CAPITAL ONE FINANCIAL CORP
Form 10-Q
November 08, 2007
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2007.

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 (NO FEE REQUIRED).**

For the transition period from ______ to ______

Commission File No. 1-13300

CAPITAL ONE FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

Delaware **(State or Other Jurisdiction of** **Incorporation or Organization)**	**54-1719854** **(I.R.S. Employer** **Identification No.)**
1680 Capital One Drive McLean, Virginia **(Address of Principal Executive Offices)**	**22102** **(Zip Code)**

(703) 720-1000

Registrant s telephone number, including area code:

(Not applicable)

(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 x 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 of the Exchange Act. (Check One):

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act.) **Yes** ¨ **No x**

As of October 31, 2007 there were 418,512,173 shares of the registrant s Common Stock, par value $.01 per share, outstanding.

Table of Contents

CAPITAL ONE FINANCIAL CORPORATION

FORM 10-Q

INDEX

September 30, 2007

Table of Contents

Part 1. Financial Information

Item 1. ***Financial Statements***

CAPITAL ONE FINANCIAL CORPORATION

Condensed Reported Consolidated Balance Sheets (unaudited)

(Dollars in thousands, except share and per share data)

	September 30 2007	December 31 2006
Assets:		
Cash and due from banks	**$ 1,819,121**	$ 2,817,519
Federal funds sold and resale agreements	**1,922,735**	1,099,156
Interest-bearing deposits at other banks	**703,805**	743,821
Cash and cash equivalents	**4,445,661**	4,660,496
Securities available for sale	**19,959,247**	15,246,887
Mortgage loans held for sale	**1,454,457**	10,435,295
Loans held for investment	**95,405,217**	96,512,139
Less: Allowance for loan and lease losses	**(2,320,000)**	(2,180,000)
Net loans held for investment	**93,085,217**	94,332,139
Accounts receivable from securitizations	**6,905,859**	4,589,235
Premises and equipment, net	**2,268,034**	2,203,280
Interest receivable	**793,693**	816,426
Goodwill	**12,952,838**	13,635,435
Other	**5,289,829**	3,820,092
Total assets	**$ 147,154,835**	$ 149,739,285
Liabilities:		
Non-interest-bearing deposits	**$ 10,840,189**	$ 11,648,070
Interest-bearing deposits	**72,502,625**	74,122,822
Total deposits	**83,342,814**	85,770,892
Senior and subordinated notes	**10,784,182**	9,725,470
Other borrowings	**22,722,519**	24,257,007
Interest payable	**552,674**	574,763
Other	**4,965,794**	4,175,947
Total liabilities	**122,367,983**	124,504,079
Stockholders Equity:		
Preferred Stock, par value $.01 per share; authorized 50,000,000 shares, none issued or outstanding		
Common stock, par value $.01 per share; authorized 1,000,000,000 shares, 418,346,994 and 412,219,973 issued as of September 30, 2007 and December 31, 2006, respectively	**4,183**	4,122
Paid-in capital, net	**15,768,525**	15,333,137
Retained earnings	**11,049,042**	9,760,184
Cumulative other comprehensive income	**346,184**	266,180
	(2,381,082)	(128,417)

Less: Treasury stock, at cost; 32,923,076 and 2,294,586 shares as of September 30, 2007 and December 31, 2006, respectively		
Total stockholders equity	**24,786,852**	25,235,206
Total liabilities and stockholders equity	**$ 147,154,835**	$ 149,739,285

See Notes to Condensed Reported Consolidated Financial Statements.

Table of Contents

CAPITAL ONE FINANCIAL CORPORATION

Condensed Reported Consolidated Statements of Income

(Dollars in thousands, except per share data) (unaudited)

	Three Months Ended September 30		Nine Months Ended September 30	
	2007	**2006**	**2007**	**2006**
Interest Income:				
Loans held for investment, including past-due fees	**$ 2,381,096**	$ 1,814,803	**$ 6,963,349**	$ 5,044,362
Securities available for sale	**252,550**	151,616	**694,608**	483,078
Other	**133,321**	98,652	**460,005**	313,370
Total interest income	**2,766,967**	2,065,071	**8,117,962**	5,840,810
Interest Expense:				
Deposits	**740,091**	442,571	**2,220,177**	1,262,412
Senior and subordinated notes	**144,643**	96,300	**417,250**	275,361
Other borrowings	**257,759**	231,685	**712,937**	604,563
Total interest expense	**1,142,493**	770,556	**3,350,364**	2,142,336
Net interest income	**1,624,474**	1,294,515	**4,767,598**	3,698,474
Provision for loan and lease losses	**595,534**	430,566	**1,342,292**	963,281
Net interest income after provision for loan and lease losses	**1,028,940**	863,949	**3,425,306**	2,735,193
Non-Interest Income:				
Servicing and securitizations	**1,354,303**	1,071,091	**3,569,281**	3,250,201
Service charges and other customer-related fees	**522,374**	459,125	**1,484,820**	1,308,254
Mortgage servicing and other	**52,661**	44,520	**172,476**	118,378
Interchange	**103,799**	150,474	**347,889**	401,503
Other	**116,525**	36,175	**321,417**	251,213
Total non-interest income	**2,149,662**	1,761,385	**5,895,883**	5,329,549
Non-Interest Expense:				
Salaries and associate benefits	**627,358**	554,504	**1,970,433**	1,607,113
Marketing	**332,693**	368,498	**989,654**	1,048,964
Communications and data processing	**194,551**	183,020	**569,405**	524,958
Supplies and equipment	**134,639**	111,625	**384,971**	322,837
Restructuring expense	**19,354**		**110,428**	
Occupancy	**77,597**	49,710	**230,835**	151,840
Other	**548,029**	459,272	**1,687,077**	1,325,293
Total non-interest expense	**1,934,221**	1,726,629	**5,942,803**	4,981,005
Income from continuing operations before income taxes	**1,244,381**	898,705	**3,378,386**	3,083,737
Income taxes	**428,010**	310,866	**1,108,279**	1,059,972
Income from continuing operations, net of tax	**816,371**	587,839	**2,270,107**	2,023,765
(Loss) from discontinued operations, net of tax	**(898,029)**		**(926,343)**	
Net (loss) income	**$ (81,658)**	$ 587,839	**$ 1,343,764**	$ 2,023,765

Basic earnings per share:								
Income from continuing operations	**$**	**2.11**	$	1.95	**$**	**5.74**	$	6.73
(Loss) from discontinued operations		**(2.32)**				**(2.34)**		
Net (loss) income	**$**	**(0.21)**	$	1.95	**$**	**3.40**	$	6.73
Diluted earnings per share								
Income from continuing operations	**$**	**2.09**	$	1.89	**$**	**5.66**	$	6.53
Loss from discontinued operations		**(2.30)**				**(2.31)**		
Net (loss) income	**$**	**(0.21)**	$	1.89	**$**	**3.35**	$	6.53
Dividends paid per share	**$**	**0.03**	$	0.03	**$**	**0.08**	$	0.08

See Notes to Condensed Reported Consolidated Financial Statements.

Table of Contents

CAPITAL ONE FINANCIAL CORPORATION

Condensed Reported Consolidated Statements of Changes in Stockholders Equity

(Dollars in thousands, except share and per share data) (unaudited)

(In thousands, except share and per share data)	Common Stock Shares	Common Stock Amount	Paid-In Capital, Net	Retained Earnings	Cumulative Other Comprehensive Income (Loss)	Treasury Stock	Total Stockholders Equity
Balance, December 31, 2005	302,786,444	$ 3,028	$ 6,848,544	$ 7,378,015	$ 6,129	$ (106,802)	$ 14,128,914
Comprehensive income:							
Net income				2,023,765			2,023,765
Other comprehensive income, net of income tax:							
Unrealized gains on securities, net of income taxes of $10,619					19,206		19,206
Foreign currency translation adjustments					161,342		161,342
Unrealized losses on cash flow hedging instruments, net of income tax benefit of $6,553					(12,743)		(12,743)
Other comprehensive income					167,805		167,805
Comprehensive income							2,191,570
Cash dividends - $.008 per share				(24,210)			(24,210)
Purchase of treasury stock						(8,575)	(8,575)
Issuances of common stock and restricted stock, net of forfeitures	689,489	7	27,670				27,677
Exercise of stock options and related tax benefits	3,079,235	30	233,058				233,088
Compensation expense for restricted stock awards and stock options			128,513				128,513
Balance, September 30, 2006	306,555,168	$ 3,065	$ 7,237,785	$ 9,377,570	$ 173,934	$ (115,377)	$ 16,676,977
Balance, December 31, 2006	**412,219,973**	**$ 4,122**	**$ 15,333,137**	**$ 9,760,184**	**$ 266,180**	**$ (128,417)**	**$ 25,235,206**
Cumulative effect from adoption of FIN 48				**(31,830)**			**(31,830)**
Cumulative effect from adoption of FAS 156, net of income taxes of $6,378				**8,809**			**8,809**
Comprehensive income:							
Net income				**1,343,764**			**1,343,764**
Other comprehensive income, net of income tax:							
Unrealized loss on securities, net of income taxes benefit of $5,436					**(1,560)**		**(1,560)**
Defined benefit pension plans, net of income tax benefit of $1,092					**(2,028)**		**(2,028)**

3

Table of Contents

(In thousands, except share and per share data)	Common Stock Shares	Common Stock Amount	Paid-In Capital, Net	Retained Earnings	Cumulative Other Comprehensive Income (Loss)	Treasury Stock	Total Stockholders Equity
Foreign currency translation adjustments					127,754		127,754
Unrealized losses on cash flow hedging instruments, net of income tax benefit of $22,833					(44,162)		(44,162)
Other comprehensive income					80,004		80,004
Comprehensive income							1,423,768
Cash dividends - $.08 per share				(31,885)			(31,885)
Purchase of treasury stock						(2,252,665)	(2,252,665)
Issuances of common stock and restricted stock, net of forfeitures	1,234,190	13	28,023				28,036
Exercise of stock options and related tax benefits of exercises and restricted stock vesting	5,030,089	49	273,708				273,757
Compensation expense for restricted stock awards and stock options			139,379				139,379
Adjustment to issuance of common stock for acquisition	(137,258)	(1)	(10,463)				(10,464)
Allocation of ESOP shares			4,741				4,741
Balance, September 30, 2007	418,346,994	$ 4,183	$ 15,768,525	$ 11,049,042	$ 346,184	$ (2,381,082)	$ 24,786,852

See Notes to Condensed Reported Consolidated Financial Statements.

Table of Contents

CAPITAL ONE FINANCIAL CORPORATION

Condensed Consolidated Statements of Cash Flows

(Dollars in thousands) (unaudited)

	Nine Months Ended September 30, 2007	2006
Operating Activities:		
Income from continuing operations, net of tax	**$ 2,270,107**	$ 2,023,765
(Loss) from discontinued operations, net of tax	**(926,343)**	
Net income	**1,343,764**	2,023,765
Adjustments to reconcile net income to cash provided by operating activities:		
Provision for loan and lease losses	**1,342,292**	963,281
Depreciation and amortization, net	**482,595**	382,968
(Gains) losses on sales of securities available for sale	**(68,306)**	25,150
Gains on sales of auto loans	**(10,927)**	(27,455)
Gains on extinguishment of debt	**(17,444)**	
Mortgage loans held for sale:		
Transfers and originations	**729,458**	(113,725)
Loss on sales	**7,712**	
Proceeds from sales	**4,905,876**	
Stock plan compensation expense	**309,969**	150,443
Changes in assets and liabilities:		
Decrease in interest receivable	**32,234**	34,438
Increase in accounts receivable from securitizations	**(2,318,418)**	(715,296)
Increase in other assets	**(1,378,508)**	(91,084)
(Decrease) increase in interest payable	**(22,429)**	15,319
Increase (decrease) in other liabilities	**838,475**	(100,999)
Net cash provided by operating activities attributable to discontinued operations	**2,196,050**	
Net cash provided by operating activities	**8,372,393**	2,546,805
Investing Activities:		
Purchases of securities available for sale	**(10,880,031)**	(5,034,885)
Proceeds from maturities of securities available for sale	**5,258,692**	2,915,064
Proceeds from sales of securities available for sale	**965,185**	2,513,479
Proceeds from securitizations of loans	**9,875,362**	9,907,624
Net increase in loans held for investment	**(8,921,503)**	(15,068,945)
Principal recoveries of loans previously charged off	**469,392**	418,581
Additions of premises and equipment, net	**(314,063)**	(530,995)
Net payments for companies acquired	**(10,464)**	
Net cash used in investing activities	**(3,557,430)**	(4,880,077)
Financing Activities:		
Net decrease in deposits	**(2,428,078)**	(320,117)
Net increase in other borrowings	**515,093**	2,088,027
Issuances of senior notes	**1,495,740**	3,188,372
Maturities of senior notes	**(462,500)**	(1,226,882)
Repurchases of senior notes		(31,296)

Purchases of treasury stock	**(2,252,665)**	(8,575)
Dividends paid	**(31,885)**	(24,210)
Net proceeds from issuances of common stock	**32,777**	27,677
Proceeds from share based payment activities	**133,499**	168,658
Net cash used in financing activities attributable to discontinued operations	**(2,031,779)**	
Net cash (used in) provided by financing activities	**(5,029,798)**	3,861,654
(Decrease) increase in cash and cash equivalents	**(214,835)**	1,528,382
Cash and cash equivalents at beginning of year	**4,660,496**	4,071,267
Cash and cash equivalents at end of period	**$ 4,445,661**	$ 5,599,649

See Notes to Condensed Reported Consolidated Financial Statements.

Table of Contents

CAPITAL ONE FINANCIAL CORPORATION

Notes to Condensed Reported Consolidated Financial Statements

(in thousands, except per share data) (unaudited)

Note 1

Summary of Significant Accounting Policies

Business

Capital One Financial Corporation (the Corporation) is a diversified financial services company whose banking and non-banking subsidiaries market a variety of financial products and services. The Corporation s principal subsidiaries are:

Capital One Bank (the Bank) which currently offers credit and debit card products, deposit products, and also engages in a wide variety of lending and other financial activities.

Capital One, National Association (CONA) which offers a broad spectrum of banking products and financial services to consumers, small businesses and commercial clients.

Capital One Auto Finance, Inc. (COAF) which offers automobile and other motor vehicle financing products.

Another subsidiary of the Corporation, Superior Savings of New England, N.A. (Superior) focuses on telephonic and media-based generation of deposits.

In the third quarter of 2007, the Company shutdown the mortgage origination operations of its wholesale mortgage banking unit, GreenPoint Mortgage (GreenPoint), an operating subsidiary of CONA. Additional information is included in this Quarterly Report under the heading Notes to Condensed Reported Consolidated Financial Statements Note 2 Discontinued Operations.

The Corporation and its subsidiaries are hereafter collectively referred to as the Company .

Basis of Presentation

The accompanying unaudited condensed reported consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete consolidated financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates.

All significant intercompany balances and transactions have been eliminated. Certain prior years amounts have been reclassified to conform to the 2007 presentation. All amounts in the following notes, excluding share and per share data, are presented in thousands.

The notes to the reported consolidated financial statements contained in the Annual Report on Form 10-K for the year ended December 31, 2006 should be read in conjunction with these condensed reported consolidated financial statements.

Recent Accounting Pronouncements

In February 2007, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard No. 159, *The Fair Value Option for Financial Assets and Liabilities*, (SFAS 159). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value with changes in fair value included in current earnings. The election is made on specified election dates, can be made on an instrument by instrument basis, and is irrevocable. SFAS 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007. Management is currently evaluating the impact of adoption of SFAS 159 on the consolidated earnings and financial position of the Company.

In September 2006, the FASB issued Statement of Financial Accounting Standard No. 157, *Fair Value Measurements* (SFAS 157). This statement defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. Management is currently evaluating the impact of adoption of SFAS 157 on the consolidated earnings and financial position of the Company.

Table of Contents

In September 2006, the FASB issued Statement of Financial Accounting Standard No. 156, *Accounting for Servicing of Financial Assets*, and (SFAS 156), which amends Statement of Financial Accounting Standards No. 140 Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (SFAS 140). SFAS 156 changes the accounting for, and reporting of, the recognition and measurement of separately recognized servicing assets and liabilities. Effective January 1, 2007, the Company adopted SFAS 156 resulting in an $8.8 million cumulative effect, net of taxes, increase to the beginning balance of retained earnings.

In February 2006, the FASB issued Statement of Financial Accounting Standard No. 155, *Accounting for Certain Hybrid Financial Instruments-an amendment of FASB Statements No. 133 and 140,* (SFAS 155). SFAS 155 amends FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities,* (SFAS 133) and SFAS 140. SFAS 155 resolves issues addressed in SFAS 133 Implementation Issue No. D1, Application of Statement 133 to Beneficial Interests in Securitized Financial Assets. SFAS 155 permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, clarifies which interest-only strips and principal-only strips are not subject to the requirements of SFAS 133, establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives, and amends SFAS 140 to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. The adoption of SFAS 155 did not have a material impact on the consolidated earnings or financial position of the Company.

Adoption of FIN 48

In June 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in accordance with SFAS No. 109, *Accounting for Income Taxes,* and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition.

The Company adopted the provisions of FIN 48 effective January 1, 2007. As a result of adoption, the Company recorded a $31.8 million reduction in retained earnings. The reduction in retained earnings upon adoption is the net impact of a $48.7 million increase in the liability for unrecognized tax benefits and a $16.8 million increase in deferred tax assets. In addition, the Company reclassified $471.1 million of unrecognized tax benefits from deferred tax liabilities to current taxes payable to conform to the deferred tax measurement and balance sheet presentation requirements of FIN 48.

The balance of unrecognized tax benefits at January 1, 2007 was $661.6 million. Included in the balance at January 1, 2007, are $83.5 million of tax positions which, if recognized, would affect the effective tax rate and $58.0 million of tax positions which, if recognized, would result in a reduction in goodwill. Also included in the balance is $466.4 million of tax positions related to items of income and expense for which the ultimate taxability or deductibility is highly certain, but for which there is uncertainty about the timing of recognition. Because of the impact of deferred tax accounting, other than interest and penalties, the acceleration of taxability or deferral of deductibility of these items would not affect the annual effective tax rate but may accelerate the payment of taxes to an earlier period.

The Company continues to recognize accrued interest and penalties related to unrecognized tax benefits as a component of income tax expense, consistent with its policy prior to adoption of FIN 48. The accrued balance of interest and penalties related to unrecognized tax benefits at January 1, 2007 is $119.1 million.

The Company is subject to examination by the Internal Revenue Service (IRS) and other tax authorities in certain countries and states in which the Company has significant business operations. The tax years subject to examination vary by jurisdiction. The IRS is currently examining the Company s federal income tax returns for the years 2003 and 2004 as well as the tax returns of certain acquired subsidiaries for the year 2004. During 2006, the IRS concluded its examination of the Company s federal income tax returns for the years 2000-2002. Tax issues for years 1995-1999 are pending in the U.S. Tax Court and the conclusion of those matters could impact tax years after 1999.

As of September 30, 2007, the IRS has proposed adjustments with respect to the timing of recognition of items of income and expense derived from the Company s credit card business in various tax years. The ultimate resolution of these issues is not expected to have a material effect on the Company s operations or financial condition. However, the Company anticipates that it is reasonably possible that a payment of up to $250 million, principally related to these timing issues, will be made within twelve months of the reporting date resulting in a significant reduction to the Company s liability for unrecognized tax benefits.

7

Table of Contents

Significant Accounting Policies

See the Company s Annual Report on Form 10-K for the year ended December 31, 2006, Item 8 Notes to Condensed Reported Financial Statements Note 1 Summary of Significant Accounting Policies for a summary of the Company s accounting policies. Refer also to the discussion below for accounting policies that may supplement or modify the discussion of accounting policies in the Company s Form 10-K for the year December 31, 2006.

Consumer Loan Securitizations

The Company primarily securitizes credit card loans, auto loans and installment loans. Securitization provides the Company with a significant source of liquidity and favorable capital treatment for securitizations accounted for as off-balance sheet arrangements. See Item 8 Notes to Condensed Reported Financial Statements Note 22 Off-Balance Sheet Securitizations in the Company s Form 10-K for the year ended December 31, 2006 for additional detail.

Loan securitization involves the transfer of a pool of loan receivables to a trust or other special purpose entity. The trust sells an undivided interest in the pool of loan receivables to third-party investors through the issuance of asset backed securities and distributes the proceeds to the Company as consideration for the loans transferred. The Company removes loans from the Reported Consolidated Balance Sheets for se