

COLONIAL BANCGROUP INC

Form 10-Q/A

February 14, 2006

Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q/A
(Amendment No. 1)

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

For the quarterly period ended March 31, 2005

OR

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

For the transition period from to

Commission file number: 1-13508

THE COLONIAL BANCGROUP, INC.

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(Exact name of registrant as specified in its charter)

DELAWARE
(State or other jurisdiction of incorporation or organization)

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

One Commerce Street
Montgomery, Alabama
(Address of principal executive offices)

36104
(Zip Code)

(334) 240-5000

(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 (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 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. 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.

<u>Class</u>	<u>Outstanding at April 30, 2005</u>
Common Stock, \$2.50 par value per share	145,721,956 shares

Table of Contents**Explanatory Note**

The Colonial BancGroup, Inc. (BancGroup , Colonial or the Company) is filing this amendment to its Quarterly Report on Form 10-Q for the quarter ended March 31, 2005 to amend and restate financial statements and other financial information filed with the Securities and Exchange Commission (SEC). This amendment is being filed to correct errors in the originally filed Quarterly Report on Form 10-Q related to the Company s derivative accounting under Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS No. 133).

In 2005 and prior years, the Company entered into interest rate swap agreements on brokered certificates of deposit (CD swaps) and junior subordinated debt (junior subordinated debt swaps) that were accounted for as fair value hedges under SFAS No. 133. The Company elected a method of fair value hedge accounting, commonly referred to as the abbreviated method of hedge accounting described in paragraph 65 of SFAS No. 133, which allowed the Company to assume no ineffectiveness in these transactions as long as critical terms did not change. The Company recently concluded that the CD swaps and junior subordinated debt swaps did not qualify for these methods in the periods covered by this restatement. In retrospect, the CD swaps did not comply due to the death puts contained in the brokered CDs, which allow the estate of the CD holder to require the bank to redeem the CD in the event of the CD holder s death. In addition, the junior subordinated debt swaps did not comply due to interest deferral features present in the junior subordinated debt. Hedge accounting under SFAS No. 133 is not allowed retrospectively because the hedge documentation required for the long-haul method was not in place at the inception of the hedge. Eliminating the application of fair value hedge accounting reverses the fair value adjustments that have been made to the brokered certificates of deposit and junior subordinated debt and results in all fair value changes for the interest rate swaps being recognized in noninterest income. Additionally, the net cash settlement payments received during each of the affected periods for these interest rate swaps were reclassified from interest expense on brokered certificates of deposit and junior subordinated debt to noninterest income. Adjustments were also made for other non-significant items.

The effect this restatement had on earnings for the affected periods is as follows:

	For the Quarter Ended	
	March 31,	March 31,
	2005	2004
	(In thousands)	
Interest expense	\$ 3,684	\$ 4,591
Noninterest income	(2,848)	10,955
Noninterest expense	213	499
Provision for income taxes	(2,442)	2,123
Net income	\$ (4,303)	\$ 3,742
Diluted earnings per share	\$ (0.03)	\$ 0.03

In addition, the following Items have changed: Item 1, Item 2 and Item 4. For additional information on the restatement see Note A, Restatement, in the Notes to the Unaudited Condensed Consolidated Financial Statements.

Table of Contents

THE COLONIAL BANGROUP, INC. AND SUBSIDIARIES

INDEX

	<u>Page Number</u>
PART I. FINANCIAL INFORMATION	
Item 1. <u>Financial Statements (Unaudited)</u>	2
<u>Condensed Consolidated Statements of Condition March 31, 2005 and December 31, 2004</u>	2
<u>Condensed Consolidated Statements of Income Three months ended March 31, 2005 and March 31, 2004</u>	3
<u>Condensed Consolidated Statements of Comprehensive Income Three months ended March 31, 2005 and March 31, 2004</u>	4
<u>Condensed Consolidated Statement of Changes in Shareholders' Equity Three months ended March 31, 2005</u>	5
<u>Condensed Consolidated Statements of Cash Flows Three months ended March 31, 2005 and March 31, 2004</u>	6
<u>Notes to the Unaudited Condensed Consolidated Financial Statements March 31, 2005</u>	7
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	20
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	34
Item 4. <u>Controls and Procedures</u>	34
PART II. OTHER INFORMATION	
Item 1. <u>Legal Proceedings</u>	35
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	35
Item 3. <u>Defaults Upon Senior Securities</u>	35
Item 4. <u>Submission of Matters to a Vote of Security Holders</u>	35
Item 5. <u>Other Information</u>	35
Item 6. <u>Exhibits</u>	35
<u>SIGNATURE</u>	36

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 by BancGroup (including its subsidiaries or its management), 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 or on BancGroup's website at 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 2005 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 BANGROUP, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CONDITION****(Unaudited)**

	March 31, 2005	December 31, 2004
	(Restated)	(Restated)
(Dollars in thousands)		
ASSETS		
Cash and due from banks	\$ 414,831	\$ 296,889
Interest bearing deposits in banks	9,509	3,828
Federal funds sold	133,214	82,160
Securities purchased under agreements to resell	385,937	221,491
Securities available for sale	3,689,652	3,647,402
Investment securities (market value: 2005, \$5,229; 2004, \$6,503)	4,952	6,152
Loans held for sale	648,643	678,496
Total loans, net of unearned income:		
Mortgage warehouse loans	663,619	1,114,923
All other loans	12,759,922	11,742,888
Less:		
Allowance for loan losses	(153,634)	(148,802)
Loans, net	13,269,907	12,709,009
Premises and equipment, net	278,791	270,236
Goodwill	499,722	352,536
Other intangibles, net	60,800	41,604
Other real estate owned	8,229	9,865
Bank-owned life insurance	335,353	315,739
Accrued interest and other assets	262,978	261,203
Total	\$ 20,002,518	\$ 18,896,610
LIABILITIES AND SHAREHOLDERS EQUITY		
Deposits:		
Noninterest bearing transaction accounts	\$ 2,958,496	\$ 2,468,529
Interest bearing transaction accounts	5,308,417	5,077,509
Total transaction accounts	8,266,913	7,546,038
Time	4,716,950	4,317,657

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Total deposits	12,983,863	11,863,695
Short-term borrowings	3,009,567	3,258,935
Subordinated debt	266,551	273,598
Junior subordinated debt	302,382	302,412
Other long-term debt	1,716,474	1,684,947
Accrued expenses and other liabilities	98,111	114,732
Total liabilities	18,376,948	17,498,319
Contingencies and commitments (Notes C and I)		
Preference stock, \$2.50 par value; 1,000,000 shares authorized and none issued at March 31, 2005 and December 31, 2004, respectively		
Common Stock, \$2.50 par value; 200,000,000 shares authorized; 145,627,339 and 133,823,776 shares issued and outstanding at March 31, 2005 and December 31, 2004, respectively		
	364,068	334,559
Additional paid in capital	561,701	343,694
Retained earnings	757,434	729,715
Unearned compensation	(7,329)	(449)
Accumulated other comprehensive loss, net of taxes	(50,304)	(9,228)
Total shareholders equity	1,625,570	1,398,291
Total	\$ 20,002,518	\$ 18,896,610

See Notes to the Unaudited Condensed Consolidated Financial Statements

Table of Contents**THE COLONIAL BANGROUP, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF INCOME****(Unaudited)**

	Three Months Ended March 31,	
	2005 (Restated)	2004 (Restated)
(In thousands, except per share amounts)		
Interest Income:		
Interest and fees on loans	\$ 207,255	\$ 158,236
Interest and dividends on securities	43,466	35,439
Interest on federal funds sold and other short-term investments	3,143	79
Total interest income	253,864	193,754
Interest Expense:		
Interest on deposits	46,855	33,978
Interest on short-term borrowings	18,648	6,496
Interest on long-term debt	25,403	24,764
Total interest expense	90,906	65,238
Net Interest Income	162,958	128,516
Provision for loan losses	5,929	7,934
Net Interest Income After Provision for Loan Losses	157,029	120,582
Noninterest Income:		
Service charges on deposit accounts	13,632	14,185
Financial planning services	3,892	3,124
Electronic banking	3,499	2,812
Mortgage banking	2,021	1,990
Mortgage warehouse fees	783	244
Securities (losses) gains, net	(1,155)	7,442
Bank-owned life insurance	3,404	2,231
Net cash settlement of swap derivatives	3,496	4,182
Change in fair value of swap derivatives	(6,344)	7,773
Other income	8,523	4,675
Total noninterest income	31,751	48,658
Noninterest Expense:		
Salaries and employee benefits	60,988	50,700
Occupancy expense of bank premises, net	14,028	12,108

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Furniture and equipment expenses	9,714	9,259
Professional services	4,435	4,223
Amortization of intangible assets	2,305	1,123
Advertising	2,228	2,351
Communications	2,509	2,475
Merger related expenses	1,138	82
Net losses related to the early extinguishment of debt	2,290	6,183
Other expenses	17,193	15,607
	<hr/>	<hr/>
Total noninterest expense	116,828	104,111
	<hr/>	<hr/>
Income before income taxes	71,952	65,129
Applicable income taxes	23,764	22,273
	<hr/>	<hr/>
Net Income	\$ 48,188	\$ 42,856
	<hr/>	<hr/>
Earnings per share:		
Basic	\$ 0.35	\$ 0.34
Diluted	\$ 0.34	\$ 0.34
Average number of shares outstanding:		
Basic	138,683	127,066
Diluted	140,280	128,029
Dividends declared per share	\$ 0.1525	\$ 0.145

See Notes to the Unaudited Condensed Consolidated Financial Statements

Table of Contents

THE COLONIAL BANGROUP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

	Three Months Ended March 31,	
	2005 (Restated)	2004 (Restated)
	(Dollars in thousands)	
Net income	\$ 48,188	\$ 42,856
Other comprehensive income, net of taxes:		
Unrealized (losses) gains on securities available for sale arising during the period, net of income taxes of \$(22,522) and \$18,187 in 2005 and 2004, respectively	(41,827)	34,046
Reclassification adjustments for net losses/(gains) included in net income, net of income taxes of \$(404) and \$2,530 in 2005 and 2004, respectively	751	(4,912)
Comprehensive income	\$ 7,112	\$ 71,990

See Notes to the Unaudited Condensed Consolidated Financial Statements

Table of Contents

THE COLONIAL BANGROUP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS EQUITY

(Unaudited)

	Common Stock		Additional Paid In Capital	Retained Earnings (Restated)	Unearned Compensation	Accumulated Other Comprehensive Loss	Total Shareholders Equity (Restated)
	Shares	Amount					
(Dollars in thousands, except per share amounts)							
Balance, December 31, 2004	133,823,776	\$ 334,559	\$ 343,694	\$ 729,715	\$ (449)	\$ (9,228)	\$ 1,398,291
Shares issued under:							
Directors plan	39,895	100	585				685
Stock option plans	92,941	232	865				1,097
Stock bonus plan, net	359,600	899	6,339		(7,217)		21
Employee Stock Purchase Plan	7,725	19	138				157
Settlement of forward equity sales agreement	8,400,000	21,000	158,580				179,580
Issuance of shares for business combination	2,903,402	7,259	51,500				58,759
Amortization of unearned compensation					337		337
Net income				48,188			48,188
Cash dividends (\$.1525 per share)				(20,469)			(20,469)
Change in unrealized loss on securities available for sale, net of taxes						(41,076)	(41,076)
Balance, March 31, 2005	145,627,339	\$ 364,068	\$ 561,701	\$ 757,434	\$ (7,329)	\$ (50,304)	\$ 1,625,570

See Notes to the Unaudited Condensed Consolidated Financial Statements

Table of Contents

THE COLONIAL BANGROUP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOW

(Unaudited)

	Three Months Ended March 31,	
	2005	2004
	(Restated)	(Restated)
	(Dollars in thousands)	
Net cash flows from operating activities	\$ 62,193	\$ 43,382
Cash flows from investing activities:		
Proceeds from maturities and calls of securities available for sale	105,717	73,028
Proceeds from sales of securities available for sale	417,121	737,805
Purchases of securities available for sale	(319,004)	(667,928)
Proceeds from maturities of investment securities	1,204	1,658
Increase in securities purchased under agreements to resell	(164,446)	
Net increase in loans	(347,617)	(237,207)
Proceeds from sale of interests in mortgage warehouse loans	434,976	
Acquisition, net of cash acquired	(152,987)	
Capital expenditures	(6,586)	(14,948)
Proceeds from sale of other real estate owned	2,385	1,212
Proceeds from sale of premises and equipment and other assets	1,845	10
Net cash flows from investing activities	(27,392)	(106,370)
Cash flows from financing activities:		
Net increase in demand, savings, and time deposits	489,967	286,874
Net (decrease) increase in federal funds purchased, repurchase agreements and other short-term borrowings	(399,336)	96,586
Proceeds from issuance of long-term debt	250,000	200,000
Repayment of long-term debt	(361,120)	(517,643)
Proceeds from issuance of common stock	1,254	1,866
Proceeds from settlement of forward equity sales agreement	179,580	
Dividends paid (\$0.1525 and \$0.145 per share for 2005 and 2004, respectively)	(20,469)	(18,418)
Net cash flows from financing activities	139,876	49,265
Net increase (decrease) in cash and cash equivalents	174,677	(13,723)
Cash and cash equivalents at beginning of year	382,877	345,717
Cash and cash equivalents at March 31	\$ 557,554	\$ 331,994
Supplemental disclosure of cash flow information:		
Cash paid during the year for:		
Interest	\$ 90,085	\$ 67,996
Income taxes	300	

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Non-cash investing and financing activities:		
Transfer of loans to other real estate	\$ 1,258	\$ 2,582
Assets (non-cash) acquired in business combination	1,159,590	
Liabilities assumed in business combination	947,844	

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 A: Restatement**

The Colonial BancGroup, Inc. is restating its financial statements and other financial information to correct errors related to the Company's derivative accounting under Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS No. 133).

In 2005 and prior years, the Company entered into interest rate swap agreements on brokered certificates of deposit (CD swaps) and junior subordinated debt (junior subordinated debt swaps) that were accounted for as fair value hedges under SFAS No. 133. The Company elected a method of fair value hedge accounting, commonly referred to as the abbreviated method of hedge accounting described in paragraph 65 of SFAS No. 133, which allowed the Company to assume no ineffectiveness in these transactions as long as critical terms did not change. The Company recently concluded that the CD swaps and junior subordinated debt swaps did not qualify for these methods in the periods covered by this restatement. In retrospect, the CD swaps did not comply due to the death puts contained in the brokered CDs, which allow the estate of the CD holder to require the bank to redeem the CD in the event of the CD holder's death. In addition, the junior subordinated debt swaps did not comply due to interest deferral features present in the junior subordinated debt. Hedge accounting under SFAS No. 133 is not allowed retrospectively because the hedge documentation required for the long-haul method was not in place at the inception of the hedge. Eliminating the application of fair value hedge accounting reverses the fair value adjustments that have been made to the brokered certificates of deposit and junior subordinated debt and results in all fair value changes for the interest rate swaps being recognized in noninterest income. Additionally, the net cash settlement payments received during each of the affected periods for these interest rate swaps were reclassified from interest expense on brokered certificates of deposit and junior subordinated debt to noninterest income. Adjustments were also made for other non-significant items.

The following tables reflect a summary of both the originally reported and the restated amounts:

Consolidated Statements of Condition:

	March 31, 2005		December 31, 2004	
	As Previously Reported(1)	As Restated	As Previously Reported(1)	As Restated
(In thousands)				
Accrued interest and other assets	\$ 261,669	\$ 262,978	\$ 261,743	\$ 261,203
Total assets	20,001,209	20,002,518	18,897,150	18,896,610
Time deposits	4,713,230	4,716,950	4,315,645	4,317,657
Total deposits	12,980,143	12,983,863	11,861,683	11,863,695
Junior subordinated debt	308,952	302,382	313,213	302,412
Accrued expenses and other liabilities	99,675	98,111	111,159	114,732

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Total liabilities	18,376,012	18,376,948	17,503,535	17,498,319
Retained earnings	757,061	757,434	725,039	729,715
Total shareholders equity	\$ 1,625,197	\$ 1,625,570	\$ 1,393,615	\$ 1,398,291

(1) Certain reclassifications were made to previously reported balances in order to be consistent with current presentation.

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

Consolidated Statements of Income (by quarter):

	Three Months Ended March 31,			
	2005		2004	
	As Previously Reported	As Restated	As Previously Reported	As Restated
	(In thousands, except per share amounts)			
Net interest income	\$ 166,642	\$ 162,958	\$ 133,107	\$ 128,516
Provision for loan losses	5,929	5,929	7,934	7,934
Noninterest Income:				
Net cash settlement of interest rate swap derivatives		3,496		4,182
Change in fair value of interest rate swap derivatives		(6,344)		7,773
Other noninterest income	34,599	34,599	37,703	36,703
Total noninterest income	34,599	31,751	37,703	48,658
Noninterest expense	116,615	116,828	103,612	104,111
Income before income taxes	78,697	71,952	59,264	65,129
Applicable income taxes	26,206	23,764	20,150	22,273
Net income	<u>\$ 52,491</u>	<u>\$ 48,188</u>	<u>\$ 39,114</u>	<u>\$ 42,856</u>
Diluted earnings per share:				
Net income	\$ 0.37	\$ 0.34	\$ 0.31	\$ 0.34
Impact of accounting correction		\$ (0.03)		\$ 0.04
Impact of other non-significant adjustments		\$		\$ (0.01)
Average diluted shares outstanding	140,280	140,280	128,029	128,029

Consolidated Statements of Changes in Shareholders' Equity:

For the Three Months Ended
March 31, 2005

As Previously Reported	As Restated
------------------------------	----------------

	(In thousands)	
Balance, beginning of period	\$ 1,393,615	\$ 1,398,291
Increase attributable to net income	52,491	48,188
Balance, end of period	\$ 1,625,197	\$ 1,625,570

In addition, the following Notes to the Unaudited Condensed Consolidated Financial Statements have been restated: E, F, G, J, and K.

Note B: 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 as stated in the 2004 Annual Report on Form 10-K/A. The Company adopted additional policies as noted below with respect to Sales and Servicing of Financial Assets and Loans Held for Sale as a result of 2005 business activities. These unaudited interim financial statements should be read in conjunction with the audited financial statements and footnotes included in BancGroup's 2004 Annual Report on Form 10-K/A.

Table of Contents

THE COLONIAL BANCGROUP, INC. AND SUBSIDIARIES

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS (Continued)

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, 2005 and December 31, 2004 and the results of operations and cash flows for the interim periods ended March 31, 2005 and 2004. All 2005 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.

Sales and Servicing of Financial Assets

The Company has a facility in which it sells certain mortgage warehouse loans and mortgage loans held for sale to a wholly-owned special purpose entity (SPE) which then sells interests in those assets to third-party commercial paper conduits. These transactions provide a source of liquidity for the Company and allow the Company to utilize its balance sheet capacity and capital for higher-yielding assets while continuing to manage the customer relationships.

Under the provisions of Statement of Financial Accounting Standards (SFAS) No. 140, any retained interests resulting from sales of financial assets should be recognized at the time of sale. Retained interests include such items as servicing assets or liabilities, subordinated tranches, interest-only strips, and cash reserve accounts. The previous carrying amount of the assets sold should be allocated between the retained interests and the assets sold based on each component's fair value in relation to the total fair value at the date of sale. Any gain or loss recognized from the sale would depend in part on the allocation of value to the assets sold and interests retained.

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. The Company does retain servicing responsibilities for the assets sold and receives a servicing fee as compensation. However, due to the short-term nature of these assets and the Company's conclusion that the fee represents adequate compensation as a servicer, no servicing asset or liability is recorded. At the time of sale, the previous carrying amount of the assets is allocated between the interests sold and interests retained based on their relative fair values, which approximate cost because of the short-term and floating-rate nature of these assets. The sales price equals the Company's carrying amount for the assets sold, thus no gain or loss is recorded at the time of sale.

The Company provides credit enhancements to these transactions by maintaining assets in the SPE as a first risk of loss position to the interests sold to the commercial paper conduits. This credit risk is reviewed quarterly, and a reserve for loss exposure is maintained in the allowance for loan losses. The Company also provides a liquidity backstop facility to the commercial paper conduits. The Company, under this facility, may be required to purchase assets from the conduits in certain limited circumstances, including the conduit's inability to place commercial paper. Colonial includes this liquidity risk in its liquidity risk analysis to ensure that it would have sufficient sources of liquidity.

Loans Held for Sale

Effective January 1, 2005, the Company began using forward sales commitments as fair value hedges of its short-term participations in mortgage loans which are included in loans held for sale on the consolidated balance sheet. Prior to January 1, 2005, all loans held for sale were carried at the lower of aggregate cost or market. After January 1, 2005, the carrying values of these hedged short-term participations are adjusted for changes in fair value. The fair values are calculated based on changes in market interest rates during the periods that the participations have been on the balance sheet. See Note J for discussion of the derivatives associated with this hedging strategy.

Table of Contents

THE COLONIAL BANGROUP, INC. AND SUBSIDIARIES

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS (Continued)

Note C: Contingencies

BancGroup and its subsidiaries are from time to time defendants in legal actions from normal business activities. Management does not anticipate that the ultimate liability arising from litigation outstanding at March 31, 2005 will have a materially adverse effect on BancGroup's financial condition.

Note D: Recent Accounting Standards

In December 2003, the American Institute of Certified Public Accountants (AICPA) issued Statement of Position (SOP) 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer*. This SOP addresses accounting for differences between contractual cash flows and cash flows expected to be collected from an investor's initial investment in loans or debt securities (loans) acquired in a transfer if those differences are attributable, at least in part, to credit quality. It includes such loans acquired in purchase business combinations and applies to all nongovernmental entities, including not-for-profit organizations. This SOP does not apply to loans originated by the entity. This SOP limits the yield that may be accreted (accretable yield) to the excess of the investor's estimate of undiscounted expected principal, interest, and other cash flows (cash flows expected at acquisition to be collected) over the investor's initial investment in the loan. This SOP requires that the excess of contractual cash flows over cash flows expected to be collected (nonaccretable difference) not be recognized as an adjustment of yield, loss accrual, or valuation allowance. This SOP prohibits investors from displaying accretable yield and nonaccretable difference in the balance sheet. Subsequent increases in cash flows expected to be collected generally should be recognized prospectively through adjustment of the loan's yield over its remaining life. Decreases in cash flows expected to be collected should be recognized as impairment. This SOP prohibits carrying over or creation of valuation allowances in the initial accounting of all loans acquired in a transfer that are within the scope of this SOP. The prohibition of the valuation allowance carryover applies to the purchase of an individual loan, a pool of loans, a group of loans, and loans acquired in a purchase business combination. This SOP is effective for loans acquired in fiscal years beginning after December 15, 2004. The changes required by this SOP are not expected to have a material impact on the Company's financial statements. With respect to the acquisition of Union Bank discussed in Note E, there were no loans which fell within the scope of this SOP.

In March 2004, the Emerging Issues Task Force (EITF) reached a final consensus on Issue 03-1, *The Meaning of Other-Than-Temporary and Its Application to Certain Investments*. The Issue applies to debt and equity securities within the scope of SFAS 115, certain debt and equity securities within the scope of SFAS 124, and equity securities that are not subject to the scope of SFAS 115 and not accounted for under the equity method of accounting (i.e., cost method investments). Issue 03-1 outlines a three-step model for assessing other-than-temporary impairment. The model involves first determining whether an investment is impaired, then evaluating whether the impairment is other-than-temporary, and if it is, recognizing an impairment loss equal to the difference between the investment's cost and its fair value. The model was to be applied prospectively to all current and future investments in interim or annual reporting periods beginning after June 15, 2004. However, in September 2004 the Financial Accounting Standards Board (FASB) staff issued FASB Staff Position (FSP) EITF Issue 03-1-1 which delayed the effective date for the measurement and recognition guidance contained in Issue 03-1. The guidance for analyzing securities for impairment will be effective with the final issuance of FSP EITF Issue 03-1-a. The disclosure guidance of Issue 03-1 remains effective and requires quantitative and qualitative disclosures for investments accounted for under SFAS 115 and SFAS 124 for the first annual reporting period ending after December 15, 2003. In addition, disclosures related to cost method investments are effective for annual reporting periods ending after June 15, 2004. Comparative information for the periods prior to the period of initial application is not required. See Note M for

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BancGroup's disclosures under Issue 03-1. The changes required by this EITF Issue are not expected to have a material impact on the Company's financial statements.

Table of Contents

THE COLONIAL BANGROUP, INC. AND SUBSIDIARIES

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS (Continued)

On December 16, 2004, the FASB issued SFAS 123(R), *Share-Based Payment*, which is a revision of SFAS 123, *Accounting for Stock-Based Compensation*. SFAS 123(R) supersedes APB Opinion 25, *Accounting for Stock Issued to Employees*, and amends SFAS 95, *Statement of Cash Flows*. Generally, the approach in SFAS 123(R) is similar to the approach described in SFAS 123. However, SFAS 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. SFAS 123(R) was originally effective for interim or annual periods beginning after June 15, 2005. However, in April 2005 the Securities and Exchange Commission (SEC) amended this requirement allowing companies to adopt the standard at the beginning of their next fiscal year that begins after June 15, 2005. Early adoption will be permitted in periods in which financial statements have not yet been issued. SFAS 123(R) permits public companies to adopt its requirements using one of two methods:

A modified prospective method in which compensation cost is recognized beginning with the effective date (a) based on the requirements of SFAS 123(R) for all share-based payments granted after the effective date and (b) based on the requirements of SFAS 123 for all awards granted to employees prior to the effective date of SFAS 123(R) that remain unvested on the effective date.

A modified retrospective method which includes the requirements of the modified prospective method described above, but also permits entities to restate based on the amounts previously recognized under SFAS 123 for purposes of pro forma disclosures either (a) all prior periods presented or (b) prior interim periods of the year of adoption.

The Company plans to adopt SFAS 123(R) on January 1, 2006 using the modified prospective method.

As permitted by SFAS 123, the Company currently accounts for share-based payments to employees using Opinion 25's intrinsic value method and, as such, generally recognizes no compensation cost for employee stock options. Accordingly, the adoption of SFAS 123(R)'s fair value method will have an impact on the Company's results of operations, although it will have no material impact on its overall financial position. The impact of adopting SFAS 123(R) cannot be predicted at this time because it will depend on levels of share-based payments granted in the future. However, had the Company adopted SFAS 123(R) in prior periods, the impact of that standard would likely have approximated the impact of SFAS 123 as described in the disclosure of pro forma net income and earnings per share included in Note K.

In March 2005, the SEC issued Staff Accounting Bulletin (SAB) No. 107, *Share-Based Payment*, which provides interpretive guidance on various issues in SFAS 123(R), particularly valuation methodologies and the selection of assumptions. This SAB also discusses the SEC staff's expectations regarding disclosures in Management's Discussion and Analysis related to share-based payment transactions, as well as the interaction of SFAS 123(R) with existing SEC guidance, such as that dealing with disclosure of non-GAAP financial measures.

Note E: Business Combinations

Union Bank Acquisition

BancGroup completed the acquisition of UB Financial Corporation's wholly-owned subsidiary, Union Bank of Florida (Union), a Florida state chartered bank, on February 10, 2005. The acquisition enhances BancGroup's geographic position and expands BancGroup's banking operations within existing locations in Florida, primarily the Dade, Broward and Palm Beach markets. Union's results of operations were included in BancGroup's consolidated financial results beginning February 11, 2005.

Total consideration for the transaction was \$233.5 million, consisting of 2,903,402 shares of BancGroup common stock valued at \$58.8 million and \$174.7 million in cash. This consideration along with other direct

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

acquisition costs and liabilities incurred led to a total acquisition cost of approximately \$240.0 million. The value of the common stock issued was determined based on the average market price of BancGroup's shares over the five day period beginning two days before and ending two days after February 3, 2005, the measurement date for this transaction. The purchase price was preliminarily allocated to the assets acquired and liabilities assumed based on their estimated fair values at the acquisition date. The final allocation of the purchase price will be adjusted after completion of additional analysis relating to the fair values of Union's tangible and identifiable intangible assets and liabilities.

The following table presents unaudited proforma results of operations for the three months ended March 31, 2005 and 2004, as if the acquisition had occurred at January 1, 2004. Since no consideration is given to operational efficiencies and expanded products and services, the proforma summary information does not necessarily reflect the results of operations as they actually would have been, if the acquisition had occurred at January 1, 2004:

	Three Months Ended March 31,	
	2005	2004
	(Restated)	(Restated)
	(unaudited)	
	(In thousands, except per share amounts)	
Net Interest Income	\$ 167,045	\$ 136,290
Net Income	48,547	46,356
Basic EPS	0.35	0.36
Diluted EPS	0.34	0.35

First Federal Savings Bank of Lake County Acquisition

On January 18, 2005, Colonial announced the signing of a definitive agreement to acquire First Federal Savings Bank of Lake County (FFLC) for approximately \$232 million. Under the terms of the agreement, FFLC shareholders will elect either two shares of Colonial stock or \$42 in cash for each FFLC share they own. The cash consideration will be capped at approximately 35% of the transaction. FFLC is headquartered in Leesburg, Florida, and had total assets of \$1.1 billion, total deposits of \$835 million and total loans of \$919 million at March 31, 2005. FFLC currently operates 16 full-service offices in Lake, Sumter, Citrus and Marion counties in Central Florida. The transaction is expected to close during the second quarter of 2005.

Table of Contents**THE COLONIAL BANGROUP, INC. AND SUBSIDIARIES****NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED****FINANCIAL STATEMENTS (Continued)****Note F: 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,		
	Net Income (Restated)	Shares	Per Share Amount (Restated)
	(in thousands, except per share amounts)		
2005			
Basic EPS	\$ 48,188	138,683	\$ 0.35
Effect of dilutive instruments:			
Options		1,597	
Diluted EPS	<u>\$ 48,188</u>	<u>140,280</u>	<u>\$ 0.34</u>
2004			
Basic EPS	\$ 42,856	127,066	\$ 0.34
Effect of dilutive instruments:			
Options		963	
Diluted EPS	<u>\$ 42,856</u>	<u>128,029</u>	<u>\$ 0.34</u>

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 492,000 and 16,000 at March 31, 2005 and 2004, respectively.

Note G: 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, wholesale 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, certain support activities not currently allocated to the aforementioned segments and income taxes. 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 funds costs to assets and earning credits to liabilities as well as an internal capital allocation methodology with an offset in Corporate/Treasury/Other. The provision for loan losses included in each segment is based on each segment's share 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 accounting 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.

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

	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, restated)								
Three Months Ended March 31, 2005								
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	1,664	(8,486)	8,258	(3,051)	(1,135)	(3,344)	6,094	
Net interest income	73,401	14,873	38,730	12,546	10,204	10,606	2,598	162,958
Provision for loan losses	3,520	(1,063)	1,702	150	426	570	624	5,929
Noninterest income	10,895	1,176	11,453	2,045	1,162	1,179	3,841	31,751
Noninterest expense	45,771	1,593	26,968	6,813	5,746	6,643	23,294	116,828
Income/(loss) before income taxes	\$ 35,005	\$ 15,519	\$ 21,513	\$ 7,628	\$ 5,194	\$ 4,572	\$ (17,479)	71,952
Income taxes								23,764
Net Income								\$ 48,188
Total Assets	\$ 7,988,907	\$ 1,727,435	\$ 3,991,503	\$ 1,354,484	\$ 781,147	\$ 1,112,352	\$ 3,046,690	\$ 20,002,518
Total Deposits	\$ 6,723,797	\$ 377,521	\$ 3,790,326	\$ 749,694	\$ 539,972	\$ 491,644	\$ 310,909	\$ 12,983,863
Three Months Ended March 31, 2004								
Net interest income before intersegment income / expense	\$ 51,694	\$ 12,984	\$ 29,405	\$ 13,343	\$ 9,782	\$ 10,517	\$ 791	\$ 128,516
Intersegment interest income / expense	2,224	(1,944)	8,932	(875)	(982)	(1,562)	(5,793)	
Net interest income	53,918	11,040	38,337	12,468	8,800	8,955	(5,002)	128,516
Provision for loan losses	3,540	219	2,300	338	376	470	691	7,934
Noninterest income	9,082	612	11,791	1,868	1,227	1,440	22,638	48,658
Noninterest expense	35,342	1,443	28,451	6,758	5,569	6,363	20,185	104,111
Income/(loss) before income taxes	\$ 24,118	\$ 9,990	\$ 19,377	\$ 7,240	\$ 4,082	\$ 3,562	\$ (3,240)	65,129
Income taxes								22,273
Net Income								\$ 42,856

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Total Assets	\$ 5,518,763	\$ 1,467,983	\$ 3,839,772	\$ 1,319,676	\$ 741,546	\$ 952,432	\$ 2,651,472	\$ 16,491,644
Total Deposits	\$ 4,481,307	\$ 233,748	\$ 3,630,150	\$ 727,745	\$ 412,919	\$ 469,425	\$ 250,015	\$ 10,205,309

Table of Contents

THE COLONIAL BANCGROUP, INC. AND SUBSIDIARIES

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS (Continued)

Note H: Long-Term Borrowings

In March 2005, Colonial prepaid \$200 million in long-term Federal Home Loan Bank advances bearing interest at a weighted average rate of 4.98% resulting in a prepayment fee for the early extinguishment of debt of \$2.29 million. The advances were refinanced with shorter term borrowings at lower rates.

Note I: 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, 2005 was not material to the Company's consolidated balance sheet. At March 31, 2005, Colonial Bank had standby letters of credit outstanding with maturities ranging from less than one year up to 16 years. The maximum potential amount of future undiscounted payments the Company could be required to make under outstanding standby letters of credit was \$203 million.

Note J: Derivatives

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

Interest Rate Swaps

At March 31, 2005, BancGroup had interest rate swap positions on subordinated debt, junior subordinated debt, brokered CDs, long-term FHLB advances and commercial loans. The fair value and related notional amounts (in thousands) of all interest rate swaps by category as of March 31, 2005 are shown below:

	March 31, 2005 (Restated)	
	Notional	
	Amount	Fair Value
Fair Value Hedges		
Interest rate swaps hedging long-term FHLB advances	\$ 575,000	\$ (2,126)
Interest rate swaps hedging subordinated debt	250,000	8,826
Interest rate swaps hedging loans	5,802	137
	<u>\$ 830,802</u>	<u>\$ 6,837</u>
Nonhedging Derivatives		
Interest rate swaps on junior subordinated debt	\$ 270,000	\$ 6,570
Interest rate swaps on brokered CDs	145,000	(3,720)
	<u>\$ 415,000</u>	<u>\$ 2,850</u>

Table of Contents

THE COLONIAL BANCGROUP, INC. AND SUBSIDIARIES

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS (Continued)

Fair Value Hedges

The Company enters into fair value hedges to effectively convert the interest rates of certain instruments from fixed to floating. The critical terms of the interest rate swaps match the terms of the corresponding hedged items. There were no hedging gains and losses resulting from hedge ineffectiveness recognized for the three months ended March 31, 2005 and 2004.

Nonhedging Derivatives

For derivatives not designated as hedging instruments, all changes in fair value are recognized in earnings during the period of change. The net cash settlement of these derivatives is included in noninterest income.

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. Most of the loans will be sold to third parties upon closing. For those loans, the Company enters into individual forward sales commitments at the same time the commitment to originate is finalized. While the forward sales commitments function as an economic offset and 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 essentially 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 \$24.1 million at March 31, 2005. The unrealized gains/losses of the origination and sales commitments were not material at March 31, 2005.

BancGroup has also 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 the Company to sell the loan participations to investor institutions for an amount equal to the Company'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, 2005 were \$611.1 million and \$26.1 million, respectively. The fair value of the forward sales commitments on the short-term participations was a loss of \$248,000 at March 31, 2005, which was offset by a gain of \$248,000 on the short-term participations. The fair value of the sales commitments on retail mortgage loans was immaterial.

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, 2005.

Note K: Stock-Based Compensation

SFAS No. 123, *Accounting for Stock-Based Compensation*, defines a fair value based method of accounting for an employee stock option or similar equity instrument. However, SFAS No. 123 allows an entity to continue to measure compensation costs for those plans using the intrinsic value based method of accounting prescribed

Table of Contents

THE COLONIAL BANCGROUP, INC. AND SUBSIDIARIES

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS (Continued)

by APB Opinion No. 25, *Accounting for Stock Issued to Employees*. Entities electing to remain with the accounting in Opinion No. 25 must make pro forma disclosures of net income and earnings per share as if the fair value based method of accounting defined in SFAS No. 123 had been applied. Under the fair value based method, compensation cost is measured at the grant date based on the value of the award and is recognized over the service period, which is usually the vesting period. Under the intrinsic value based method, compensation cost is 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. BancGroup has elected to continue to measure compensation cost for its stock option plans under the provisions in Opinion No. 25 and has calculated the fair value of outstanding options for purposes of pro forma disclosure utilizing the Black-Scholes method.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

The majority of the Company's options granted vest ratably over a period of five years; therefore for purposes of pro forma disclosures, the compensation expense related to these options has been allocated over the vesting period.

The Company's actual and pro forma information follows (in thousands except per share data):

	Three Months Ended March 31,	
	2005	2004
	(Restated)	(Restated)
Net income:		
As reported	\$ 48,188	\$ 42,856
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of tax	(395)	(359)
Pro forma net income	\$ 47,793	\$ 42,497

Three Months Ended
March 31,

	2005 (Restated)	2004 (Restated)
Basic earnings per share:		
As reported	\$ 0.35	\$ 0.34
Pro forma	\$ 0.34	\$ 0.33
Diluted earnings per share		
As reported	\$ 0.34	\$ 0.34
Pro forma	\$ 0.34	\$ 0.33

Note L: 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. Actuarial computations for financial reporting purposes are

Table of Contents

THE COLONIAL BANGROUP, INC. AND SUBSIDIARIES

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS (Continued)

based on the projected unit credit method. The measurement date is March 31. Based on current actuarial projections, BancGroup will not be required to make a contribution to the plan in 2005. However, BancGroup assesses the funded status of the plan quarterly and may, at its discretion, make contributions even when not required. Currently, BancGroup does not expect to make a material contribution during 2005.

Employee pension benefit plan status at March 31:

	Three Months Ended March 31,	
	2005	2004
	(In thousands)	
Components of net periodic benefit cost		
Service cost	\$ 1,845	\$ 1,414
Interest cost	1,156	936
Expected return on plan assets	(1,220)	(1,011)
Amortization of transition asset		(1)
Amortization of prior service cost	2	2
Amortization of actuarial loss	312	187
	<u>2,095</u>	<u>1,527</u>
Net quarterly benefit cost	<u>\$ 2,095</u>	<u>\$ 1,527</u>

Note M: 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, 2005.

Description of Securities	Less than 12 months		12 months or more		Total	
	Market Value	Unrealized Losses	Market Value	Unrealized Losses	Market Value	Unrealized Losses
	(In thousands)					
	\$ 17,688	\$ (381)	\$ 165,833	\$ (9,332)	\$ 183,521	\$ (9,713)

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U.S. Treasury obligations and direct obligations of U.S.						
Government agencies						
Federal Agency mortgage-backed securities	65,300	(1,049)	191,915	(10,886)	257,215	(11,935)
Federal Agency collateralized mortgage obligations	989,114	(20,433)	80,296	(2,904)	1,069,410	(23,337)
Private collateralized mortgage obligations	1,617,120	(29,279)	249,495	(7,906)	1,866,615	(37,185)
Corporate notes	2,021	(8)			2,021	(8)
Total temporarily impaired securities	\$ 2,691,243	\$ (51,150)	\$ 687,539	\$ (31,028)	\$ 3,378,782	\$ (82,178)

The securities above consist of Treasury notes and government agency debentures, agency collateralized mortgage obligations (CMO s) and mortgage-backed securities, AAA-rated private CMO s, and corporate notes. As of March 31, 2005, there were 178 securities carried at 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

Table of Contents

THE COLONIAL BANGROUP, INC. AND SUBSIDIARIES

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS (Continued)

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 N: 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 SPE which then sold interests in those assets to third-party commercial paper conduits. Refer to Note B for further information regarding accounting for these transactions.

Total cash proceeds from the sales of interests in these assets to the conduits during the first quarter of 2005 were \$750 million, attributable to \$435 million of mortgage warehouse loans and \$315 million of loans held for sale. Based on the structure of these transactions, the Company only retained interest in the assets retained in the SPE as a first risk of loss position. No gain or loss was recorded at 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 2005, the Company accrued approximately \$400,000 of noninterest income related to these transactions, of which \$188,000 was servicing income, but no cash was received.

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, 2005		Three Months Ended March 31, 2005	
	Principal Balance	Loans past due 30 days or more	Average Balance	Net Credit Losses
(In thousands)				
Loans				
Assets managed	\$ 13,858,517	\$ 62,795	\$ 13,225,137	\$ 7,015
less: interests sold	434,976		38,712	
Assets held in portfolio	\$ 13,423,541	\$ 62,795	\$ 13,186,425	\$ 7,015
Loans held for sale				
Assets managed	\$ 963,667	\$	\$ 756,110	\$

less: interests sold	315,024		36,288	
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Assets held in portfolio	\$ 648,643	\$	\$ 719,822	\$
	<u> </u>	<u> </u>	<u> </u>	<u> </u>

Note O: Variable Interest Entities

As discussed in Note N, the Company sells certain financial assets to a wholly-owned SPE which then sells interests in those assets to third-party commercial paper conduits. While the Company has a variable interest in these conduits, it is not considered to be the primary beneficiary, as the Company does not retain the majority of the expected losses or returns. The third-party conduits had approximately \$27.4 billion in capital outstanding at March 31, 2005. The Company's maximum exposure to loss at March 31, 2005 as a result of its involvement with these non-consolidated conduits is \$50 million, which is the amount that would be paid by the Company in the event of credit-related defaults.

There has been no material change in the Company's other variable interest entities. Refer to the Company's 2004 Annual Report on Form 10-K/A for additional information.

Table of Contents

Item 2. Management's Discussion And Analysis Of Financial Condition And Results Of Operations

RESTATEMENT

The Colonial BancGroup, Inc. is restating its financial statements and other financial information to correct errors related to the Company's derivative accounting under Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS No. 133).

In 2005 and prior years, the Company entered into interest rate swap agreements on brokered certificates of deposit (CD swaps) and junior subordinated debt (junior subordinated debt swaps) that were accounted for as fair value hedges under SFAS No. 133. The Company elected a method of fair value hedge accounting, commonly referred to as the abbreviated method of hedge accounting described in paragraph 65 of SFAS No. 133, which allowed the Company to assume no ineffectiveness in these transactions as long as critical terms did not change. The Company recently concluded that the CD swaps and junior subordinated debt swaps did not qualify for these methods in the periods covered by this restatement. In retrospect, the CD swaps did not comply due to the death puts contained in the brokered CDs, which allow the estate of the CD holder to require the bank to redeem the CD in the event of the CD holder's death. In addition, the junior subordinated debt swaps did not comply due to interest deferral features present in the junior subordinated debt. Hedge accounting under SFAS No. 133 is not allowed retrospectively because the hedge documentation required for the long-haul method was not in place at the inception of the hedge. Eliminating the application of fair value hedge accounting reverses the fair value adjustments that have been made to the brokered certificates of deposit and junior subordinated debt and results in all fair value changes for the interest rate swaps being recognized in noninterest income. Additionally, the net cash settlement payments received during each of the affected periods for these interest rate swaps were reclassified from interest expense on brokered certificates of deposit and junior subordinated debt to noninterest income. Adjustments were also made for other non-significant items.

For additional information on the restatement see Note A, Restatement, in the Notes to the Unaudited Condensed Consolidated Financial Statements.

Table of Contents**Forward-Looking Statements**

This discussion and analysis contains statements that are considered forward-looking statements within the meaning of the federal securities laws. See page 1 for additional information regarding forward-looking statements.

Critical Accounting Policies

Accounting policies considered relatively more critical due to either the subjectivity involved in the estimate and/or the potential impact that changes in the estimates can have on the reported financial results include the accounting for the allowance for loan losses and the assessment of goodwill impairment. Information concerning these policies is included in the Critical Accounting Policies section of Management's Discussion and Analysis in BancGroup's 2004 Annual Report on Form 10-K/A. There were no significant changes in these accounting policies during the first three months of 2005.

Overview

The Colonial BancGroup, Inc. is a \$20 billion financial services company providing diversified services including retail and commercial banking, wealth management services, mortgage banking and insurance through its branch network, private banking offices or officers, ATMs and the internet as well as other distribution channels to consumers and businesses. At March 31, 2005, BancGroup's branch network consisted of 306 offices in Florida, Alabama, Georgia, Nevada, Tennessee and Texas.

BancGroup is primarily a Florida bank with more of its assets in Florida than in any other state. The following is a summary of approximate assets, deposits and branches by state as of March 31, 2005 on a pro forma basis with the FFLC acquisition which is anticipated to close in the second quarter of 2005.

	% of total	% of total	
	Assets	Deposits (Restated)	Branches
Florida	52%	58%	159
Alabama	19%	27%	115
Georgia	6%	5%	20
Texas	5%	4%	12
Nevada	4%	4%	13
Corporate/Other	14%	2%	3
Total	100%	100%	322

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BancGroup reported record net income for the quarter ended March 31, 2005 of \$48.2 million, a 12% increase over the \$42.9 million recorded for the same period of the previous year. Diluted earnings per share was \$0.34 per share for the quarter ended March 31, 2005 and 2004.

Table of Contents**Financial Condition**

Changes in selected components of the Company's balance sheet from December 31, 2004 to March 31, 2005 (as restated) are as follows:

	December 31, 2004 to March 31, 2005 Increase (Decrease)	
	Amount	%
(Dollars in thousands)		
Securities available for sale and investment securities	\$ 41,050	1.1%
Loans held for sale	(29,853)	(4.4)%
Total loans, net:		
Mortgage warehouse loans	(451,304)	(40.5)%
All other loans, net of unearned income	1,017,034	8.7%
Total loans, net of unearned income	565,730	4.4%
Total assets	1,105,908	5.9%
Non-time deposits	720,875	9.6%
Total deposits	1,120,168	9.4%
Short-term borrowings	(249,368)	(7.7)%
Long-term debt	24,450	1.1%
Shareholders' equity	227,279	16.3%

Securities

Securities available for sale and investment securities totaled \$3.69 billion or 18.5% of total assets at March 31, 2005 compared to \$3.65 billion or 19.3% of total assets at December 31, 2004. At March 31, 2005, the Company's securities had an effective duration of 3.98 years. Approximately \$40.6 million in securities were sold during the quarter at a net realized loss of approximately \$1.2 million. Unrealized net losses on securities available for sale changed from a pretax loss of \$14.2 million at December 31, 2004 to a pretax loss of \$77.4 million at March 31, 2005 due to increases in market rates.

Loans and Loans Held for Sale

To increase sources of liquidity, Colonial entered into a transaction during the first quarter of 2005 whereby interests in certain assets generated by its mortgage warehouse lending unit are sold to third-party conduits financed by the issuance of asset backed commercial paper. This transaction allows Colonial to continue to manage its customer relationships while increasing balance sheet capacity for higher yielding assets. At March 31, 2005, Colonial had sold interests in its mortgage warehouse loans and loans held for sale of \$435 million and \$315 million, respectively, and had unused funding capacity of \$250 million. Mortgage warehouse loans ended the quarter at \$664 million compared to \$1.1 billion at the end of 2004.

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Loans held for sale is made up of three components: mortgage warehouse, retail mortgages, and non-mortgage loans held for sale. Total loans held for sale decreased \$30 million from December 31, 2004 primarily due to a decrease of \$45 million in the mortgage warehouse component as a result of the previously discussed sale. The purpose of the mortgage warehouse component of loans held for sale is to accommodate the funding needs of mortgage company customers, therefore these balances as well as the retail mortgage balances fluctuate as demand for residential mortgages changes.

Total loans, excluding mortgage warehouse lending, increased by \$1.0 billion from the end of 2004. Excluding the Union Bank acquisition and mortgage warehouse lending, total loans grew \$366 million or 12.5% annualized from the end of 2004. This growth was spread geographically with 48% from Florida, 24% from

Table of Contents

Alabama, 14% from Georgia, 15% from Texas, 3% from other offset by a 4% decline in Nevada. The Nevada region experienced unusually large payoffs in commercial real estate in the first quarter.

The following table reflects the Company's loan mix.

Gross Loans By Category

	March 31, 2005	December 31, 2004
(Dollars in thousands)		
Commercial, financial, and agricultural	\$ 1,079,178	\$ 1,007,686
Real estate-commercial	4,465,887	4,265,700
Real estate-construction	4,535,815	3,925,972
Residential-real estate	2,376,828	2,223,889
Consumer	188,042	187,315
Mortgage warehouse	663,619	1,114,923
Other	114,172	132,326
Total loans, net of unearned income	\$ 13,423,541	\$ 12,857,811

Management believes that its existing distribution of commercial real estate and construction loans, whether grouped geographically, by industry, or by borrower, reduces BancGroup's risk exposure. The current distribution of commercial real estate and construction loans remains diverse in location, size, and collateral function. This diversification, in addition to our emphasis on quality underwriting, serves to reduce the risk of losses. The following charts reflect the geographic diversity and property type distribution of construction and commercial real estate loans at March 31, 2005.

	Construction	% of Total	Commercial Real Estate	% of Total
(Dollars in thousands)				
Average Loan Size	\$ 675		\$ 622	
Geographic Diversity				
Florida	\$ 2,450,539	54.0%	\$ 2,394,194	53.6%
Alabama	525,877	11.6%	771,021	17.3%
Georgia	510,016	11.2%	472,236	10.6%
Texas	497,638	11.0%	266,617	6.0%
Nevada	340,794	7.5%	223,740	5.0%
Other	210,951	4.7%	338,079	7.5%
Total	\$ 4,535,815	100.0%	\$ 4,465,887	100.0%

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	% of Property Type Distribution to			% of Property Type Distribution to	
	Construction Portfolio	Total Portfolio		Commercial Real Estate	Total Portfolio
Residential Development and Lots	26.7%	9.0%	Retail	25.6%	8.4%
Land Only	19.6%	6.6%	Office	18.9%	6.3%
Residential Home Construction	17.4%	5.9%	Multi-Family	12.3%	4.1%
Condominium	11.5%	3.9%	Warehouse	11.9%	4.0%
Retail	8.1%	2.7%	Other*	9.0%	3.0%
Other*	5.8%	2.0%	Healthcare	7.1%	2.4%
Commercial Development	4.5%	1.5%	Lodging	7.0%	2.3%
Office	3.9%	1.3%	Church or School	3.8%	1.3%
Multi-Family	2.5%	0.9%	Recreation	2.9%	1.0%
			Industrial	1.5%	0.5%
Total Construction	100.0%	33.8%	Total Commercial Real Estate	100.0%	33.3%

* Other includes all loans in categories smaller than the lowest percentages shown above.

Table of Contents**Selected Characteristics of the 75 Largest Construction and Commercial Real Estate Loans**

	<u>Construction</u>	<u>Commercial Real Estate</u>
75 Largest Loans Total (in thousands)	\$ 1,205,073	\$ 780,699
% of 75 largest loans to category total	26.6%	17.5%
Average Loan to Value Ratio (75 largest loans)	69.1%	67.7%
Average Debt Coverage Ratio (75 largest loans)	N/A	1.38x

Commercial real estate and construction loans combined had growth, excluding acquisitions, of \$332 million or 4.1% from December 31, 2004 to March 31, 2005. Geographically, the Florida locations continue to contribute most of the growth in these particular portfolios. The acquisition of Union in Florida in February 2005 contributed an additional \$478 million to these portfolios. Colonial continues to focus its commercial real estate and construction growth efforts on high quality properties owned and/or developed by experienced customers with whom we have established relationships. Substantially all construction and commercial real estate loans have personal guarantees of the principals involved.

Residential real estate loans represent approximately 18% and 17% of total loans at March 31, 2005 and December 31, 2004, respectively. These loans are primarily adjustable rate first and second mortgages on single-family, owner-occupied properties.