INTERNATIONAL BANCSHARES CORP
Form 10-Q
May 10, 2006

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF

THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2006

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE**

SECURITIES EXCHANGE ACT OF 1934

For the transition period from   to

Commission file number 0-9439

INTERNATIONAL BANCSHARES CORPORATION

(Exact name of registrant as specified in its charter)

Texas (State or other jurisdiction of incorporation or organization)	**74-2157138** (I.R.S. Employer Identification No.)

1200 San Bernardo Avenue, Laredo, Texas 78042-1359

(Address of principal executive offices)

(Zip Code)

(956) 722-7611

(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 ý No o

Indicate by check mark if 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 ý   Accelerated Filer o   Non-accelerated filer o

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No ý

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

Class	Shares Issued and Outstanding
Common Stock, $1.00 par value	63,138,882 shares outstanding at May 1, 2006

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Condition (Unaudited)

(Dollars in Thousands)

		March 31, 2006		December 31, 2005
Assets				
Cash and due from banks	$	222,056	$	216,118
Federal funds sold		125,000		242,000
Total cash and cash equivalents		347,056		458,118
Time deposits with banks		396		396
Investment securities:				
Held-to-maturity (Market value of $2,375 on March 31, 2006 and December 31, 2005)		2,375		2,375
Available-for-sale (Amortized cost of $4,506,442 on March 31, 2006 and $4,331,517 on December 31, 2005)		4,440,393		4,266,952
Total investment securities		4,442,768		4,269,327
Loans, net of unearned discounts		4,647,153		4,625,692
Less allowance for possible loan losses		(73,095)		(77,796)
Net loans		4,574,058		4,547,896
Bank premises and equipment, net		363,363		351,986
Accrued interest receivable		49,271		48,647
Other investments		331,387		332,675
Identified intangible assets, net		38,007		39,224
Goodwill, net		289,262		289,262
Other assets		46,634		54,322
Total assets	$	10,482,202	$	10,391,853

		March 31, 2006		December 31, 2005
Liabilities and Shareholders Equity				
Liabilities:				
Deposits:				
Demand non-interest bearing	$	1,393,203	$	1,339,380
Savings and interest bearing demand		2,144,775		2,156,234
Time		3,240,376		3,160,812
Total deposits		6,778,354		6,656,426
Securities sold under repurchase agreements		762,966		760,762
Other borrowed funds		1,815,074		1,870,075
Junior subordinated deferrable interest debentures		236,538		236,391
Other liabilities		87,038		75,332
Total liabilities		9,679,970		9,598,986
Shareholders equity:				
Common shares of $1.00 par value. Authorized 275,000,000 shares; issued 86,124,719 shares on March 31, 2006 and 86,059,121 shares on December 31, 2005		86,125		86,059
Surplus		136,496		135,619
Retained earnings		812,391		788,416
Accumulated other comprehensive loss		(42,931)		(41,968)
		992,081		968,126
Less cost of shares in treasury, 22,851,952 shares on March 31, 2006 and 22,330,354 shares on December 31, 2005		(189,849)		(175,259)
Total shareholders equity		802,232		792,867
Total liabilities and shareholders equity	$	10,482,202	$	10,391,853

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Income (Unaudited)

(Dollars in Thousands, except per share data)

	Three Months Ended March 31, 2006	Three Months Ended March 31, 2005
Interest income:		
Loans, including fees	$ 90,402	$ 79,825
Federal funds sold	1,376	567
Investment securities:		
Taxable	49,256	36,513
Tax-exempt	1,172	1,217
Other interest income	111	197
Total interest income	142,317	118,319
Interest expense:		
Savings deposits	8,904	5,474
Time deposits	26,199	14,480
Federal funds purchased and securities sold under repurchase agreements	7,872	5,448
Other borrowings	20,005	11,604
Junior subordinated deferrable interest debentures	5,024	4,200
Total interest expense	68,004	41,206
Net interest income	74,313	77,113
Provision for possible loan losses	597	2,610
Net interest income after provision for possible loan losses	73,716	74,503
Non-interest income:		
Service charges on deposit accounts	20,998	20,045
Other service charges, commissions and fees		
Banking	6,928	6,045
Non-banking	3,989	1,632
Investment securities transactions, net		(26)
Other investments, net	4,573	4,417
Other income	4,130	10,310
Total non-interest income	40,618	42,423

	Three Months Ended March 31, 2006	Three Months Ended March 31, 2005
Non-interest expense:		
Employee compensation and benefits	$ 29,472	$ 27,475
Occupancy	6,242	5,448
Depreciation of bank premises and equipment	6,744	5,710
Professional fees	2,931	3,208
Stationery and supplies	1,558	1,367
Amortization of identified intangible assets	1,217	1,298
Advertising	2,956	2,786
Other	27,737	12,732
Total non-interest expense	78,857	60,024
Income before income taxes	35,477	56,902
Provision for income taxes	11,502	19,242
Net income	$ 23,975	$ 37,660
Basic earnings per common share:		
Weighted average number of shares outstanding:	63,492,138	63,603,714
Net income	$ .38	$ .59
Fully diluted earnings per common share:		
Weighted average number of shares outstanding:	64,170,136	64,574,730
Net income	$ .37	$ .58

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income (Unaudited)

(Dollars in Thousands)

	Three Months Ended March 31, 2006	2005
Net income	$ 23,975	$ 37,660
Other comprehensive loss, net of tax		
Unrealized holding losses on securities arising during period, net of reclassification adjustment for losses included in net income	(963)	(32,235)
Comprehensive income	$ 23,012	$ 5,425

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows (Unaudited)

(Dollars in Thousands)

	Three Months Ended March 31, 2006	2005
Operating activities:		
Net income	$ 23,975	$ 37,660
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of loan premiums	372	348
Provision for possible loan losses	597	2,610
Amortization of time deposit discounts		(1,800)
Depreciation of bank premises and equipment	6,744	5,710
Loss (gain) on sale of bank premises and equipment	13	(73)
Depreciation and amortization of leased assets	542	422
Accretion of investment securities discounts	(113)	(176)
Amortization of investment securities premiums	987	7,474
Investment securities transactions, net		26
Accretion of junior subordinated debenture discounts	147	256
Amortization of identified intangible assets	1,217	1,298
Earnings from affiliates and other investments	(3,339)	(3,374)
Stock compensation expense	234	
Deferred tax (benefit) expense	(6,686)	568
Increase in accrued interest receivable	(624)	(2,733)
Net decrease in other assets	7,147	3,885
Net increase in other liabilities	18,911	15,396
Net cash provided by operating activities	50,124	67,497
Investing activities:		
Proceeds from maturities of securities	1,810	500
Proceeds from sales of available-for-sale securities		75,960
Purchases of available for sale securities	(363,561)	(474,819)
Principal collected on mortgage-backed securities	185,953	163,977
Net increase in loans	(27,131)	(76,379)
Distributions (purchases) of other investments	4,627	(19,010)
Purchases of bank premises and equipment	(18,393)	(13,052)
Proceeds from sale of bank premises and equipment	259	407
Net cash used in investing activities	(216,436)	(342,416)

	Three Months Ended March 31, 2006	2005
Financing activities:		
Net increase in non-interest bearing demand deposits	$ 53,823	$ 81,383
Net decrease in savings and interest bearing demand deposits	(11,459)	(1,925)
Net increase (decrease) in time deposits	79,564	(50,152)
Net increase in securities sold under repurchase agreements	2,204	186,208
Proceeds from issuance of other borrowed funds	1,012,000	1,145,000
Principal payments on other borrowed funds	(1,067,001)	(1,005,003)
Purchase of treasury stock	(14,590)	(104)
Proceeds from stock transactions	709	1,548
Net provided by financing activities	55,250	356,955
(Decrease) increase in cash and cash equivalents	(111,062)	82,036
Cash and cash equivalents at beginning of period	458,118	195,770
Cash and cash equivalents at end of period	$ 347,056	$ 277,806
Supplemental cash flow information:		
Interest paid	$ 68,940	$ 39,353
Income taxes paid		4,443

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(Unaudited)

Note 1 - Basis of Presentation

The accounting and reporting policies of International Bancshares Corporation (Corporation) and Subsidiaries (the Corporation and Subsidiaries collectively referred to herein as the Company) conform to accounting principles generally accepted in the United States of America and to general practices within the banking industry. The consolidated financial statements include the accounts of the Corporation and its wholly-owned subsidiaries, International Bank of Commerce, Laredo (IBC), Commerce Bank, International Bank of Commerce, Zapata, International Bank of Commerce, Brownsville and the Corporation s wholly-owned non-bank subsidiaries, IBC Subsidiary Corporation, IBC Life Insurance Company, IBC Trading Company, and IBC Capital Corporation, as well as the GulfStar Group in which the Company owns a controlling interest. All significant inter-company balances and transactions have been eliminated in consolidation. The consolidated financial statements are unaudited, but include all adjustments, which, in the opinion of management, are necessary for a fair presentation of the results of the periods presented. All such adjustments were of a normal and recurring nature. It is suggested that these financial statements be read in conjunction with the financial statements and the notes thereto in the Company s latest Annual Report on Form 10K. The consolidated statement of condition at December 31, 2005 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. Certain reclassifications have been made to make prior periods comparable.

The Company operates as one segment. The operating information used by the Company s chief executive officer for purposes of assessing performance and making operating decisions about the Company is the consolidated statements presented in this report. The Company has four active operating subsidiaries, namely, the bank subsidiaries, otherwise known as International Bank of Commerce, Laredo, Commerce Bank, International Bank of Commerce, Zapata and International Bank of Commerce, Brownsville. The Company applies the provisions of SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, in determining its reportable segments and related disclosures. None of the Company s other subsidiaries meets the 10% threshold for disclosure under SFAS No. 131.

All per share data presented has been restated to reflect the stock splits effected through stock dividends, Note 8.

Note 2 Loans

A summary of net loans, by loan type at March 31, 2006 and December 31, 2005 is as follows:

	March 31, 2006	December 31, 2005

	(Dollars in thousands)	
Commercial, financial and agricultural	$ 2,317,123	$ 2,376,276
Real estate-mortgage	843,513	847,512
Real estate construction	992,717	901,518
Consumer	201,182	218,607
Foreign	292,739	281,947
Total loans	4,647,274	4,625,860
Unearned discount	(121)	(168)
Loans, net of unearned discount	$ 4,647,153	$ 4,625,692

Note 3 Stock Options

On April 1, 2005, the Board of Directors adopted the 2005 International Bancshares Corporation Stock Option Plan (the 2005 Plan). The 2005 Plan replaced the 1996 International Bancshares Corporation Key Contributor Stock Option Plan (the 1996 Plan). Under the 2005 Plan both qualified incentive stock options (ISOs) and non-qualified stock options (NQSOs) may be granted. Options granted may be exercisable for a period of up to 10 years from the date of grant, excluding ISOs granted to 10% shareholders, which may be exercisable for a period of up to only five years. Through March 31, 2006, 110,950 shares were available for future grants under the 2005 Plan.

Through March 31, 2006, the Company has granted non-qualified stock options exercisable for a total of 167,847 shares, adjusted for stock dividends, of Common Stock to certain employees of the GulfStar Group. The grants were not made under either the 1996 Plan or the 2005 Plan. The options are exercisable for a period of seven years and vest in equal increments over a period of five years. All options granted to the GulfStar Group employees had an option price of not less than the fair market value of the Common Stock on the date of grant.

On January 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards No. 123R, (SFAS No. 123R), Share-Based Payment, (Revised 2004). SFAS No. 123R sets accounting requirements for share-based compensation to employees and non-employee directors, including employee stock purchase plans, and requires companies to recognize in the statement of operations the grant-date fair value of stock options and other equity-based compensation.

The Company chose the modified-prospective transition alternative in adopting SFAS 123R. Under the modified-prospective transition method, compensation cost is recognized in financial statements issued subsequent to the date of adoption for all stock-based payments granted, modified or settled after the date of adoption, as well as for any unvested awards that were granted prior to the date of adoption.

The fair value of each option award is estimated on the date of grant using a Black-Scholes-Merton option valuation model that uses the assumptions noted in the following table. Expected volatility is based on the historical volatility of the price of the Company s stock. The Company uses historical data to estimate the expected dividend yield and employee termination rates within the valuation model. The expected term of options is derived from the simplified method as prescribed by SEC Staff Accounting Bulletin No. 107. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. The fair value of the options granted in 2005 were estimated using the Black-Scholes-Merton option-pricing model based on the assumptions in the following table. Through March 31, 2006, no new options were granted.

	Three Months Ended March 31,	
	2006	**2005**
Expected term (in years)		5.5
Expected stock price volatility		25%
Expected dividend yield		2.5%
Forfeiture rate		10%
Risk free interest rate		3.72%

A summary of option activity under the stock option plans for the three months ended March 31, 2006 is as follows:

	Number of options		Weighted average exercise price	Weighted average remaining contractual term (years)		Aggregate intrinsic value ($)
Options outstanding at December 31, 2005	1,626,155	$	16.55			
Plus: Options granted						
Less:						
Options exercised	65,598		10.81			
Options expired						
Options forfeited	10,860		28.63			
Options outstanding at March 31, 2006	1,549,697	$	16.71	3.42	$	18,967,000
Options fully vested and exercisable at March 31, 2006	1,017,706	$	11.84	1.76	$	17,239,000

Stock-based compensation expense included in the consolidated statements of income for the three months ended March 31, 2006 was approximately $234,000. As of March 31, 2006 there was approximately $2,284,000 of total unrecognized stock-based compensation cost related to non-vested options granted under our plans that will be recognized over a weighted average period of 2.6 years.

A summary of the status of the Company s non-vested options as of March 31, 2006, and changes during the three months ended March 31, 2006, is presented below:

Non-vested Options	**Options**		**Weighted average grant-date fair value ($)**
Non-vested options at December 31, 2005	546,942	$	7.52
Granted			
Vested	4,091		8.84
Forfeited	10,860		7.40
Non-vested options at March 31, 2006	531,991	$	7.52

Other information pertaining to option activity during the three month period ending March 31, 2006 and March 31, 2005 is as follows:

	Three Months Ended March 31,			
		2006		**2005**
Weighted average grant date fair value of stock options granted			$	8.76
Total fair value of stock options vested	$	36,174	$	28,280
Total intrinsic value of stock options exercised	$	1,202,000	$	2,317,000

Awards granted prior to the Company s adoption of SFAS No. 123R were accounted for under the recognition and measurement principles of APB Opinion 25, Accounting for Stock Issued to Employees, and related interpretations. Accordingly, no stock-based employee compensation cost is reflected in net income in the accompanying unaudited consolidated statements of income for the three months ended March 31, 2005 because all options granted under the Company s plans had exercise prices equal to the market value of the underlying common stock on the date of grant.

Pro forma net income and net income per share, as if the Company had applied the fair value recognition provisions of SFAS 123 to stock-based compensation for the period presented prior to the Company s adoption of SFAS 123R is as follows:

		Three Months Ended 2005 (Dollars in Thousands, except per share data)
Net income, as reported	$	37,660
Deduct: Total stock-based compensation expense determined under the fair value based method for all awards, net of tax related tax effects		(70)
Pro forma net income	$	37,590
Earnings per share:		
Basic earnings		
As reported	$	.59
Pro forma		.59
Diluted earnings		
As reported	$	.58
Pro forma		.58

Note 4 - Investment Securities

The Company classifies debt and equity securities into one of three categories: held-to maturity, available-for-sale, or trading. Such classifications are reassessed for appropriate classification at each reporting date. Securities classified as held-to-maturity are carried at amortized cost for financial statement reporting, while securities classified as available-for-sale and trading are carried at their fair value. Unrealized holding gains and losses are included in net income for those securities classified as trading , while unrealized holding gains and losses related to those securities classified as available-for-sale are excluded from net income and reported net of tax as other comprehensive income (loss) and accumulated other comprehensive income (loss) until realized.

A summary of the investment securities held for investment and securities available-for-sale as reflected on the books of the Company is as follows:

		March 31, 2006		December 31, 2005
		(Dollars in Thousands)		
U.S. Treasury securities				
Available-for-sale	$	1,298	$	1,298
Mortgage-backed securities				
Available-for-sale		4,323,948		4,148,844
States and political subdivisions				
Available-for-sale		97,766		99,557
Other				
Held-to-maturity		2,375		2,375

Available-for-sale		17,381		17,253
Total investment securities	$	4,442,768	$	4,269,327

Note 5 - Allowance for Possible Loan Losses

A summary of the transactions in the allowance for possible loan losses is as follows:

	March 31, 2006	March 31, 2005
	(Dollars in Thousands)	
Balance at December 31,	$ 77,796	$ 84,905
Losses charged to allowance	(5,631)	(1,231)
Recoveries credited to allowance	333	565
Net losses charged to allowance	(5,298)	(666)
Provisions charged to operations	597	2,610
Balance at March 31,	$ 73,095	$ 86,849

Impaired loans are those loans where it is probable that all amounts due according to contractual terms of the loan agreement will not be collected. The Company has identified these loans through its normal loan review procedures. Impaired loans are measured based on (1) the present value of expected future cash flows discounted at the loan s effective interest rate; (2) the loan s observable market price; or (3) the fair value of the collateral if the loan is collateral dependent. Substantially all of the Company s impaired loans are measured at the fair value of the collateral. In limited cases the Company may use other methods to determine the level of impairment of a loan if such loan is not collateral dependent.

The following table details key information regarding the Company s impaired loans:

	March 31, 2006	December 31, 2005
	(Dollars in Thousands)	
Balance of impaired loans where there is a related allowance for loan loss	$ 32,084	$ 34,796
Balance of impaired loans where there is no related allowance for loan loss		
Total impaired loans	$ 32,084	$ 34,796