NBT BANCORP INC
Form 10-K
March 01, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-K

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE
SECURITIES EXCHANGE ACT OF 1934
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2006
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE
SECURITIES EXCHANGE ACT OF 1934
FOR THE TRANSITION PERIOD FROM ______ TO ______
COMMISSION FILE NUMBER: 0-14703

NBT BANCORP INC.
(Exact name of registrant as specified in its charter)

Delaware	**16-1268674**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

52 SOUTH BROAD STREET
NORWICH, NEW YORK 13815
(Address of principal executive office) (Zip Code)
(607) 337-2265 (Registrant’s telephone number, including area code)

Securities registered pursuant to section 12(b) of the Act: None
Securities registered pursuant to section 12(g) of the Act: Common Stock ($0. 01 par value per share)

Stock Purchase Rights Pursuant to Stockholders Rights Plan

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15 (d) of the Act. Yes o No x

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 o

Indicate by check mark if disclosure of delinquent filers pursuant to item 405 of Regulation S-K (Section 299.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant’s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K o.

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

Large accelerated filer x	Accelerated filer o	Non-accelerated filer o

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

Based upon the closing price of the registrant’s common stock as of June 30, 2006, the aggregate market value of the voting stock, common stock, par value, $0.01 per share, held by non-affiliates of the registrant is $755,900,535.

The number of shares of Common Stock outstanding as of February 15, 2007, was 34,344,022.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant’s definitive Proxy Statement for it’s Annual Meeting of Stockholders to be held on May 1, 2007 are incorporated by reference into Part III, Items 10, 11, 12, 13 and 14 of this Form 10-K.

NBT BANCORP INC.
FORM 10-K - Year Ended December 31, 2006

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PART I

* Information called for by Part III (Items 10 through 14) is incorporated by reference to the Registrant's Proxy Statement for the 2007 Annual Meeting of Stockholders.

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PART I

ITEM 1. BUSINESS

NBT Bancorp Inc. (the "Registrant" or the "Company") is a registered financial holding company incorporated in the state of Delaware in 1986, with its principal headquarters located in Norwich, New York. The Company, on a consolidated basis, at December 31, 2006 had assets of $5.1 billion and stockholders' equity of $403 million. The Registrant is the parent holding company of NBT Bank, N.A. (the Bank), NBT Financial Services, Inc. (NBT Financial), Hathaway Agency, Inc., CNBF Capital Trust I, NBT Statutory Trust I and NBT Statutory Trust II (see Note 12 to the Notes to Consolidated Financial Statements). Through the Bank and NBT Financial, the Company is focused on community banking operations. The Trusts were organized to raise additional regulatory capital and to provide funding for certain acquisitions. The Registrant's primary business consists of providing commercial banking and financial services to its customers in its market area. The principal assets of the Registrant are all of the outstanding shares of common stock of its direct subsidiaries, and its principal sources of revenue are the management fees and dividends it receives from the Bank and NBT Financial.

The Bank is a full service commercial bank formed in 1856, which provides a broad range of financial products to individuals, corporations and municipalities throughout the central and upstate New York and northeastern Pennsylvania market area. The Bank conducts business through two geographic operating divisions, NBT Bank and Pennstar Bank.

The NBT Bank division has 80 divisional offices and 109 automated teller machines (ATMs), located primarily in central and upstate New York. At December 31, 2006, NBT Bank had total loans and leases of $2.7 billion and total deposits of $3.0 billion.

The Pennstar Bank division has 38 divisional offices and 55 ATMs, located primarily in northeastern Pennsylvania. At December 31, 2006, Pennstar Bank had total loans and leases of $729.1 million and total deposits of $852.0 million.

The Bank has six operating subsidiaries, NBT Capital Corp., Pennstar Services Company, Broad Street Property Associates, Inc., NBT Services, Inc., Pennstar Realty Trust, and CNB Realty Trust. NBT Capital Corp., formed in 1998, is a venture capital corporation formed to assist young businesses to develop and grow in the markets we serve. Broad Street Property Associates, Inc. formed in 2004, is a property management company. NBT Services, Inc. formed in 2004, is the holding company of and has an 80% ownership interest in NBT Settlement Services, LLC. NBT Settlement Services, formed in 2004, provides title insurance products to individuals and corporations. Pennstar Realty Trust, formed in 2000, and CNB Realty Trust formed in 1998, are real estate investment trusts. Pennstar Services Company, formed in 2002, provides administrative and support services to the Pennstar Bank division of the Bank.

NBT Financial, formed in 1999, is the parent company of EPIC Advisors, Inc. ("EPIC"). EPIC, acquired in January 2005, is a full service 401(k) plan recordkeeping firm. During March 2005, NBT Financial sold M. Griffith, Inc., a registered securities broker-dealer offering financial and retirement planning as well as life, accident and health insurance.

CNBF Capital Trust I ("Trust I"), a Delaware statutory business trust formed in 1999 and NBT Statutory Trust I, a Delaware statutory business trust formed in 2005, for the purpose of issuing trust preferred securities and lending the proceeds to the Company. In connection with acquisition of CNB Bancorp, Inc. mentioned below, the Company formed NBT Statutory Trust II (“Trust II”) in February 2006 to fund the cash portion of the acquisition as well as to provide regulatory capital. The Company raised $51.5 million through Trust II in February 2006. The Company guarantees, on a limited basis, payments of distributions on the trust preferred securities and payments on redemption of the trust preferred securities. The Trusts are variable interest entities (VIEs) for which the Company is not the primary beneficiary, as defined in Financial Accounting Standards Board Interpretation (“FIN”) No. 46 “Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin No. 51 (Revised December 2003) (FIN 46R).” In accordance with FIN 46R, the accounts of the Trusts are not included in the Company’s consolidated financial statements. See the Company’s accounting policy related to consolidation in Note 1 — Summary of Significant Accounting Policies in the notes to consolidated financial statements included in Item 8 Financial Statements and Supplementary Data, which is located elsewhere in this report.

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On February 10, 2006, the Company acquired CNB Bancorp, Inc. ("CNB"), a bank holding company headquartered in Gloversville, New York. The acquisition was accomplished by merging CNB with and into the Company. By virtue of this acquisition, CNB's banking subsidiary, City National Bank and Trust Company, was merged with and into NBT Bank. City National Bank and Trust Company operated 9 full-service community banking offices - located in Fulton, Hamilton, Montgomery and Saratoga counties, with approximately $400 million in assets.

In connection with the Merger, the Company issued an aggregate of 2.1 million shares of Company common stock and $39 million in cash to the former holders of CNB common stock.

CNB nonqualified stock options, entitling holders to purchase CNB common stock outstanding, were cancelled on the closing date and such option holders received an option payment subject to the terms of the Merger Agreement. The total number of CNB nonqualified stock options that were canceled was 103,545, which resulted in a cash payment to option holders before any applicable federal or state withholding tax, of approximately $1.3 million. In accordance with the terms of the Merger Agreement, all outstanding CNB incentive stock options as of the effective date were assumed by the Company. At that time, there were 144,686 CNB incentive stock options that were exchanged for 237,278 replacement incentive stock options of the Company.

Based on the $22.42 per share closing price of the Company's common stock on February 10, 2006, the transaction is valued at approximately $88 million.

COMPETITION

The banking and financial services industry in New York and Pennsylvania generally, and in the Company's market areas specifically, is highly competitive. The increasingly competitive environment is a result primarily of changes in regulation, changes in technology and product delivery systems, additional financial service providers, and the accelerating pace of consolidation among financial services providers. The Company competes for loans and leases, deposits, and customers with other commercial banks, savings and loan associations, securities and brokerage companies, mortgage companies, insurance companies, finance companies, money market funds, credit unions, and other nonbank financial service providers. Many of these competitors are much larger in total assets and capitalization, have greater access to capital markets and offer a broader range of financial services than the Company. In order to compete with other financial services providers, the Company stresses the community nature of its banking operations and principally relies upon local promotional activities, personal relationships established by officers, directors, and employees with their customers, and specialized services tailored to meet the needs of the communities served.

SUPERVISION AND REGULATION

As a bank holding company, the Company is subject to extensive regulation, supervision, and examination by the Board of Governors of the Federal Reserve System ("FRS") as its primary federal regulator. The Company also has qualified for and elected to be registered with the FRS as a financial holding company. The Bank, as a nationally chartered bank, is subject to extensive regulation, supervision and examination by the Office of the Comptroller of the Currency ("OCC") as its primary federal regulator and, as to certain matters, by the FRS and the Federal Deposit Insurance Corporation ("FDIC").

The Company is subject to capital adequacy guidelines of the FRS. The guidelines apply on a consolidated basis and require bank holding companies to maintain a minimum ratio of Tier 1 capital to total average assets (or "leverage ratio") of 4%. For the most highly rated bank holding companies, the minimum ratio is 3%. The FRS capital adequacy guidelines also require bank holding companies to maintain a minimum ratio of Tier 1 capital to risk-weighted assets of 4% and a minimum ratio of qualifying total capital to risk-weighted assets of 8%. As of December 31, 2006, the

Company's leverage ratio was 7.57%, its ratio of Tier 1 capital to risk-weighted assets was 10.42%, and its ratio of qualifying total capital to risk-weighted assets was 11.67%. The FRS may set higher minimum capital requirements for bank holding companies whose circumstances warrant it, such as companies anticipating significant growth or facing unusual risks. The FRS has not advised the Company of any special capital requirement applicable to it.

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Any holding company whose capital does not meet the minimum capital adequacy guidelines is considered to be undercapitalized and is required to submit an acceptable plan to the FRS for achieving capital adequacy. Such a company's ability to pay dividends to its shareholders and expand its lines of business through the acquisition of new banking or nonbanking subsidiaries also could be restricted.

The Bank is subject to leverage and risk-based capital requirements and minimum capital guidelines of the OCC that are similar to those applicable to the Company. As of December 31, 2006, the Bank was in compliance with all minimum capital requirements. The Bank's leverage ratio was 7.16%, its ratio of Tier 1 capital to risk-weighted assets was 9.83%, and its ratio of qualifying total capital to risk-weighted assets was 11.09%.

Under FDIC regulations, no FDIC-insured bank can accept brokered deposits unless it is well capitalized, or is adequately capitalized and receives a waiver from the FDIC. In addition, these regulations prohibit any bank that is not well capitalized from paying an interest rate on brokered deposits in excess of three-quarters of one percentage point over certain prevailing market rates. As of December 31, 2006, the Bank's total brokered deposits were $208.6 million.

The Bank also is subject to substantial regulatory restrictions on its ability to pay dividends to the Company. Under OCC regulations, the Bank may not pay a dividend, without prior OCC approval, if the total amount of all dividends declared during the calendar year, including the proposed dividend, exceed the sum of its retained net income to date during the calendar year and its retained net income over the preceding two years. As of December 31, 2006, approximately $68.1 million was available for the payment of dividends without prior OCC approval. The Bank's ability to pay dividends also is subject to the Bank being in compliance with regulatory capital requirements. As indicated above, the Bank is currently in compliance with these requirements.

The OCC generally prohibits a depository institution from making any capital distributions (including payment of a dividend) or paying any management fee to its parent holding company if the depository institution would thereafter be undercapitalized. Undercapitalized institutions are subject to growth limitations and are required to submit a capital restoration plan. If a depository institution fails to submit an acceptable capital restoration plan, it is treated as if it is "significantly undercapitalized." Significantly undercapitalized depository institutions may be subject to a number of requirements and restrictions, including orders to sell sufficient voting stock to become "adequately capitalized," requirements to reduce total assets, and cessation of receipt of deposits from correspondent banks. "Critically undercapitalized" institutions are subject to the appointment of a receiver or conservator.

The deposits of the Bank are insured up to regulatory limits by the FDIC. The Federal Deposit Insurance Reform Act of 2005, which was signed into law on February 8, 2006, gave the FDIC increased flexibility in assessing premiums on banks and savings associations, including the Bank, to pay for deposit insurance and in managing its deposit insurance reserves. The FDIC has adopted regulations to implement its new authority. Under these regulations, all insured depository institutions are placed into one of four risk categories. Approximately 95% of all insured institutions, including the Bank, are in Risk Category I, the most favorable category. Within this category, all insured institutions pay a base rate assessment of 5 basis points on all insured deposits (which rate may be adjusted annually by the FDIC by up to 3 basis points without public comment) and an additional assessment up to 2 basis points based on the risk of loss to the Depository Insurance Fund ("DIF") posed by the particular institution. For institutions such as the Bank, which do not have a long-term public debt rating, the individual risk assessment is based on its supervisory ratings and certain financial ratios and other measurements of its financial condition. For institutions that have a long-term public debt rating, the individual risk assessment is based on its supervisory ratings and its debt rating. The new law became effective on January 1, 2007, and the first premiums, payable quarterly after the end of each quarter, are payable by June 30, 2007. The reform legislation also provided a credit to all insured depository institutions, based on the amount of their insured deposits at year-end 1996, that may be used as an offset to the premiums that are assessed. The Bank estimates that it will receive full, which will eliminate its 2007 deposit insurance assessment.

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The Federal Deposit Insurance Act provides for additional assessments to be imposed on insured depository institutions to pay for the cost of Financing Corporation (“FICO”) funding. The FICO assessments are adjusted quarterly to reflect changes in the assessment base of the DIF and do not vary depending upon a depository institution’s capitalization or supervisory evaluation. During 2006, FDIC assessments for purposes of funding FICO bond obligations ranged from an annualized $0.0132 per $100 of deposits for the first quarter of 2006 to $0.0124 per $100 of deposits for the fourth quarter of 2006. The Bank paid $0.4 million of FICO assessments in 2006. For the first quarter of 2007, the FICO assessment rate is $0.0122 per $100 of deposits.

Transactions between the Bank and any of its affiliates, including the Company, are governed by sections 23A and 23B of the Federal Reserve Act and FRS regulations thereunder. An “affiliate” of a bank is any company or entity that controls, is controlled by, or is under common control with the bank. A subsidiary of a bank that is not also a depository institution is not treated as an affiliate of the bank for purposes of sections 23A and 23B, unless the subsidiary is also controlled through a non-bank chain of ownership by affiliates or controlling shareholders of the bank, the subsidiary is a financial subsidiary that operates under the expanded authority granted to national banks under the Gramm-Leach-Bliley Act (“GLB Act”), or the subsidiary engages in other activities that are not permissible for a bank to engage in directly (except insurance agency subsidiaries). Generally, sections 23A and 23B are intended to protect insured depository institutions from suffering losses arising from transactions with non-insured affiliates, by limiting the extent to which a bank or its subsidiaries may engage in covered transactions with any one affiliate and with all affiliates of the bank in the aggregate, and requiring that such transactions be on terms that are consistent with safe and sound banking practices.

On October 13, 2006, the Financial Services Regulatory Relief Act of 2006 was signed into law. This Act permits a financial holding company, such as the Company, to increase cross-marketing between its banking subsidiaries, such as the Bank, and any commercial companies in which it may invest pursuant to its merchant banking authority under the GLB Act. The Act also directs the FRS and the SEC to engage in joint rulemaking to clarify that traditional banking activities involving some elements of securities brokerage activities may be performed by banks without SEC supervision. A proposed rule was issued for public comment on December 18, 2006. Other provisions of this Act increase parity between banks and thrifts with regard to certain powers, accounting practices, and lending limits, and may increase competition between them.

Under the GLB Act, a financial holding company may engage in certain financial activities that a bank holding company may not otherwise engage in under the Bank Holding Company Act (“BHC Act”). In addition to engaging in banking and activities closely related to banking as determined by the FRS by regulation or order prior to November 11, 1999, a financial holding company may engage in activities that are financial in nature or incidental to financial activities, or activities that are complementary to a financial activity and do not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally.

The GLB Act requires all financial institutions, including the Company and the Bank, to adopt privacy policies, restrict the sharing of nonpublic customer data with nonaffiliated parties at the customer’s request, and establish procedures and practices to protect customer data from unauthorized access. In addition, the Fair and Accurate Credit Transactions Act of 2003 (“FACT Act”) includes many provisions concerning national credit reporting standards, and permits consumers, including customers of the Company, to opt out of information sharing among affiliated companies for marketing purposes. The FACT Act also requires banks and other financial institutions to notify their customers if they report negative information about them to a credit bureau or if they are granted credit on terms less favorable than those generally available. The FRS and the Federal Trade Commission have extensive rulemaking authority under the FACT Act, and the Company and the Bank are subject to these provisions. The Company has developed policies and procedures for itself and its subsidiaries, including the Bank, and believes it is in compliance with all privacy, information sharing, and notification provisions of the GLB Act and the FACT Act.

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Periodic disclosures by companies in various industries of the loss or theft of computer-based nonpublic customer information have led several members of Congress to call for the adoption of national standards for the safeguarding of such information and the disclosure of security breaches. Several committees of both houses of Congress have discussed plans to conduct hearings on data security and related issues.

Under Title III of the USA PATRIOT Act, also known as the International Money Laundering Abatement and Anti-Terrorism Financing Act of 2001, all financial institutions, including the Company and the Bank, are required in general to identify their customers, adopt formal and comprehensive anti-money laundering programs, scrutinize or prohibit altogether certain transactions of special concern, and be prepared to respond to inquiries from U.S. law enforcement agencies concerning their customers and their transactions. The USA PATRIOT Act also encourages information-sharing among financial institutions, regulators, and law enforcement authorities by providing an exemption from the privacy provisions of the GLB Act for financial institutions that comply with this provision. The effectiveness of a financial institution in combating money laundering activities is a factor to be considered in any application submitted by the financial institution under the Bank Merger Act, which applies to the Bank, or the BHC Act, which applies to the Company. Failure of a financial institution to maintain and implement adequate programs to combat money laundering and terrorist financing, or to comply with all of the relevant laws or regulations, could have serious legal, financial and reputational consequences for the institution. As of December 31, 2006, the Company and the Bank believe they are in compliance with the USA PATRIOT Act and regulations thereunder.

The Sarbanes-Oxley Act ("SOA") implemented a broad range of measures to increase corporate responsibility, enhance penalties for accounting and auditing improprieties at publicly traded companies, and protect investors by improving the accuracy and reliability of corporate disclosures pursuant to federal securities laws. SOA applies generally to companies that have securities registered under the Exchange Act, including publicly-held bank holding companies such as the Company. It includes very specific additional disclosure requirements and new corporate governance rules, requires the SEC and securities exchanges to adopt extensive additional disclosure, corporate governance and other related rules, and mandates further studies of certain issues by the SEC and the Comptroller General. SOA represents significant federal involvement in matters traditionally left to state regulatory systems, such as the regulation of the accounting profession, and to state corporate law, such as the relationship between a board of directors and management and between a board of directors and its committees. In addition, the federal banking regulators have adopted generally similar requirements concerning the certification of financial statements by bank officials.

Home mortgage lenders, including banks, are required under the Home Mortgage Disclosure Act to make available to the public expanded information regarding the pricing of home mortgage loans, including the "rate spread" between the interest rate on loans and certain Treasury securities and other benchmarks. The availability of this information has led to increased scrutiny of higher-priced loans at all financial institutions to detect illegal discriminatory practices and to the initiation of a limited number of investigations by federal banking agencies and the U.S. Department of Justice. The Company has no information that it or its affiliates is the subject of any investigation.

EMPLOYEES

At December 31, 2006, the Company had 1,314 full-time equivalent employees. The Company's employees are not presently represented by any collective bargaining group. The Company considers its employee relations to be good.

AVAILABLE INFORMATION

The Company’s website is http://www.nbtbancorp.com. The Company makes available free of charge through its website, its annual reports on Form 10-K; quarterly reports on Form 10-Q; current reports on Form 8-K; and any amendments to those reports led or furnished pursuant to the Securities Exchange Act of 1934 as soon as reasonably practicable after such material is electronically filed with, or furnished to the SEC. The reference to our website does not constitute incorporation by reference of the information contained in the website and should not be considered part of this document.

ITEM 1A. RISK FACTORS

There are risks inherent to the Company’s business. The material risks and uncertainties that management believes affect the Company are described below. The risks and uncertainties described below are not the only ones facing the Company. Additional risks and uncertainties that management is not aware of or focused on or that management currently deems immaterial may also impair the Company’s business operations. This report is qualified in its entirety by these risk factors. If any of the following risks actually occur, the Company’s financial condition and results of operations could be materially and adversely affected.

The Company is Subject to Interest Rate Risk

The Company’s earnings and cash flows are largely dependent upon its net interest income. Net interest income is the difference between interest income earned on interest-earning assets such as loans and securities and interest expense paid on interest-bearing liabilities such as deposits and borrowed funds. Interest rates are highly sensitive to many factors that are beyond the Company’s control, including general economic conditions and policies of various governmental and regulatory agencies and, in particular, the Board of Governors of the Federal Reserve System. Changes in monetary policy, including changes in interest rates, could influence not only the interest the Company receives on loans and securities and the amount of interest it pays on deposits and borrowings, but such changes could also affect (i) the Company’s ability to originate loans and obtain deposits, (ii) the fair value of the Company’s financial assets and liabilities, and (iii) the average duration of the Company’s mortgage-backed securities portfolio. If the interest rates paid on deposits and other borrowings increase at a faster rate than the interest rates received on loans and other investments, the Company’s net interest income, and therefore earnings, could be adversely affected. Earnings could also be adversely affected if the interest rates received on loans and other investments fall more quickly than the interest rates paid on deposits and other borrowings.

Although management believes it has implemented effective asset and liability management strategies to reduce the potential effects of changes in interest rates on the Company’s results of operations, any substantial, unexpected, prolonged change in market interest rates could have a material adverse effect on the Company’s financial condition and results of operations. See the section captioned “Net Interest Income” in Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations and the section captioned “Impact of Inflation and Changing Prices” in Item 7A. Quantitative and Qualitative Disclosure About Market Risk located elsewhere in this report for further discussion related to the Company’s management of interest rate risk.

The Company is Subject to Lending Risk

There are inherent risks associated with the Company’s lending activities. These risks include, among other things, the impact of changes in interest rates and changes in the economic conditions in the markets where the Company operates as well as those across the States of New York and Pennsylvania, as well as the entire United States. Increases in interest rates and/or weakening economic conditions could adversely impact the ability of borrowers to repay outstanding loans or the value of the collateral securing these loans. The Company is also subject to various laws and regulations that affect its lending activities. Failure to comply with applicable laws and regulations could subject the Company to regulatory enforcement action that could result in the assessment of significant civil money penalties against the Company.

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As of December 31, 2006, approximately 43% of the Company's loan and lease portfolio consisted of commercial, agricultural, construction and commercial real estate loans. These types of loans are generally viewed as having more risk of default than residential real estate loans or consumer loans. These types of loans are also typically larger than residential real estate loans and consumer loans. Because the Company's loan portfolio contains a significant number of commercial and industrial, construction and commercial real estate loans with relatively large balances, the deterioration of one or a few of these loans could cause a significant increase in nonperforming loans. An increase in nonperforming loans could result in a net loss of earnings from these loans, an increase in the provision for loan losses and an increase in loan charge-offs, all of which could have a material adverse effect on the Company's financial condition and results of operations. See the section captioned "Loans and Leases and Corresponding Interest and Fees on Loans" in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations located elsewhere in this report for further discussion related to commercial and industrial, construction and commercial real estate loans.

The Company's Allowance For Loan and Lease Losses May Be Insufficient

The Company maintains an allowance for loan and lease losses, which is an allowance established through a provision for loan and lease losses charged to expense, that represents management's best estimate of probable losses that have been incurred within the existing portfolio of loans and leases. The allowance, in the judgment of management, is necessary to reserve for estimated loan and lease losses and risks inherent in the loan and lease portfolio. The level of the allowance reflects management's continuing evaluation of industry concentrations; specific credit risks; loan loss experience; current loan and lease portfolio quality; present economic, political and regulatory conditions and unidentified losses inherent in the current loan portfolio. The determination of the appropriate level of the allowance for loan and lease losses inherently involves a high degree of subjectivity and requires the Company to make significant estimates of current credit risks and future trends, all of which may undergo material changes. Changes in economic conditions affecting borrowers, new information regarding existing loans, identification of additional problem loans and other factors, both within and outside of the Company's control, may require an increase in the allowance for loan losses. In addition, bank regulatory agencies periodically review the Company's allowance for loan losses and may require an increase in the provision for loan losses or the recognition of further loan charge-offs, based on judgments different than those of management. In addition, if charge-offs in future periods exceed the allowance for loan and lease losses, the Company will need additional provisions to increase the allowance for loan and lease losses. These increases in the allowance for loan and lease losses will result in a decrease in net income and, possibly, capital, and may have a material adverse effect on the Company's financial condition and results of operations. See the section captioned "Risk Management - Credit Risk" in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations located elsewhere in this report for further discussion related to the Company's process for determining the appropriate level of the allowance for loan and losses.

The Company's Profitability Depends Significantly on Economic Conditions in Upstate New York and Northeastern Pennsylvania

The Company's success depends primarily on the general economic conditions of upstate New York and northeastern Pennsylvania and the specific local markets in which the Company operates. Unlike larger national or other regional banks that are more geographically diversified, the Company provides banking and financial services to customers primarily in the upstate New York areas of Norwich, Oneonta, Amsterdam-Gloversville, Albany, Binghamton, Utica-Rome, Plattsburg, and Ogdensburg-Massena and northeastern Pennsylvania areas of Scranton, Wilkes-Barre and East Stroudsburg. The local economic conditions in these areas have a significant impact on the demand for the Company's products and services as well as the ability of the Company's customers to repay loans, the value of the collateral securing loans and the stability of the Company's deposit funding sources. A significant decline in general economic conditions, caused by inflation, recession, acts of terrorism, outbreak of hostilities or other international or domestic occurrences, unemployment, changes in securities markets or other factors could impact these local economic conditions and, in turn, have a material adverse effect on the Company’s financial condition and results of operations.

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The Company Operates In a Highly Competitive Industry and Market Area

The Company faces substantial competition in all areas of its operations from a variety of different competitors, many of which are larger and may have more financial resources. Such competitors primarily include national, regional, and community banks within the various markets the Company operates. Additionally, various out-of-state banks continue to enter or have announced plans to enter the market areas in which the Company currently operates. The Company also faces competition from many other types of financial institutions, including, without limitation, savings and loans, credit unions, finance companies, brokerage firms, insurance companies, factoring companies and other financial intermediaries. The financial services industry could become even more competitive as a result of legislative, regulatory and technological changes and continued consolidation. Banks, securities firms and insurance companies can merge under the umbrella of a financial holding company, which can offer virtually any type of financial service, including banking, securities underwriting, insurance (both agency and underwriting) and merchant banking. Also, technology has lowered barriers to entry and made it possible for non-banks to offer products and services traditionally provided by banks, such as automatic transfer and automatic payment systems. Many of the Company's competitors have fewer regulatory constraints and may have lower cost structures. Additionally, due to their size, many competitors may be able to achieve economies of scale and, as a result, may offer a broader range of products and services as well as better pricing for those products and services than the Company can. The Company's ability to compete successfully depends on a number of factors, including, among other things:

- The ability to develop, maintain and build upon long-term customer relationships based on top quality service, high ethical standards and safe, sound assets.
- The ability to expand the Company's market position.
- The scope, relevance and pricing of products and services offered to meet customer needs and demands.
- The rate at which the Company introduces new products and services relative to its competitors.
- Customer satisfaction with the Company's level of service.
- Industry and general economic trends.

Failure to perform in any of these areas could significantly weaken the Company's competitive position, which could adversely affect the Company's growth and profitability, which, in turn, could have a material adverse effect on the Company's financial condition and results of operations.

The Company Is Subject To Extensive Government Regulation and Supervision

The Company, primarily through NBT Bank and certain non-bank subsidiaries, is subject to extensive federal regulation and supervision. Banking regulations are primarily intended to protect depositors' funds, federal deposit insurance funds and the banking system as a whole, not shareholders. These regulations affect the Company's lending practices, capital structure, investment practices, dividend policy and growth, among other things. Congress and federal regulatory agencies continually review banking laws, regulations and policies for possible changes. Changes to statutes, regulations or regulatory policies, including changes in interpretation or implementation of statutes, regulations or policies, could affect the Company in substantial and unpredictable ways. Such changes could subject the Company to additional costs, limit the types of financial services and products the Company may offer and/or increase the ability of non-banks to offer competing financial services and products, among other things. Failure to comply with laws, regulations or policies could result in sanctions by regulatory agencies, civil money penalties and/or reputation damage, which could have a material adverse effect on the Company's business, financial condition and results of operations. While the Company has policies and procedures designed to prevent any such violations, there can be no assurance that such violations will not occur. See the section captioned "Supervision and Regulation" in Item 1., which is located elsewhere in this report.

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The Company's Controls and Procedures May Fail or Be Circumvented

Management regularly reviews and updates the Company's internal controls, disclosure controls and procedures, and corporate governance policies and procedures. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of the Company's controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on the Company's business, results of operations and financial condition.

New Lines of Business or New Products and Services May Subject The Company to Additional Risks

From time to time, the Company may implement new lines of business or offer new products and services within existing lines of business. There are substantial risks and uncertainties associated with these efforts, particularly in instances where the markets are not fully developed. In developing and marketing new lines of business and/or new products and services the Company may invest significant time and resources. Initial timetables for the introduction and development of new lines of business and/or new products or services may not be achieved and price and profitability targets may not prove feasible. External factors, such as compliance with regulations, competitive alternatives, and shifting market preferences, may also impact the successful implementation of a new line of business or a new product or service. Furthermore, any new line of business and/or new product or service could have a significant impact on the effectiveness of the Company's system of internal controls. Failure to successfully manage these risks in the development and implementation of new lines of business or new products or services could have a material adverse effect on the Company's business, results of operations and financial condition.

The Company Relies on Dividends From Its Subsidiaries For Most Of Its Revenue

NBT is a separate and distinct legal entity from its subsidiaries. It receives substantially all of its revenue from dividends from its subsidiaries. These dividends are the principal source of funds to pay dividends on the Company's common stock and interest and principal on the Company's debt. Various federal and/or state laws and regulations limit the amount of dividends that NBT Bank may pay to NBT. Also, NBT's right to participate in a distribution of assets upon a subsidiary's liquidation or reorganization is subject to the prior claims of the subsidiary's creditors. In the event NBT Bank is unable to pay dividends to NBT, NBT may not be able to service debt, pay obligations or pay dividends on the Company's common stock.

The inability to receive dividends from NBT Bank could have a material adverse effect on the Company's business, financial condition and results of operations. See the section captioned "Supervision and Regulation" in Item 1. Business and Note 15 — Stockholders' Equity in the notes to consolidated financial statements included in Item 8. Financial Statements and Supplementary Data, which are located elsewhere in this report.

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The Company May Not Be Able To Attract and Retain Skilled People

The Company's success depends, in large part, on its ability to attract and retain key people. Competition for the best people in most activities engaged in by the Company can be intense and the Company may not be able to hire people or to retain them. The unexpected loss of services of one or more of the Company's key personnel could have a material adverse impact on the Company's business because of their skills, knowledge of the Company's market, years of industry experience and the difficulty of promptly finding qualified replacement personnel.

The Company's Information Systems May Experience An Interruption Or Breach In Security

The Company relies heavily on communications and information systems to conduct its business. Any failure, interruption or breach in security of these systems could result in failures or disruptions in the Company's customer relationship management, general ledger, deposit, loan and other systems. While the Company has policies and procedures designed to prevent or limit the effect of the failure, interruption or security breach of its information systems, there can be no assurance that any such failures, interruptions or security breaches will not occur or, if they do occur, that they will be adequately addressed. The occurrence of any failures, interruptions or security breaches of the Company's information systems could damage the Company's reputation, result in a loss of customer business, subject the Company to additional regulatory scrutiny, or expose the Company to civil litigation and possible financial liability, any of which could have a material adverse effect on the Company's financial condition and results of operations.

The Company Continually Encounters Technological Change

The financial services industry is continually undergoing rapid technological change with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and to reduce costs. The Company's future success depends, in part, upon its ability to address the needs of its customers by using technology to provide products and services that will satisfy customer demands, as well as to create additional efficiencies in the Company's operations. Many of the Company's competitors have substantially greater resources to invest in technological improvements. The Company may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to its customers. Failure to successfully keep pace with technological change affecting the financial services industry could have a material adverse impact on the Company's business and, in turn, the Company's financial condition and results of operations.

Severe Weather, Natural Disasters, Acts Of War Or Terrorism and Other External Events Could Significantly Impact The Company's Business

Severe weather, natural disasters, acts of war or terrorism and other adverse external events could have a significant impact on the Company's ability to conduct business. Such events could affect the stability of the Company's deposit base, impair the ability of borrowers to repay outstanding loans, impair the value of collateral securing loans, cause significant property damage, result in loss of revenue and/or cause the Company to incur additional expenses. Although management has established disaster recovery policies and procedures, the occurrence of any such event could have a material adverse effect on the Company's business, which, in turn, could have a material adverse effect on the Company's financial condition and results of operations.

The Company's Articles Of Incorporation, By-Laws and Stockholder Rights Plan As Well As Certain Banking Laws May Have An Anti-Takeover Effect

Provisions of the Company's articles of incorporation and by-laws, federal banking laws, including regulatory approval requirements, and the Company's stock purchase rights plan could make it more difficult for a third party to acquire the Company, even if doing so would be perceived to be beneficial to the Company's stockholders. The combination of these provisions effectively inhibits a non-negotiated merger or other business combination, which, in turn, could adversely affect the market price of the Company's common stock.

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ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

The Company's headquarters are located at 52 South Broad Street, Norwich, New York 13815. The Company operated the following number of community banking branches and automated teller machines (ATMs) as of December 31, 2006:

County	Branches	ATMs
NBT Bank Division		
New York		
Albany County	3	4
Broome County	7	12
Chenango County	11	13
Clinton County	3	2
Delaware County	5	6
Essex County	3	6
Franklin County	1	1
Fulton County	7	12
Greene County	—	1
Hamilton County	1	1
Herkimer County	2	1
Montgomery County	7	6
Oneida County	6	11
Otsego County	9	16
Saratoga County	4	6
Schenectady County	1	1
Schoharie County	4	3
St. Lawrence County	5	6
Tioga County	1	1

County	Branches	ATMs
Pennstar Bank Division		
Pennsylvania		
Lackawanna County	18	26
Luzerne County	4	8
Monroe County	4	5
Pike County	3	4
Susquehanna County	6	8
Wayne County	3	4

The Company leases fifty four of the above listed branches from third parties under terms and conditions considered by management to be equitable to the Company. The Company owns all other banking premises. The Company believes that its offices are sufficient for its present operations. All automated teller machines are owned.

ITEM 3. LEGAL PROCEEDINGS

There are no material pending legal proceedings, other than ordinary routine litigation incidental to the business, to which the Company or any of its subsidiaries is a party or of which their property is the subject.

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ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON STOCK AND RELATED STOCKHOLDER MATTERS, AND ISSUER REPURCHASES OF EQUITY SECURITIES

The common stock of NBT Bancorp Inc. ("Common Stock") is quoted on the Nasdaq Stock Market National Market Tier under the symbol "NBTB." The following table sets forth the market prices and dividends declared for the Common Stock for the periods indicated:

	High	Low	Dividend
2005			
1st quarter	$ 23.79	$ 20.75	$ 0.19
2nd quarter	25.50	22.79	0.19
3rd quarter	24.15	20.10	0.19
4th quarter	25.66	21.48	0.19
2006			
1st quarter	**$ 23.90**	**$ 21.02**	**$ 0.19**
2nd quarter	**23.24**	**21.03**	**0.19**
3rd quarter	**24.57**	**21.44**	**0.19**
4th quarter	**26.47**	**22.36**	**0.19**

The closing price of the Common Stock on February 15, 2007 was $24.35.

As of February 15, 2007, there were 7,289 shareholders of record of Company common stock.

Stock Repurchases

The table below sets forth the information with respect to purchases made by the Company (as defined in Rule 10b-18(a)(3) under the Securities Exchange Act of 1934), of our common stock during the quarter ended December 31, 2006:

Period	Total Number of Shares Purchased	Average Price Paid Per share	Total Number of Shares Purchased As Part of Publicly Announced Plans	Maximum Number of Shares That May Yet Be Purchased Under the Plans (1)
10/1/06 - 10/31/06	-	-	-	737,147
11/1/06 - 11/30/06	-	-	-	737,147
12/1/06 - 12/31/06	-	-	-	737,147
Total	-	-		737,147

(1)

On January 23, 2006, NBT announced that the NBT Board of Directors approved a new repurchase program whereby NBT is authorized to repurchase up to an additional 1,000,000 shares (approximately 3%) of its outstanding common stock from time to time as market conditions warrant in open market and privately negotiated transactions. At that time, there were 503,151 shares remaining under a previous authorization that was authorized on January 24, 2005 and combined with the new repurchase program. As of December 31, 2006, there were 737,147 shares available for repurchase under the Plans.

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Performance Graph

The following graph compares the cumulative total stockholder return (i.e., price change, reinvestment of cash dividends and stock dividends received) on our common stock against the cumulative total return of the NASDAQ Stock Market (U.S. Companies) Index and the Index for NASDAQ Financial Stocks. The stock performance graph assumes that $100 was invested on December 31, 2001. The graph further assumes the reinvestment of dividends into additional shares of the same class of equity securities at the frequency with which dividends are paid on such securities during the relevant fiscal year. The yearly points marked on the horizontal axis correspond to December 31 of that year. We calculate each of the referenced indices in the same manner. All are market-capitalization-weighted indices, so companies judged by the market to be more important (i.e., more valuable) count for more in all indices.

Dividends

We depend primarily upon dividends from our subsidiaries for a substantial part of our revenue. Accordingly, our ability to pay dividends depends primarily upon the receipt of dividends or other capital distributions from our subsidiaries. Payment of dividends to the Company from the Bank is subject to certain regulatory and other restrictions. Under OCC regulations, the Bank may pay dividends to the Company without prior regulatory approval so long as it meets its applicable regulatory capital requirements before and after payment of such dividends and its total dividends do not exceed its net income to date over the calendar year plus retained net income over the preceding two years. At December 31, 2006, the Bank was in compliance with all applicable minimum capital requirements and had the ability to pay dividends of $68.1 million to the Company without the prior approval of the OCC.

If the capital of the Company is diminished by depreciation in the value of its property or by losses, or otherwise, to an amount less than the aggregate amount of the capital represented by the issued and outstanding stock of all classes having a preference upon the distribution of assets, no dividends may be paid out of net profits until the deficiency in the amount of capital represented by the issued and outstanding stock of all classes having a preference upon the distribution of assets has been repaired. See the section captioned “Supervision and Regulation” in Item 1 and Note 15 - Stockholders Equity in the notes to consolidated financial statements in included in Item 8. Financial Statements and Supplementary Data, which are located elsewhere in this report.

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ITEM 6. SELECTED FINANCIAL DATA

The following summary of financial and other information about the Company is derived from the Company's audited consolidated financial statements for each of the five fiscal years ended December 31, 2006 and should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the Company's consolidated financial statements and accompanying notes, included elsewhere in this report:

	Year ended December 31,				
(In thousands, except per share data)	**2006**	2005	2004	2003	2002
Interest, fee and dividend income	**$ 288,842**	$ 236,367	$ 210,179	$ 207,298	$ 227,222
Interest expense	**125,009**	78,256	59,692	62,874	80,402
Net interest income	**163,833**	158,111	150,487	144,424	146,820
Provision for loan and lease losses	**9,395**	9,464	9,615	9,111	9,073
Noninterest income excluding securities (losses) gains	**49,504**	43,785	40,673	37,603	31,934
Securities (losses) gains, net	**(875)**	(1,236)	216	175	(413)
Other noninterest expense	**122,966**	115,305	109,777	104,517	102,455
Income before income taxes	**80,101**	75,891	71,984	68,574	66,813
Net income	**55,947**	52,438	50,047	47,104	44,999
Per common share					
Basic earnings	**$ 1.65**	$ 1.62	$ 1.53	$ 1.45	$ 1.36
Diluted earnings	**1.64**	1.60	1.51	1.43	1.35
Cash dividends paid	**0.76**	0.76	0.74	0.68	0.68
Book value at year-end	**11.79**	10.34	10.11	9.46	8.96
Tangible book value at year-end	**8.42**	8.75	8.66	7.94	7.47
Average diluted common shares outstanding	**34,206**	32,710	33,087	32,844	33,235
At December 31,					
Securities available for sale, at fair value	**$ 1,106,322**	$ 954,474	$ 952,542	$ 980,961	$ 1,007,583
Securities held to maturity, at amortized cost	**136,314**	93,709	81,782	97,204	82,514
Loans and leases	**3,412,654**	3,022,657	2,869,921	2,639,976	2,355,932
Allowance for loan and lease losses	**50,587**	47,455	44,932	42,651	40,167
Assets	**5,087,572**	4,426,773	4,212,304	4,046,885	3,723,726
Deposits	**3,796,238**	3,160,196	3,073,838	3,001,351	2,922,040
Borrowings	**838,558**	883,182	752,066	672,631	451,076
Stockholders' equity	**403,817**	333,943	332,233	310,034	292,382
Key ratios					
Return on average assets	**1.14%**	1.21%	1.21%	1.22%	1.23%

Return on average equity	**14.47**	15.86	15.69	15.90	16.13
Average equity to average assets	**7.85**	7.64	7.74	7.69	7.64
Net interest margin	**3.70**	4.01	4.03	4.16	4.43
Dividend payout ratio	**46.34**	47.50	49.01	47.55	50.37
Tier 1 leverage	**7.57**	7.16	7.13	6.76	6.73
Tier 1 risk-based capital	**10.42**	9.80	9.78	9.96	9.93
Total risk-based capital	**11.67**	11.05	11.04	11.21	11.18

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Selected Quarterly Financial Data

(Dollars in thousands, except per share data)	**2006**				2005			
	First	**Second**	**Third**	**Fourth**	First	Second	Third	Fourth
Interest, fee and dividend income	**$ 66,306**	**$ 71,831**	**$ 74,688**	**$ 76,017**	$ 55,461	$ 57,866	$ 60,282	$ 62,758
Interest expense	**26,187**	**30,462**	**33,768**	**34,592**	16,647	18,542	20,331	22,736
Net interest income	**40,119**	**41,369**	**40,920**	**41,425**	38,814	39,324	39,951	40,022
Provision for loan and lease losses	**1,728**	**1,703**	**2,480**	**3,484**	1,796	2,320	2,752	2,596
Noninterest income excluding net securities (losses) gains	**12,158**	**12,534**	**12,510**	**12,302**	10,715	11,004	11,088	10,978
Net securities (losses) gains	**(934)**	**22**	**7**	**30**	(4)	51	(737)	(546)
Noninterest expense	**30,472**	**31,694**	**29,918**	**30,882**	28,881	28,696	28,579	29,149
Net income	**$ 13,588**	**$ 14,169**	**$ 14,542**	**$ 13,648**	$ 12,789	$ 13,128	$ 13,526	$ 12,995
Basic earnings per share	**$ 0.41**	**$ 0.41**	**$ 0.43**	**$ 0.40**	$ 0.39	$ 0.41	$ 0.42	$ 0.40
Diluted earnings per share	**$ 0.40**	**$ 0.41**	**$ 0.43**	**$ 0.40**	$ 0.39	$ 0.40	$ 0.41	$ 0.40
Net interest margin	**3.86%**	**3.73%**	**3.60%**	**3.63%**	4.09%	4.02%	3.99%	3.97%
Return on average assets	**1.18%**	**1.15%**	**1.15%**	**1.07%**	1.23%	1.22%	1.23%	1.17%
Return on average equity	**15.11%**	**14.71%**	**14.89%**	**13.31%**	15.74%	16.21%	16.06%	15.47%
Average diluted common shares outstanding	**33,746**	**34,472**	**34,197**	**34,402**	32,977	32,584	32,729	32,556

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

GENERAL

The financial review which follows focuses on the factors affecting the consolidated financial condition and results of operations of NBT Bancorp Inc. (the "Registrant") and its wholly owned subsidiaries, NBT Bank, N.A. (the Bank), NBT Financial Services, Inc. (NBT Financial), Hathaway Agency, Inc., CNBF Capital Trust I, NBT Statutory Trust I and NBT Statutory Trust II, during 2006 and, in summary form, the preceding two years. Collectively, the Registrant and its subsidiaries are referred to herein as "the Company." Net interest margin is presented in this discussion on a fully taxable equivalent (FTE) basis. Average balances discussed are daily averages unless otherwise described. The audited consolidated financial statements and related notes as of December 31, 2006 and 2005 and for each of the years in the three-year period ended December 31, 2006 should be read in conjunction with this review. Amounts in prior period consolidated financial statements are reclassified whenever necessary to conform to the 2006 presentation.

The preparation of the consolidated financial statements requires management to make estimates and assumptions, in the application of certain accounting policies, about the effect of matters that are inherently uncertain. Those estimates and assumptions affect the reported amounts of certain assets, liabilities, revenues and expenses. Different amounts could be reported under different conditions, or if different assumptions were used in the application of these accounting policies.

The business of the Company is providing commercial banking and financial services through its subsidiaries. The Company’s primary market area is central and upstate New York and northeastern Pennsylvania. The Company has been, and intends to continue to be, a community-oriented financial institution offering a variety of financial services. The Company’s principal business is attracting deposits from customers within its market area and investing those funds primarily in loans and leases, and, to a lesser extent, in marketable securities. The financial condition and operating results of the Company are dependent on its net interest income which is the difference between the interest and dividend income earned on its earning assets and the interest expense paid on its interest bearing liabilities, primarily consisting of deposits and borrowings. Net income is also affected by provisions for loan and lease losses and noninterest income, such as service charges on deposit accounts, broker/dealer fees, trust fees, and gains/losses on securities sales; it is also impacted by noninterest expense, such as salaries and employee benefits, data processing, communications, occupancy, and equipment.

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The Company's results of operations are significantly affected by general economic and competitive conditions (particularly changes in market interest rates), government policies, changes in accounting standards, and actions of regulatory agencies. Future changes in applicable laws, regulations, or government policies may have a material impact on the Company. Lending activities are substantially influenced by the demand for and supply of housing, competition among lenders, the level of interest rates, the state of the local and regional economy, and the availability of funds. The ability to gather deposits and the cost of funds are influenced by prevailing market interest rates, fees and terms on deposit products, as well as the availability of alternative investments including mutual funds and stocks.

CRITICAL ACCOUNTING POLICIES

The Company has identified several policies as being critical because they require management to make particularly difficult, subjective and/or complex judgments about matters that are inherently uncertain and because of the likelihood that materially different amounts would be reported under different conditions or using different assumptions. These policies relate to the allowance for loan losses and pension accounting.

Management of the Company considers the accounting policy relating to the allowance for loan and lease losses to be a critical accounting policy given the uncertainty in evaluating the level of the allowance required to cover credit losses inherent in the loan and lease portfolio and the material effect that such judgments can have on the results of operations. While management's current evaluation of the allowance for loan and lease losses indicates that the allowance is adequate, under adversely different conditions or assumptions, the allowance would need to be increased. For example, if historical loan and lease loss experience significantly worsened or if current economic conditions significantly deteriorated, additional provisions for loan and lease losses would be required to increase the allowance. In addition, the assumptions and estimates used in the internal reviews of the Company's nonperforming loans and potential problem loans has a significant impact on the overall analysis of the adequacy of the allowance for loan and lease losses. While management has concluded that the current evaluation of collateral values is reasonable under the circumstances, if collateral values were significantly lowered, the Company's allowance for loan and lease policy would also require additional provisions for loan and lease losses.

Management is required to make various assumptions in valuing its pension assets and liabilities. These assumptions include the expected rate of return on plan assets, the discount rate, and the rate of increase in future compensation levels. Changes to these assumptions could impact earnings in future periods. The Company takes into account the plan asset mix, funding obligations, and expert opinions in determining the various rates used to estimate pension expense. The Company also considers the Moody's AA corporate bond yields and other market interest rates in setting the appropriate discount rate. In addition, the Company reviews expected inflationary and merit increases to compensation in determining the rate of increase in future compensation levels.

The Company's policy on the allowance for loan and lease losses and pension accounting is disclosed in note 1 to the consolidated financial statements. A more detailed description of the allowance for loan and lease losses is included in the "Risk Management" section of this Form 10-K. All significant pension accounting assumptions and detail is disclosed in Note 16 to the consolidated financial statements. All accounting policies are important, and as such, the Company encourages the reader to review each of the policies included in Note 1 to obtain a better understanding on how the Company's financial performance is reported.

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FORWARD LOOKING STATEMENTS

Certain statements in this filing and future filings by the Company with the Securities and Exchange Commission, in the Company's press releases or other public or shareholder communications, or in oral statements made with the approval of an authorized executive officer, contain forward-looking statements, as defined in the Private Securities Litigation Reform Act. These statements may be identified by the use of phrases such as "anticipate," "believe," "expect," "forecasts," "projects," "will," "can," "would," "should," "could," "may," or other similar terms. There are a number of facto of which are beyond the Company's control that could cause actual results to differ materially from those contemplated by the forward looking statements. Factors that may cause actual results to differ materially from those contemplated by such forward-looking statements include, among others, the following possibilities:

• Local, regional, national and international economic conditions and the impact they may have on the Company and its customers and the Company's assessment of that impact.
• Changes in the level of non-performing assets and charge-offs.
• Changes in estimates of future reserve requirements based upon the periodic review thereof under relevant regulatory and accounting requirements.
• The effects of and changes in trade and monetary and fiscal policies and laws, including the interest rate policies of the Federal Reserve Board.
• Inflation, interest rate, securities market and monetary fluctuations.
• Political instability.
• Acts of war or terrorism.
• The timely development and acceptance of new products and services and perceived overall value of these products and services by users.
• Changes in consumer spending, borrowings and savings habits.
• Changes in the financial performance and/or condition of the Company's borrowers.
• Technological changes.
• Acquisitions and integration of acquired businesses.
• The ability to increase market share and control expenses.
• Costs or difficulties related to the integration of the businesses of the Company and CNB may be greater than expected.
• Changes in the competitive environment among financial holding companies.
• The effect of changes in laws and regulations (including laws and regulations concerning taxes, banking, securities and insurance) with which the Company and its subsidiaries must comply.
• The effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board and other accounting standard setters.
• Changes in the Company's organization, compensation and benefit plans.
• The costs and effects of legal and regulatory developments including the resolution of legal proceedings or regulatory or other governmental inquiries and the results of regulatory examinations or reviews.
• Greater than expected costs or difficulties related to the integration of new products and lines of business.
• The Company's success at managing the risks involved in the foregoing items.

The Company cautions readers not to place undue reliance on any forward-looking statements, which speak only as of the date made, and to advise readers that various factors, including but not limited to those described above, could affect the Company's financial performance and could cause the Company's actual results or circumstances for future periods to differ materially from those anticipated or projected. Except as required by law, the Company does not undertake, and specifically disclaims any obligations to, publicly release any revisions that may be made to any forward-looking statements to reflect statements to the occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

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OVERVIEW

The Company had net income of $55.9 million or $1.64 per diluted share for 2006, compared to net income of $52.4 million or $1.60 per diluted share for 2005. Results were driven by several factors. Net interest income increased $5.7 million or 3.6% in 2006 compared to 2005. The increase in net interest income resulted mainly from an increase in average earning assets of $528.8 million, or 13.1% to $4.6 billion in 2006, driven by a 11.6% increase in average loans and leases for the period. Noninterest income increased $6.1 million or 14.3% compared to 2005. Included in noninterest income for 2006 were net securities losses totaling $0.9 million compared to net securities losses of $1.2 million in 2005. Excluding net security gains and losses, total noninterest income increased 13.1% in 2006 compared with 2005. Offsetting the increases in net interest income and noninterest income was an increase in noninterest expense of $7.7 million in 2006 compared to 2005. Noninterest income and expense increased in all line items, primarily as a result of the CNB merger in February of 2006 (see Item 1 for merger details). The provision for loan and lease losses decreased slightly in 2006 compared to 2005, as potential problem loans have decreased as a percentage of the loan portfolio, offset by an increase in net charge-offs.

The Company had net income of $52.4 million or $1.60 per diluted share for 2005, compared to net income of $50.0 million or $1.51 per diluted share for 2004. Results were driven by several factors. Net interest income increased $7.6 million or 5.1% in 2005 compared to 2004. The increase in net interest income resulted mainly from an increase in average earning assets of 5.3%, driven by an 7.9% increase in average loans and leases for the period. Noninterest income increased $1.7 million or 4.1% compared to 2004. Included in noninterest income for 2005 were net securities losses totaling $1.2 million compared to net securities gains of $0.2 million in 2004. Excluding net security gains and losses, total noninterest income increased 7.7% in 2005 compared with 2004. This increase resulted from increases in retirement plan administration fees (from the acquisition of EPIC in January 2005), other income, service charges on deposit accounts, ATM and debit card fees and trust revenue offset by a decline in broker/dealer and insurance revenue of $3.6 million (from the sale of M. Griffith Inc. in March 2005). Offsetting the increases in net interest income and noninterest income was an increase in noninterest expense of $5.5 million in 2005 compared to 2004. The increase in noninterest expense resulted mainly from increases in salaries and employee benefits, occupancy expense, equipment and other operating expense offset by a goodwill impairment charge in 2004 and a decrease in data processing and communications expense. The provision for loan and lease losses decreased slightly in 2005 compared to 2004, as credit quality was stable, net charge-offs as a percentage of total loans and leases decreased, and the Company experienced a decline in the rate of loan growth in 2005, which was 5.3% at December 31, 2005 compared to a growth rate of 8.7% for 2004.

ASSET/LIABILITY MANAGEMENT

The Company attempts to maximize net interest income, and net income, while actively managing its liquidity and interest rate sensitivity through the mix of various core deposit products and other sources of funds, which in turn fund an appropriate mix of earning assets. The changes in the Company’s asset mix and sources of funds, and the resultant impact on net interest income, on a fully tax equivalent basis, are discussed below.

The following table includes the condensed consolidated average balance sheet, an analysis of interest income/expense and average yield/rate for each major category of earning assets and interest bearing liabilities on a taxable equivalent basis. Interest income for tax-exempt securities and loans and leases has been adjusted to a taxable-equivalent basis using the statutory Federal income tax rate of 35%.

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Table 1. Average Balances and Net Interest Income

	2006			2005			2004		
(Dollars in thousands)	**Average Balance**	**Interest**	**Yield/Rate**	Average Balance	Interest	Yield/Rate	Average Balance	Interest	Yield/Rate
Assets									
Short-term interest bearing accounts	**$ 8,116**	**$ 395**	**4.87%**	$ 7,298	$ 229	3.14%	$ 7,583	$ 222	2.93%
Securities available for sale 1	**1,110,405**	**53,992**	**4.86**	954,461	43,113	4.52	970,024	44,633	4.60
Securities held to maturity 1	**115,636**	**7,071**	**6.11**	88,244	5,035	5.71	85,771	4,385	5.11
Investment in FRB and FHLB Banks	**39,437**	**2,076**	**5.26**	37,607	1,898	5.05	34,813	854	2.45