

COLONIAL BANCGROUP INC

Form 10-Q

May 05, 2006

[Table of Contents](#)

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

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**FORM 10-Q**

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(Mark One)

**x**    **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED March 31, 2006**  
**OR**

**..**    **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_.**  
**COMMISSION FILE NUMBER: 1-13508**

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**THE COLONIAL BANCGROUP, INC.**

(Exact name of registrant as specified in its charter)

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

**63-0661573**  
(I.R.S. Employer Identification No.)

**One Commerce Street**

**Suite 800**

**Montgomery, AL**  
(Address of principal executive offices)

**(334) 240-5000**

**36104**  
(Zip Code)

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(Registrant's telephone number, including area code)

None

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to the filing requirements for at least the past 90 days. YES ☒ NO ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer: in Rule 12b-2 of the Exchange Act. (Check One):

Large accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES ☐ NO ☒

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

Class
Common Stock, \$2.50 Par Value

Outstanding at April 30, 2006
154,594,778

**Table of Contents**

**THE COLONIAL BANCGROUP, INC. AND SUBSIDIARIES**

**INDEX**

	<b>Page Number</b>
<b><u>PART I. FINANCIAL INFORMATION</u></b>	
Item 1. <u>Financial Statements (Unaudited)</u>	4
<u>Condensed Consolidated Statements of Condition March 31, 2006 and December 31, 2005</u>	4
<u>Condensed Consolidated Statements of Income Three months ended March 31, 2006 and March 31, 2005</u>	5
<u>Condensed Consolidated Statements of Comprehensive Income Three months ended March 31, 2006 and March 31, 2005</u>	6
<u>Condensed Consolidated Statement of Changes in Shareholders' Equity Three months ended March 31, 2006</u>	7
<u>Condensed Consolidated Statements of Cash Flows Three months ended March 31, 2006 and March 31, 2005</u>	8
<u>Notes to the Unaudited Condensed Consolidated Financial Statements March 31, 2006</u>	9
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	21
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	37
Item 4. <u>Controls and Procedures</u>	37
<b><u>PART II. OTHER INFORMATION</u></b>	
Item 1. <u>Legal Proceedings</u>	38
Item 1A. <u>Risk Factors</u>	38
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	38
Item 3. <u>Defaults Upon Senior Securities</u>	38
Item 4. <u>Submission of Matters to a Vote of Security Holders</u>	38
Item 5. <u>Other Information</u>	38
Item 6. <u>Exhibits</u>	38
<b><u>SIGNATURE</u></b>	39

**Table of Contents**

**THE COLONIAL BANCGROUP, INC. AND SUBSIDIARIES**

**CAUTIONARY STATEMENT PURSUANT TO SAFE HARBOR PROVISIONS**

**OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995:**

**FORWARD-LOOKING STATEMENTS**

This report and the information incorporated by reference include forward-looking statements within the meaning of the federal securities laws. Words such as believes, estimates, plans, expects, should, may, might, outlook, and anticipates, and similar expressions, as they are used in this report, are intended to identify forward-looking statements. The forward-looking statements in these reports are subject to risks and uncertainties that could cause actual results to differ materially from those expressed in or implied by the statements. In addition to factors mentioned elsewhere in this report or previously disclosed in BancGroup's SEC reports (accessible on the SEC's website at [www.sec.gov](http://www.sec.gov) or on BancGroup's website at [www.colonialbank.com](http://www.colonialbank.com)), the following factors, among others, could cause actual results to differ materially from forward-looking statements and future results could differ materially from historical performance. These factors are not exclusive:

deposit attrition, customer loss, or revenue loss in the ordinary course of business;

increases in competitive pressure in the banking industry;

costs or difficulties related to the integration of the businesses of BancGroup and institutions it acquires are greater than expected;

the inability of BancGroup to realize elements of its strategic plans for 2006 and beyond;

changes in the interest rate environment which expand or reduce margins or adversely affect critical estimates as applied and projected returns on investments;

economic conditions affecting real estate values and transactions in BancGroup's market and/or general economic conditions, either nationally or regionally, that are less favorable than expected;

natural disasters in BancGroup's primary market areas result in prolonged business disruption or materially impair the value of collateral securing loans;

management's assumptions and estimates underlying critical accounting policies prove to be inadequate or materially incorrect or are not borne out by subsequent events;

changes which may occur in the regulatory environment;

a significant rate of inflation (deflation);

acts of terrorism or war; and

changes in the securities markets.

Many of these factors are beyond BancGroup's control. The reader is cautioned not to place undue reliance on any forward looking statements made by or on behalf of BancGroup. Any such statement speaks only as of the date the statement was made or as of such date that may be referenced within the statement. BancGroup does not undertake any obligation to update or revise any forward-looking statements.

**Table of Contents****PART I. FINANCIAL INFORMATION****Item 1. Financial Statements (Unaudited)**

**THE COLONIAL BANCGROUP, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CONDITION**  
**(Unaudited)**

	March 31, 2006 (Dollars in thousands)	December 31, 2005
ASSETS		
Cash and due from banks	\$ 449,556	\$ 429,549
Interest bearing deposits in banks	3,673	9,417
Federal funds sold	28,419	59,625
Securities purchased under agreements to resell	578,743	589,902
Securities available for sale	2,866,513	2,841,404
Investment securities (market value: 2006, \$2,798; 2005, \$3,126)	2,656	2,950
Loans held for sale	1,227,520	1,097,892
Total loans, net of unearned income:		
Mortgage warehouse loans	436,248	483,701
Loans, excluding mortgage warehouse loans	14,845,657	14,416,163
Less:		
Allowance for loan losses	(173,632)	(171,051)
Loans, net	15,108,273	14,728,813
Premises and equipment, net	348,023	340,201
Goodwill	626,956	635,413
Other intangibles, net	56,278	59,599
Other real estate owned	3,633	6,108
Bank-owned life insurance	348,325	345,842
Accrued interest and other assets	319,970	279,482
Total	\$ 21,968,538	\$ 21,426,197
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Noninterest bearing transaction accounts	\$ 3,107,338	\$ 3,167,875
Interest bearing transaction accounts	6,187,503	5,845,068
Total transaction accounts	9,294,841	9,012,943
Time	6,560,487	6,470,506
Total deposits	15,855,328	15,483,449
Short-term borrowings	1,894,895	1,542,796
Subordinated debt	377,748	391,347
Junior subordinated debt	307,416	307,446
Other long-term debt	1,421,834	1,640,038
Accrued expenses and other liabilities	164,381	128,430
Total liabilities	20,021,602	19,493,506
Contingencies and commitments (Notes 7 and 13)		
Preferred stock, \$2.50 par value; 50,000,000 shares authorized and none issued at March 31, 2006 and December 31, 2005		

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Preference stock, \$2.50 par value; 1,000,000 shares authorized and none issued at March 31, 2006 and December 31, 2005		
Common stock, \$2.50 par value; 400,000,000 shares authorized; 155,788,685 and 155,602,747 shares issued and 154,428,758 and 154,242,820 outstanding at March 31, 2006 and December 31, 2005, respectively	<b>389,472</b>	389,007
Additional paid in capital	<b>756,261</b>	759,704
Retained earnings	<b>907,306</b>	868,515
Treasury stock, at cost (1,359,927 shares at March 31, 2006 and December 31, 2005)	<b>(31,510)</b>	(31,510)
Unearned compensation		(6,430)
Accumulated other comprehensive loss, net of taxes	<b>(74,593)</b>	(46,595)
 Total shareholders' equity	 <b>1,946,936</b>	 1,932,691
 Total	 <b>\$ 21,968,538</b>	 \$ 21,426,197

See Notes to the Unaudited Condensed Consolidated Financial Statements

**Table of Contents**

**THE COLONIAL BANCGROUP, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF INCOME**  
**(Unaudited)**

	<b>Three Months Ended March 31,</b>	
	<b>2006</b>	<b>2005</b>
	<b>(In thousands, except per share amounts)</b>	
<b>Interest Income:</b>		
Interest and fees on loans	\$ 288,387	\$ 207,255
Interest and dividends on securities	35,971	43,466
Interest on federal funds sold and other short-term investments	10,317	3,143
<b>Total interest income</b>	<b>334,675</b>	<b>253,864</b>
<b>Interest Expense:</b>		
Interest on deposits	99,968	46,855
Interest on short-term borrowings	15,387	18,648
Interest on long-term debt	31,160	25,403
<b>Total interest expense</b>	<b>146,515</b>	<b>90,906</b>
<b>Net Interest Income</b>	<b>188,160</b>	<b>162,958</b>
Provision for loan losses	12,342	5,929
<b>Net Interest Income After Provision for Loan Losses</b>	<b>175,818</b>	<b>157,029</b>
<b>Noninterest Income:</b>		
Service charges on deposit accounts	14,213	13,632
Financial planning services	3,129	3,892
Electronic banking	4,107	3,499
Mortgage banking	2,897	2,021
Mortgage warehouse fees	6,262	783
Bank-owned life insurance	3,939	3,404
Goldleaf income	1,171	2,216
Net cash settlement of swap derivatives		3,496
Securities and derivatives gains (losses), net	4,228	(1,155)
Change in fair value of swap derivatives		(6,344)
Gain on sale of Goldleaf	2,829	
Other income	5,783	6,307
<b>Total noninterest income</b>	<b>48,558</b>	<b>31,751</b>
<b>Noninterest Expense:</b>		
Salaries and employee benefits	68,793	60,988
Occupancy expense of bank premises, net	15,534	14,028
Furniture and equipment expenses	11,392	9,714
Professional services	4,435	4,435
Amortization of intangible assets	3,057	2,305
Advertising	2,887	2,228
Communications	2,587	2,509
Merger related expenses		1,138
Net losses related to the early extinguishment of debt		2,290
Goldleaf expense	964	2,070
Other expenses	16,212	15,123



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Total noninterest expense	125,861	116,828
Income before income taxes	98,515	71,952
Applicable income taxes	33,495	23,764
<b>Net Income</b>	<b>\$ 65,020</b>	<b>\$ 48,188</b>
<b>Earnings per share:</b>		
Basic	\$ 0.42	\$ 0.35
Diluted	\$ 0.42	\$ 0.34
<b>Average number of shares outstanding:</b>		
Basic	153,968	138,683
Diluted	155,183	140,280
<b>Dividends declared per share</b>	<b>\$ 0.17</b>	<b>\$ 0.1525</b>

See Notes to the Unaudited Condensed Consolidated Financial Statements

**Table of Contents**

**THE COLONIAL BANCGROUP, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

**(Unaudited)**

	<b>Three Months Ended March 31,</b>	
	<b>2006</b>	<b>2005</b>
	<b>(Dollars in thousands)</b>	
<b>Net income</b>	<b>\$ 65,020</b>	<b>\$ 48,188</b>
<b>Other comprehensive income, net of taxes:</b>		
Unrealized losses on securities available for sale arising during the period, net of income taxes of \$13,874 and \$22,522 in 2006 and 2005, respectively	<b>(25,767)</b>	<b>(41,827)</b>
Reclassification adjustments for net (gains) losses included in net income, net of income taxes of \$605 and \$(404) in 2006 and 2005, respectively	<b>(1,125)</b>	<b>751</b>
Unrealized losses on cash flow hedging instruments, net of income taxes of \$2,028 in 2006	<b>(3,766)</b>	
Additional minimum pension liability adjustment, net of income taxes of \$(1,340) in 2006	<b>2,660</b>	
<b>Comprehensive income</b>	<b>\$ 37,022</b>	<b>\$ 7,112</b>

See Notes to the Unaudited Condensed Consolidated Financial Statements

**Table of Contents****THE COLONIAL BANCGROUP, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY****(Unaudited)**

	Common Stock		Additional Paid In Capital (Dollars in thousands, except per share amounts)	Treasury Stock (Dollars in thousands, except per share amounts)	Retained Earnings (Dollars in thousands, except per share amounts)	Unearned Compensation (Dollars in thousands, except per share amounts)	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
	Shares	Amount						
Balance, December 31, 2005	154,242,820	\$ 389,007	\$ 759,704	\$ (31,510)	\$ 868,515	\$ (6,430)	\$ (46,595)	\$ 1,932,691
Adoption of SFAS 123(R)			(6,430)			6,430		
Shares issued under:								
Directors plan	28,408	71	522					593
Stock option plans	150,270	376	1,569					1,945
Stock bonus plan, net	(250)	(1)	1					
Employee Stock Purchase Plan	7,510	19	167					186
Stock-based compensation expense			728					728
Net income					65,020			65,020
Cash dividends (\$0.17 per share)					(26,229)			(26,229)
Change in unrealized loss on securities available for sale, net of taxes and reclassification adjustments							(26,892)	(26,892)
Change in unrealized loss on derivative instruments used as cash flow hedges, net of taxes							(3,766)	(3,766)
Additional minimum pension liability adjustment, net of taxes							2,660	2,660
<b>Balance, March 31, 2006</b>	<b>154,428,758</b>	<b>\$ 389,472</b>	<b>\$ 756,261</b>	<b>\$ (31,510)</b>	<b>\$ 907,306</b>	<b>\$</b>	<b>\$ (74,593)</b>	<b>\$ 1,946,936</b>

See Notes to the Unaudited Condensed Consolidated Financial Statements

**Table of Contents****THE COLONIAL BANCGROUP, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)**

	<b>Three Months Ended March 31,</b>	
	<b>2006</b>	<b>2005</b>
	<b>(Dollars in thousands)</b>	
<b>Net cash flows from operating activities</b>	<b>\$ (50,175)</b>	<b>\$ 62,193</b>
<b>Cash flows from investing activities:</b>		
Proceeds from maturities and calls of securities available for sale	58,218	105,717
Proceeds from sales of securities available for sale	473,512	417,121
Purchases of securities available for sale	(597,245)	(319,004)
Proceeds from maturities of investment securities	299	1,204
Increase in securities purchased under agreements to resell	11,159	(164,446)
Net increase in loans excluding proceeds from sales of interests in mortgage warehouse loans	(383,611)	(347,617)
Proceeds from sales of interests in mortgage warehouse loans		434,976
Net cash paid in bank acquisition		(152,987)
Net cash received from Goldleaf divestiture (gross proceeds of \$11.8 million)	10,558	
Capital expenditures	(15,831)	(6,586)
Proceeds received from bank-owned life insurance	923	
Proceeds from sale of other assets	5,598	4,230
Net investment in unconsolidated affiliates	(10,757)	
 Net cash flows from investing activities	 (447,177)	 (27,392)
<b>Cash flows from financing activities:</b>		
Net increase in demand, savings and time deposits	372,285	489,967
Net increase (decrease) in federal funds purchased, repurchase agreements and other short-term borrowings	352,099	(399,336)
Proceeds from issuance of long-term debt		250,000
Repayment of long-term debt	(219,877)	(361,120)
Proceeds from issuance of common stock	2,131	1,254
Proceeds from issuance of shares under forward equity sales agreement		179,580
Dividends paid	(26,229)	(20,469)
 Net cash flows from financing activities	 480,409	 139,876
 Net (decrease) increase in cash and cash equivalents	 (16,943)	 174,677
Cash and cash equivalents at beginning of year	498,591	382,877
 Cash and cash equivalents at March 31	 \$ 481,648	 \$ 557,554
<b>Supplemental disclosure of cash flow information:</b>		
Cash paid during the year for:		
Interest	\$ 133,333	\$ 90,085
Income taxes	2,000	300
<b>Non-cash investing and financing activities:</b>		
Transfer of loans to other real estate	\$ 1,391	\$ 1,258
Assets (non-cash) acquired in business combination		1,159,590
Liabilities assumed in business combination		947,844
Assets (non-cash) sold in Goldleaf divestiture	12,236	
Liabilities sold in Goldleaf divestiture	4,507	

Assets acquired under capital leases

**2,280**

See Notes to the Unaudited Condensed Consolidated Financial Statements

**Table of Contents****THE COLONIAL BANCGROUP, INC. AND SUBSIDIARIES****NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****Note 1: Accounting Policies**

The accounting and reporting policies of The Colonial BancGroup, Inc. and its subsidiaries (variously referred to herein as "BancGroup", "Colonial", or the "Company") are detailed in the 2005 Annual Report on Form 10-K. As discussed more fully below, effective January 1, 2006 the Company changed certain of those policies as a result of the adoption of new accounting standards. These unaudited interim financial statements should be read in conjunction with the audited financial statements and footnotes included in BancGroup's 2005 Annual Report on Form 10-K.

In the opinion of BancGroup, the accompanying unaudited condensed consolidated financial statements contain all adjustments (consisting only of normal recurring accruals) necessary to present fairly BancGroup's financial position as of March 31, 2006 and December 31, 2005 and the results of operations and cash flows for the interim periods ended March 31, 2006 and 2005. All 2006 interim amounts are subject to year-end audit, and the results of operations for the interim period herein are not necessarily indicative of the results of operations to be expected for the year.

Certain reclassifications were made to prior periods in order to conform with the current period presentation.

***Stock-Based Compensation***

Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 123(R), *Share-Based Payment*. Under SFAS 123(R), all stock-based payments are measured at fair value at the date of grant and expensed over their vesting or service period. The expense will be recognized using the straight-line method. Prior to January 1, 2006, the Company accounted for stock based-compensation under the intrinsic value method prescribed by Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*. Under APB 25, compensation cost was only recognized for the excess, if any, of the quoted market price of the stock at the grant date or other measurement date over the amount an employee must pay to acquire the stock. As such, under APB 25 the Company generally recognized no compensation expense for stock options since the exercise prices equaled the market prices of BancGroup common stock on the grant dates. The Company did, however, recognize compensation cost for restricted stock awards since such awards have no exercise price.

The Company adopted SFAS 123(R) using the modified prospective transition method under which compensation cost is recognized beginning on January 1, 2006 (a) based on the requirements of SFAS 123(R) for all awards granted on or after January 1, 2006 and (b) based on the requirements of SFAS 123 for all awards granted prior to, and that remain unvested as of, January 1, 2006. The modified prospective transition method does not require the restatement of prior periods to reflect the fair value method of expensing stock-based compensation. SFAS 123(R) does require a cumulative effect adjustment of previously recognized compensation expense in order to estimate forfeitures for awards outstanding on the adoption date. The cumulative effect adjustment was immaterial.

The adoption of SFAS 123(R) had the following effects on the Company's financial results for the three months ended March 31, 2006 (in thousands, except per share amounts):

Income before taxes	\$ (410)
Net income	(383)
Basic earnings per share	(0.00)
Diluted earnings per share	(0.00)

**Table of Contents****THE COLONIAL BANCGROUP, INC. AND SUBSIDIARIES****NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Total compensation cost for stock-based compensation awards (both stock options and restricted stock awards) recognized under the fair value method during the three months ended March 31, 2006 was \$728,000. The related income tax benefit was \$145,000. Pro forma financial information as if compensation cost had been recognized under the fair value method for the three months ended March 31, 2005 is as follows:

	<b>Three months ended March 31, 2005 (In thousands, except per share data)</b>
<b>Net income:</b>	
As reported	\$ 48,188
Add: Stock-based employee compensation expense determined under intrinsic value method included in reported net income, net of tax	212
Deduct: Total stock-based employee compensation expense determined under fair value method for all awards, net of tax	(607)
<b>Pro forma net income</b>	<b>\$ 47,793</b>
<b>Basic earnings per share:</b>	
As reported	\$ 0.35
Pro forma	\$ 0.34
<b>Diluted earnings per share:</b>	
As reported	\$ 0.34
Pro forma	\$ 0.34

The Company estimates the fair value of stock options using the Black-Scholes valuation model. Key input assumptions used in the model include the exercise price of the award, the expected option term, the expected volatility of the Company's stock over the option's expected term, the risk-free interest rate over the option's expected term and the Company's expected annual dividend yield. The Company believes that the valuation technique and the approach utilized to develop the underlying assumptions are appropriate in estimating the fair value of the Company's stock options granted. Estimates of fair value are not intended to predict actual future events or the value ultimately realized by the stock option recipients. As a result of implementing SFAS 123(R), the Company refined its process for estimating expected option term and expected stock price volatility.

The fair value of each option grant was estimated on the grant date using the Black-Scholes option pricing model with the following assumptions:

	<b>Three months ended March 31, 2006</b>	<b>Three months ended March 31, 2005</b>
Expected option term	5.33 years	5 years
Weighted average expected volatility	23.26%	24.90%
Weighted average risk-free interest rate	4.59%	3.72%
Weighted average expected annual dividend yield	2.70%	3.05%

For options granted during the three months ended March 31, 2006, the expected option term was determined based upon the Company's historical experience with employees' exercise and post-vesting termination behavior. The expected volatility was determined based upon historical daily prices of the Company's common stock over the most recent period equal to the expected option term, as well as implied price volatility based on the Company's exchange traded options. The indicated historical and implied volatilities were weighted 75% and 25%, respectively. Less emphasis was placed on implied volatility compared to historical volatility because the volume of exchange traded options is relatively low. The risk-free rate was determined





## **Table of Contents**

### **THE COLONIAL BANCGROUP, INC. AND SUBSIDIARIES**

#### **NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

based on the interpolated rate as of the grant date of a zero coupon treasury security with a maturity equal to the expected option term. The expected annual dividend yield was determined based on forecasted dividends for 2006 and the Company's stock price as of December 31, 2005.

For options granted during the three months ended March 31, 2005, the expected option term was determined based on consideration of the option attributes (five year graded vesting; ten year total option life) as well as the guidance of SFAS 123 which stated that when presented with a range of reasonable estimates for expected option life, if no amount within the range is a better estimate than any other amount, it is appropriate to use an estimate at the low end of the range. The expected volatility was determined based on analysis of historical monthly prices of the Company's common stock over the most recent period equal to the expected option term. The risk-free rate was determined based on the rate of a constant maturity treasury security with a maturity equal to the expected option term. The expected annual dividend yield was determined based on forecasted dividends for 2005 and the Company's stock price as of the grant date.

#### ***Accounting Changes and Error Corrections***

Effective January 1, 2006, the Company adopted SFAS 154, *Accounting Changes and Error Corrections*, which replaced APB 20, *Accounting Changes*, and SFAS 3, *Reporting Accounting Changes in Interim Financial Statements*. SFAS 154 requires that certain changes in accounting principle be retrospectively applied. Under retrospective application, the new accounting principle is applied as of the beginning of the first period presented as if that principle has always been used. The cumulative effect of the change is reflected in the carrying value of assets and liabilities as of the first period presented, and the offsetting adjustments are recorded to opening retained earnings. Each period presented is adjusted to reflect the period-specific effects of applying the change. Only direct effects of the change will be included in the retrospective application; all indirect effects will be recognized in the period of change. SFAS 154 applies to all voluntary changes in accounting principle as well as to changes required by an accounting pronouncement that does not include specific transition provisions. The adoption of SFAS 154 did not have a material impact on the Company's financial statements.

#### ***Other-Than-Temporary Impairment of Securities***

Effective January 1, 2006, the Company adopted Financial Accounting Standards Board (FASB) Staff Position (FSP) 115-1, *The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments*. The FSP addresses the determination as to when an investment is considered impaired, whether that impairment is other-than-temporary and the measurement of an impairment loss. The FSP also includes accounting considerations subsequent to the recognition of an other-than-temporary impairment and requires certain disclosures about unrealized losses that have not been recognized as other-than-temporary impairments. Refer to Note 3 for related disclosures. The adoption of FSP 115-1 did not have a material impact on the Company's financial statements.

#### **Note 2: Recent Accounting Standards**

In February 2006, the FASB issued SFAS 155, *Accounting for Certain Hybrid Instruments*. This Statement amends SFAS 133, *Accounting for Derivative Instruments and Hedging Activities*, and SFAS 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, and resolves issues addressed in Statement 133 Implementation Issue No. D1, *Application of Statement 133 to Beneficial Interests in Securitized Financial Assets*.

SFAS 155 permits, but does not require, fair value accounting for any hybrid financial instrument that contains an embedded derivative that would otherwise require bifurcation in accordance with SFAS 133, and amends SFAS 140 to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. In addition, SFAS 155 establishes a requirement to evaluate interests in securitized financial assets to identify

**Table of Contents****THE COLONIAL BANCGROUP, INC. AND SUBSIDIARIES****NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation. This Statement also clarifies which interest-only strips and principal-only strips are not subject to the requirements of SFAS 133 and makes clear that concentrations of credit risk in the form of subordination are not embedded derivatives.

SFAS 155 is effective for all financial instruments acquired or issued after the beginning of an entity's fiscal year that begins after September 15, 2006. The fair value election provided for in this guidance may also be applied upon adoption of this Statement for hybrid financial instruments that had been bifurcated under SFAS 133 prior to the adoption of this guidance. Earlier adoption is permitted as of the beginning of an entity's fiscal year, provided the entity has not yet issued financial statements, including financial statements for any interim period for that fiscal year. The changes required by SFAS 155 are not expected to have a material impact on the Company's financial statements.

In March 2006, the FASB issued SFAS 156, *Accounting for Servicing of Financial Assets*. SFAS 156 amends SFAS 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. SFAS 156 requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable. SFAS 156 permits an entity to choose to either subsequently measure servicing rights at fair value and report changes in fair value in earnings, or amortize servicing rights in proportion to and over the estimated net servicing income or loss and assess the rights for impairment or need for an increased obligation.

This Statement is effective as of the beginning of an entity's first fiscal year that begins after September 15, 2006. Earlier adoption is permitted as of the beginning of an entity's fiscal year, provided the entity has not yet issued financial statements, including interim financial statements, for any period of that fiscal year. The requirement to recognize and initially measure servicing assets and liabilities at fair value should be applied prospectively to all transactions after the adoption of the Statement. The changes required by SFAS 156 are not expected to have a material impact on the Company's financial statements.

**Note 3: Securities**

The following table reflects gross unrealized losses and market value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at March 31, 2006.

	Less than 12 months Market		12 months or more Market		Total Market	
	Value	Unrealized Losses	Value	Unrealized Losses	Value	Unrealized Losses
			(In thousands)			
U.S. Treasury obligations and direct obligations of U.S. Government Sponsored Entities	\$ 69,652	\$ (5,376)	\$ 111,676	\$ (6,364)	\$ 181,328	\$ (11,740)
Mortgage-backed securities of Government Sponsored Entities	133,048	(2,953)	180,237	(12,338)	313,285	(15,291)
Collateralized mortgage obligations of Government Sponsored Entities	629,616	(13,019)	200,768	(10,084)	830,384	(23,103)
Private collateralized mortgage obligations	726,016	(19,176)	592,061	(26,947)	1,318,077	(46,123)
Obligations of state and political subdivisions	19,258	(513)	501	(4)	19,759	(517)
Total temporarily impaired securities	\$ 1,577,590	\$ (41,037)	\$ 1,085,243	\$ (55,737)	\$ 2,662,833	\$ (96,774)

**Table of Contents****THE COLONIAL BANCGROUP, INC. AND SUBSIDIARIES****NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The securities above consist of U.S. Treasury obligations and debentures of Government Sponsored Entities, collateralized mortgage obligations (CMO's) and mortgage-backed securities of Government Sponsored Entities, AAA-rated private CMO's, and obligations of state and political subdivisions. As of March 31, 2006, there were 241 securities with an unrealized loss relating to the level of interest rates prevailing in the market. Because of the creditworthiness of the issuers and because the future direction of interest rates is unknown, the impairments are deemed to be temporary. The severity and duration of such impairments are determined by the level of interest rates set by the market. Additionally, BancGroup has the ability to retain these securities until maturity when full repayment would be received. There are also no known current funding needs which would require their liquidation.

**Note 4: Loans**

A summary of the major categories of loans outstanding is shown in the table below.

	March 31, 2006	December 31, 2005
	(Dollars in thousands)	
Commercial, Financial, Agricultural	\$ 1,103,206	\$ 1,107,494
Real Estate-Commercial	4,442,441	4,424,465
Real Estate-Construction	5,824,577	5,483,424
Real Estate-Residential	3,096,441	3,048,007
Consumer Loans	219,675	227,321
Mortgage Warehouse Loans	436,248	483,701
Other	179,629	145,149
Total Loans	15,302,217	14,919,561
Less: unearned income	(20,312)	(19,697)
Total Loans, net of unearned income	\$ 15,281,905	\$ 14,899,864

**Note 5: Allowance for Loan Losses**

An analysis of the allowance for loan losses is as follows:

	March 31, 2006
Balance, January 1	\$ 171,051
Provision charged to income	12,342
Loans charged off	(13,136)
Recoveries	3,375
Balance, March 31	\$ 173,632

**Note 6: Sales and Servicing of Financial Assets**

During the first quarter of 2005, the Company structured a facility in which it sold certain mortgage warehouse loans and mortgage loans held for sale to a wholly-owned special purpose entity (SPE) which then sold interests in those assets to third-party commercial paper conduits

(conduits).

The SPE had \$1.5 billion outstanding to the conduits at March 31, 2006. There were no incremental sales to the conduits during the first quarter of 2006. Based on the structure of these transactions, the Company's only retained interest is the assets retained in the SPE as a first risk of loss position. No gain or loss was recorded at

**Table of Contents****THE COLONIAL BANCGROUP, INC. AND SUBSIDIARIES****NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

the time of sale. The Company receives servicing income based on a percentage of the outstanding balance of assets sold. During the first quarter of 2006, the Company recognized approximately \$5.7 million of noninterest income related to these transactions, of which approximately \$3.8 million was servicing income, and received \$5.8 million in cash.

The following table presents a summary of the components of managed financial assets, representing both owned and sold assets, along with quantitative information about delinquencies and net credit losses:

	As of March 31, 2006		Three Months Ended March 31, 2006	
	Principal Balance	Loans past due 30 days or more	Average Balance	Net Credit Losses(1)
	(In thousands)			
<b>Mortgage warehouse loans</b>				
Assets managed	\$ 873,968	\$	\$ 957,753	\$
less: interests sold, with servicing retained	437,720		539,840	
Assets held in portfolio	\$ 436,248	\$	\$ 417,913	\$
<b>Loans held for sale</b>				
Assets managed	\$ 2,289,800	\$	\$ 2,085,026	\$
less: interests sold	1,062,280		960,160	
Assets held in portfolio	\$ 1,227,520	\$	\$ 1,124,866	\$

(1) Represents net charge-offs.

**Note 7: Guarantees**

Standby letters of credit are contingent commitments issued by Colonial Bank generally to guarantee the performance of a customer to a third party. A financial standby letter of credit is a commitment by Colonial Bank to guarantee a customer's repayment of an outstanding loan or debt instrument. In a performance standby letter of credit, Colonial Bank guarantees a customer's performance under a contractual nonfinancial obligation for which it receives a fee. These guarantees are primarily issued to support public and private borrowing arrangements, including commercial paper, bond financing and similar transactions. The Company holds various assets as collateral supporting those commitments for which collateral is deemed necessary. FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*, requires the fair value of these commitments to be recorded on the balance sheet. The fair value of the commitment typically approximates the fee received from the customer for issuing such commitments. These fees are deferred and are recognized over the commitment period. The amount recorded for deferred fees as of March 31, 2006 was not material to the Company's consolidated balance sheet. At March 31, 2006, Colonial Bank had standby letters of credit outstanding with maturities of generally one year or less. The maximum potential amount of future undiscounted payments the Company could be required to make under outstanding standby letters of credit was approximately \$285 million.

**Note 8: Variable Interest Entities**

During the first quarter of 2006, Colonial invested in three joint ventures which invest in real estate developments. Two of the developments are located in the Atlanta, Georgia area, and the third is in the Raleigh, North Carolina area. These entities are not required to be consolidated. As of March 31, 2006, these entities have total assets of \$21.1 million, and the Company's maximum exposure to loss totals \$20.6 million.

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There has been no material change in the Company's other variable interest entities. Refer to the Company's 2005 Annual Report on Form 10-K for additional information.

**Table of Contents****THE COLONIAL BANCGROUP, INC. AND SUBSIDIARIES****NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 9: Derivatives**

BancGroup maintains positions in derivative financial instruments to manage interest rate risk and facilitate asset/liability management strategies. Derivatives are recorded at fair value in other assets or other liabilities.

***Interest Rate Swaps***

At March 31, 2006, BancGroup had interest rate swap positions hedging long-term FHLB advances, subordinated debt, brokered CDs and loans. The notional amounts and fair values of all interest rate swaps by category as of March 31, 2006 are shown below:

	<b>March 31, 2006</b>	
	<b>Notional</b>	
	<b>Amount</b>	<b>Fair Value</b>
	<b>(In thousands)</b>	
<b>Fair Value Hedges</b>		
Interest rate swaps hedging long-term FHLB advances	\$ 25,000	\$ (1,143)
Interest rate swaps hedging subordinated debt	393,998	(8,875)
Interest rate swaps hedging brokered CDs	321,209	(1,033)
	<b>\$ 740,207</b>	<b>\$ (11,051)</b>
<b>Cash Flow Hedges</b>		
Interest rate swaps hedging loans	\$ 750,000	\$ (19,239)
	<b>\$ 750,000</b>	<b>\$ (19,239)</b>

***Fair Value Hedges***

The Company enters into fair value hedges to effectively convert the interest rates of certain instruments from fixed to floating. The Company recognized a loss of approximately \$73,000 due to hedge ineffectiveness for the three months ended March 31, 2006 and no hedging gains or losses resulting from hedge ineffectiveness for the three months ended March 31, 2005.

***Cash Flow Hedges***

The Company enters into cash flow hedges to effectively convert the interest rates of certain variable rate loans from floating to fixed. The initial and ongoing assessments of hedge effectiveness as well as the periodic measurements of hedge ineffectiveness are performed using the change in variable cash flows method. The derivatives are recorded at fair value and to the extent the hedges are effective, an offsetting entry, net of taxes, is recorded in other comprehensive income. There were no cash flow hedging gains or losses resulting from hedge ineffectiveness recognized for the three months ended March 31, 2006 or March 31, 2005. Amounts included in other comprehensive income are amortized to earnings automatically through the accounting for the cash flows of the swaps as adjustments to interest income each period (unless a swap is terminated). At March 31, 2006, the cash flow hedges had an average remaining maturity of approximately 2.2 years.

***Commitments to Originate and Sell Mortgage Loans***

BancGroup, as part of its retail mortgage loan production activities, routinely enters into short-term commitments to originate loans (interest rate locks). Most of these loans will be sold to third parties upon closing. For those loans, the Company enters into an individual forward sales

commitment at the same time the commitment to originate is finalized. While the forward sales commitments function as an economic offset and



**Table of Contents****THE COLONIAL BANCGROUP, INC. AND SUBSIDIARIES****NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

effectively eliminate the Company's financial risk of rate changes during the rate lock period, both the commitment to originate mortgage loans that will be sold and the commitment to sell the mortgage loans are derivatives, the fair values of which are substantially equal and offsetting. The fair values are calculated based on changes in market interest rates after the commitment date. The notional amounts of these mortgage loan origination commitments and the related forward sales commitments were approximately \$67.8 million at March 31, 2006. The fair value of the origination and sales commitments were approximately \$371,000 at March 31, 2006.

BancGroup has executed individual forward sales commitments related to short-term participations in mortgage loans and retail mortgage loans, which are all classified as loans held for sale. The forward sales commitments related to the short-term participations allow BancGroup to sell the mortgage loan participations to investor institutions for an amount equal to BancGroup's original acquisition cost. The Company has designated these commitments as fair value hedges of the short-term participations. The forward sales commitments on retail mortgage loans function as an economic offset and mitigate the Company's market risk on these loans. The notional values of the forward sales commitments on short-term participations and retail mortgage loans at March 31, 2006 were \$1.2 billion and \$41 million, respectively. The fair value of the forward sales commitments on the short-term participations was a gain of \$11 million at March 31, 2006, which was offset by a loss of \$11 million on the short-term participations. The fair value of the sales commitments on retail mortgage loans was a gain of \$75,000 at March 31, 2006.

**Options**

BancGroup occasionally enters into over-the-counter option contracts on bonds in its securities portfolio. SFAS 133 requires that the fair value of these option contracts be recorded in the financial statements. However, there were no option contracts outstanding at March 31, 2006.

**Note 10: Long-Term Borrowings**

During the quarter, Colonial modified \$400 million in long-term FHLB advances bearing interest at a weighted average rate of 5.67% and with a weighted average remaining maturity of 4.94 years into new advances bearing interest at a weighted average rate of 4.33% and with a weighted average maturity of 15 years.

**Note 11: Pension Plan**

BancGroup and subsidiaries are participants in a pension plan that covers most employees who have met certain age and length of service requirements. The plan provides benefits based on final average earnings, covered compensation, and years of benefit service. On December 31, 2005, BancGroup closed the pension plan to new employees and set the compensation amount and years of service for the future benefits calculation for participants. Actuarial computations for financial reporting purposes are based on the projected unit credit method. The measurement date is December 31. Based on current actuarial projections, BancGroup will not be required to make a contribution to the plan in 2006.

	<b>Three Months Ended March 31,</b>	
	<b>2006</b>	<b>2005</b>
	<b>(In thousands)</b>	
<b>Components of net periodic benefit cost:</b>		
Service cost	\$	\$ 1,845
Interest cost	<b>1,117</b>	1,156
Expected return on plan assets	<b>(1,617)</b>	(1,220)
Amortization of prior service cost		2
Amortization of actuarial loss		312
<b>Net (income) expense</b>	<b>\$ (500)</b>	<b>\$ 2,095</b>



**Table of Contents****THE COLONIAL BANCGROUP, INC. AND SUBSIDIARIES****NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 12: Stock-Based Compensation**

The Company has a long-term incentive compensation plan which permits the granting of various types of incentive stock-based awards including stock options, restricted stock, stock appreciation rights and performance units, all of which may be issued only to key employees, officers and directors of BancGroup. A total of 10,000,000 shares of BancGroup common stock are authorized to be issued under the plan. The terms of the plan stipulate that the exercise price of incentive stock options may not be less than the fair market value of BancGroup common stock on the date they are granted, and the exercise price of nonqualified stock options may not be less than 85% of the fair market value of BancGroup common stock on the date of grant. All options expire no more than ten years from the date of grant, or three months after an employee's termination. Options become exercisable on a pro-rata basis over a period of five years. Restricted stock awards typically vest over a five-year period unless they are subject to specific performance criteria. There have been no stock appreciation rights or performance units granted under the plan.

Prior to the long-term incentive plan that is currently in place, the Company had other incentive plans which permitted the granting of various types of stock-based awards. The awards granted under those plans may still be exercised, however no new awards may be granted. As of March 31, 2006, there were 1,388,982 stock options and 7,307 restricted stock awards still outstanding from those plans.

Pursuant to various business combinations, BancGroup has assumed incentive and nonqualified stock options according to the respective exchange ratios.

The following table summarizes BancGroup's stock option activity since December 31, 2004:

		<b>Weighted Average</b>
	<b>Options</b>	<b>Exercise Price</b>
Outstanding at December 31, 2004	3,866,949	\$ 13.85
Granted	683,619	18.51
Exercised	(646,236)	11.21
Cancelled	(308,970)	17.20
Outstanding at December 31, 2005	3,595,362	\$ 14.89
Granted	129,500	24.87
Exercised	(150,270)	12.95
Cancelled	(46,000)	16.05
Outstanding at March 31, 2006	3,528,592	\$ 15.36

**Table of Contents****THE COLONIAL BANCGROUP, INC. AND SUBSIDIARIES****NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following table provides additional information about BancGroup's stock-based awards (dollars in thousands, except weighted average per share amounts):

**For the three months ended March 31, 2006:**

Weighted average grant date fair value of options granted	\$ 5.47
Total intrinsic value of options exercised	1,743
Total cash received from options exercised	1,946
Total fair value of options vested	132
Total fair value of restricted stock vested	\$ 158

**For options outstanding as of March 31, 2006:**

Aggregate intrinsic value	\$ 34,019
Weighted average remaining contractual life	6.38 years

**For options fully vested and expected to vest as of March 31, 2006:**

Number	2,778,785
Weighted average exercise price	\$ 14.47
Aggregate intrinsic value	\$ 29,256
Weighted average remaining contractual life	5.91 years

**For options fully vested and exercisable as of March 31, 2006:**

Number	2,117,707
Weighted average exercise price	\$ 12.31
Aggregate intrinsic value	\$ 26,870
Weighted average remaining contractual life	4.97 years

The following table summarizes BancGroup's restricted stock activity since December 31, 2004:

	Restricted Stock	Weighted Average Grant Date Fair Value
Nonvested at December 31, 2004	108,755	\$ 12.11
Granted	447,000	20.65
Vested	(50,057)	11.71
Cancelled	(118,065)	17.98
Nonvested at December 31, 2005	387,633	\$ 20.22
Granted		
Vested	(12,236)	12.90
Cancelled	(250)	14.01
Nonvested at March 31, 2006	375,147	\$ 20.47

As of March 31, 2006, the total compensation cost related to nonvested awards not yet recognized was \$10.1 million. That cost is expected to be recognized over a weighted average period of 3.90 years. Windfall tax benefits realized during the three months ended March 31, 2006 related to the exercise of stock options and vesting of restricted stock were \$229,000.

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In 1987, BancGroup adopted the Restricted Stock Plan for Directors (Directors Plan) whereby directors of BancGroup and its subsidiary banks may receive common stock in lieu of cash director fees. The election to participate in the Directors Plan is made at the inception of the director's term except for BancGroup directors who make their election annually. Shares earned under the plan for regular fees are issued quarterly while supplemental fees are issued annually. All shares become vested at the expiration of the director's term. During 2005 and the three months ended March 31, 2006, respectively, 49,356 and 28,408 shares of common stock were issued under the Directors Plan, representing approximately \$859,000 and \$593,000 in directors' fees.

**Table of Contents****THE COLONIAL BANCGROUP, INC. AND SUBSIDIARIES****NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

In 1994, BancGroup adopted the Employee Stock Purchase Plan which provides employees of BancGroup, who work in excess of 29 hours per week, with a convenient way to become shareholders of BancGroup. The participant authorizes a regular payroll deduction of not less than \$10 and not more than 10% of salary. The participant may also contribute whole dollar amounts of not less than \$100 or not more than \$1,000 each month toward the purchase of the stock at market price. There are 600,000 shares authorized for issuance under this Plan. An additional 400,000 may be acquired from time to time on the open market for issuance under the Plan.

**Note 13: Contingencies**

BancGroup and its subsidiaries are, from time to time, defendants in legal actions arising from normal business activities. Management does not anticipate that the outcome of any litigation presently pending at March 31, 2006 will have a material adverse effect on BancGroup's consolidated financial statements or the results of operations.

**Note 14: Earnings Per Share**

The following table reflects a reconciliation of the numerator and denominator of the basic EPS computation to the numerator and denominator of the diluted EPS computation:

	Three Months Ended March 31,		
	Income	Shares (in thousands, except per share amounts)	Per Share Amount
<b>2006</b>			
Basic EPS	\$ 65,020	153,968	\$ 0.42
Effect of dilutive instruments:			
Options and nonvested restricted stock		1,215	
Diluted EPS	\$ 65,020	155,183	\$ 0.42
<b>2005</b>			
Basic EPS	\$ 48,188	138,683	\$ 0.35
Effect of dilutive instruments:			
Options and nonvested restricted stock		1,597	
Diluted EPS	\$ 48,188	140,280	\$ 0.34

The above calculations exclude options that could potentially dilute basic EPS in the future but were antidilutive for the periods presented. The number of such options excluded was approximately 871,000 and 492,000 at March 31, 2006 and 2005, respectively.

**Note 15: Segment Information**

The Company has six reportable segments for management reporting. Each regional bank segment consists of commercial lending and full service branches in its geographic region with its own management team. The branches provide a full range of traditional banking products as well as financial planning and mortgage banking services. The mortgage warehouse segment headquartered in Orlando, Florida provides funding to mortgage origination companies that is collateralized by residential mortgage loans. The Company reports Corporate/Treasury/Other which includes the investment securities portfolio, nondeposit funding activities including long-term debt, short-term liquidity and balance sheet risk management including derivative hedging activities, the parent company's activities, intercompany eliminations and certain support activities not currently allocated to



**Table of Contents****THE COLONIAL BANCGROUP, INC. AND SUBSIDIARIES****NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

the aforementioned segments. In addition, Corporate/Treasury/Other includes income from bank-owned life insurance, income and expenses from various nonbank subsidiaries, joint ventures and equity investments, merger related expenses and the unallocated portion of the Company's financial planning business.

The results for these segments are based on our management reporting process, which assigns balance sheet and income statement items to each segment. Unlike financial reporting there is no authoritative guidance for management reporting equivalent to generally accepted accounting principles. Colonial uses an internal funding methodology to assign funding costs to assets and earning credits to liabilities as well as an internal capital allocation methodology with an offset in Corporate/Treasury/Other. For 2006, the provision for loan losses included in each banking segment is based on their actual net charge-offs experience. The provision included in the mortgage warehouse segment remained consistent with the prior year. During 2005, the provision for loan losses included in each segment was based on an allocation of the Company's loan loss reserve. Certain back office support functions are allocated to each segment on the basis most applicable to the function being allocated. The management reporting process measures the performance of the defined segments based on our management structure and is not necessarily comparable with similar information for other financial services companies. If the management structure and/or allocation process changes, allocations, transfers and assignments may change. Results for prior periods have been restated for comparability.

	Florida Regional Bank	Florida Mortgage Warehouse	Alabama Regional Bank	Georgia Regional Bank	Nevada Regional Bank	Texas Regional Bank	Corporate/ Treasury Other	Consolidated BancGroup
(Dollars in thousands)								
<b>Three Months Ended March 31, 2006</b>								
Net interest income before intersegment income / expense	\$ 90,787	\$ 33,372	\$ 31,026	\$ 18,750	\$ 12,118	\$ 19,528	\$ (17,421)	\$ 188,160
Intersegment interest income / expense	(391)	(18,114)	6,359	(5,780)	(555)	(6,762)	25,243	
Net interest income	90,396	15,258	37,385	12,970	11,563	12,766	7,822	188,160
Provision for loan losses	3,434	(722)	6,101	127	55	81	3,266	12,342
Noninterest income	13,628	6,664	9,829	1,729	1,409	990	14,309	48,558
Noninterest expense	48,709	2,048	20,170	6,271	5,522	6,739	36,402	125,861
Income/(loss) before income taxes	\$ 51,881	\$ 20,596	\$ 20,943	\$ 8,301	\$ 7,395	\$ 6,936	\$ (17,537)	98,515
Income taxes								33,495
Net Income								\$ 65,020
Total Assets	\$ 10,272,604	\$ 2,356,175	\$ 3,643,319	\$ 1,387,311	\$ 916,217	\$ 1,247,267	\$ 2,145,645	\$ 21,968,538
Total Deposits	\$ 8,816,093	\$ 443,639	\$ 3,594,058	\$ 829,996	\$ 766,415	\$ 623,414	\$ 781,713	\$ 15,855,328
<b>Three Months Ended March 31, 2005</b>								
Net interest income before intersegment income / expense	\$ 71,737	\$ 23,359	\$ 30,472	\$ 15,597	\$ 11,339	\$ 13,950	\$ (3,496)	\$ 162,958
Intersegment interest income / expense	1,645	(8,486)	8,242	(3,054)	(1,140)	(3,348)	6,141	

Net interest income