LAKELAND FINANCIAL CORP
Form 10-Q
November 08, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2006

OR

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

For the transition period from ___________ to ____________

LAKELAND FINANCIAL CORPORATION
(Exact name of registrant as specified in its charter)

Indiana	**0-11487**	**35-1559596**
(State or other jurisdiction Of incorporation)	(Commission File Number)	(IRS Employer Identification No.)

202 East Center Street, P.O. Box 1387, Warsaw, Indiana 46581-1387

(Address of principal executive offices)(Zip Code)

(574) 267-6144

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 [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-2 of the Exchange Act.

Large accelerated filer[ ] Accelerated filer [X] 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 [X]

Number of shares of common stock outstanding at October 31, 2006: 12,115,658

LAKELAND FINANCIAL CORPORATION

Form 10-Q Quarterly Report

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PART II.

PART 1

LAKELAND FINANCIAL CORPORATION

ITEM 1 FINANCIAL STATEMENTS

LAKELAND FINANCIAL CORPORATION

CONSOLIDATED BALANCE SHEETS

As of September 30, 2006 and December 31, 2005

(in thousands except for share data)

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	September 30, 2006 (Unaudited)	December 31, 2005
ASSETS		
Cash and due from banks	**$ 73,774**	$ 77,387
Short-term investments	**30,390**	5,292
Total cash and cash equivalents	**104,164**	82,679
Securities available for sale (carried at fair value)	**299,520**	290,935
Real estate mortgages held for sale	**1,422**	960
Loans, net of allowance for loan losses of $14,288 and $12,774	**1,316,897**	1,185,956
Land, premises and equipment, net	**25,136**	24,563
Bank owned life insurance	**20,337**	19,654
Accrued income receivable	**8,245**	7,416
Goodwill	**4,970**	4,970
Other intangible assets	**877**	1,034
Other assets	**18,098**	16,446
Total assets	**$ 1,799,666**	$ 1,634,613

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LAKELAND FINANCIAL CORPORATION

CONSOLIDATED BALANCE SHEETS

As of September 30, 2006 and December 31, 2005

(in thousands except for share data)

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	September 30, 2006 (Unaudited)	December 31, 2005
LIABILITIES AND STOCKHOLDERS' EQUITY		
Noninterest bearing deposits	**$ 245,420**	$ 247,605
Interest bearing deposits	**1,288,457**	1,018,640
Total deposits	**1,533,877**	1,266,245
Short-term borrowings		
Federal funds purchased	**0**	43,000
Securities sold under agreements to repurchase	**93,992**	91,071
U.S. Treasury demand notes	**1,820**	2,471
Other short-term borrowings	**0**	75,000
Total short-term borrowings	**95,812**	211,542
Accrued expenses payable	**11,522**	10,423
Other liabilities	**495**	2,095
Long-term borrowings	**45**	46
Subordinated debentures	**30,928**	30,928
Total liabilities	**1,672,679**	1,521,279
STOCKHOLDERS' EQUITY		
Common stock: 180,000,000 shares authorized ,no par value		
12,097,378 shares issued and 12,011,019 outstanding as of September 30, 2006		
11,972,108 shares issued and 11,894,684 outstanding as of December 31, 2005	**1,453**	1,453
Additional paid-in capital	**16,169**	14,287
Retained earnings	**113,471**	102,327
Accumulated other comprehensive loss	**(2,988)**	(3,814)
Treasury stock, at cost (2006-86,359 shares, 2005-77,424 shares)	**(1,118)**	(919)
Total stockholders' equity	**126,987**	113,334
Total liabilities and stockholders' equity	**$ 1,799,666**	$ 1,634,613

The accompanying notes are an integral part of these consolidated financial statements.

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LAKELAND FINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

For the Three Months and Nine Months Ended September 30, 2006 and 2005

(in thousands except for share and per share data)

(Unaudited)

(Page 1 of 2)

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
	2006	2005	**2006**	2005
NET INTEREST INCOME				
Interest and fees on loans				
Taxable	**$23,936**	$17,894	**$66,968**	$48,561
Tax exempt	**74**	47	**206**	132
Interest and dividends on securities				
Taxable	**2,463**	2,313	**7,461**	6,949
Tax exempt	**591**	585	**1,793**	1,759
Interest on short-term investments	**157**	83	**504**	184
Total interest income	**27,221**	20,922	**76,932**	57,585
Interest on deposits	**12,398**	6,609	**31,875**	16,139
Interest on borrowings				
Short-term	**1,167**	1,207	**4,363**	2,950
Long-term	**661**	572	**1,877**	1,607
Total interest expense	**14,226**	8,388	**38,115**	20,696
NET INTEREST INCOME	**12,995**	12,534	**38,817**	36,889
Provision for loan losses	**510**	659	**1,602**	1,779
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	**12,485**	11,875	**37,215**	35,110
NONINTEREST INCOME				
Wealth advisory and investment brokerage fees	**952**	742	**2,864**	2,261
Service charges on deposit accounts	**1,983**	1,860	**5,668**	5,112
Loan, insurance and service fees	**548**	480	**1,746**	1,442
Merchant card fee income	**661**	692	**1,809**	1,857
Other income	**476**	331	**1,496**	1,319
Net gains on sales of real estate mortgages held for sale	**137**	275	**467**	726
Net securities gains (losses)	**(14)**	0	**(68)**	0
Total noninterest income	**4,743**	4,380	**13,982**	12,717

(continued)

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LAKELAND FINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

For the Three Months and Nine Months Ended September 30, 2006 and 2005

(in thousands except for share and per share data)

(Unaudited)

(Page 2 of 2)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	**2006**	2005
NONINTEREST EXPENSE				
Salaries and employee benefits	**5,595**	5,051	**16,609**	15,224
Net occupancy expense	**680**	728	**1,901**	2,059
Equipment costs	**430**	468	**1,345**	1,476
Data processing fees and supplies	**611**	586	**1,754**	1,715
Credit card interchange	**465**	442	**1,211**	1,158
Other expense	**2,156**	2,080	**6,721**	6,384
Total noninterest expense	**9,937**	9,355	**29,541**	28,016
INCOME BEFORE INCOME TAX EXPENSE	**7,291**	6,900	**21,656**	19,811
Income tax expense	**2,561**	2,378	**7,494**	6,830
NET INCOME	**$4,730**	$4,522	**$14,162**	$12,981
Other comprehensive income/loss, net of tax:				
Unrealized gain/(loss) on available for sale securities	**3,106**	(1,552)	**826**	(1,793)
TOTAL COMPREHENSIVE INCOME	**$7,836**	$2,970	**$14,988**	$11,188
BASIC WEIGHTED AVERAGE COMMON SHARES	**12,084,244**	11,957,730	**12,054,663**	11,913,014
BASIC EARNINGS PER COMMON SHARE	**$0.39**	$0.38	**$1.17**	$1.09
DILUTED WEIGHTED AVERAGE COMMON SHARES	**12,388,372**	12,309,552	**12,366,453**	12,279,174
DILUTED EARNINGS PER COMMON SHARE	**$0.38**	$0.37	**$1.15**	$1.06

The accompanying notes are an integral part of these consolidated financial statements.

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LAKELAND FINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Nine Months Ended September 30, 2006 and 2005

(in thousands)

(Unaudited)

(Page 1 of 2)

	2006	2005
Cash flows from operating activities:		
Net income	**$ 14,162**	$ 12,981
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation	**1,241**	1,214
Provision for loan losses	**1,602**	1,779
Amortization of intangible assets	**157**	158
Amortization of loan servicing rights	**467**	449
Net change in loan servicing rights valuation allowance	**(64)**	(109)
Loans originated for sale	**(26,715)**	(34,192)
Net gain on sales of loans	**(466)**	(725)
Proceeds from sale of loans	**26,467**	34,114
Net (gain) loss on sale of premises and equipment	**(19)**	(74)
Net loss on sales of securities available for sale	**68**	0
Net securities amortization	**1,078**	2,003
Stock compensation expense	**141**	0
Earnings on life insurance	**(538)**	(494)
Net change:		
Accrued income receivable	**(829)**	(738)
Accrued expenses payable	**2,196**	2,417
Other assets	**(1,732)**	(815)
Other liabilities	**(1,600)**	(42)
Total adjustments	**1,454**	4,945
Net cash from operating activities	**15,616**	17,926
Cash flows from investing activities:		
Proceeds from sale of securities available for sale	**$ 21,616**	$ 0
Proceeds from maturities, calls and principal paydowns of securities available for sale	**38,681**	37,206
Purchases of securities available for sale	**(68,724)**	(44,653)
Purchase of life insurance	**(145)**	(131)
Net increase in total loans	**(132,614)**	(142,447)
Proceeds from sales of land, premises and equipment	**194**	591
Purchases of land, premises and equipment	**(1,989)**	(1,494)
Net cash from investing activities	**(142,981)**	(150,928)

(Continued)

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LAKELAND FINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Nine Months Ended September 30, 2006 and 2005

(in thousands)

(Unaudited)

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	2006	2005
Cash flows from financing activities:		
Net increase in total deposits	**267,632**	135,571
Net increase (decrease) in short-term borrowings	**(115,730)**	(40,996)
Payments on long-term borrowings	**(1)**	0
Dividends paid	**(4,394)**	(3,984)
Proceeds from stock option exercise	**1,542**	1,158
Purchase of treasury stock	**(199)**	(162)
Net cash from financing activities	**148,850**	91,587
Net change in cash and cash equivalents	**21,485**	(41,415)
Cash and cash equivalents at beginning of the period	**82,679**	103,858
Cash and cash equivalents at end of the period	**$ 104,164**	$ 62,443
Cash paid during the period for:		
Interest	**$ 36,276**	$ 18,971
Income taxes	**8,395**	6,620
Supplemental non-cash disclosures:		
Loans transferred to other real estate	**71**	0

The accompanying notes are an integral part of these consolidated financial statements.

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LAKELAND FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2006

(In thousands)

(Unaudited)

NOTE 1. BASIS OF PRESENTATION

This report is filed for Lakeland Financial Corporation (the Company) and its wholly-owned subsidiary, Lake City Bank (the Bank). All significant inter-company balances and transactions have been eliminated in consolidation. Also included is the Bank s wholly-owned subsidiary, LCB Investments Limited (LCB Investments).

The unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with instructions for Form 10-Q. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (all of which are normal and recurring in nature) considered necessary for a fair presentation have been included. Operating results for the three-month and nine-month periods ending September 30, 2006 are not necessarily indicative of the results that may be expected for the year ending December 31, 2006. The 2005 Lakeland Financial Corporation Annual Report on Form 10-K should be read in conjunction with these statements.

NOTE 2. STOCK COMPENSATION

Effective January 1, 2006, employee compensation expense under stock options is reported using Statement 123 (revised 2004), *Share-Based Payment.* Previously all awards were recorded under the intrinsic value method of APB Opinion No. 25 *Accounting for Stock Issued to Employees.* Statement 123(R) was adopted using the modified prospective method and no restatements were made to prior periods. The following tables provide comparative information on the effects of stock-based compensation expense on net income and earnings per share, as if Statement 123 had been applied for all periods.

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	Nine Months Ended	
	September 30,	
	2006	2005
Net income (in thousands) as reported	$ 14,162	$ 12,981
Deduct: stock based compensation expense determined under fair value based method	n/a	246
Pro forma net income	$ 14,162	$ 12,735
Basic earnings per common share as reported	$ 1.17	$ 1.09
Pro forma basic earnings per share	n/a	$ 1.07
Diluted earnings per share as reported	$ 1.15	$ 1.06
Pro forma diluted earnings per share	n/a	$ 1.04

	Three Months Ended	
	September 30,	
	2006	2005
Net income (in thousands) as reported	$ 4,730	$ 4,522
Deduct: stock based compensation expense determined under fair value based method	n/a	66
Pro forma net income	$ 4,730	$ 4,456
Basic earnings per common share as reported	$ 0.39	$ 0.38
Pro forma basic earnings per share	n/a	$ 0.38
Diluted earnings per share as reported	$ 0.38	$ 0.37
Pro forma diluted earnings per share	n/a	$ 0.36

There is no pro forma effect for the nine months and three months ended September 30, 2006 since stock based compensation was recorded under Statement 123(R) in 2006. Included in net income for the nine months ended September 30, 2006 was employee compensation expense of $141,000, net of tax of $57,000. Included in net income for the three months ended September 30, 2006 was employee compensation expense of $47,000, net of tax of $19,000.

Basic earnings per common share is based upon weighted-average common shares outstanding. Diluted earnings per share show the dilutive effect of additional common shares issueable.

The common shares outstanding for the stockholders equity section of the consolidated balance sheet at September 30, 2006 reflects the acquisition of 86,359 shares of Company common stock to offset a liability for a directors deferred compensation plan. These fully vested shares are treated as outstanding when computing the weighted-average common shares outstanding for the calculation of both basic and diluted earnings per share.

NOTE 3. LOANS

	September 30, 2006	December 31, 2005
Commercial and industrial loans	$ 944,616	$ 850,984
Agri-business and agricultural loans	125,146	113,574
Real estate mortgage loans	96,467	66,833
Real estate construction loans	5,954	7,987
Installment loans and credit cards	159,024	159,390
Subtotal	1,331,207	1,198,768
Less: Allowance for loan losses	(14,288)	(12,774)
Net deferred loan fees	(22)	(38)
Loans, net	$1,316,897	$1,185,956
Impaired loans	$ 14,898	$ 6,948
Non-performing loans	$ 15,413	$ 7,495
Allowance for loan losses to total loans	1.07%	1.07%

Changes in the allowance for loan losses are summarized as follows:

	Nine months ended September 30, 2006	2005
Balance at beginning of period	$ 12,774	$ 10,754
Provision for loan losses	1,602	1,779
Charge-offs	(176)	(410)
Recoveries	88	110
Net loans charged-off	(88)	(300)
Balance at end of period	$ 14,288	$ 12,233

NOTE 4. SECURITIES

The fair values of securities available for sale were as follows:

	September 30, 2006	December 31, 2005
U.S. Treasury securities	$ 965	$ 966
U.S. Government agencies	30,486	30,484
Mortgage-backed securities	212,999	206,596
State and municipal securities	55,070	52,889
Total	$ 299,520	$ 290,935

As of September 30, 2006, net unrealized losses on the total securities available for sale portfolio totaled $2.9 million. As of December 31, 2005, net unrealized losses on the total securities available for sale portfolio totaled $4.2 million. Management considers the unrealized losses to be market driven and no loss is expected to be realized unless the securities are sold. All of the securities are backed by the U.S. Government, government agencies, government sponsored agencies or are A rated or better, in the case of non-local municipal securities. None of the securities have call provisions (with the exception of the municipal securities) and payments as originally agreed are being received. There are no concerns of credit losses and there is nothing to indicate that full principal will not be received. The Company does not have a history of actively trading securities, but keeps the securities available for sale should liquidity or other needs develop that would warrant the sale of securities. While these securities are held in the available for sale portfolio, the current intent and ability is to hold them until a recovery in fair value or maturity.

NOTE 5. EMPLOYEE BENEFIT PLANS

Components of Net Periodic Benefit Cost

	Nine Months Ended September 30,			
	Pension Benefits		SERP Benefits	
	2006	2005	2006	2005
Service cost	$ 0	$ 0	$ 0	$ 0
Interest cost	108	112	57	60
Expected return on plan assets	(126)	(109)	(69)	(77)
Recognized net actuarial loss	33	28	39	33
Net pension expense	$ 15	$ 31	$ 27	$ 16

	Three Months Ended September 30, Pension Benefits		SERP Benefits	
	2006	2005	2006	2005
Service cost	$ 0	$ 0	$ 0	$ 0
Interest cost	36	37	19	20
Expected return on plan assets	(42)	(36)	(23)	(26)
Recognized net actuarial loss	11	9	13	12
Net pension expense	$ 5	$ 10	$ 9	$ 6

The Company previously disclosed in its financial statements for the year ended December 31, 2005, that it expected to contribute $229,000 to its pension plan and $68,000 to its SERP plan in 2006. As of September 30, 2006, $173,000 had been contributed to the pension plan and $68,000 to the SERP plan. The Company does not anticipate making any additional contributions to its pension plan or SERP plan during the remainder of 2006.

NOTE 6. NEW ACCOUNTING PRONOUNCEMENTS

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 158 (SFAS No. 158), Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106, and 132(R). SFAS No. 158 requires the recognition of the funded status of a benefit plan in the statement of financial position. The Statement also requires recognition in other comprehensive income of certain gains and losses that arise during the period but are deferred under current pension accounting rules, as well as modifies the timing of reporting. SFAS No. 158 provides recognition and disclosure elements to be effective as of the end of the fiscal year after December 15, 2006 and measurement elements to be effective for fiscal years ending after December 15, 2008. The Company is currently assessing the potential impact that the adoption of SFAS No. 158 will have on its financial statements.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108 (SAB No. 108), Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements. This SAB addresses how the effects of prior-year uncorrected misstatements should be considered when quantifying misstatements in current-year financial statements. SAB No. 108 requires registrants to quantify errors using both the balance sheet and income statement approaches and to evaluate whether either approach results in quantifying a misstatement as material in light of relevant quantitative and qualitative factors. When the effect of initial adoption is determined to be material, the SAB allows registrants to record that effect as a cumulative effect adjustment of beginning-of-year retained earnings. SAB No. 108 is effective for annual financial statements covering the first fiscal year ending after November 15, 2006. The Company is currently assessing the potential impact that the adoption of SAB No. 108 will have on its financial statements; the impact is not expected to be material.

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109. FIN 48 requires that realization of an uncertain income tax position be more likely than not before it can be recognized in the financial statements. Further, FIN 48 prescribes the benefit to be recorded in the financial statements as the amount most likely to be realized assuming a review by tax authorities having all relevant information and applying current conventions. FIN 48 also clarifies the financial statement classification of tax-related penalties and interest and sets forth new disclosures regarding unrecognized tax benefits. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company is currently evaluating the requirements of FIN 48 and the impact this interpretation may have on its financial statements.

NOTE 7. RECLASSIFICATIONS

Certain amounts appearing in the financial statements and notes thereto for prior periods have been reclassified to conform with the current presentation. The reclassification had no effect on net income or stockholders equity as previously reported.

Part 1

LAKELAND FINANCIAL CORPORATION

ITEM 2 - MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION

and

RESULTS OF OPERATIONS

September 30, 2006

OVERVIEW

Lakeland Financial Corporation is the holding company for Lake City Bank. The Company is headquartered in Warsaw, Indiana and operates 43 offices in 12 counties in northern Indiana. The Company earned $14.2 million for the first nine months of 2006, versus $13.0 million in the same period of 2005, an increase of 9.1%. The increase was driven by a $1.9 million increase in net interest income as well as an increase of $1.3 million in noninterest income. Offsetting these positive impacts was an increase of $1.5 million in noninterest expense. Basic earnings per share for the first nine months of 2006 were $1.17 per share versus $1.09 per share for the first nine months of 2005. Diluted earnings per share reflect the potential dilutive impact of stock options granted under the stock option plan. Diluted earnings per share for the first nine months of 2006 were $1.15 per share, versus $1.06 per share for the first nine months of 2005.

Net income for the third quarter of 2006 was $4.7 million, an increase of 4.6% versus $4.5 million for the comparable period of 2005. The increase was driven by a $461,000 increase in net interest income as well as a $363,000 increase in noninterest income. Offsetting these positive impacts was an increase of $582,000 in noninterest expense. Basic earnings per share for the third quarter of 2006 were $0.39 per share, versus $0.38 per share for the third quarter of 2005. Diluted earnings per share for the third quarter of 2006 were $0.38 per share, versus $0.37 per share for the third quarter of 2005.

RESULTS OF OPERATIONS

Net Interest Income

For the nine-month period ended September 30, 2006, net interest income totaled $38.8 million, an increase of 5.2%, or $1.9 million, versus the first nine months of 2005. Net interest income increased in the nine-month period of 2006 versus the comparable period of 2005, primarily due to a $197.8 million, or 14.5%, increase in average earning assets to $1.556 billion. For the three-month period ended September 30, 2006, net interest income totaled $13.0 million, an increase of 3.7%, or $461,000. This increase was driven by a $180.7 million, or 12.8%, increase in average earning assets.

Given the Company s mix of interest earning assets and interest bearing liabilities at September 30, 2006, the Company would generally be considered to have an asset sensitive balance sheet, although the current interest rate environment has countered the asset-sensitive nature of the balance sheet. This balance sheet structure would normally be expected to produce a stable or improving net interest margin in a rising rate environment. Despite this balance sheet structure and a rising rate environment during 2006 and 2005, the Company experienced net interest margin compression in the first nine months of 2006 versus the first nine months of 2005. Management attributes this compression primarily to a highly competitive deposit pricing environment that is having a negative impact on the net interest margin. In addition, the Company s mix of deposits has shifted to more reliance on certificates of deposits, which generally carry a higher interest rate cost than other types of interest bearing deposits. Also contributing to the erosion in net interest margin was the yield performance of the Company s investment portfolio, which is primarily composed of collateralized mortgage obligations and municipal securities. As a result of the flat yield curve, reinvestment rates have typically been substantially lower than those of the maturing security.

During the first nine months of 2006, total interest and dividend income increased by $19.3 million, or 33.6%, to $76.9 million, versus $57.6 million during the first nine months of 2005. During the third quarter of 2006, interest and dividend income increased by $6.3 million, or 30.1%, to $27.2 million, versus $20.9 million during the same quarter of 2005. These increases were primarily the result of general increases in interest rates, as well as an increase in average earning assets. The tax equivalent yield on average earning assets increased by 92 basis points to 6.7% for the nine-month period ended September 30, 2006 versus the same period of 2005. For the third quarter of 2006, the yield increased 89 basis points to 6.8%, versus 6.0% for the third quarter of 2005.

During the first nine months of 2006, loan interest income increased by $18.5 million, or 38.0%, to $67.2 million, versus $48.7 million during the first nine months of 2005. The increase was driven by a $187.1 million, or 17.6%, increase in average daily loan balances, as well as a 106 basis point increase in the tax equivalent yield on loans to 7.2%, versus 6.1% in the first nine months of 2005. During the third quarter of 2006, loan interest income increased $6.1 million, or 33.8% to $24.0 million versus $17.9 million during the third quarter of 2005. The increase was driven by a $173.5 million, or 15.6%, increase in average daily loan balances as well as a 101 basis point increase in the tax equivalent yield on loans, to 7.4%, versus 6.4% in the third quarter of 2005.

The average daily securities balances for the first nine months of 2006 increased $5.4 million, or 1.9%, to $292.3 million, versus $286.9 million for the same period of 2005. During the same periods, income from securities increased by $546,000, or 6.3%, to $9.3 million versus $8.7 million during the first nine months of 2005. The increase was primarily the result of a 14 basis point increase in the tax equivalent yield on securities, to 4.6% versus 4.5% in the first nine months of 2005. The average daily securities balances for the third quarter of 2006 increased $5.0 million, or 1.7%, to $292.9 million, versus $288.0 million, for the same period of 2005. During the third quarter of 2006, income from securities was $3.1 million, an increase of $156,000, or 5.4%, versus the third quarter of 2005. The increase was driven by the increase in average daily securities balances. The tax equivalent yield for the third quarter of 2006 was 4.5% compared to 4.4% for the third quarter of 2005.

Total interest expense increased $17.4 million, or 84.2%, to $38.1 million for the nine-month period ended September 30, 2006, from $20.7 million for the comparable period in 2005. The increase was primarily the result of a 126 basis point increase in the Company s daily cost of funds to 3.3%, versus 2.0% for the same period of 2005. Total interest expense increased $5.8 million, or 69.6%, to $14.2 million for the third quarter of 2006, versus $8.4 million for the third quarter of 2005. The increase was primarily the result of a 120 basis point increase in the Company s daily cost of funds to 3.6%, from 2.4% for the same period of 2005. Increases in total deposits also contributed to increases in total interest expense over the nine-month and three-month periods.

On an average daily basis, total deposits (including demand deposits) increased $217.6 million, or 19.0%, to $1.362 billion for the nine-month period ended September 30, 2006, versus $1.144 billion during the same period in 2005. The average daily balances for the third quarter of 2006 increased $233.7 million, or 19.6%, to $1.426 billion from $1.193 billion during the third quarter of 2005. On an average daily basis, non-interest bearing demand deposits increased to $219.9 million for the nine-month period ended September 30, 2006, versus $218.9 million for the same period in 2005. The average daily noninterest bearing demand deposit balances for the third quarter of 2006 were $219.8 million, versus $217.0 million for the third quarter of 2005. On an average daily basis, interest bearing transaction accounts increased $53.0 million, or 15.7%, to $389.7 million for the nine-month period ended September 30, 2006, versus the same period in 2005. Average daily interest bearing transaction accounts increased $88.3 million, or 27.3%, to $412.0 million for the third quarter of 2006, versus $323.7 million for the third quarter of 2005. When comparing the nine months ended September 30, 2006 with the same period of 2005, the average daily balance of time deposits, which pay a higher rate of interest compared to demand deposit and transaction accounts, increased $166.9 million, primarily as a result of increases in public fund deposits and brokered certificates of deposit. The rate paid on time deposit accounts increased 129 basis points to 4.5% for the nine-month period ended September 30, 2006, versus the same period in 2005. During the third quarter of 2006, the average daily balance of time deposits increased $146.0 million, and the rate paid increased 127 basis points to 4.8%, versus the third quarter of 2005.

Due to strong loan growth and additional relationship opportunities, the Company also continues to focus on public fund deposits as a core funding strategy. In addition, the Company has introduced brokered certificates of deposit to the funding mix as a result of loan growth. On an average daily basis, total brokered certificates of deposit increased $37.4 million to $55.2 million for the nine-month period ended September 30, 2006, versus $17.9 million for the same period in 2005. During the third quarter of 2006, average daily brokered certificates of deposit were $44.9 million, versus $49.1 million during the third quarter of 2005. On an average daily basis, total public fund certificates of deposit increased $60.5 million to $267.8 million for the nine-month period ended September 30, 2006, versus $207.3 million for the same period in 2005. During the third quarter of 2006, average daily public fund certificates of deposit were $296.9 million, versus $231.8 million during the third quarter of 2005.

Average daily balances of borrowings were $181.4 million during the nine months ended September 30, 2006, versus $209.3 million during the same period of 2005, and the rate paid on borrowings increased 170 basis points to 4.6%. During the third quarter of 2006, the average daily balances of borrowings decreased $59.1 million to $154.2 million, versus $213.3 million for the same period of 2005. The rate on borrowings increased 143 basis points to 4.7% for the third quarter of 2006 versus the third quarter of 2005. On an average daily basis, total deposits (including demand deposits) and purchased funds increased 14.0% and 12.4%, respectively, when comparing the nine-month and three-month periods ended September 30, 2006 versus the same periods in 2005. The following tables set forth consolidated information regarding average balances and rates:

DISTRIBUTION OF ASSETS, LIABILITIES AND STOCKHOLDERS EQUITY;
INTEREST RATES AND INTEREST DIFFERENTIAL
(in thousands of dollars)

	Nine Months Ended September 30,						
	2006				2005		
	Average Balance	Interest Income	Yield (1)		Average Balance	Interest Income	Yield (1)
ASSETS							
Earning assets:							
Loans:							
Taxable (2)(3)	$ 1,243,736	$ 66,968	7.20	%	$ 1,058,227	$ 48,561	6.14 %
Tax exempt (1)	5,958	245	5.50		4,416	172	5.21
Investments: (1)							
Available for sale	292,298	10,057	4.60		286,866	9,569	4.46
Short-term investments	10,608	392	4.94		4,761	83	1.49
Interest bearing deposits	3,268	112	4.58		3,838	101	3.52
Total earning assets	1,555,868	77,774	6.68	%	1,358,108	58,486	5.76 %
Nonearning assets:							
Cash and due from banks	58,854	0			54,439	0	
Premises and equipment	24,597	0			25,068	0	
Other nonearning assets	50,367	0			43,907	0	
Less allowance for loan loss losses	(13,453)	0			(11,403)	0	
Total assets	$ 1,676,233	$ 77,774			$ 1,470,119	$ 58,486	

(1) Tax exempt income was converted to a fully taxable equivalent basis at a 35 percent tax rate for 2006 and 2005. The tax equivalent rate for tax exempt loans and tax exempt securities acquired after January 1, 1983 included the TEFRA adjustment applicable to nondeductible interest expenses.

(2) Loan fees, which are immaterial in relation to total taxable loan interest income for the nine months ended September 30, 2006 and 2005, are included as taxable loan interest income.

(3) Nonaccrual loans are included in the average balance of taxable loans.

DISTRIBUTION OF ASSETS, LIABILITIES AND STOCKHOLDERS EQUITY;
INTEREST RATES AND INTEREST DIFFERENTIAL (Cont.)
(in thousands of dollars)

	Nine Months Ended September 30,					
	2006 Average Balance	Interest Expense	Yield	2005 Average Balance	Interest Expense	Yield
LIABILITIES AND STOCKHOLDERS EQUITY						
Interest bearing liabilities:						
Savings deposits	$ 68,426	$ 108	0.21 %	$ 71,668	$ 58	0.11 %
Interest bearing checking accounts	389,657	8,715	2.99	336,705	3,649	1.45
Time deposits:						
In denominations under $100,000	260,771	7,697	3.95	225,411	5,179	3.07
In denominations over $100,000	423,089	15,355	4.85	291,589	7,253	3.33
Miscellaneous short-term borrowings	150,434	4,363	3.88	168,365	2,950	2.34
Long-term borrowings	30,973	1,877	8.10	40,974	1,607	5.24
Total interest bearing liabilities	1,323,350	38,115	3.85 %	1,134,712	20,696	2.44 %
Noninterest bearing liabilities and stockholders equity:						
Demand deposits	219,925	0		218,925	0	
Other liabilities	13,340	0		9,697	0	
Stockholders equity	119,618	0		106,785	0	
Total liabilities and stockholders equity	$ 1,676,233	$ 38,115		$ 1,470,119	$ 20,696	
Net interest differential yield on average daily earning assets		$ 39,659	3.40 %		$ 37,790	3.72 %

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DISTRIBUTION OF ASSETS, LIABILITIES AND STOCKHOLDERS EQUITY;
INTEREST RATES AND INTEREST DIFFERENTIAL
(in thousands of dollars)

	Three Months Ended September 30,					
	2006			2005		
	Average Balance	Interest Income	Yield (1)	Average Balance	Interest Income	Yield (1)
ASSETS						
Earning assets:						
Loans:						
Taxable (2)(3)	$ 1,283,130	$ 23,936	7.40 %	$ 1,111,440	$ 17,894	6.39 %
Tax exempt (1)	6,264	88	5.57	4,426	62	5.60
Investments: (1)						