

MERCANTILE BANKSHARES CORP
Form 10-Q
October 31, 2006

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 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, 2006

OR

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

For the transition period from to

Commission file number: **0-5127**

MERCANTILE BANKSHARES CORPORATION

(Exact name of registrant as specified in its charter)

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Maryland

(State or other jurisdiction of
incorporation or organization)

52-0898572

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

2 Hopkins Plaza

Baltimore, Maryland 21201

(Address of principal executive offices) (Zip Code)

(410) 237-5900

(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. (Check one).

Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

As of October 20, 2006, there were 125,490,121 shares of registrant's Common Stock, \$2 par value per share, outstanding.

MERCANTILE BANKSHARES CORPORATION
Quarterly Report on Form 10-Q
September 30, 2006

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

MERCANTILE BANKSHARES CORPORATION
CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except per share data)	September 30, 2006	December 31, 2005	September 30, 2005
ASSETS			
Cash and due from banks	\$ 318,184	\$ 369,536	\$ 328,964
Interest-bearing deposits in other banks	200	200	200
Federal funds sold	133,608	25,104	232,129
Total cash and cash equivalents	451,992	394,840	561,293
Investment securities available-for-sale (Note 4)	3,126,770	3,089,628	3,048,846
Investment securities held-to-maturity (Note 4) - fair value of \$14,766 (September 2006), \$17,181 (December 2005) and \$17,380 (September 2005)	14,361	16,659	16,804
Total investment securities	3,141,131	3,106,287	3,065,650
Loans held-for-sale	1,930	26,263	42,307
Loans:			
Commercial	2,925,300	2,957,301	2,925,445
Commercial real estate	4,148,895	3,703,297	3,638,238
Construction	1,952,013	1,607,095	1,543,633
Residential real estate	1,988,336	1,802,373	1,778,684
Home equity lines	476,746	505,508	520,214
Consumer	1,043,048	1,032,271	1,039,845
Total loans	12,534,338	11,607,845	11,446,059
Less: allowance for loan losses	(143,853)	(156,673)	(157,176)
Loans, net	12,390,485	11,451,172	11,288,883
Bank premises and equipment, less accumulated depreciation of \$152,829 (September 2006), \$146,585 (December 2005) and \$147,395 (September 2005)	142,664	137,419	146,615
Other real estate owned, net	67	667	777
Goodwill, net	760,347	670,028	670,306
Other intangible assets, net (Note 8)	47,818	46,653	47,485
Other assets	638,813	588,400	580,138
Total assets	\$ 17,575,247	\$ 16,421,729	\$ 16,403,454
COMMITMENTS and CONTINGENCIES (Note 7)			
LIABILITIES			
Deposits:			
Noninterest-bearing deposits	\$ 3,301,554	\$ 3,324,650	\$ 3,329,331
Interest-bearing deposits	9,473,557	8,752,700	8,710,575
Total deposits	12,775,111	12,077,350	12,039,906
Short-term borrowings	1,558,710	1,237,714	1,266,672
Accrued expenses and other liabilities	188,331	169,780	165,398
Long-term debt	659,688	742,163	780,087
Total liabilities	15,181,840	14,227,007	14,252,063
SHAREHOLDERS EQUITY			
Preferred stock, no par value; authorized 2,000,000 shares; issued and outstanding - None			
Common stock, \$2 par value; authorized 200,000,000 shares; issued shares - 125,476,310 (September 2006), 82,165,414 (December 2005) and 82,078,721 (September 2005)	250,953	164,331	164,157
Capital surplus	667,307	676,830	669,185
Retained earnings	1,503,226	1,386,405	1,343,076
Accumulated other comprehensive loss	(28,079)	(32,844)	(25,027)

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Total shareholders' equity	2,393,407	2,194,722	2,151,391
Total liabilities and shareholders' equity	\$ 17,575,247	\$ 16,421,729	\$ 16,403,454

See Notes to Consolidated Financial Statements.

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MERCANTILE BANKSHARES CORPORATION
STATEMENTS OF CONSOLIDATED INCOME

(Dollars in thousands, except per share data)	For the 9 months ended September 30,		For the 3 months ended September 30,	
	2006	2005	2006	2005
INTEREST INCOME				
Interest and fees on loans	\$ 628,369	\$ 508,135	\$ 224,218	\$ 185,714
Interest and dividends on investment securities:				
Taxable interest income	93,323	77,052	32,393	26,686
Tax-exempt interest income	2,273	2,348	730	839
Other investment income	1,986	1,753	660	526
Total interest and dividends on investment securities	97,582	81,153	33,783	28,051
Other interest income	2,611	1,546	855	760
Total interest income	728,562	590,834	258,856	214,525
INTEREST EXPENSE				
Interest on deposits	175,638	95,280	68,792	38,591
Interest on short-term borrowings	39,738	17,228	15,215	7,702
Interest on long-term debt	27,394	23,634	8,780	8,990
Total interest expense	242,770	136,142	92,787	55,283
NET INTEREST INCOME	485,792	454,692	166,069	159,242
Provision for credit losses		1,576		820
NET INTEREST INCOME AFTER PROVISION FOR CREDIT LOSSES	485,792	453,116	166,069	158,422
NONINTEREST INCOME				
Investment and wealth management	82,582	71,505	27,596	23,668
Service charges on deposit accounts	33,936	32,992	12,776	11,478
Mortgage banking related fees	5,042	10,329	497	5,151
Investment securities gains (losses)	205	458	218	(32)
Nonmarketable investments	13,383	13,683	1,150	4,190
Other income	49,693	52,042	17,530	18,619
Total noninterest income	184,841	181,009	59,767	63,074
NONINTEREST EXPENSES				
Salaries	147,755	148,482	51,424	51,748
Employee benefits	42,538	35,490	13,511	11,637
Net occupancy expense of bank premises	23,991	20,918	8,289	7,139
Furniture and equipment expenses	24,752	23,168	8,353	7,965
Communications and supplies	12,083	11,992	3,796	3,933
Other expenses	77,447	72,398	27,056	25,960
Total noninterest expenses	328,566	312,448	112,429	108,382
Income before income taxes	342,067	321,677	113,407	113,114
Applicable income taxes	126,643	120,221	41,834	42,158
NET INCOME	\$ 215,424	\$ 201,456	\$ 71,573	\$ 70,956
NET INCOME PER SHARE OF COMMON STOCK (Note 3):				
Basic	\$ 1.74	\$ 1.67	\$ 0.57	\$ 0.58
Diluted	\$ 1.73	\$ 1.65	\$ 0.57	\$ 0.57
DIVIDENDS PAID PER COMMON SHARE	\$ 0.82	\$ 0.74	\$ 0.28	\$ 0.25

See Notes to Consolidated Financial Statements.

MERCANTILE BANKSHARES CORPORATION
STATEMENTS OF CHANGES IN CONSOLIDATED SHAREHOLDERS EQUITY

For the 9 months ended September 30, 2006 and 2005

(Dollars in thousands, except per share data)	Total	Common Stock	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)
BALANCE, DECEMBER 31, 2004	\$ 1,917,683	\$ 158,601	\$ 530,705	\$ 1,231,102	\$ (2,725)
Net income	201,456			201,456	
Unrealized losses on securities available-for-sale, net of reclassification adjustment, net of taxes	(22,302)				(22,302)
Comprehensive income (Note 9)	179,154				
Cash dividends paid:					
Common stock (\$0.74 per share)	(89,017)			(89,017)	
Issuance of 2,444,408 shares for bank acquisition	124,335	4,889	119,446		
Fair value of 138,764 converted options related to employee stock option plan of acquired bank	5,182		5,182		
Issuance of 82,444 shares for dividend reinvestment and stock purchase plan	4,098	165	3,933		
Issuance of 17,550 shares for employee stock purchase dividend reinvestment plan	873	35	838		
Stock options					
Issuance of 181,808 shares	3,664	364	3,300		
Expense	2,519		2,519		
Stock awards					
Issuance of 41,823 shares	2,211	84	2,127		
Deferred compensation	(2,242)			(2,242)	
Expense	1,972			1,972	
Directors' deferred compensation plan					
Issuance of 10,182 shares	439	19	420		
Contribution	520		520		
Dividend			195	(195)	
BALANCE, SEPTEMBER 30, 2005	\$ 2,151,391	\$ 164,157	\$ 669,185	\$ 1,343,076	\$ (25,027)
BALANCE, DECEMBER 31, 2005	\$ 2,194,722	\$ 164,331	\$ 676,830	\$ 1,386,405	\$ (32,844)
Net income	215,424			215,424	
Unrealized gains on securities available-for-sale, net of reclassification adjustment, net of taxes	4,765				4,765
Comprehensive income (Note 9)	220,189				
Cash dividends paid					
Common stock (\$0.82 per share)	(101,556)			(101,556)	
Issuance of 1,833,757 shares in connection with bank acquisition	63,140	3,668	59,472		
Fair value of 138,066 converted options related to employee stock option plan of acquired bank	1,605		1,605		
Issuance of 134,274 shares for dividend reinvestment and stock purchase plan	4,706	268	4,438		
Issuance of 26,505 shares for employee stock purchase dividend reinvestment plan	996	53	943		
Stock options					
Issuance of 107,767 shares	1,975	216	1,759		
Expense	2,219		2,219		
Stock awards and units					
Issuance of 157,243 shares	189	314	(125)		
Repurchase of 38,471 shares for tax settlement	(1,477)	(77)	(1,400)		
Expense	5,748		5,748		
Directors' deferred compensation plan					
Issuance of 4,995 shares	192	10	182		
Contribution	841		841		

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Dividend			253	(253)
Adjustment for adoption of SFAS No. 123R			(3,206)	3,206
Issuance of 41,084,826 shares for a 3-for-2 stock split	(82)	82,170	(82,252)
BALANCE, SEPTEMBER 30, 2006	\$ 2,393,407	\$ 250,953	\$ 667,307	\$ 1,503,226	\$ (28,079)

See Notes to Consolidated Financial Statements.

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MERCANTILE BANKSHARES CORPORATION
STATEMENTS OF CONSOLIDATED CASH FLOWS

	For the 9 months ended September 30,	
Increase (decrease) in cash and cash equivalents (Dollars in thousands)	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 215,424	\$ 201,456
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for credit losses		1,576
Depreciation	11,857	11,581
Amortization of other intangible assets	7,064	6,482
Tax benefit from the issuance of stock-based awards	115	83
Write-downs of other real estate owned		1
Gains on sales of other real estate owned	(7	) (153
Gains on sales of investments securities	(205	) (458
Gains on sales of premises	(103	) (4,341
Net (increase) decrease in assets:		
Loans held-for-sale	25,568	(31,307
Interest receivable	(11,975	) (9,332
Nonmarketable investments	(8,964	) 11,912
Other assets	(13,246	) (80
Net increase (decrease) in liabilities:		
Interest payable	19,359	13,710
Other liabilities	(15,502	) (11,871
Net cash provided by operating activities	229,385	189,259
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from maturities of investment securities held-to-maturity	2,298	3,372
Proceeds from maturities of investment securities available-for-sale	705,128	655,641
Proceeds from sales of investment securities available-for-sale	101,670	121,207
Purchases of investment securities available-for-sale	(723,014	) (782,084
Net increase in customer loans	(511,661	) (551,290
Proceeds from sales of other real estate owned	2,241	273
Capital expenditures	(16,117	) (12,878
Proceeds from sales of premises	536	7,981
Proceeds from sale of interest in Ltd Partnership	6,705	
Business acquisitions (net of cash received)	(61,251	) (78,655
Business acquisitions contingent consideration	(8,806)
Purchase of nonmarketable investments	(12,112	) (57,105
Net cash used in investing activities	(514,383	) (693,538
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net (decrease) increase in noninterest-bearing deposits	(118,812	) 172,450
Net increase in interest-bearing deposits	383,457	442,943
Net increase in short-term borrowings	266,837	369,109
Repayment of long-term debt	(95,362	) (84,659
Tax benefit from the issuance of stock-based awards	1,040	530
Excess tax benefit related to stock-based awards	346	447
Proceeds from issuance of shares	7,677	8,635
Repurchase of common shares	(1,477)
Dividends paid	(101,556	) (89,017
Net cash provided by financing activities	342,150	820,438
Net increase in cash and cash equivalents	57,152	316,159
Cash and cash equivalents at beginning of period	394,840	245,134
Cash and cash equivalents at end of period	\$ 451,992	\$ 561,293
SUPPLEMENTAL INFORMATION		
Cash payments for interest	\$ 222,237	\$ 121,081
Cash payments for income taxes	135,974	133,745

See Notes to Consolidated Financial Statements.

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MERCANTILE BANKSHARES CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

The consolidated financial statements, which include the accounts of Mercantile Bankshares Corporation (Bankshares) (Nasdaq: MRBK) and all of its affiliates, are prepared in conformity with accounting principles generally accepted in the United States of America and follow general practice within the banking industry. In the opinion of management, the consolidated financial statements include all adjustments necessary for a fair presentation of the interim period. These adjustments are of a normal nature and include adjustments to eliminate all significant intercompany transactions. In view of the changing conditions in the national economy, the effect of actions taken by regulatory authorities and normal seasonal factors, the results for the interim period are not necessarily indicative of annual performance. For purposes of comparability, certain prior period amounts have been reclassified to conform to current period presentation.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and contingent assets and liabilities in the financial statements, and the disclosure of revenue and expenses during the reporting period. These assumptions are based on information available as of the date of the financial statements and could differ from actual results. See Bankshares Annual Report on Form 10-K for more detail.

On January 10, 2006, Bankshares announced a three-for-two stock split on its common stock payable in the form of a stock dividend on January 27, 2006 to stockholders of record as of the close of business on January 20, 2006. For comparative purposes, certain share, average share and per share amounts have been restated.

2. Business Combinations / Restructuring

The following provides information concerning acquisitions and restructurings. Acquisitions were accounted for as purchases with the results of their operations subsequent to the acquisition date included in Bankshares Statements of Consolidated Income.

On July 17, 2006, Bankshares completed its acquisition of James Monroe Bancorp, Inc. (James Monroe), an Arlington, Virginia-based commercial bank. James Monroe was merged into Mercantile-Safe Deposit & Trust Company (MSD&T). At the time of the acquisition, James Monroe operated six full-service branches and a loan production office located in Northern Virginia and suburban Washington, D.C. The total consideration paid to James Monroe shareholders in connection with the acquisition was \$71.4 million in cash and 1.8 million shares of Bankshares common stock. The results of James Monroe s operations have been included in Bankshares financial results subsequent to July 17, 2006. The assets and liabilities of James Monroe were recorded on the Consolidated Balance Sheet at their respective fair values. The fair values have been determined as of July 17, 2006 and are subject to refinement, as further information becomes available. The transaction resulted in total assets acquired of \$552 million, including \$414 million in gross loans; and liabilities assumed of \$507 million, including \$434 million in total deposits. Additionally, Bankshares preliminarily recorded \$87.0 million of goodwill. Intangible assets subject to amortization are being amortized on an accelerated basis.

Bankshares exit costs, referred to herein as merger-related costs, are defined to include those costs for branch closings and related severance, combining operations such as systems conversions, and printing and mailing costs incurred by Bankshares prior to and after the merger date and are included in Bankshares results of operations. Bankshares expensed merger-related costs totaling \$0.7 million for the three month period ended September 30, 2006. The costs associated with these activities are included in noninterest expense. Merger-related expenses incurred to date consisted largely of expenses for systems conversion costs. Bankshares will incur additional merger-related expenses of \$1.5 million during the fourth quarter of 2006 and the first quarter of 2007 as systems conversions, branch closings and integration of operations continue and these expenses will be recorded when incurred.

3. Earnings per Share

Basic earnings per share (EPS) are computed by dividing income available to common shareholders by weighted average common shares outstanding. Diluted EPS are computed using the same components as basic EPS with the denominator adjusted for the dilutive effect of weighted average common shares from the various share-based compensation plans. The following tables provide reconciliations between the computation of basic EPS and diluted EPS for the nine and three months ended September 30, 2006 and 2005, respectively.

	For the 9 months ended September 30, 2006			2005		
	Net Income	Weighted Average Common Shares	EPS	Net Income	Weighted Average Common Shares	EPS
(In thousands, except per share data)						
Basic EPS	\$ 215,424	123,678	\$ 1.74	\$ 201,456	120,818	\$ 1.67
Dilutive effect of :						
Stock options		760			635	
Restricted stock awards and units		109			113	
Vested directors' deferred compensation plan shares		295			258	
Diluted EPS	\$ 215,424	124,842	\$ 1.73	\$ 201,456	121,824	\$ 1.65

	For the 3 months ended September 30, 2006			2005		
	Net Income	Weighted Average Common Shares	EPS	Net Income	Weighted Average Common Shares	EPS
(In thousands, except per share data)						
Basic EPS	\$ 71,573	124,750	\$ 0.57	\$ 70,956	122,797	\$ 0.58
Dilutive effect of :						
Stock options		742			776	
Restricted stock awards and units		100			116	
Vested directors' deferred compensation plan shares		301			264	
Diluted EPS	\$ 71,573	125,893	\$ 0.57	\$ 70,956	123,953	\$ 0.57

Antidilutive weighted average common shares from the various share-based compensation plans excluded from the computation of diluted earnings per share were 430,857 and 666,503 for the nine months and three months ended September 30, 2006. There were no antidilutive weighted average common shares excluded from the computation of diluted earnings per share for the nine months and three months ended September 30, 2005.

4. Investment Securities

At September 30, 2006 and December 31, 2005, securities with an amortized cost of \$1.5 billion and \$1.3 billion, respectively, were pledged as collateral for repurchase transactions and certain deposits as required by regulatory guidelines. The following table shows the amortized cost and fair value of investment securities at September 30, 2006 and December 31, 2005.

(Dollars in thousands)	September 30, 2006				December 31, 2005			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Investment securities held-to-maturity								
States and political subdivisions	\$ 14,361	\$ 425	\$ 20	\$ 14,766	\$ 16,659	\$ 541	\$ 19	\$ 17,181
Investment securities available-for-sale								
U.S. Treasury	\$ 409,137	\$ 512	\$ 2,041	\$ 407,608	\$ 434,893	\$ 223	\$ 3,080	\$ 432,036
U.S. Government agencies	928,550	240	7,996	920,794	992,040	29	12,761	