

IRWIN FINANCIAL CORP

Form 10-Q

October 29, 2004

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2004

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

For the transition period from _____ to _____.

Commission File Number: 0-6835

IRWIN FINANCIAL CORPORATION

(Exact Name of Corporation as Specified in its Charter)

Indiana

35-1286807

(State or Other Jurisdiction of Incorporation or Organization)

(I.R.S. Employer Identification No.)

500 Washington Street Columbus, Indiana

47201

(Address of Principal Executive Offices)

(Zip Code)

(812) 376-1909

www.irwinfinancial.com

(Corporation's Telephone Number, Including Area Code)

(Web Site)

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

Yes **No**

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

Yes No

As of October 25, 2004, there were 28,350,990 outstanding common shares, no par value, of the Registrant.

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IRWIN FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS (Unaudited)

	September 30, 2004	December 31, 2003
	<hr/>	<hr/>
	(Dollars in thousands)	
Assets:		
Cash and cash equivalents	\$ 213,458	\$ 140,810
Interest-bearing deposits with financial institutions	58,450	81,166
Residual interests	70,968	71,491
Investment securities- held-to-maturity (Market value: \$30,175 at September 30, 2004 and \$24,971 at December 31, 2003)	30,152	24,956
Investment securities- available-for-sale	77,516	67,569
Loans held for sale	971,357	883,895
Loans and leases, net of unearned income Note 2	3,401,643	3,161,054
Less: Allowance for loan and lease losses Note 3	(47,796)	(64,285)
	<hr/>	<hr/>
	3,353,847	3,096,769
Servicing assets Note 4	389,171	380,123
Accounts receivable	84,018	62,045
Accrued interest receivable	16,208	15,502
Premises and equipment, net	31,444	32,208
Other assets	118,982	131,825
	<hr/>	<hr/>
Total assets	\$5,415,571	\$4,988,359
	<hr/>	<hr/>
Liabilities and Shareholders Equity:		
Deposits		
Noninterest-bearing	\$ 981,327	\$ 850,529
Interest-bearing	1,777,900	1,352,763
Certificates of deposit over \$100,000	727,230	696,370
	<hr/>	<hr/>
	3,486,457	2,899,662
Short-term borrowings Note 5	132,691	429,758
Collateralized debt Note 6	667,797	590,131
Other long-term debt Note 7	270,175	270,184
Other liabilities	372,104	366,364
	<hr/>	<hr/>

Total liabilities	<u>4,929,224</u>	<u>4,556,099</u>
Commitments and contingencies Note 11		
Shareholders' equity		
Preferred stock, no par value authorized 4,000,000 shares; none issued		
Common stock, no par value authorized 40,000,000 shares; issued 29,612,080 shares as of September 30, 2004 and December 31, 2003, respectively; including 1,277,059 and 1,477,778, shares in treasury as of September 30, 2004 and December 31, 2003, respectively	112,000	112,000
Additional paid-in capital	557	1,264
Deferred compensation	(516)	(504)
Accumulated other comprehensive loss, net of deferred income tax expense of \$540 and \$120 as of September 30, 2004, and December 31, 2003, respectively	810	182
Retained earnings	<u>401,338</u>	<u>352,647</u>
	514,189	465,589
Less treasury stock, at cost	<u>(27,842)</u>	<u>(33,329)</u>
Total shareholders' equity	<u>486,347</u>	<u>432,260</u>
Total liabilities and shareholders' equity	<u>\$5,415,571</u>	<u>\$4,988,359</u>

The accompanying notes are an integral part of the consolidated financial statements.

Table of Contents**IRWIN FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME (Unaudited)**

	Three Months Ended September 30,	
	2004	2003
	(Dollars in thousands, except per share)	
Interest income:		
Loans and leases	\$ 62,088	\$ 59,626
Loans held for sale	23,112	33,978
Residual interests	3,350	4,131
Investment securities	1,371	1,125
Federal funds sold	44	20
	<hr/>	<hr/>
Total interest income	89,965	98,880
	<hr/>	<hr/>
Interest expense:		
Deposits	11,984	9,873
Short-term borrowings	2,796	3,383
Collateralized debt	3,782	4,045
Other long-term debt - Note 7	5,743	419
Preferred securities distribution - Note 7		5,527
	<hr/>	<hr/>
Total interest expense	24,305	23,247
	<hr/>	<hr/>
Net interest income	65,660	75,633
Provision for loan and lease losses	1,898	14,778
	<hr/>	<hr/>
Net interest income after provision for loan and lease losses	63,762	60,855
Other income:		
Loan servicing fees	34,423	28,523
Amortization of servicing assets - Note 4	(28,070)	(34,064)
(Impairment) recovery of servicing assets - Note 4	(18,358)	41,665
	<hr/>	<hr/>
Net loan administration (loss) income	(12,005)	36,124
Gain from sales of loans	48,626	91,569
Gain on sale of mortgage servicing assets	440	7
Trading gains (losses)	4,326	(1,403)
Derivative gains (losses), net	21,045	(28,046)

Other	5,503	6,412
	<u> </u>	<u> </u>
	67,935	104,663
Other expense:		
Salaries	53,986	62,220
Pension and other employee benefits	12,127	9,573
Office expense	3,271	5,330
Premises and equipment	10,096	9,533
Marketing and development	3,103	3,400
Professional fees	5,132	2,980
Other	14,777	21,370
	<u> </u>	<u> </u>
	102,492	114,406
	<u> </u>	<u> </u>
Income before income taxes	29,205	51,112
Provision for income taxes	12,011	19,994
	<u> </u>	<u> </u>
Net income	\$ 17,194	\$ 31,118
	<u> </u>	<u> </u>
Earnings per share: - Note 9		
Basic	\$ 0.61	\$ 1.11
	<u> </u>	<u> </u>
Diluted	\$ 0.57	\$ 1.03
	<u> </u>	<u> </u>
Dividends per share	\$ 0.08	\$ 0.07
	<u> </u>	<u> </u>

The accompanying notes are an integral part of the consolidated financial statements.

Table of Contents**IRWIN FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME (Unaudited)**

	Nine Months Ended September 30,	
	2004	2003
	(Dollars in thousands, except per share)	
Interest income:		
Loans and leases	\$ 181,759	\$ 179,460
Loans held for sale	59,397	86,800
Residual interests	9,893	17,100
Investment securities	3,733	3,134
Federal funds sold	82	119
	<hr/>	<hr/>
Total interest income	254,864	286,613
	<hr/>	<hr/>
Interest expense:		
Deposits	31,532	32,679
Short-term borrowings	6,611	12,053
Collateralized debt	10,501	11,569
Other long-term debt Note 7	17,101	1,745
Preferred securities distribution Note 7		16,581
	<hr/>	<hr/>
Total interest expense	65,745	74,627
	<hr/>	<hr/>
Net interest income	189,119	211,986
Provision for loan and lease losses	11,838	37,655
	<hr/>	<hr/>
Net interest income after provision for loan and lease losses	177,281	174,331
Other income:		
Loan servicing fees	100,620	75,231
Amortization of servicing assets Note 4	(89,413)	(102,112)
Recovery (impairment) of servicing assets Note 4	6,210	(1,966)
	<hr/>	<hr/>
Net loan administration income (loss)	17,417	(28,847)
Gain from sales of loans	140,669	311,081
Gain on sale of mortgage servicing assets	8,857	7
Trading gains (losses)	15,668	(52,323)
Derivative gains (losses), net	25,869	(15,904)

Other	17,917	16,982
	<u> </u>	<u> </u>
	226,397	230,996
Other expense:		
Salaries	158,602	176,851
Pension and other employee benefits	34,813	31,431
Office expense	12,950	16,200
Premises and equipment	30,890	28,751
Marketing and development	10,670	11,157
Professional fees	14,436	8,664
Other	48,325	40,646
	<u> </u>	<u> </u>
	310,686	313,700
	<u> </u>	<u> </u>
Income before income taxes	92,992	91,627
Provision for income taxes	37,513	35,505
	<u> </u>	<u> </u>
Net income	\$ 55,479	\$ 56,122
	<u> </u>	<u> </u>
Earnings per share: Note 9		
Basic	\$ 1.96	\$ 2.01
	<u> </u>	<u> </u>
Diluted	\$ 1.84	\$ 1.89
	<u> </u>	<u> </u>
Dividends per share	\$ 0.24	\$ 0.21
	<u> </u>	<u> </u>

The accompanying notes are an integral part of the consolidated financial statements.

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IRWIN FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (Unaudited)
Three Months Ended September 30, 2004, and 2003

	Total	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Deferred Compensation	Additional Paid in Capital	Common Stock	Treasury Stock
(Dollars in thousands)							
Balance at July 1, 2004	\$469,486	\$386,410	\$ 71	\$ (538)	\$ 579	\$112,000	\$(29,036)
Net income	17,194	17,194					
Unrealized gain on investment securities net of \$142 tax liability	212		212				
Foreign currency adjustment net of \$352 tax liability	527		527				
Total comprehensive income	17,933						
Deferred compensation	22			22			
Cash dividends	(2,266)	(2,266)					
Tax benefit on stock option exercises	100				100		
Treasury stock:							
Purchase of 867 shares	(23)						(23)
Sales of 52,342 shares	1,095				(122)		1,217
Balance September 30, 2004	\$486,347	\$401,338	\$ 810	\$ (516)	\$ 557	\$112,000	\$(27,842)
Balance at July 1, 2003	\$384,835	\$308,760	\$ (58)	\$ (489)	\$2,422	\$112,000	\$(37,800)
Net income	31,118	31,118					
Unrealized loss on investment securities net of \$57 tax benefit	(84)		(84)				
Unrealized loss on interest rate cap net of \$17 tax liability	26		26				
Foreign currency adjustment net of \$16 tax benefit	(24)		(24)				

Total comprehensive income	31,036						
Deferred compensation	68			68			
Cash dividends	(1,959)	(1,959)					
Tax benefit on stock option exercises	22				22		
Treasury stock:							
Purchase of 1,321 shares	(33)						(33)
Sales of 24,766 shares	485				(31)		516
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Balance September 30, 2003	\$414,454	\$337,919	\$ (140)	\$ (421)	\$2,413	\$112,000	\$(37,317)
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>

The accompanying notes are an integral part of the consolidated financial statements.

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IRWIN FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (Unaudited)
Nine Months Ended September 30, 2004, and 2003

	Total	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Deferred Compensation	Additional Paid in Capital	Common Stock	Treasury Stock
(Dollars in thousands)							
Balance at January 1, 2004	\$432,260	\$352,647	\$ 182	\$ (504)	\$ 1,264	\$112,000	\$(33,329)
Net income	55,479	55,479					
Unrealized gain on investment securities net of \$93 tax liability	139		139				
Unrealized gain on interest rate cap net of \$131 tax liability	196		196				
Foreign currency adjustment net of \$195 tax liability	293		293				
Total comprehensive income	56,107						
Deferred compensation	(12)			(12)			
Cash dividends	(6,788)	(6,788)					
Tax benefit on stock option exercises	778				778		
Treasury stock:							
Purchase of 11,307 shares	(370)						(370)
Sales of 212,026 shares	4,372				(1,485)		5,857
Balance at September 30, 2004	<u>\$486,347</u>	<u>\$401,338</u>	<u>\$ 810</u>	<u>\$ (516)</u>	<u>\$ 557</u>	<u>\$112,000</u>	<u>\$(27,842)</u>
Balance at January 1, 2003	\$360,555	\$287,662	\$(1,142)	\$ (240)	\$ 3,606	\$112,000	\$(41,331)
Net income	56,122	56,122					
Unrealized loss on investment securities net of \$45 tax benefit	(72)		(72)				
Unrealized loss on	(47)		(47)				

interest rate cap net of \$31 tax benefit							
Foreign currency adjustment net of \$576 tax liability	865		865				
Minimum SERP liability net of \$170 tax liability	<u>256</u>		<u>256</u>				
Total comprehensive income	57,124						
Deferred compensation	(181)		(181)				
Cash dividends	(5,865)	(5,865)					
Conversion of 1,700 trust preferred shares to 2,142 common shares	43			(1)		44	
Tax benefit on stock option exercises	1,031			1,031			
Treasury stock: Purchase of 122,464 shares	(2,822)					(2,822)	
Sales of 330,666 shares	<u>4,569</u>			<u>(2,223)</u>		<u>6,792</u>	
Balance at September 30, 2003	<u>\$414,454</u>	<u>\$337,919</u>	<u>\$ (140)</u>	<u>\$ (421)</u>	<u>\$ 2,413</u>	<u>\$112,000</u>	<u>\$(37,317)</u>

The accompanying notes are an integral part of the consolidated financial statements.

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IRWIN FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

	Nine Months Ended September 30,	
	2004	2003
	(Dollars in thousands)	
Net income	\$ 55,479	\$ 56,122
Adjustments to reconcile net income to cash provided (used) by operating activities:		
Depreciation, amortization, and accretion, net	6,056	8,747
Amortization and impairment of servicing assets	83,203	104,078
Provision for loan and lease losses	11,838	37,655
Gain on sale of mortgage servicing assets	(8,857)	(7)
Gain from sales of loans held for sale	(140,669)	(311,081)
Originations and purchases of loans held for sale	(10,934,035)	(21,131,799)
Proceeds from sales and repayments of loans held for sale	10,873,116	21,590,397
Proceeds from sale of mortgage servicing assets	29,494	
Net decrease in residuals	523	78,368
Net (increase) decrease in accounts receivable	(21,973)	16,554
Other, net	15,567	12,694
	(30,258)	461,728
Lending and investing activities:		
Proceeds from maturities/calls of investment securities:		
Held-to-maturity	92,987	495
Available-for-sale	1,399	38,682
Purchase of investment securities:		
Held-to-maturity	(98,395)	(99)
Available-for-sale	(10,958)	(83,253)
Net decrease (increase) in interest-bearing deposits with financial institutions	22,716	(27,777)
Net increase in loans, excluding sales	(303,958)	(379,606)
Proceeds from sale of loans	36,279	33,182
Other, net	(4,857)	(6,125)
	(264,787)	(424,501)
Financing activities:		
Net increase in deposits	586,795	324,931
Net decrease in short-term borrowings	(297,067)	(550,724)
Repayments of long-term debt	(9)	(8)

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Proceeds from issuance of collateralized borrowings	449,223	373,658
Repayments of collateralized borrowings	(369,277)	(176,352)
Purchase of treasury stock for employee benefit plans	(370)	(2,822)
Proceeds from sale of stock for employee benefit plans	5,150	5,600
Dividends paid	(6,788)	(5,865)
	<u> </u>	<u> </u>
Net cash provided (used) by financing activities	367,657	(31,582)
	<u> </u>	<u> </u>
Effect of exchange rate changes on cash	36	(144)
	<u> </u>	<u> </u>
Net decrease in cash and cash equivalents	72,648	5,501
Cash and cash equivalents at beginning of period	140,810	157,771
	<u> </u>	<u> </u>
Cash and cash equivalents at end of period	\$ 213,458	\$ 163,272
	<u> </u>	<u> </u>
Supplemental disclosures of cash flow information:		
Cash flow during the period:		
Interest paid	\$ 65,765	\$ 78,052
	<u> </u>	<u> </u>
Income taxes (refund) paid	\$ (4,998)	\$ 42,928
	<u> </u>	<u> </u>
Noncash transactions:		
Liability for loans held for sale eligible for repurchase Note 1	\$ 67,658	\$ 111,390
	<u> </u>	<u> </u>
Conversion of trust preferred stock to common stock	\$	\$ 43
	<u> </u>	<u> </u>

The accompanying notes are an integral part of the consolidated financial statements.

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Consolidation: Irwin Financial Corporation and its subsidiaries (the Corporation) provide financial services throughout the United States and Canada. We are engaged in the mortgage banking, commercial banking, home equity lending, commercial finance, and venture capital lines of business. Our direct and indirect subsidiaries include Irwin Mortgage Corporation, Irwin Union Bank and Trust Company, Irwin Union Bank, F.S.B., Irwin Home Equity Corporation, Irwin Commercial Finance Corporation and Irwin Ventures, LLC. Intercompany balances and transactions have been eliminated in consolidation. In the opinion of management, the financial statements reflect all material adjustments necessary for a fair presentation. The Corporation does not meet the criteria as primary beneficiary for our wholly-owned trusts holding our company-obligated mandatorily redeemable preferred securities established by Financial Accounting Standards Board (FASB) Interpretation No. 46 (FIN 46), Consolidation of Variable Interest Entities. As a result, these trusts are not consolidated.

Use of Estimates: The preparation of financial statements in conformity with generally accepted accounting principles requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Residual Interests: Residual interests are stated at fair value. Unrealized gains and losses are included in earnings. Until the first quarter of 2002, whenever we sold receivables in securitizations of home equity loans and lines of credit, we sold assets and retained residual interests, one or more subordinated tranches, and in some cases a cash reserve account, all of which are retained interests in the securitized receivables in a manner that qualified for gain-on-sale under Statement of Financial Accounting Standard (SFAS) 140. Gain or loss on the sale of the loans depended, in part, on the previous carrying amount of the financial assets involved in the transfer, allocated between the assets sold and the retained interests based on their relative fair value at the date of transfer.

To obtain fair value of residual interests, quoted market prices are used if available. However, quotes are generally not available for residual interests, so we generally estimate fair value based on the present value of expected cash flows using estimates of the key assumptions—prepayment speeds, credit losses, forward yield curves, and discount rates commensurate with the risks involved—that management believes market participants would use to value similar assets. Adjustments to carrying values are recorded as trading gains or losses.

Cash and Cash Equivalents Defined: For purposes of the statement of cash flows, we consider cash and due from banks and federal funds sold to be cash equivalents.

Loans Held for Sale: Included in loans held for sale at the mortgage line of business were loans for which we have the right, but not the obligation, to repurchase due to default, under the terms of the government servicing agency contracts. Upon default, we have the non-contingent right to repurchase these loans which causes repurchase accounting under Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. The liability associated with these loans is reflected in other liabilities on our Consolidated Balance Sheet.

Stock-Based Employee Compensation: We have two stock-based employee compensation plans. We use the intrinsic value method to account for our plans under the recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. No stock-based employee compensation cost is reflected in net income for any of the periods presented, as all options granted under these plans had an exercise price equal to the market value of the underlying common stock on the date of grant. To date, the

Board of Directors has not chosen to expense stock options. The Board wishes to analyze new guidance from the FASB, Securities and Exchange Commission (SEC) and other relevant authorities regarding the standardization of valuation methods. Accordingly, we plan to begin expensing options when the new requirements become effective or earlier should the Board of Directors determine it to be in the best interests of our stakeholders. We will continue to disclose the impact of expensing stock options, using our valuation method, which is based on a Black-Scholes model using assumptions management believes to be reasonable. The following table illustrates the effect on net income and earnings per share if we had applied the fair value recognition provisions of Statement of Financial Accounting Standard (SFAS) 123, Accounting for Stock-Based Compensation, to stock-based employee compensation:

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	Three Months Ended September 30,		Nine months ended September 30,	
	2004	2003	2004	2003
	(Dollars in thousands)			
Net income as reported	\$ 17,194	\$ 31,118	\$ 55,479	\$ 56,122
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(670)	(699)	(1,969)	(2,187)
Pro forma net income	<u>\$ 16,524</u>	<u>\$ 30,419</u>	<u>\$ 53,510</u>	<u>\$ 53,935</u>
Basic earnings per share				
As reported	\$ 0.61	\$ 1.11	\$ 1.96	\$ 2.01
Pro forma	\$ 0.58	\$ 1.09	\$ 1.89	\$ 1.93
Diluted earnings per share				
As reported	\$ 0.57	\$ 1.03	\$ 1.84	\$ 1.89
Pro forma	\$ 0.55	\$ 1.01	\$ 1.78	\$ 1.82

Recent Accounting Developments: We adopted FASB Interpretation No. 46 (FIN 46), Consolidation of Variable Interest Entities as of December 31, 2003 and as a result, deconsolidated IFC Capital Trust II, IFC Capital Trust III, IFC Capital Trust IV, IFC Capital Trust V, IFC Capital Trust VI, and IFC Statutory Trust VII (IFC Trusts). The sole assets of the IFC Trusts are subordinated debentures of Irwin Financial Corporation. The IFC Trusts' liabilities are represented by Trust Preferred Securities, which have previously been listed as Company-obligated mandatorily redeemable preferred securities of subsidiary trusts on our consolidated balance sheets. Under FIN 46, the subordinated debentures, which are substantially equal in amount to the Trust Preferred Securities, cease to be eliminated in consolidation and are included in other long-term debt in our consolidated balance sheets at December 31, 2003 and September 30, 2004. Details about the IFC Trusts and debentures can be found in Note 7,

Other Long-Term Debt. The Trust Preferred Securities currently qualify as Tier 1 regulatory capital. In May 2004, the Federal Reserve Bank issued proposed rules that retain Tier 1 capital treatment of Trust Preferred Securities for bank holding companies.

Reclassifications: Certain amounts in the 2003 consolidated financial statements have been reclassified to conform to the 2004 presentation. These changes had no impact on previously reported net income or shareholders' equity.

Table of Contents**Note 2 Loans and Leases**

Loans and leases are summarized as follows:

	September 30, 2004	December 31, 2003
	(Dollars in thousands)	
Commercial, financial and agricultural	\$1,614,983	\$1,503,619
Real estate-construction	325,330	306,669
Real estate-mortgage	870,374	859,541
Consumer	30,979	27,370
Direct financing leases		
Domestic	447,737	364,413
Canadian	242,572	207,355
Unearned income		
Domestic	(98,347)	(78,875)
Canadian	(31,985)	(29,038)
	<hr/>	<hr/>
Total loans and leases, net of unearned income	\$3,401,643	\$3,161,054
	<hr/>	<hr/>

Note 3 Allowance for Loan and Lease Losses

Changes in the allowance for loan and lease losses are summarized below:

	As of and For the Nine Months Ended September 30, 2004	As of and For the Year Ended December 31, 2003
	(Dollars in thousands)	
Balance at beginning of period	\$ 64,285	\$ 50,936
Provision for loan and lease losses	11,838	47,583
Charge-offs	(21,040)	(37,312)
Recoveries	3,951	3,420
Reduction due to reclassification of loans to loans held for sale	(10,808)	(690)
Other	(430)	348
	<hr/>	<hr/>
Balance at end of period	\$ 47,796	\$ 64,285
	<hr/>	<hr/>

The 2004 provision and allowance for loan and lease losses reflects transactions related to the transfer and sale or pending sale of portfolio loans associated with two portfolio sales at our home equity lending line of business. We transferred \$355 million in loans to loans held for sale when the decisions were made to sell these portfolio loans. These loans had an associated allowance of \$20.6 million. The loans were transferred with an allowance of \$10.8 million to reduce their carrying value to fair market value. After the transfers, the remaining \$9.8 million of excess allowance was reversed through the provision for loan and lease losses.

Table of Contents**Note 4 Servicing Assets**

Included on the consolidated balance sheet at September 30, 2004 and December 31, 2003 are \$389.2 million and \$380.1 million, respectively, of capitalized servicing assets. These amounts relate to the mortgage and home equity loans serviced by us for investors. Changes in our capitalized servicing assets, net of valuation allowance, are shown below:

	As of and For the Nine Months Ended September 30, 2004	As of and For the Year Ended December 31, 2003
	(Dollars in thousands)	
Beginning balance	\$380,123	\$ 174,935
Additions	112,890	296,551
Amortization	(89,413)	(135,519)
Recovery of impairment	6,210	44,516
Reduction for servicing sales	(20,639)	(360)
	<u>\$389,171</u>	<u>\$ 380,123</u>

We have established a valuation allowance to record servicing assets at their fair market value. Changes in the allowance are summarized below:

	September 30, 2004	December 31, 2003
	(Dollars in thousands)	
Balance at beginning of year	\$ 76,869	\$159,865
Recovery of impairment	(6,210)	(44,516)
Reclass for sales of servicing	(18,204)	
Other than temporary impairment ⁽¹⁾	(6,999)	(38,480)
	<u>\$ 45,456</u>	<u>\$ 76,869</u>

⁽¹⁾ Other than temporary impairment was recorded to reflect our view that the originally recorded value of certain servicing rights and subsequent impairment associated with those rights is unlikely to be recovered in market value. There was no related direct impact on net income as this other than temporary impairment affected only balance sheet

accounts. However, the write-down will result in a reduction of amortization expense and potentially reduced recovery of impairment in future periods.

Note 5 Short-Term Borrowings

Short-term borrowings are summarized as follows:

	September 30, 2004	December 31, 2003
	(Dollars in thousands)	
Federal Home Loan Bank borrowings	\$ 1,348	\$286,000
Drafts payable related to mortgage loan closings	79,446	72,686
Lines of credit and other	51,897	1,057
Federal funds		53,600
Commercial paper		16,415
	<hr/>	<hr/>
Total	\$132,691	\$429,758
	<hr/>	<hr/>
Weighted average interest rate	1.25%	1.61%

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Federal Home Loan Bank borrowings are collateralized by loans and loans held for sale.

Drafts payable related to mortgage loan closings are related to mortgage closings that have not been presented to the banks for payment. When presented for payment, these borrowings will be funded internally or by borrowing from the lines of credit.

We have lines of credit available to fund loan originations and operations with variable rates ranging from 1.6% to 3.0% at September 30, 2004.

Note 6 Collateralized Debt

We pledge or sell loans structured as secured financings at our home equity and commercial finance lines of business. Sale treatment is precluded on these transactions because we fail the true-sale requirements of SFAS 140 as we maintain effective control over the loans and leases securitized. This type of structure results in cash being received (and subsequently used by us to pay-down short-term fundings), debt being recorded, and the establishment of an allowance for credit losses. The notes associated with these transactions are collateralized by \$0.7 billion in home equity loans, home equity lines of credit, and leases. The principal and interest on these debt securities are paid using the cash flows from the underlying loans and leases. Accordingly, the timing of the principal payments on these debt securities is dependent on the payments received on the underlying collateral. The interest rates on the bonds are at a floating rate. We have an interest only senior note on the securitization at the home equity lending line of business that as of September 30, 2004 had a notional balance of \$30.5 million (which does not represent the amount at risk), pays interest at 10%, and matures on September 25, 2005. The 2002-1 asset backed structure was sold during the second quarter resulting in the recognition of a \$2.5 million gain and the removal of \$205 million of loans and associated collateralized debt from our balance sheet. The 2003-1 structure will be sold in October. The \$150 million of loans in the 2003-1 structure were transferred from loans to loans held for sale as of September 30, resulting in a reversal of \$3.5 million in loan loss provision.

Collateralized debt is summarized as follows:

	Maturity	Weighted Average Interest Rate at		
		September 30, 2004	September 30, 2004	December 31, 2003
(Dollars in thousands)				
Commercial finance line of business				
2003 domestic asset backed note	7/2010	2.70	\$ 33,969	\$ 51,694
2003 Canadian asset backed note	11/2008	4.07	103,107	77,902
Home equity line of business 2004-1 asset backed notes: Combined variable rate senior note	12/2024-12/2034	1.89	365,196	

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Combined variable rate subordinate note	12/2034	2.74	24,775	
2003-1 asset backed notes:				
Combined variable rate senior note	2/2028	2.15	69,099	160,874
Combined variable rate subordinate note	2/2028	3.92	68,625	61,763
Unamortized premium/discount			3,026	4,446
2002-1 asset backed notes:				
Combined variable rate senior note				156,699
Combined variable rate subordinate note				72,551
Unamortized premium/discount				4,202
Total			\$667,797	\$590,131

Note 7 -Other Long-Term Debt

At September 30, 2004 and December 31, 2003 we had \$270 million of other long-term debt. Included in both years is \$30 million of subordinated debt with an interest rate of 7.58% and a maturity date of July 2014.

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We also have obligations represented by subordinated debentures at September 30, 2004 of \$240 million. These securities were issued by wholly-owned trusts of Irwin Financial Corporation that were created for the purpose of issuing cumulative trust preferred securities. In accordance with FIN 46 we are no longer consolidating these trusts. Refer to Note 1 for information regarding the accounting change for these securities implemented in 2003. These debentures are the sole assets of these trusts as of September 30, 2004. All debentures and securities are callable at par after five years from origination date although at this time we have no plans to call. The securities are all Tier 1 qualifying capital at September 30, 2004. Highlights about these debentures and the related trusts are listed below:

Name	Origination Date	Interest Rate at September 30, 2004	Maturity Date	Subordinated Debt		Other
				September 30, 2004	December 31, 2003	
(Dollars in thousands)						
IFC Capital Trust II	Nov 2000	10.50%	Sep 2030	\$ 53,351	\$ 53,351	
IFC Capital Trust III	Nov 2000	8.75	Sep 2030	53,268	53,268	initial conversion ratio of 1.261 shares of common stock to 1 convertible preferred security, currently callable at 10% premium
IFC Capital Trust IV	Jul 2001	10.25	Jul 2031	15,464	15,464	
IFC Capital Trust V	Nov 2001	9.95	Nov 2031	30,928	30,928	
IFC Capital Trust VI	Oct 2002	8.70	Sep 2032	35,567	35,567	
IFC Statutory Trust VII	Nov 2003	4.88	Nov 2033	51,547	51,547	rate changes quarterly at three month LIBOR plus 290 basis points
				\$240,125	\$240,125	

Table of Contents**Note 8 Employee Retirement Plans**

Components of net periodic cost of pension benefit are as follows:

	Three Months Ended September 30,	
	2004	2003
	(Dollars in thousands)	
Service	\$ 762	\$ 396
Interest	479	413
Expected return on plan assets	(395)	(314)
Amortization of transition obligation	3	3
Amortization of prior service cost	10	10
Amortization of actuarial loss	204	193
	<u> </u>	<u> </u>
Net periodic benefit cost	<u>\$ 1,063</u>	<u>\$ 701</u>
	Nine Months Ended September 30,	
	2004	2003
	(Dollars in thousands)	
Service	\$ 1,750	\$ 1,188
Interest	1,390	1,238
Expected return on plan assets	(1,204)	(939)
Amortization of transition obligation	8	8
Amortization of prior service cost	29	29
Amortization of actuarial loss	555	578
	<u> </u>	<u> </u>
Net periodic benefit cost	<u>\$ 2,528</u>	<u>\$ 2,102</u>

As of September 30, 2004, we have not made any contributions to our pension plan in 2004. We anticipate making a cash contribution of approximately \$3 million to this plan before year end.

Table of Contents**Note 9 Earnings Per Share**

Earnings per share calculations are summarized as follows:

	Basic Earnings Per Share	Effect of Stock Options	Effect of Convertible Shares	Diluted Earnings Per Share
(Dollars in thousands, except per share data)				
Three months ended September 30, 2004				
Net income available to common shareholders	\$ 17,194	\$	\$ 678	\$ 17,872
Shares	<u>28,293</u>	<u>366</u>	<u>2,607</u>	<u>31,266</u>
Per-Share amount	<u>\$ 0.61</u>	<u>\$ (0.01)</u>	<u>\$ (0.03)</u>	<u>\$ 0.57</u>
Three months ended September 30, 2003				
Net income available to common shareholders	\$ 31,118	\$	\$ 679	\$ 31,797
Shares	<u>27,949</u>	<u>306</u>	<u>2,609</u>	<u>30,864</u>
Per-Share amount	<u>\$ 1.11</u>	<u>\$ (0.01)</u>	<u>\$ (0.07)</u>	<u>\$ 1.03</u>
Nine Months ended September 30, 2004				
Net income available to common shareholders	\$ 55,479	\$	\$ 2,035	\$ 57,514
Shares	<u>28,244</u>	<u>405</u>	<u>2,607</u>	<u>31,256</u>
Per-Share amount	<u>\$ 1.96</u>	<u>\$ (0.02)</u>	<u>\$ (0.10)</u>	<u>\$ 1.84</u>
Nine Months ended September 30, 2003				
Net income available to common shareholders	\$ 56,122	\$	\$ 2,037	\$ 58,159
Shares	<u>27,877</u>	<u>272</u>	<u>2,609</u>	<u>30,758</u>
Per-Share amount	<u>\$ 2.01</u>	<u>\$ (0.01)</u>	<u>\$ (0.11)</u>	<u>\$ 1.89</u>

At September 30, 2004 and 2003, 94,044 and 705,482 shares, respectively, related to stock options were not included in the dilutive earnings per share calculation because they had exercise prices below the stock price as of the respective dates.

Note 10 Industry Segment Information

We have five principal segments that provide a broad range of financial services. The mortgage banking line of business originates, sells, and services residential first mortgage loans. The commercial banking line of business provides commercial banking services. The home equity lending line of business originates, sells and services home equity loans and lines of credit. The commercial finance line of business originates leases and loans against commercial equipment and real estate. The venture capital line of business invests in early-stage technology companies focusing on financial services. Our other segment primarily includes the parent company and eliminations.

The accounting policies of each segment are the same as those described in the Summary of Significant Accounting Policies. Below is a summary of each segment's revenues, net income, and assets