | 8,787        |
| Balance, end of period   | \$ 170,927                             | \$ 157,647   | \$ 170,927                           | \$ 157,647   |
| Total net charge-offs to average loans (annualized)            | (0.52)%                                | (0.81)%      | (0.58)%                              | (0.60)%      |
| Ratio of allowance for credit losses to total period end loans |  |              | 2.25%                                | 2.01%        |



*Other Assets*

Other assets included the following:

**Other Assets**

| Dollars in thousands                   | June 30,<br>2003 | December 31,<br>2002 | June 30,<br>2002 |
|--|------------------|----------------------|------------------|
| Interest rate swap mark-to-market      | \$ 70,168        | \$ 56,690            | \$ 29,472        |
| Accrued interest receivable            | 44,543           | 45,124               | 49,386           |
| Claim in receivership and other assets | 23,285           | 23,142               | 22,987           |
| Loans held-for-sale                    | 3,625            | 18,155               | 54,516           |
| Income tax refund                      | 3,305            | 3,464                |                  |
| Other                                  | 55,687           | 40,191               | 45,032           |
| Total other assets                     | \$ 200,613       | \$ 186,766           | \$ 201,393       |

The claim in receivership and other assets were acquired in the acquisition of Pacific Bank. The claim in receivership, which is approximately half of the balance, is expected to be realized in 2003.

See — Net Interest Income for a discussion of interest rate swaps that result in the swap mark-to-market asset of \$70.2 million.

*Off Balance Sheet*

In the normal course of business, the Company is a party to financial instruments with off-balance sheet risk. These financial instruments include commitments to extend credit, letters of credit, and financial guarantees. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount reflected in the consolidated balance sheet. Commitments to extend credit are agreements to lend to a client as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since a portion of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each client's creditworthiness on a case-by-case basis.

The Company had outstanding loan commitments aggregating \$3,292.8 million at June 30, 2003. In addition, the Company had \$355.2 million outstanding in bankers' acceptances and letters of credit of which \$295.8 million relate to standby letters of credit at June 30, 2003. Substantially all of the Company's loan commitments are on a variable rate basis and are comprised of real estate and commercial loan commitments.

*Deposits*

Deposits totaled \$10.2 billion at June 30, 2003, an increase of 16 percent compared with \$8.8 billion at June 30, 2002, and increased 3 percent over the \$9.9 billion at March 31, 2003. New clients, additional trust and escrow deposits and a lower earnings credit on analyzed deposit accounts resulting from lower interest rates, contributed to the growth of deposits.

Demand deposits accounted for 48 percent of total deposits at June 30, 2003. Core deposits, which continued to provide substantial benefits to the Bank's cost of funds, were 90 percent of total deposits at June 30, 2003. See — Net Interest Income.

**CAPITAL ADEQUACY REQUIREMENT**

The following table presents the regulatory standards for well capitalized institutions and the capital ratios for the Corporation and the Bank at June 30, 2003, December 31, 2002 and June 30, 2002.

|                                  | <b>Regulatory<br/>Well<br/>Capitalized<br/>Standards</b> | <b>June 30,<br/>2003</b> | <b>December 31,<br/>2002</b> | <b>June 30,<br/>2002</b> |
|----------------------------------|--|--------------------------|------------------------------|--------------------------|
| <b>City National Corporation</b> |  |                          |                              |                          |
| Tier 1 leverage                  | %  | 7.17%                    | 7.55%                        | 7.44                     |
| Tier 1 risk-based capital        | 6.00   | 10.21                    | 9.87                         | 9.74                     |
| Total risk-based capital         | 10.00  | 14.45                    | 14.26                        | 14.24                    |
| <b>City National Bank</b>        |  |                          |                              |                          |
| Tier 1 leverage                  | 5.00   | 7.74                     | 7.24                         | 6.98                     |
| Tier 1 risk-based capital        | 6.00   | 10.93                    | 9.46                         | 9.14                     |
| Total risk-based capital         | 10.00  | 15.18                    | 13.85                        | 13.65                    |

Tier 1 capital ratios include the impact of \$25.4 million of preferred stock issued by real estate investment trust subsidiaries of the Bank which is included in minority interest in consolidated subsidiaries.

On January 22, 2003, the Board of Directors authorized a 1-million-share stock buyback program. During the second quarter of 2003, 537,300 shares were repurchased under this program at an average price of \$41.64 per share. A total of 750,100 shares have been repurchased under this program at an average cost of \$42.47 per share, leaving 249,900 shares available for repurchase. The shares purchased under the buyback programs may be reissued for acquisitions, upon the exercise of stock options, and for other general corporate purposes. There were 2,027,574 treasury shares at June 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. In addition, the Board of Directors approved a 37 percent increase in the Company's quarterly common stock cash dividend. The new quarterly dividend of \$0.28 per share is up from the \$0.205 per share previously paid.

**LIQUIDITY MANAGEMENT**

The Company continues to manage its liquidity through the combination of core deposits, federal funds purchased, repurchase agreements, collateralized borrowing lines at the Federal Reserve Bank and the Federal Home Loan Bank of San Francisco and a portfolio of securities available-for-sale. Liquidity is also provided by maturing securities and loans.

## Edgar Filing: CITY NATIONAL CORP - Form 10-Q

Average core deposits and shareholders' equity comprised 83 percent of total funding of average assets in the second quarter of 2003, compared with 76 percent in the second quarter of 2002. This increase allowed the Company to decrease its use of more costly alternative funding sources. See — Net Interest Income.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

#### ASSET/LIABILITY MANAGEMENT

The principal objective of asset/liability management is to maximize net interest income subject to margin volatility and liquidity constraints. Margin volatility results when the rate reset (or repricing) characteristics of assets are materially different from those of the Company's liabilities. Liquidity risk results from the mismatching of asset and liability cash flows. Management chooses asset/liability strategies that promote stable earnings and reliable

funding. Interest rate risk and funding positions are kept within limits established by the Board of Directors to ensure that risk taking is managed within prudent interest rate and liquidity guidelines.

A quantitative and qualitative discussion about market risk is included on pages A-16 to A-20 of the Corporation's Form 10-K for the year ended December 31, 2002.

*Net Interest Simulation:* During the first half of 2003, the Company maintained a moderate asset sensitive interest rate position. Based on the balance sheet at June 30, 2003, the Company's net interest income simulation model indicates that net interest income would not be substantially adversely impacted by changes in interest rates. Assuming a static balance sheet, a gradual 100 basis point decline in interest rates over a twelve-month horizon would result in a decrease in projected net interest income of approximately 3.0 percent. The 3.0 percent at-risk amount is up slightly from the previous two quarters, which were 2.7 percent and 2.3 percent at December 31, 2002, and March 31, 2003 respectively. (Note: The 100 basis point decline could cause some rates to be negative. We assume that discount rates may fall to zero but no further.) A gradual 100bp increase in interest rates over the next 12-month period would result in an increase in projected net interest income of approximately 2.4 percent. This is little changed from the December 31, 2002, and March 31, 2003 results which were 2.8 percent and 2.3 percent respectively. Exposure remains within ALCO guidelines. The Company continues to use a variety of other tools to manage its asset sensitivity.

*Present Value of Equity:* The model indicates that the Present Value of Equity (PVE) is only slightly vulnerable to a sudden and substantial change in interest rates. As of June 30, 2003 a 200 basis point increase in interest rates results in a 2.1 percent decline in PVE. This compares to a 2.6 percent decline at December 31, 2002, and reflects the increase in asset sensitivity experienced over the previous six months. PVE improves only slightly as rates decrease due to their very low starting levels.

As of June 30, 2003, the Company had \$976.4 million of notional principal in receive fixed-pay LIBOR interest rate swaps, of which \$841.4 million have maturities greater than one year. The Company's interest-rate risk-management instruments had a fair value and credit exposure risk of \$70.2 million and \$57.5 million at June 30, 2003 and March 31, 2003, respectively taking into consideration legal right of offset. The credit exposure represents the cost to replace, on a present value basis and at current market rates, the net positive value of all contracts for each counterparty that were outstanding at the end of the period. The Company's swap agreements require collateral to mitigate the amount of credit risk if certain market value exposure thresholds are exceeded. As of June 30, 2003, collateral securing swap agreements consisted of securities with a total market value of \$58.9 million to reduce counterparty exposure.

At June 30, 2003 the Company's outstanding foreign exchange contracts for both those purchased as well as sold totaled \$123.8 million including \$2.4 million of foreign exchange contracts with maturities over 1 year. Total outstanding foreign exchange contracts for both those purchased as well as sold were \$72.7 million including \$2.4 million of foreign exchange contracts with maturities over 1 year at March 31, 2003. The Company enters into foreign exchange contracts with its clients and counterparty banks primarily for the purpose of offsetting or hedging for clients' transaction and economic exposures arising out of commercial transactions. The Company's policies also permit limited proprietary currency positioning. The Company actively manages its foreign exchange exposures within prescribed risk limits and controls.

ITEM 4. CONTROL AND PROCEDURES

**EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES**

Under SEC rules, the Company is required to maintain disclosure controls and procedures designed to ensure that information required by the Company in the reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. As part of the Company's system of disclosure controls and procedures, we have created a disclosure committee which consists of certain members of the Company's senior management. The Company's disclosure controls and procedures are designed to ensure that material information related to the Company, including its

consolidated subsidiaries, is made known to management, including the chief executive officer, chief financial officer and other members of the disclosure committee, in a timely manner.

The Company has carried out an evaluation of the effectiveness of the design and operation of its disclosure controls and procedures as of the end of the period covered by this report. The Company's management, including the Company's disclosure committee and its chief executive officer and chief financial officer, supervised and participated in the evaluation. Based on the evaluation, the chief executive officer and the chief financial officer concluded that the Company's disclosure controls and procedures were effective as of the evaluation date.

#### **CHANGES IN INTERNAL CONTROLS**

There were no significant changes in the Company's internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation.

**CAUTIONARY STATEMENT FOR PURPOSES OF THE SAFE HARBOR PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995**

We have made forward-looking statements in this document that are subject to risks and uncertainties. These statements are based on the beliefs and assumptions of our management, and on information currently available to our management. Forward-looking statements include the information concerning our possible or assumed future results of operations, business and earnings outlook and statements preceded by, followed by, or that include the words will, believes, expects, anticipates, intends, plans, estimates, or similar expressions.

Our management believes these forward-looking statements are reasonable. However, you should not place undue reliance on the forward-looking statements, since they are based on current expectations. Actual results may differ materially from those currently expected or anticipated.

Forward-looking statements are not guarantees of performance. They involve risks, uncertainties, and assumptions. Our future results and shareholder values may differ materially from those expressed in these forward-looking statements. Many of the factors described below that will determine these results and values are beyond our ability to control or predict. For those statements, we claim the protection of the safe harbor contained in the Private Securities Litigation Reform Act of 1995.

Forward-looking statements speak only as of the date they are made and the Company does not undertake to update forward-looking statements to reflect circumstances or events that occur as of the date the statements are made or to update earnings guidance including the factors that influence earnings.

**A number of factors, some of which are beyond the Corporation's ability to control or predict, could cause future results to differ materially from those contemplated by such forward-looking statements.** These factors include (1) the unknown economic impact caused by the State of California's budget shortfall, (2) earthquake or other natural disasters impacting the condition of real estate collateral, (3) the effect of acquisitions and integration of acquired businesses, and (4) economic uncertainty created by worldwide geopolitical unrest, hostilities, terrorist attacks and related events, any of which could hurt our business.

Loan delinquencies may increase;

Problem assets and foreclosures may increase;

Demand for our products and services may decline; and

Collateral for loans made by us, especially real estate, may decline in value, in turn reducing



clients' borrowing power, and reducing the value of assets and collateral associated with our existing loans.

**Changes in interest rates affect our profitability.** We derive our income mainly from the difference or spread between the interest earned on loans, securities, and other interest-earning assets, and interest paid on deposits, borrowings, and other interest-bearing liabilities. In general, the wider the spread, the more we earn. When market rates of interest change, the interest we receive on our assets and the interest we pay on our liabilities fluctuates. This causes changes in our spread and affects our net interest income. In addition, interest rates affect how much money we lend.

**Significant changes in the provision or applications of laws or regulations affecting our business could materially affect our business.** The banking industry is subject to extensive federal and state regulations, and significant new laws or changes in, or repeals of, existing laws may cause results to differ materially. Also, federal monetary policy, particularly as implemented through the Federal Reserve System, significantly affects our credit conditions, primarily through open market operations in U.S. government securities, the discount rate for member bank borrowing, and bank reserve requirements. A material change in these conditions would affect our results. Parts of our business are also subject to federal and state securities laws and regulations. Significant changes in these laws and regulations would also affect our business.

**We face strong competition from financial service companies and other companies that offer banking services which can hurt our business.** Increased competition in our market may result in reduced loans and deposits. Ultimately, we may not be able to compete successfully against current and future competitors. Many competitors offer the banking services that we offer in our service area. These competitors include national, regional, and community banks. We also face competition from

many other types of financial institutions, including, without limitation, savings and loans, finance companies, brokerage firms, insurance companies, credit unions, mortgage banks, and other financial intermediaries. Recently passed legislation will make it easier for other types of financial institutions to compete with us.

**Our results would be adversely affected if we suffered higher than expected losses on our loans.** We assume risk from the possibility that we will suffer losses because borrowers, guarantors, and related parties fail to perform under the terms of their loans. We try to minimize this risk by adopting and implementing what we believe are effective underwriting and credit policies and procedures, including how we establish and review the allowance for credit losses. We assess the likelihood of nonperformance, track loan performance, and diversify our credit portfolio. Those policies and procedures may still not prevent unexpected losses that could adversely affect our results.

**Our financial results could be adversely affected by unanticipated changes in regulatory, judicial, or legislative tax treatment of business transactions.**

**PART II. OTHER INFORMATION**

**ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K**

(a) Exhibits

No.

10.1 Amendment to City National Corporation 1995 Omnibus Plan

31.1 Chief Executive Officer certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002

31.2 Chief Financial Officer certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002

32.0 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002

(b) Report on Form 8-K

On July 15, 2003, the Corporation filed a report on Form 8-K under item 9 (Regulation FD Disclosure) and item 12 (results of Operations and Financial Condition) of Form 8-K and is included under item 9 in accordance with SEC Release No. 33-8126 regarding the financial results for the quarter and six months ended June 30, 2003. Included in the report was a press release dated July 15, 2003.

**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.

**CITY NATIONAL CORPORATION**

(Registrant)

**DATE:** August 14, 2003

/s/ Frank P. Pekny

**FRANK P. PEKNY**

Executive Vice President and

Chief Financial Officer/Treasurer

(Authorized Officer and Principal Financial Officer)