CAMCO FINANCIAL CORP
Form 10-Q
May 09, 2006

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FORM 10-Q
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

(Mark One)

þ **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 0-25196
CAMCO FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	51-0110823
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

6901 Glenn Highway, Cambridge, Ohio 43725-9757

(Address of principal executive office) (Zip code)

Registrant s telephone number, including area code: (740) 435-2020

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 þ No o

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

Large accelerated filer o Accelerated filer þ Non-accelerated filer o

Indicated by checkmark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act).

Yes o No þ

As of May 3, 2006, the latest practicable date, 7,531,713 shares of the registrant s common stock, $1.00 par value, were issued and outstanding.

Camco Financial Corporation
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Camco Financial Corporation
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(In thousands, except share data)

	March 31, 2006	December 31, 2005
ASSETS		
Cash and due from banks	$ 19,277	$ 21,786
Interest-bearing deposits in other financial institutions	10,584	11,299
Cash and cash equivalents	29,861	33,085
Investment securities available for sale at market	47,784	47,907
Investment securities held to maturity at cost, approximate market value of $941 and $947 as of March 31, 2006 and December 31, 2005, respectively	918	919
Mortgage-backed securities available for sale at market	57,623	61,607
Mortgage-backed securities held to maturity at cost, approximate market value of $3,070 and $3,251 as of March 31, 2006 and December 31, 2005, respectively	3,135	3,257
Loans held for sale at lower of cost or market	3,325	1,947
Loans receivable net	840,105	846,763
Office premises and equipment net	11,813	11,569
Real estate acquired through foreclosure	1,636	2,581
Federal Home Loan Bank stock at cost	27,496	27,112
Accrued interest receivable	5,219	5,297
Prepaid expenses and other assets	1,851	1,228
Cash surrender value of life insurance	20,981	20,793
Goodwill net of accumulated amortization	6,683	6,683
Prepaid federal income taxes		500
Total assets	**$ 1,058,430**	**$ 1,071,248**
LIABILITIES AND STOCKHOLDERS EQUITY		
Deposits	$ 676,376	$ 660,242
Advances from the Federal Home Loan Bank and other borrowings	280,280	307,223
Advances by borrowers for taxes and insurance	2,092	3,249
Accounts payable and accrued liabilities	4,965	5,331
Dividends payable	1,131	1,102
Accrued federal income taxes	276	
Deferred federal income taxes	3,079	3,338
Total liabilities	$ 968,199	980,485
Commitments		

Stockholders equity		
Preferred stock $1 par value; authorized 100,000 shares; no shares outstanding		
Common stock $1 par value; authorized 14,900,000 shares; 8,829,839 issued at March 31, 2006 and December 31, 2005.	8,830	8,830
Additional paid-in capital	59,602	59,567
Retained earnings substantially restricted	43,119	42,569
Accumulated other comprehensive income (loss) unrealized gains on securities designated as available for sale, net of related tax effects	(2,183)	(1,663)
Less 1,293,125 and 1,251,125 shares of treasury stock at March 31, 2006 and December 31, 2005, respectively at cost	(19,137)	(18,540)
Total stockholders equity	90,231	90,763
Total liabilities and stockholders equity	**$ 1,058,430**	**$ 1,071,248**

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Camco Financial Corporation
CONSOLIDATED STATEMENTS OF EARNINGS
For the three months ended March 31,
(In thousands, except per share data)

	2006	2005
Interest income		
Loans	$ 13,249	$ 11,962
Mortgage-backed securities	633	751
Investment securities	480	185
Interest-bearing deposits and other	790	607
Total interest income	15,152	13,505
Interest expense		
Deposits	4,424	3,503
Borrowings	2,949	2,634
Total interest expense	7,373	6,137
Net interest income	7,779	7,368
Provision for losses on loans	360	240
Net interest income after provision for losses on loans	7,419	7,128
Other income		
Late charges, rent and other	462	745
Loan servicing fees	360	378
Service charges and other fees on deposits	352	334
Gain on sale of loans	99	170
Increase (decrease) in mortgage servicing rights net	(22)	51
Gain on sale of real estate acquired through foreclosure	55	9
Gain on sale of mortgage-backed securities and fixed assets		19
Total other income	1,306	1,706
General, administrative and other expense		
Employee compensation and benefits	3,736	3,446
Deferred loan origination costs SFAS No. 91	(487)	(482)
Occupancy and equipment	780	797
Data processing	393	331
Advertising	303	229
Franchise taxes	246	79
Other operating	1,291	1,165
Total general, administrative and other expense	6,262	5,565

Earnings before federal income taxes	2,463	3,269
Federal income taxes	784	1,051
NET EARNINGS	**$ 1,679**	**$ 2,218**
EARNINGS PER SHARE		
Basic	**$ .22**	**$ .29**
Diluted	**$ .22**	**$ .29**
Dividends declared per share	**$ .150**	**$ .145**

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Camco Financial Corporation
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
For the three months ended March 31,
(In thousands)

	2006	**2005**
Net earnings	$ 1,679	$ 2,218
Other comprehensive income, net of tax:		
Unrealized holding gains (losses) on securities during the period, net of tax effects (benefits) of $(268) and $(511) in 2006 and 2005, respectively	(520)	(992)
Reclassification adjustment for realized gains included in earnings net of taxes of $0 and $4 in 2006 and 2005, respectively	0	(9)
Comprehensive income	**$ 1,159**	**$ 1,217**

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Camco Financial Corporation
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the three months ended March 31,
(In thousands)

	2006	2005
Cash flows from operating activities:		
Net earnings for the period	$ 1,679	$ 2,218
Adjustments to reconcile net earnings to net cash provided by (used in) operating activities:		
Amortization of deferred loan origination fees	56	19
Amortization of premiums and discounts on investment and mortgage-backed securities net	76	135
Amortization of mortgage servicing rights net	191	151
Depreciation and amortization	294	320
Amortization of loan purchase accounting adjustments, net	(22)	(22)
Provision for losses on loans	360	240
Stock Option expense	35	
Loss (gain) on sale of real estate acquired through foreclosure	(55)	(9)
Gain on sale of mortgage-backed securities		(13)
Federal Home Loan Bank stock dividends	(384)	(286)
Gain on sale of loans	(99)	(170)
Loans originated for sale in the secondary market	(13,140)	(16,150)
Proceeds from sale of loans in the secondary market	11,861	14,541
Net increase in cash surrender value of life insurance	(188)	(185)
Tax benefits related to exercise of stock options		32
Increase (decrease) in cash due to changes in:		
Accrued interest receivable	78	87
Prepaid expenses and other assets	(623)	214
Accrued interest and other liabilities	(366)	(989)
Federal income taxes		
Current	776	3,708
Deferred	8	(8)
Net cash provided by (used in) operating activities	537	3,833
Cash flows provided by (used in) investing activities:		
Purchases of investment securities designated as available for sale		(8,978)
Proceeds from sale of investments designated as available for sale		27
Proceeds from maturities of investment securities		5,000
Principal repayments on mortgage-backed securities	3,367	4,911
Purchases of mortgage-backed securities designated as available for sale		(3,349)
Loan principal repayments	74,282	67,526
Additions to real estate acquired through foreclosure	(20)	(6)
Loan disbursements	(67,061)	(71,156)
Purchases of loans	(637)	(854)
Additions to office premises and equipment	(538)	(121)
Proceeds from sale of real estate acquired through foreclosure	509	993

Net cash used in investing activities	9,902	(6,007)
Net cash (used in) provided by operating and investing activities balance carried forward	10,439	(2,174)

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Camco Financial Corporation
CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)
For the three months ended March 31,
(In thousands)

	2006	2005
Net cash (used in) provided by operating and investing activities (balance brought forward)	$ 10,439	$ (2,174)
Cash flows provided by (used in) financing activities:		
Net increase (decrease) in deposits	16,134	7,075
Proceeds from Federal Home Loan Bank advances	7,000	
Repayment of Federal Home Loan Bank advances	(33,943)	(6,008)
Dividends paid on common stock	(1,100)	(1,112)
Proceeds from exercise of stock options		126
Purchase of treasury shares	(597)	
Decrease in advances by borrowers for taxes and insurance	(1,157)	(1,006)
Net cash provided by (used in) financing active	(13,663)	(925)
Increase (decrease) in cash and cash equivalents	(3,224)	(3,099)
Cash and cash equivalents at beginning of period	33,085	42,894
Cash and cash equivalents at end of period	**$ 29,861**	**$ 39,795**
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Interest on deposits and borrowings	**$ 7,304**	**$ 6,190**
Cash paid for taxes		
Supplemental disclosure of noncash investing activities:		
Unrealized gains (losses) on securities designated as available for sale, net of related tax effects	**$ (765)**	**$ (992)**
Recognition of mortgage servicing rights in accordance with SFAS No. 140	**$ 169**	**$ 202**
Transfers from mortgage loans to real estate acquired through foreclosure	**$ 205**	**$ 1,200**
Dividends declared but unpaid	**$ 1,131**	**$ 1,114**

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Camco Financial Corporation
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
For the three-month periods ended March 31, 2006 and 2005

1. Basis of Presentation

The accompanying unaudited consolidated financial statements were prepared in accordance with instructions for Form 10-Q and, therefore, do not include information or footnotes necessary for a complete presentation of financial position, results of operations and cash flows in conformity with accounting principles generally accepted in the United States of America (US GAAP). Accordingly, these financial statements should be read in conjunction with the consolidated financial statements and notes thereto of Camco Financial Corporation (Camco or the Corporation) included in Camco s Annual Report on Form 10-K for the year ended December 31, 2005. However, all adjustments (consisting only of normal recurring accruals) which, in the opinion of management, are necessary for a fair presentation of the consolidated financial statements, have been included. The results of operations for the three month period ended March 31, 2006, are not necessarily indicative of the results which may be expected for the entire year.

2. Principles of Consolidation

The accompanying consolidated financial statements include the accounts of Camco and its two wholly-owned subsidiaries: Advantage Bank (Advantage or the Bank) and Camco Title Agency, Inc.

3. Critical Accounting Policies

Management s Discussion and Analysis of Financial Condition and Results of Operations, as well as disclosures found elsewhere in this quarterly report, are based upon Camco s consolidated financial statements, which are prepared in accordance with US GAAP. The preparation of these financial statements requires Camco to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. Several factors are considered in determining whether or not a policy is critical in the preparation of financial statements. These factors include, among other things, whether the estimates are significant to the financial statements, the nature of the estimates, the ability to readily validate the estimates with other information including third parties or available prices, and sensitivity of the estimates to changes in economic conditions and whether alternative accounting methods may be utilized under US GAAP.

Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the valuation of mortgage servicing rights and goodwill impairment. Actual results could differ from those estimates.

Allowance for Loan Losses

The procedures for assessing the adequacy of the allowance for loan losses reflect our evaluation of credit risk after careful consideration of all information available to us. In developing this assessment, we must rely on estimates and exercise judgment regarding matters where the ultimate outcome is unknown such as economic factors, developments affecting companies in specific industries and issues with respect to single borrowers. Depending on changes in circumstances, future assessments of credit risk may yield materially different results, which may require an increase or a decrease in the allowance for loan losses.

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Camco Financial Corporation
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
For the three-month periods ended March 31, 2006 and 2005

3. Critical Accounting Policies (continued)

Allowance for Loan Losses (continued)

The allowance is regularly reviewed by management to determine whether the amount is considered adequate to absorb probable losses. This evaluation includes specific loss estimates on certain individually reviewed loans, statistical loss estimates for loan pools that are based on historical loss experience, and general loss estimates that are based upon the size, quality, and concentration characteristics of the various loan portfolios, adverse situations that may affect a borrower s ability to repay, and current economic and industry conditions. Also considered as part of that judgement is a review of the Bank s trends in delinquencies and loan losses, as well as trends in delinquencies and losses for the region and nationally, and economic factors.

The allowance for loan losses is maintained at a level believed adequate by management to absorb probable losses inherent in the loan portfolio. Management s evaluation of the adequacy of the allowance is an estimate based on management s current judgement about the credit quality of the loan portfolio. While the Corporation strives to reflect all known risk factors in its evaluations, judgment errors may occur.

Mortgage Servicing Rights

To determine the fair value of its mortgage servicing rights (MSRs) each reporting quarter, the Corporation transmits information to a third party provider, representing individual loan information in each pooling period accompanied by escrow amounts. The third party then evaluates the possible impairment of MSRs as described below.

Servicing assets are recognized as separate assets when loans are sold with servicing retained. A pooling methodology in which loans with similar characteristics are pooled together is applied for valuation purposes. Once pooled, each grouping of loans is evaluated on a discounted earnings basis to determine the present value of future earnings that a purchaser could expect to realize from the portfolio. Earnings are projected from a variety of sources including loan service fees, interest earned on float, net interest earned on escrow balances, miscellaneous income and costs to service the loans. The present value of future earnings is the estimated market value for the pool, calculated using consensus assumptions that a third party purchaser would utilize in evaluating a potential acquisition of the servicing. Events that may significantly affect the estimates used are changes in interest rates and the related impact on mortgage loan prepayment speeds and the payment performance of the underlying loans. The interest rate for float, which is supplied by management, takes into consideration the investment portfolio average yield as well as current short duration investment yields. Management believes this methodology provides a reasonable estimate. Mortgage loan prepayment speeds are calculated by the third party provider utilizing the Economic Outlook as published by the Office of Chief Economist of Freddie Mac in estimating prepayment speeds and provides a specific scenario with each evaluation. Based on the assumptions discussed, pre-tax projections are prepared for each pool of loans serviced. These earning figures approximate the cash flow that could be received from the servicing portfolio. Valuation results are presented quarterly to management.

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Camco Financial Corporation
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
For the three-month periods ended March 31, 2006 and 2005

3. Critical Accounting Policies (continued)

At that time, management reviews the information and mortgage servicing rights are marked to lower of amortized cost or market for the current quarter.

Goodwill

We have developed procedures to test goodwill for impairment on an annual basis using June 30 financial information. This testing procedure is outsourced to a third party that evaluates possible impairment based on the following:

The test involves assigning tangible assets and liabilities, identified intangible assets and goodwill to reporting units and comparing the fair value of each reporting unit to its carrying value including goodwill. The value is determined assuming a freely negotiated transaction between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts. Accordingly, to derive the fair value of the reporting unit, the following common approaches to valuing business combination transactions involving financial institutions are utilized by a third party selected by Camco: (1) the comparable transactions approach specifically based on earnings, book, assets and deposit premium multiples received in recent sales of comparable thrift franchises; and (2) the discounted cash flow approach. The application of the valuation techniques take into account the reporting unit s operating history, the current market environment and future prospects. As of the most recent quarter, the only reporting unit carrying goodwill is the Bank.

If the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not impaired and no second step is required. If not, a second test is required to measure the amount of goodwill impairment. The second test of the overall goodwill impairment compares the implied fair value of the reporting unit goodwill with the carrying amount of the goodwill. The impairment loss shall equal the excess of carrying value over fair value.

After each testing period, the third party compiles a summary of the test that is then provided to the Enterprise Risk and Audit Committee and management for review.

Summary

Management believes the accounting estimates related to the allowance for loan losses, the capitalization, amortization, and valuation of mortgage servicing rights and the goodwill impairment test are critical accounting estimates because: (1) the estimates are highly susceptible to change from period to period because they require management to make assumptions concerning the changes in the types and volumes of the portfolios, rates of future prepayments, and anticipated economic conditions, and (2) the impact of recognizing an impairment or loan loss could have a material effect on Camco s assets reported on the balance sheet as well as its net earnings. Management has discussed the development and selection of these critical accounting estimates with the Enterprise Risk and Audit Committee of the Board of Directors and the Enterprise Risk and Audit Committee has reviewed Camco s disclosures relating to such matters in the quarterly Management s Discussion and Analysis.

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Camco Financial Corporation
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
For the three-month periods ended March 31, 2006 and 2005

4. Earnings Per Share

Basic earnings per common share are computed based upon the weighted-average number of common shares outstanding during the period. Diluted earnings per common share include the dilutive effect of additional potential common shares issuable under the Corporation s stock option plans. The computations are as follows:

	For the three months ended March 31,	
	2006	**2005**
Weighted-average common shares outstanding (basic)	7,563,452	7,677,795
Dilutive effect of assumed exercise of stock options	3,718	33,638
Weighted-average common shares outstanding (diluted)	**7,567,170**	**7,711,433**

Anti-dilutive options to purchase 232,364 and 167,879 shares of common stock with respective weighted-average exercise prices of $15.87 and $16.46 were outstanding at March 31, 2006 and 2005, respectively, but were excluded from the computation of common share equivalents for those respective periods because the exercise prices were greater than the average market price of the common shares.

5. Stock Option Plans

Under the 1995 Plan, 161,488 shares were reserved for issuance. Under the 2002 Plan, 400,000 shares were reserved for issuance. Additionally, in connection with the acquisition of First Ashland Financial Corporation, the stock options of Ashland were converted into options to purchase 174,421 shares of the Corporation s stock at an exercise price of $7.38 per share, all of which were exercisable through 2005. In connection with the 2000 acquisition of Westwood Homestead Financial Corporation, the stock options of Westwood Homestead were converted into options to purchase 311,794 shares of the Corporation s stock at a weighted-average exercise price of $11.89 per share, which expire in 2008.

Effective January 1, 2006, the Corporation adopted SFAS No. 123R, Accounting for Stock-Based Compensation, which contains a fair-value based method for valuing stock-based compensation that measures compensation cost at the grant date based on the fair value of the award.

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Camco Financial Corporation
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
For the three-month periods ended March 31, 2006 and 2005

5. Stock Option Plans (continued)

Prior to January 1, 2006, the Corporation utilized APB Opinion No. 25 and related Interpretations in accounting for its stock option plans in 2005. Accordingly, no compensation cost has been recognized for the plans in 2005. Had compensation cost for the Corporation s stock option plans been determined based on the fair value at the grant dates for awards under the plans consistent with the accounting method utilized in SFAS No. 123R, the Corporation s net earnings and earnings per share for the three-month periods ended March 31, 2006 and 2005 would have been reported as the pro forma amounts indicated below:

		2006		2005
	(In thousands, except per share data)			
Net earnings				
As reported	$	1,679	$	2,218
Add: Stock-based compensation, expense included in reported income, net of tax		30		
Deduct: Total stock-based compensation expense determined under fair value based method for awards, net of tax		(30)		(21)
	$	**1,679**	**$**	**2,197**
Earnings per share				
Basic				
As reported	$	.22	$	.29
Stock-based compensation, net of tax				
Pro-forma	**$**	**.22**	**$**	**.29**
Diluted				
As reported	$	.22	$	.29
Stock-based compensation, net of tax				