

AMSOUTH BANCORPORATION

Form 10-Q

May 03, 2004

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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended March 31, 2004 Commission file number 1-7476

AMSOUTH BANCORPORATION

(Exact Name of registrant as specified in its charter)

DELAWARE
(State or other jurisdiction)

of Incorporation or Organization)

AMSOUTH CENTER
1900 Fifth Avenue North

Birmingham, Alabama 35203
(Address of principal executive offices)

63-0591257
(I.R.S. Employer Identification No.)

(205) 320-7151
(Registrant's telephone number, including area code)

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

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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 April 27, 2004, AmSouth Bancorporation had 352,249,000 shares of common stock outstanding.

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Forward-Looking Statements. Statements made in this report that are not purely historical are forward-looking statements (as defined in the Private Securities Litigation Reform Act of 1995), including any statements regarding descriptions of management's plans, objectives or goals for future operations, products or services, and forecasts of its revenues, earnings or other measures of performance. Forward-looking statements are based on current management expectations and, by their nature, are subject to risks and uncertainties. A number of factors—many of which are beyond AmSouth's control—could cause actual conditions, events or results to differ significantly from those described in the forward-looking statements. Factors which could cause results to differ materially from current management expectations include, but are not limited to: the execution of AmSouth's strategic initiatives; legislation and regulation; general economic conditions, especially in the Southeast; the performance of the stock and bond markets; changes in interest rates, yield curves and interest rate spread relationships; prepayment speeds within the loan and investment security portfolios; deposit flows; the cost of funds; cost of federal deposit insurance premiums; demand for loan products; demand for financial services; competition; changes in the quality or composition of AmSouth's loan and investment portfolios including capital market inefficiencies that may affect the marketability and valuation of available-for-sale securities; changes in accounting and tax principles, policies or guidelines; other economic, competitive, governmental and regulatory factors affecting AmSouth's operations, products, services and prices; unexpected judicial actions and developments; results of investigations, examinations and reviews of regulatory and law enforcement authorities; and the outcome of litigation, which is inherently uncertain and depends on the findings of judges and juries. To the extent that terrorist attacks or other hostilities, including geopolitical conflicts, cause a prolonged negative impact on the economy, the effects may include: adverse changes in customers' borrowing, investing or spending patterns; market disruptions; adverse effects on the performance of the United States and foreign equity markets; currency fluctuations; exchange controls; restriction of asset growth; negative effects on credit quality; and other effects that could adversely impact the performance, earnings, and revenue growth of the financial services industry, including AmSouth. Forward-looking statements speak only as of the date they are made. AmSouth does not undertake a duty to update forward-looking statements to reflect circumstances or events that occur after the date the forward-looking statements are made.

Table of Contents**PART I****FINANCIAL INFORMATION****Item 1. Financial Statements (Unaudited)****AMSOUTH BANCORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENT OF CONDITION****(Unaudited)**

	March 31	December 31	March 31
	2004	2003	2003
	<u> </u>	<u> </u>	<u> </u>
(Dollars in thousands)			
ASSETS			
Cash and due from banks	\$ 1,074,116	\$ 1,163,986	\$ 1,372,188
Federal funds sold and securities purchased under agreements to resell	654,000	-0-	441,988
Trading securities	552	2,721	1,060
Available-for-sale securities	6,371,254	7,125,971	5,110,643
Held-to-maturity securities (market value of \$6,206,159, \$4,948,556 and \$4,781,480, respectively)	6,139,369	4,928,195	4,682,460
Loans held for sale	234,842	102,292	10,871
Loans	30,613,623	30,088,814	28,381,565
Less: Allowance for loan losses	382,450	384,124	383,936
Unearned income	719,900	749,450	682,617
	<u> </u>	<u> </u>	<u> </u>
Net loans	29,511,273	28,955,240	27,315,012
Other interest-earning assets	44,735	40,218	35,027
Premises and equipment, net	993,651	964,692	864,517
Cash surrender value - bank owned life insurance	1,077,426	1,065,996	1,029,321
Accrued interest receivable and other assets	1,313,750	1,266,205	1,236,412
	<u> </u>	<u> </u>	<u> </u>
	\$ 47,414,968	\$ 45,615,516	\$ 42,099,499
	<u> </u>	<u> </u>	<u> </u>
LIABILITIES AND SHAREHOLDERS' EQUITY			
Deposits and interest-bearing liabilities:			
Deposits:			
Noninterest-bearing demand	\$ 6,544,028	\$ 6,273,835	\$ 5,569,319
Interest-bearing checking	6,737,060	6,183,832	5,767,727
Money market and savings deposits	7,887,543	7,592,020	7,636,685
Time	6,118,682	6,278,053	6,317,130
Certificates of deposit of \$100,000 or more	3,103,575	2,818,490	2,052,939
Foreign	1,153,804	1,294,123	656,649
	<u> </u>	<u> </u>	<u> </u>
Total deposits	31,544,692	30,440,353	28,000,449
Federal funds purchased and securities sold under agreements to repurchase	1,927,492	2,026,253	1,826,851
Other borrowed funds	325,169	343,202	149,842
Long-term Federal Home Loan Bank advances	5,783,600	5,737,952	5,732,740
Other long-term debt	2,286,091	2,114,482	1,550,816
	<u> </u>	<u> </u>	<u> </u>
Total deposits and interest-bearing liabilities	41,867,044	40,662,242	37,260,698
Accrued expenses and other liabilities	2,175,575	1,723,605	1,713,622

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Total liabilities	44,042,619	42,385,847	38,974,320
Shareholders' equity:			
Preferred stock - no par value:			
Authorized - 2,000,000 shares; Issued and outstanding - none	-0-	-0-	-0-
Common stock - par value \$1 a share:			
Authorized - 750,000,000 shares; Issued - 416,769,000, 416,878,000 and 416,909,000 shares, respectively	416,769	416,878	416,909
Capital surplus	714,262	715,663	706,234
Retained earnings	3,295,748	3,228,533	3,016,279
Cost of common stock in treasury - 63,865,000, 64,987,000 and 65,264,000 shares, respectively	(1,054,734)	(1,076,644)	(1,082,170)
Deferred compensation on restricted stock	(14,551)	(14,501)	(16,667)
Accumulated other comprehensive income/(loss)	14,855	(40,260)	84,594
Total shareholders' equity	3,372,349	3,229,669	3,125,179
	\$ 47,414,968	\$ 45,615,516	\$ 42,099,499

See notes to consolidated financial statements.

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AMSOUTH BANCORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF EARNINGS

(Unaudited)

	Three Months Ended	
	March 31	
	2004	2003
	(In thousands except per share data)	
INTEREST INCOME		
Loans	\$ 375,715	\$ 398,543
Available-for-sale securities	83,419	77,682
Held-to-maturity securities	62,593	60,865
Trading securities	72	55
Loans held for sale	2,627	160
Federal funds sold and securities purchased under agreements to resell	151	166
Other interest-earning assets	59	154
Total interest income	524,636	537,625
INTEREST EXPENSE		
Interest-bearing checking	7,346	8,035
Money market and savings deposits	9,315	13,997
Time deposits	44,807	52,293
Certificates of deposit of \$100,000 or more	17,241	15,486
Foreign deposits	2,589	1,684
Federal funds purchased and securities sold under agreements to repurchase	6,645	5,919
Other borrowed funds	1,981	1,145
Long-term Federal Home Loan Bank advances	60,469	66,718
Other long-term debt	14,746	9,306
Total interest expense	165,139	174,583
NET INTEREST INCOME	359,497	363,042
Provision for loan losses	28,100	44,700
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	331,397	318,342
NONINTEREST REVENUES		
Service charges on deposit accounts	93,215	75,556
Trust income	28,880	26,027
Consumer investment services income	20,411	16,310
Interchange income	16,299	16,687
Bank owned life insurance policies	11,669	13,834
Bankcard income	6,856	6,201
Mortgage income	7,512	10,016
Portfolio income	9,667	5,930
Other noninterest revenues	25,921	22,324

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Total noninterest revenues	220,430	192,885
	<u> </u>	<u> </u>
NONINTEREST EXPENSES		
Salaries and employee benefits	173,706	154,065
Net occupancy expense	35,252	31,525
Equipment expense	30,544	27,968
Postage and office supplies	12,958	11,939
Marketing expense	11,746	9,158
Professional fees	8,330	8,412
Communications expense	6,412	7,563
Amortization of intangibles	1,163	1,198
Other noninterest expenses	42,163	37,778
	<u> </u>	<u> </u>
Total noninterest expenses	322,274	289,606
	<u> </u>	<u> </u>
INCOME BEFORE INCOME TAXES	229,553	221,621
Income taxes	69,454	66,265
	<u> </u>	<u> </u>
NET INCOME	\$ 160,099	\$ 155,356
	<u> </u>	<u> </u>
Average common shares outstanding	351,196	351,981
Earnings per common share	\$.46	\$.44
Diluted average common shares outstanding	356,908	355,265
Diluted earnings per common share	\$.45	\$.44

See notes to consolidated financial statements.

Table of Contents**AMSOUTH BANCORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY****(Unaudited)**

	<u>Common Stock</u>	<u>Capital Surplus</u>	<u>Retained Earnings</u>	<u>Treasury Stock</u>	<u>Deferred Compensation on Restricted Stock</u>	<u>Accumulated Other Comprehensive Income/(Loss)</u>	<u>Total</u>
(In thousands)							
BALANCE AT JANUARY 1, 2004	\$ 416,878	\$ 715,663	\$ 3,228,533	\$ (1,076,644)	\$ (14,501)	\$ (40,260)	\$ 3,229,669
Comprehensive income:							
Net income	-0-	-0-	160,099	-0-	-0-	-0-	160,099
Other comprehensive income, net of tax:							
Changes in unrealized gains and losses on derivative instruments (net of \$6,830 tax expense)	-0-	-0-	-0-	-0-	-0-	12,684	12,684
Changes in unrealized gains and losses on available-for-sale securities, net of reclassification adjustment (net of \$25,390 tax expense)	-0-	-0-	-0-	-0-	-0-	42,431	42,431
Comprehensive income							215,214
Cash dividends declared	-0-	-0-	(85,072)	-0-	-0-	-0-	(85,072)
Common stock transactions:							
Purchase of common stock	-0-	-0-	-0-	(30,890)	-0-	-0-	(30,890)
Employee stock plans	(109)	(1,897)	(7,812)	49,904	(50)	-0-	40,036
Direct stock purchase and dividend reinvestment plan	-0-	496	-0-	2,896	-0-	-0-	3,392
BALANCE AT MARCH 31, 2004	\$ 416,769	\$ 714,262	\$ 3,295,748	\$ (1,054,734)	\$ (14,551)	\$ 14,855	\$ 3,372,349
Disclosure of reclassification amount:							
Changes in unrealized holding gains and losses on available-for-sale securities arising during the period						\$ 47,731	
Less: Reclassification adjustment for net securities gains realized in net income						5,300	
Net change in unrealized gains and losses on available-for-sale securities, net of tax						\$ 42,431	
Changes in unrealized holding gains and losses on derivatives arising during the period						\$ 15,675	
Less: Reclassification adjustment for gains realized in net income (net of \$1,802 tax expense)						2,991	
Net change in unrealized gains and losses on derivatives, net of tax						\$ 12,684	

See notes to consolidated financial statements.

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	Three Months Ended	
	March 31	
	2004	2003
	(In thousands)	
OPERATING ACTIVITIES		
Net income	\$ 160,099	\$ 155,356
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	28,100	44,700
Depreciation and amortization of premises and equipment	26,206	22,519
Amortization of premiums and discounts on held-to-maturity securities and available-for-sale securities	9,338	5,681
Net (increase) decrease in loans held for sale, excluding guaranteed mortgage loan securitizations	(330,220)	9,038
Net decrease in trading securities	2,175	46,898
Net gains on sales of available-for-sale securities	(8,494)	(4,976)
Net gain on guaranteed mortgage loan securitizations	(1,151)	(7,500)
Net gain on sales of business operations, subsidiaries and other assets	(5,474)	-0-
Net gain on sales of home equity loans	(4,884)	-0-
Net increase in accrued interest receivable, bank-owned life insurance and other assets	(19,555)	(32,596)
Net increase in accrued expenses and other liabilities	42,774	114,670
Provision for deferred income taxes	31,935	31,995
Amortization of intangible assets	1,163	1,198
Other operating activities, net	23,273	21,848
	<u>(44,715)</u>	<u>408,831</u>
INVESTING ACTIVITIES		
Proceeds from maturities and prepayments of available-for-sale securities	272,946	643,837
Proceeds from sales of available-for-sale securities	922,946	261,679
Purchases of available-for-sale securities	(318,920)	(1,065,745)
Proceeds from maturities, prepayments and calls of held-to-maturity securities	383,232	668,570
Purchases of held-to-maturity securities	(1,290,855)	(809,791)
Net increase in federal funds sold and securities purchased under agreements to resell	(654,000)	(415,970)
Net (increase) decrease in other interest-earning assets	(4,517)	28,785
Net increase in loans, excluding guaranteed mortgage loan securitizations and sales of home equity loans	(912,769)	(1,064,487)
Proceeds from guaranteed mortgage loan securitizations	344,892	537,570
Proceeds from sales of business operations, subsidiaries and other assets	850	-0-
Proceeds from sales of home equity loans	156,552	-0-
Net purchases of premises and equipment	(55,165)	(48,130)
	<u>(1,154,808)</u>	<u>(1,263,682)</u>
FINANCING ACTIVITIES		

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Net increase in deposits	1,104,064	685,753
Net (decrease) increase in federal funds purchased and securities sold under agreements to repurchase	(98,761)	57,304
Net decrease in other borrowed funds	(18,033)	(1,176)
Issuance of long-term Federal Home Loan Bank advances and other long-term debt	250,000	900,000
Payments for maturing Federal Home Loan Bank advances and other long-term debt	(54,408)	(505,580)
Cash dividends paid	(84,584)	(81,691)
Proceeds from employee stock plans, direct stock purchase and dividend reinvestment plan	42,265	47,062
Purchase of common stock	(30,890)	(96,618)
	<u> </u>	<u> </u>
Net cash provided by financing activities	1,109,653	1,005,054
	<u> </u>	<u> </u>
(Decrease) Increase in cash and cash equivalents	(89,870)	150,203
Cash and cash equivalents at beginning of period	1,163,986	1,221,985
	<u> </u>	<u> </u>
Cash and cash equivalents at end of period	\$ 1,074,116	\$ 1,372,188
	<u> </u>	<u> </u>

See notes to consolidated financial statements

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AMSOUTH BANCORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Three months ended March 31, 2004 and 2003

Basis of Presentation The consolidated financial statements conform to accounting principles generally accepted in the United States. The accompanying interim financial statements are unaudited; however, in the opinion of management, all adjustments necessary for the fair presentation of the consolidated financial statements have been included. All such adjustments are of a normal recurring nature. Certain amounts in the prior year's financial statements have been reclassified to conform with the 2004 presentation. These reclassifications had no effect on net income. The notes included herein should be read in conjunction with the notes to consolidated financial statements included in AmSouth Bancorporation's (AmSouth) 2003 annual report on Form 10-K.

The consolidated financial statements and notes are presented in accordance with the instructions for Form 10-Q. The consolidated financial statements include the accounts of AmSouth and all of its subsidiaries, all of which are wholly-owned. All significant intercompany balances and transactions have been eliminated. Certain amounts in the prior years' financial statements have been reclassified to conform to the 2004 presentation. These reclassifications are immaterial and had no effect on net income.

The Financial Accounting Standards Board (FASB) issued a revised version of Interpretation No. 46 - Consolidation of Variable Interest Entities (Interpretation 46), in December of 2003. This accounting guidance significantly changes how companies determine whether they must consolidate an entity depending on whether the entity is a voting rights entity or a variable interest entity (VIE). The revised Interpretation 46 is effective no later than the end of the first interim or annual period ending after December 15, 2003 for entities created after January 31, 2003, and for entities created before February 1, 2003, no later than the end of the first interim or annual period ending after March 15, 2004. As required, AmSouth adopted the guidance of Interpretation 46 for all entities.

In accordance with the new guidance, AmSouth considers a voting rights entity to be a subsidiary and consolidates it if AmSouth has a controlling financial interest in the entity. VIEs are consolidated by AmSouth if it is exposed to the majority of the VIE's expected losses and/or residual returns (i.e., AmSouth is considered to be the primary beneficiary).

Unconsolidated investments in voting rights entities or VIEs in which AmSouth has significant influence over operating and financing decisions (usually defined as a voting or economic interest of 20% to 50%) are accounted for using the equity method. Unconsolidated investments in voting rights entities or VIEs in which AmSouth has a voting or economic interest of less than 20% are generally carried at cost.

Prior to the adoption of Interpretation 46, AmSouth generally determined whether consolidation of an entity was appropriate based on the nature and amount of equity contributed by third parties, the decision-making power granted to those parties and the extent of their control over the entity's operating and financial policies. Entities controlled, generally through majority ownership, were consolidated and were considered subsidiaries.

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Use of Estimates The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, benefit plan obligations and expenses and the valuation of derivative instruments used in hedging transactions and the corresponding value of items being hedged.

Recent Accounting Developments In December 2003, the FASB issued a revision to Statement No. 132, *Employers' Disclosures about Pensions and Other Postretirement Benefits* (Statement 132). Statement 132 requires enhanced disclosures for defined benefit pension plans. Statement 132 requires companies to provide

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more details about their plan assets, investment strategy, measurement dates, benefit obligations, cash flows, and components of net periodic benefit cost recognized during interim periods. The disclosures required by Statement 132 are effective for financial statements with fiscal years ending after December 15, 2003, except for disclosures regarding estimated future benefit payments. Disclosures regarding estimated future benefit payments will be required for fiscal years ending after June 15, 2004. The interim-period disclosures required by this statement are effective for interim periods beginning after December 15, 2003. See discussion on Pension later in Notes to Consolidated Financial Statements for the disclosures required by this statement. As Statement 132 relates to changes in disclosures, its adoption did not have an impact on AmSouth's financial condition or results of operations.

In December 2003, the American Institute of Certified Public Accountants issued Statement of Position 03-3, Accounting for Certain Loans and Debt Securities Acquired in a Transfer (SOP 03-3). SOP 03-3 addresses accounting for differences between contractual cash flows expected to be collected and an investor's initial investment in loans or debt securities acquired in a transfer if those differences are attributable, at least in part, to credit quality. It includes loans and debt securities acquired in purchase business combinations. SOP 03-3 limits the yield that may be accreted (accretable yield) to the excess of the investor's estimate of undiscounted expected principal, interest and other cash flows (cash flows expected at acquisition to be collected) over the investor's initial investment in the loan. SOP 03-3 requires that the excess of contractual cash flows over cash flows to be collected (nonaccretable difference) not be recognized as an adjustment of yield, loss accrual or valuation allowance. SOP 03-3 prohibits investors from displaying accretable yield and nonaccretable difference in the balance sheet. Subsequent increases in cash flows expected to be collected generally should be recognized prospectively through adjustment of the loan's yield over its remaining life. Decreases in cash flows expected to be collected should be recognized as impairment. SOP 03-3 prohibits carrying over or creation of valuation allowances in the initial accounting of all loans acquired in a transfer that are within the scope of SOP 03-3. The prohibition of the valuation allowance carryover applies to the purchase of an individual loan, a pool of loans, a group of loans, and loans acquired in a purchase business combination. SOP 03-3 is effective for loans acquired in fiscal years beginning after December 15, 2004. AmSouth does not anticipate that the adoption of SOP 03-3 will have a material impact on its financial condition or results of operations.

On March 9, 2004, the SEC issued Staff Accounting Bulletin 105, Application of Accounting Principles to Loan Commitments, (SAB 105) to inform registrants of the Staff's view that the fair value of the recorded loan commitments should not consider the expected future cash flows related to the associated servicing of the future loan. The provisions of SAB 105 must be applied to loan commitments accounted for as derivatives that are entered into after March 31, 2004. The staff will not object to the application of existing accounting practices to loan commitments accounted for as derivatives that are entered into on or before March 31, 2004, with appropriate disclosures. On April 1, 2004, AmSouth adopted the provisions of SAB 105. AmSouth records the value of its mortgage loan commitments at fair market value for mortgages it intends to sell. AmSouth does not currently include, and was not including, the value of mortgage servicing or any other internally-developed intangible assets in the valuation of its mortgage loan commitments. Therefore, the adoption of SAB 105 did not have an impact on AmSouth's financial condition or results of operations.

In March 2004, the Emerging Issues Task Force reached a consensus on Issue 03-1, Meaning of Other Than Temporary Impairment (Issue 03-1). The Task Force reached a consensus on an other-than-temporary impairment model for debt and equity securities accounted for under Statement of Financial Accounting Standards No. 115, Accounting for Certain Investments in Debt and Equity Securities and cost method investments. The basic model developed by the Task Force in evaluating whether an investment within the scope of Issue 03-1 is other-than-temporarily impaired is as follows: Step 1: Determine whether the investment is impaired. An investment is impaired if its fair value is less than its cost. Step 2: Evaluate whether the impairment is other-than-temporary. Step 3: If the impairment is other-than-temporary, recognize an impairment loss equal to the difference between the investment's cost and its fair value. The three-step model used to determine other-than-temporary impairments shall be applied prospectively to all current and future investments in interim or annual reporting periods beginning after June 15, 2004. AmSouth does not anticipate that the adoption of Issue 03-1 will have a material impact on its financial condition or results of operations.

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Cash Flows For the three months ended March 31, 2004 and 2003, AmSouth paid interest of \$157.4 million and \$165.0 million, respectively, on its deposits and obligations. During the three months ended March 31, 2004 and 2003, AmSouth received income tax refunds of \$9.1 million and \$10.0 million, respectively. Noncash transfers from loans to foreclosed properties for the three months ended March 31, 2004 and 2003, were \$10.8 million and \$14.0 million, respectively. Noncash transfers from foreclosed properties to loans for the three months ended March 31, 2004 and 2003 were \$300 thousand and \$304 thousand, respectively. During the three months ended March 31, 2003, AmSouth had noncash transfers from loans to available-for-sale and held-to-maturity securities of approximately \$109 million in connection with a guaranteed mortgage loan securitization.

Stock-Based Compensation AmSouth has long-term incentive compensation plans that permit the granting of incentive awards in the form of stock options, restricted stock awards and stock appreciation rights. Generally, the terms of these plans stipulate that the exercise price of options may not be less than the fair market value of AmSouth's common stock on the date the options are granted. Options generally vest between one and three years from the date of grant, with all of the 2004 option grants vesting ratably over three years. All of the options granted during the first three months of 2004 expire ten years from the date of grant. All other options outstanding generally expire not later than ten years from the date of grant.

AmSouth has adopted the disclosure-only provisions of Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation (Statement 123) which allows an entity to continue to measure compensation costs for those plans using the intrinsic value-based method of accounting prescribed by APB Opinion No. 25, Accounting for Stock Issued to Employees (APB 25). AmSouth has elected to follow APB 25 and related interpretations in accounting for its employee stock options. Accordingly, compensation cost for fixed and variable stock-based awards is measured by the excess, if any, of the fair market price of the underlying stock over the amount the individual is required to pay. Compensation cost for fixed awards is measured at the grant date, while compensation cost for variable awards is estimated until both the number of shares an individual is entitled to receive and the exercise or purchase price are known (measurement date). No option-based employee compensation cost is reflected in net income, as all options granted had an exercise price equal to the market value of the underlying common stock on the date of grant. AmSouth does, however, currently recognize compensation expense related to restricted stock issuances as disclosed in the table below. The pro forma information below was determined as if AmSouth had accounted for all employee stock-based awards under the fair value method of Statement 123. For purposes of pro forma disclosures, the estimated fair value of the options and restricted stock awards is amortized to expense over the awards vesting period. AmSouth's pro forma information follows (in thousands except earnings per share information):

	For the three months ended	
	March 31,	March 31,
	2004	2003
	<u> </u>	<u> </u>
Net income:		
As reported	\$ 160,099	\$ 155,356
Add: Stock-based compensation expense included in reported net income, net of tax	198	492
Deduct: Total stock-based compensation expense determined under fair value-based method for all awards, net of tax	(7,694)	(6,528)
Pro forma	<u>\$ 152,603</u>	<u>\$ 149,320</u>
Earnings per common share:		
As reported	\$.46	\$.44
Pro forma	\$.43	\$.42
Diluted earnings per common share:		
As reported	\$.45	\$.44

Pro forma

\$.43

\$.42

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This pro forma information includes expenses related to all stock options granted during the first quarters of 2004 and 2003, as well as the expense related to the unvested portion of prior year grants and assumes that the fair value for these options was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted-average assumptions for the three months ending March 31, 2004 and 2003, respectively: a risk-free interest rate of 3.88% and 3.82%, a dividend yield of 3.98% and 4.49%, a volatility factor of 30.90% and 31.40%, and a weighted-average expected life of 7.0 years for both periods. The weighted-average fair value of options granted during the three months ended March 31, 2004 and 2003 was \$5.70 and \$4.49, respectively. The estimated fair value of the options is then amortized to expense over the options vesting period to determine the expense for the periods.

Derivatives In accordance with Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities, (Statement 133) AmSouth recognizes all of its derivative instruments as either assets or liabilities in the statement of financial condition at fair value. For those derivative instruments that are designated and qualify as hedging instruments, AmSouth designates the hedging instrument, based upon the exposure being hedged, as either a fair value hedge or a cash flow hedge. Derivative instruments designated in a hedge relationship to mitigate exposure to changes in the fair value of an asset, liability or firm commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges under Statement 133. Derivative instruments designated in a hedge relationship to mitigate exposure to variability in expected future cash flows or other types of forecasted transactions are considered cash flow hedges.

For derivative instruments that are designated and qualify as fair value hedges, the gain or loss on the derivative instrument as well as the offsetting loss or gain on the hedged item attributable to the hedged risk are recognized in other noninterest revenue during the period of the change in fair values. For derivative instruments that are designated and qualify as cash flow hedges, the effective portion of the gain or loss on the derivative instrument is reported as a component of other comprehensive income and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. The remaining gain or loss on the derivative instrument in excess of the cumulative change in the present value of future cash flows of the hedged item, if any, is recognized in other noninterest revenue during the period of change. For derivative instruments not designated as hedging instruments, the gain or loss is recognized in current earnings during the period of change.

AmSouth, at the hedge's inception and at least quarterly thereafter, performs a formal assessment to determine whether changes in the fair values or cash flows of the derivative instruments have been highly effective in offsetting changes in the fair values or cash flows of the hedged items and whether they are expected to be highly effective in the future. If it is determined a derivative instrument has not been or will not continue to be highly effective as a hedge, hedge accounting is discontinued prospectively, and the derivative instrument continues to be carried at fair value with all changes in fair value being recorded in noninterest revenue, but with no corresponding offset being recorded on the hedged item or in other comprehensive income for cash flow hedges.

Fair Value Hedging Strategy AmSouth has entered into interest rate swap agreements for interest rate risk exposure management purposes. The interest rate swap agreements utilized by AmSouth effectively modify AmSouth's exposure to interest rate risk by converting a portion of AmSouth's fixed-rate certificates of deposit to floating rate. AmSouth also has interest rate swap agreements which effectively convert portions of its fixed-rate long-term debt to floating rate. During the three months ended March 31, 2004 and 2003, AmSouth recognized a net loss of \$403 thousand and \$150 thousand, respectively, related to the ineffective portion of its hedging instruments.

AmSouth has entered into forward contracts to hedge the fair value of specific pools of mortgage loans held for sale from changes in interest rates. The impact of hedge ineffectiveness during the three months ended March 31, 2004, was not material to the earnings of AmSouth. In addition to the forward contracts treated as hedges

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under Statement 133, AmSouth's derivative portfolio also included forward contracts entered into to offset the impact of changes in interest rates on AmSouth's mortgage pipeline designated for future sale. Statement 133 also requires AmSouth to treat its mortgage banking loan commitments as derivatives. Accordingly, the change in fair value of the forward contracts entered into to hedge the mortgage pipeline, while not qualifying as hedges under Statement 133, is somewhat offset by changes in the fair value of the mortgage pipeline. AmSouth had no open forward contracts to sell mortgage loans at March 31, 2003.

Cash Flow Hedging Strategy AmSouth has entered into interest rate swap agreements that effectively convert a portion of its floating-rate loans to a fixed-rate basis, thus reducing the impact of interest-rate changes on future interest income. Approximately \$1.5 billion and \$275 million of AmSouth's loans were designated as the hedged items to interest rate swap agreements at March 31, 2004 and 2003, respectively. AmSouth has entered into interest rate swap agreements to hedge the anticipated reissuance of Federal funds purchases which effectively convert a portion of its Federal funds purchased to