COMMUNITY TRUST BANCORP INC /KY/
Form 10-Q
November 09, 2006

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

[X]	QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
	For the quarterly period ended September 30, 2006
	Or
[ ]	TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
	For the transition period from _____________ to _____________

Commission file number 0-11129

COMMUNITY TRUST BANCORP, INC.
(Exact name of registrant as specified in its charter)

Kentucky	**61-0979818**
(State or other jurisdiction of incorporation or organization)	*IRS Employer Identification No.*
346 North Mayo Trail **Pikeville, Kentucky** *(address of principal executive offices)*	**41501** *(Zip Code)*

(606) 432-1414
(Registrant's telephone number)

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 ü	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 ü	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 ü

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practical date.

Common stock - 15,149,523 shares outstanding at October 31, 2006

PART I - FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

The accompanying information has not been audited by independent registered public accountants; however, in the opinion of management such information reflects all adjustments necessary for a fair presentation of the results for the interim period. All such adjustments are of a normal and recurring nature.

The accompanying condensed consolidated financial statements are presented in accordance with the requirements of Form 10-Q and consequently do not include all of the disclosures normally required by accounting principles generally accepted in the United States of America or those normally made in the Registrant's annual report on Form 10-K. Accordingly, the reader of the Form 10-Q should refer to the Registrant's Form 10-K for the year ended December 31, 2005 for further information in this regard.

Community Trust Bancorp, Inc.
Condensed Consolidated Balance Sheets
(unaudited)

(dollars in thousands)	**September 30 2006**	**December 31 2005**
Assets:		
Cash and due from banks	$ 78,171	$ 91,066
Federal funds sold	24,390	31,145
Cash and cash equivalents	102,561	122,211
Securities available-for-sale at fair value		
(amortized cost of $422,808 and $402,241, respectively)	415,691	395,572
Securities held-to-maturity at amortized cost		
(fair value of $40,237 and $46,528, respectively)	42,213	48,444
Loans held for sale	1,826	135
Loans	2,154,129	2,107,344
Allowance for loan losses	(28,006)	(29,506)
Net loans	2,126,123	2,077,838
Premises and equipment, net	56,025	57,966
Goodwill	65,059	63,523
Core deposit intangible (net of accumulated amortization of $4,795 and		
$4,319, respectively)	2,710	3,186
Federal Reserve Bank and Federal Home Loan Bank stock	27,659	26,682
Other assets	54,452	55,497
Total assets	$ 2,894,319	$ 2,851,054
Liabilities and shareholders' equity:		
Deposits		
Noninterest bearing	$ 414,037	$ 445,929
Interest bearing	1,865,668	1,800,622
Total deposits	2,279,705	2,246,551
Repurchase agreements	158,085	129,156
Federal funds purchased and other short-term borrowings	5,914	17,485
Advances from Federal Home Loan Bank	81,395	122,835
Long-term debt	61,341	61,341
Other liabilities	32,980	19,741
Total liabilities	2,619,420	2,597,109
Shareholders' equity:		
Preferred stock, 300,000 shares authorized and unissued		
Common stock, $5 par value, shares authorized 25,000,000;		
Shares outstanding 2006 - 15,141,136; 2005 - 14,997,369	75,706	74,987
Capital surplus	150,367	147,626

Retained earnings		53,452		35,667
Accumulated other comprehensive loss, net of tax		(4,626)		(4,335)
Total shareholders' equity		274,899		253,945
Total liabilities and shareholders' equity	$	2,894,319	$	2,851,054

See notes to condensed consolidated financial statements.

Community Trust Bancorp, Inc.
Condensed Consolidated Statements of Income and Other Comprehensive Income
(unaudited)

	Three Months Ended September 30		Nine Months Ended September 30	
(in thousands except per share data)	**2006**	**2005**	**2006**	**2005**
Interest income:				
Interest and fees on loans, including loans held for sale	$ 42,114	$ 36,100	$ 120,510	$ 99,215
Interest and dividends on securities				
Taxable	4,947	4,230	14,550	13,570
Tax exempt	514	520	1,550	1,580
Other, including interest on federal funds sold	480	390	2,171	1,350
Total interest income	48,055	41,240	138,781	115,715
Interest expense:				
Interest on deposits	16,546	11,226	45,558	30,223
Interest on repurchase agreements and other short-term borrowings	2,212	1,019	6,497	2,503
Interest on advances from Federal Home Loan Bank	916	1,266	2,926	3,786
Interest on long-term debt	1,354	1,354	4,061	4,061
Total interest expense	21,028	14,865	59,042	40,573
Net interest income	27,027	26,375	79,739	75,142
Provision for loan losses	(1,755)	(2,470)	(3,105)	(5,537)
Net interest income after provision for loan losses	25,272	23,905	76,634	69,605
Noninterest income:				
Service charges on deposit accounts	5,220	4,723	15,081	13,230
Gains on sales of loans, net	265	440	885	1,092
Trust income	927	751	2,669	2,231
Securities gains, net	0	0	0	3
Other	2,217	3,126	6,642	9,428
Total noninterest income	8,629	9,040	25,277	25,984
Noninterest expense:				
Salaries and employee benefits	10,750	10,816	32,538	31,690
Occupancy, net	1,489	1,674	4,960	4,772
Equipment	1,246	1,134	3,728	3,265
Data processing	958	1,116	2,744	3,391
Legal and professional fees	760	627	2,076	2,152
Stationery, printing, and office supplies	178	373	643	1,082
Taxes other than payroll, property, and income	911	813	2,584	2,409

FDIC insurance	70	72	211	217
Other	3,595	3,165	10,417	9,703
Total noninterest expense	19,957	19,790	59,901	58,681
Income before income taxes	13,944	13,155	42,010	36,908
Income taxes	4,060	4,072	12,466	11,386
Net income	9,884	9,083	29,544	25,522
Other comprehensive income, net of tax:				
Unrealized holding gains (losses) on securities available-for-sale	2,627	(897)	(291)	(2,288)
Comprehensive income	$ 12,511	$ 8,186	$ 29,253	$ 23,234
Basic earnings per share	$ 0.65	$ 0.61	$ 1.96	$ 1.71
Diluted earnings per share	0.64	0.60	1.93	1.68
Dividends declared per share	0.26	0.24	0.78	0.72
Weighted average shares outstanding-basic	15,129	14,917	15,064	14,885
Weighted average shares outstanding-diluted	15,369	15,215	15,272	15,166

See notes to condensed consolidated financial statements.

Community Trust Bancorp, Inc.
Condensed Consolidated Statements of Cash Flows
(unaudited)

	Nine months ended September 30	
(in thousands)	**2006**	**2005**
Cash flows from operating activities:		
Net income	$ 29,544	$ 25,522
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	4,347	3,799
Provision for loan and other real estate losses	3,314	5,583
Securities gains, net	0	(3)
Gains on sale of mortgage loans held for sale	(885)	(1,092)
Gains (losses) on sale of assets, net	252	(13)
Proceeds from sale of mortgage loans held for sale	46,766	47,805
Funding of mortgage loans held for sale	(47,572)	(47,458)
Amortization of securities premiums, net	755	1,293
Changes in:		
Other liabilities	13,239	6,404
Other assets	(1,301)	(6,510)
Net cash provided by operating activities	48,459	35,330
Cash flows from investing activities:		
Securities available-for-sale:		
Proceeds from sales	103,900	31,850
Proceeds from prepayments and maturities	46,988	83,163
Purchase of securities	(172,100)	(54,378)
Securities held-to-maturity:		
Proceeds from prepayments and maturities	6,122	11,503
Change in loans, net	(53,321)	(134,796)
Purchase of premises, equipment, and other real estate	(2,145)	(3,757)
Proceeds from sale of premises and equipment	32	21
Proceeds from sale of other real estate and other repossessed assets	3,251	2,368
Additions in other real estate owned	(72)	(305)
Net assets acquired	(1,536)	(4,308)
Net cash used in investing activities	(68,881)	(68,639)
Cash flows from financing activities:		
Change in deposits, net	33,154	38,489
Change in repurchase agreements and other short-term borrowings, net	17,358	28,436
Payments on advances from Federal Home Loan Bank	(41,440)	(43,414)
Issuance of common stock	2,733	1,604
Excess tax benefits from stock-based compensation	727	0
Dividends paid	(11,760)	(10,720)
Net cash provided by financing activities	772	14,395
Net decrease in cash and cash equivalents	(19,650)	(18,914)
Cash and cash equivalents at beginning of year	122,211	129,580

Cash and cash equivalents at end of period	$ 102,561	$ 110,666

See notes to condensed consolidated financial statements.

Community Trust Bancorp, Inc.
Notes to Condensed Consolidated Financial Statements *(unaudited)*

Note 1 - Summary of Significant Accounting Policies

In the opinion of management, the unaudited condensed consolidated financial statements include all adjustments (which consist of normal recurring accruals) necessary, to present fairly the condensed consolidated financial position as of September 30, 2006, the results of operations for the three and nine months ended September 30, 2006 and 2005, and the cash flows for the nine months ended September 30, 2006 and 2005. In accordance with accounting principles generally accepted in the United States of America for interim financial information, these statements do not include certain information and footnote disclosures required by accounting principles generally accepted in the United States of America for complete annual financial statements. Financial information as of December 31, 2005 has been derived from the audited consolidated financial statements of Community Trust Bancorp, Inc. (the "Corporation"). The results of operations for the three and nine months ended September 30, 2006 and 2005 and the cash flows for the nine months ended September 30, 2006 and 2005 are not necessarily indicative of the results to be expected for the full year. For further information, refer to the consolidated financial statements and footnotes thereto for the year ended December 31, 2005, included in the Corporation's Annual Report on Form 10-K.

Principles of Consolidation - The unaudited condensed consolidated financial statements include the accounts of the Corporation and its separate and distinct, wholly owned subsidiaries Community Trust Bank, Inc. (the "Bank") and Community Trust and Investment Company. All significant intercompany transactions have been eliminated in consolidation.

Reclassifications - Certain reclassifications have been made in the prior year consolidated financial statements to conform to current year classifications.

New Accounting Standards

Ø **Stock-Based Employee Compensation -** In December 2004, Statement of Financial Accounting Standards ("SFAS") No. 123R, *Share-Based Payment*, was issued. SFAS No. 123R is a revision of SFAS No. 123, *Accounting for Stock-Based Compensation*, and supersedes Accounting Principles Board ("APB") Opinion No. 25, *Accounting for Stock Issued to Employees*. SFAS No. 123R requires the cost resulting from all share-based payment transactions be recognized in the financial statements, and establishes fair value as the measurement objective in accounting for share-based payment arrangements. In March 2005, the Securities and Exchange Commission issued Staff Accounting Bulletin Number 107 that provided additional guidance to public companies relating to share-based payment transactions and the implementation of SFAS 123R. On January 1, 2006, the Corporation adopted SFAS No. 123R using the "modified prospective" method. As further discussed under Note 2 - Stock-Based Compensation, the adoption of SFAS 123R resulted in compensation expense for the three and nine months ended September 30, 2006 of $157 thousand and $477 thousand, respectively.

Ø **Accounting for Conditional Asset Retirement Obligations -** In March 2005, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations* ("FIN 47"), to clarify the term "conditional asset retirement" as used in SFAS 143, *Accounting for Asset Retirement Obligations*. FIN 47 requires that a liability be recognized for the fair value of a conditional asset retirement obligation when incurred, if the fair value of the liability can be reasonably estimated. Uncertainty about the timing or method of settlement of a conditional asset retirement obligation would be factored into the measurement of the liability when sufficient information exists. This interpretation is effective no later than the end of fiscal years ending after December 15, 2005. Accordingly, the Corporation adopted FIN 47 in the first quarter of 2006. Management has assessed the impact of FIN 47 and has determined that the adoption of FIN 47 did not have a material impact on the Corporation's financial position, results of operations, or cash flows.

Ø **Accounting for Servicing of Financial Assets -** In March 2006, SFAS No. 156, *Accounting for Servicing of Financial Assets*, was issued. SFAS No. 156 amends SFAS No. 140, *Accounting Transfers and Servicing of Financial Assets and Extinguishment of Liabilities*, with respect to the accounting for separately recognized servicing assets and servicing liabilities. SFAS No. 156 (1) requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset; (2) requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value; (3) if practicable, permits an entity to choose either the amortization or fair value method following subsequent measurement methods for each class of separately recognized servicing assets and servicing liabilities; (4) and at its initial adoption, permits a one-time reclassification of available-for-sale securities to trading securities by entities with recognized servicing rights, without calling into question the treatment of other available-for-sale securities under SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, provided that the available-for-sale securities are identified in some manner as offsetting the entity's exposure to changes in fair value of servicing assets or servicing liabilities that a servicer elects to subsequently measure at fair value. SFAS No. 156 requires separate presentation of servicing assets and servicing liabilities subsequently measured at fair value in the statement of financial position and additional disclosures for all separately recognized servicing assets and servicing liabilities. SFAS No. 156 is effective as of the first of the fiscal year beginning after September 15, 2006. The adoption of this statement is not expected to have a material effect on the Corporation's consolidated financial statements.

Ø **Accounting for Certain Hybrid Financial Instruments -** In February 2006, the FASB issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments, an amendment of FASB Statement No. 133 and 140*. SFAS No. 155 amends FASB Statements No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, as well as resolves issues addressed in Statement No. 133 Implementation Issue No. D1, *Application of Statement No. 133 to Beneficial Interests in Securitized Financial Assets*. Specifically, SFAS No. 155: i) permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation; ii) clarifies which interest-only strips and principal-only strips are not subject to the requirements of Statement No. 133; iii) establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation; iv) clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives; and v) amends Statement No. 140 to eliminate the prohibition on a qualifying SPE from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. SFAS No. 155 is effective for all financial instruments acquired or issued after the beginning of the first fiscal year that begins after September 15, 2006. The adoption of this statement is not expected to have a material effect on the Corporation’s consolidated financial statements.

Ø **Accounting for Uncertainty in Income Taxes -** In July 2006, the FASB issued Interpretation No. 48 (“FIN 48”), *Accounting for Uncertainty in Income Taxes - An Interpretation of FASB Statement No. 109*. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. This statement also prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The evaluation of a tax position in accordance with this statement is a two-step process. The first step is a recognition process to determine whether it is more likely than not that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. The second step is a measurement process whereby a tax position that meets the more likely than not recognition threshold is calculated to determine the amount of benefit to recognize in the financial statements. FIN 48 is effective for fiscal years beginning after December 15, 2006 and the cumulative effect of applying the provisions of this statement will be recognized as an adjustment to the beginning balance of retained earnings. The Corporation is currently in the process of evaluating the impact of adopting FIN 48 on its consolidated financial statements.

Note 2 - Stock-Based Compensation

On January 1, 2006, the Corporation adopted SFAS No. 123R which requires that companies measure and recognize compensation expense at an amount equal to the fair value of share-based payments granted under compensation arrangements. Prior to January 1, 2006, the Corporation accounted for its stock-based compensation plans under the recognition and measurement principles of APB Opinion 25 and related interpretations, and no compensation expense was recognized for stock option grants since all options granted had an exercise price equal to the market value of the underlying common stock on the date of grant.

The Corporation adopted SFAS 123R using the “modified prospective” method, which results in no restatement of prior period amounts. Under this method, the provisions of SFAS 123R apply to all awards granted or modified after the date of adoption. In addition, compensation expense must be recognized for any unvested stock option awards outstanding as of the date of adoption over the remaining vesting period. The Corporation calculates the fair value of options using a Black-Scholes option pricing model. For the three and nine months ended September 30, 2006, the Corporation’s compensation expense related to stock option grants was $157 thousand and $477 thousand, respectively ($130 thousand and $394 thousand after tax and $0.01 and $0.03 per basic and diluted share) and as of September 30, 2006, there was a total of $1.5 million of unrecognized compensation expense related to unvested stock option awards that will be recognized as expense as the awards vest over a weighted average period of 1.4 years. SFAS 123R also requires the benefits of tax deductions in excess of recognized compensation expense to be reported in the Statement of Cash Flows as a financing cash inflow rather than an operating cash inflow. In addition, SFAS 123R required a modification to the Corporation’s calculation of the dilutive effect of stock option awards on earnings per share. For companies that adopt SFAS 123R using the “modified prospective” method, disclosure of pro forma information for periods prior to adoption must continue to be made. The following table sets forth the effect of the change from applying the Corporation's previous method of accounting for share-based payment arrangements with employees:

	Nine Months Ended September 30, 2006	
(in thousands except per share data)	**Current Method**	**Previous Method**
Income from continuing operations	$ 42,010	$ 42,488
Income before income taxes	42,010	42,488
Net income	29,544	29,938
Cash flow from operations	48,459	49,186
Cash flow from financing activities	772	45
Basic earnings per share	1.96	1.99
Diluted earnings per share	1.93	1.96

The following table sets forth the pro forma effect on net income and earnings per share as if the fair value method had been applied to the three and nine month periods ended September 30, 2005:

(in thousands except per share data)	**Three Months Ended September 30 2005**	**Nine Months Ended September 30 2005**

Net income, as reported	$	9,083	$	25,522
Less: Total stock-based employee compensation expense determined under a fair value based method for all awards, net of related income tax effect		(214)		(644)
Pro forma net income	$	8,869	$	24,878
Earnings per share:				
Basic - as reported	$	0.61	$	1.71
Basic - pro forma		0.59		1.67
Diluted - as reported		0.60		1.68
Diluted - pro forma		0.58		1.64

There were no options granted during the three months ended September 30, 2006 or 2005. The fair value of options granted during the nine months ended September 30, 2006 and 2005 was established at the date of grant using a Black-Scholes option pricing model with the weighted average assumptions as follows:

	Nine Months Ended September 30			
		2006		2005
Expected dividend yield		3.21%		3.11%
Risk-free interest rate		4.53%		3.92%
Expected volatility		36.39%		37.66%
Expected term (in years)		7.5		6.5
Weighted average fair value of options	$	10.51	$	9.72

For stock options granted in 2006, the Corporation has elected to apply the simplified method for “plain vanilla” options to determine the expected term, as provided by the Securities and Exchange Commission’s Staff Accounting Bulletin Number 107.

Note 3 - Securities

Securities are classified into held-to-maturity and available-for-sale categories. Held-to-maturity securities are those that the Corporation has the positive intent and ability to hold to maturity and are reported at amortized cost. Available-for-sale securities are those that the Corporation may decide to sell if needed for liquidity, asset-liability management or other reasons. Available-for-sale securities are reported at fair value, with unrealized gains or losses included as a separate component of equity, net of tax.

The amortized cost and fair value of securities at September 30, 2006 are summarized as follows:

Available-for-Sale

(in thousands)		**Amortized Cost**		**Fair Value**
U.S. Treasury and Government agencies	$	15,287	$	15,425
State and political subdivisions		45,179		45,962
U.S. agency mortgage-backed pass through certificates		256,691		249,152
Collateralized mortgage obligations		1		1
Total debt securities		317,158		310,540
Marketable equity securities		105,650		105,151
Total available-for-sale securities	$	422,808	$	415,691

Held-to-Maturity

(in thousands)	Amortized Cost	Fair Value
State and political subdivisions	$ 3,068	$ 2,821
U.S. agency mortgage-backed pass through certificates	39,145	37,416
Total held-to-maturity securities	$ 42,213	$ 40,237

The amortized cost and fair value of securities as of December 31, 2005 are summarized as follows:

Available-for-Sale

(in thousands)	Amortized Cost	Fair Value
U.S. Treasury and Government agencies	$ 2,005	$ 2,005
State and political subdivisions	45,911	46,932
U.S. agency mortgage-backed pass through certificates	295,822	288,631
Collateralized mortgage obligations	1,003	1,012
Other debt securities	17,500	16,992
Total debt securities	362,241	355,572
Marketable equity securities	40,000	40,000
Total available-for-sale securities	$ 402,241	$ 395,572

Held-to-Maturity

(in thousands)	Amortized Cost	Fair Value
State and political subdivisions	$ 3,134	$ 2,982
U.S. agency mortgage-backed pass through certificates	45,310	43,546
Total held-to-maturity securities	$ 48,444	$ 46,528

Note 4 - Loans

Major classifications of loans are summarized as follows:

(in thousands)	September 30 2006	December 31 2005
Commercial construction	$ 131,838	$ 115,721
Commercial secured by real estate	638,324	665,911
Commercial other	327,557	301,828
Real estate construction	50,540	51,232
Real estate mortgage	573,739	542,809
Consumer	420,122	414,920
Equipment lease financing	12,009	14,923
Total loans	$ 2,154,129	$ 2,107,344

Note 5 - Borrowings

Short-term debt consists of the following:

(in thousands)

	September 30 2006	December 31 2005
Subsidiaries:		
Repurchase agreements	$ 158,085	$ 129,156
Federal funds purchased	5,914	17,485
Total short-term debt	$ 163,999	$ 146,641

On April 28, 2006, the Corporation entered into a revolving note agreement for a line of credit in the amount of $12 million, all of which is currently available to meet any future cash needs. The agreement will mature on April 28, 2007.

All federal funds purchased and the majority of repurchase agreements mature and reprice daily. The average rates paid for federal funds purchased and repurchase agreements on September 30, 2006 were 5.12% and 4.89%, respectively.

Federal Home Loan Bank advances consisted of the following monthly amortizing and term borrowings:

(in thousands)	September 30 2006	December 31 2005
Monthly amortizing	$ 1,395	$ 1,835
Term	80,000	121,000
	$ 81,395	$ 122,835

The advances from the Federal Home Loan Bank that require monthly principal payments were due for repayment as follows:

	Principal Payments Due by Period at September 30, 2006				
(in thousands)	**Total**	**Within 1 Year**	**1-5 Years**	**5-10 Years**	**After 10 Years**
Outstanding advances, weighted average interest rate - 4.70%	$ 1,395	$ 451	$ 896	$ 31	$ 17

The term advances that require the total payment to be made at maturity follow:

(in thousands)	September 30 2006	December 31 2005
Advance #144, 2.88%, due 8/30/06	$ 0	$ 40,000
Advance #145, 3.31%, due 8/30/07	40,000	40,000
Advance #146, 3.70%, due 8/30/08	40,000	40,000
Advance #148, 1.76%, due 6/6/13	0	1,000
	$ 80,000	$ 121,000

The advances are collateralized by Federal Home Loan Bank stock of $23.4 million and certain first mortgage loans totaling $109.9 million as of September 30, 2006. Advances totaling $81.4 million at September 30, 2006 had fixed interest rates ranging from 1.00% to 7.05% with a weighted average rate of 3.53%. The advances are subject to restrictions or penalties in the event of prepayment.

Long-term debt consists of the following:

(in thousands)	September 30 2006	December 31 2005
Junior subordinated debentures, 9.00%, due 3/31/27	$ 35,568	$ 35,568
Junior subordinated debentures, 8.25%, due 3/31/32	25,773	25,773
Total long-term debt	$ 61,341	$ 61,341

Although the junior subordinated debentures mature on March 31, 2027 and March 31, 2032, they are subject to early mandatory redemption in whole under certain limited circumstances and are callable at par in whole or in part anytime after March 31, 2007.

6. Earnings Per Share

The following table sets forth the computation of basic and diluted earnings per share:

	Three Months Ended September 30		Nine Months Ended September 30	
(in thousands)	2006	2005	2006	2005
Numerator:				
Net income	$ 9,884	$ 9,083	$ 29,544	$ 25,522
Denominator:				
Basic earnings per share:				
Weighted average shares	15,129	14,917	15,064	14,885
Diluted earnings per share:				
Effect of dilutive stock options	240	298	208	281
Adjusted weighted average shares	15,369	15,215	15,272	15,166
Earnings per share:				
Basic earnings per share	$ 0.65	$ 0.61	$ 1.96	$ 1.71
Diluted earnings per share	0.64	0.60	1.93	1.68

7. Fair Market Value of Financial Instruments

The following schedule shows the estimated fair value of each class of financial instruments for which it is practicable to estimate that value:

(in thousands)	September 30 2006		December 31 2005	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets				
Cash and cash equivalents	$ 102,561	$ 102,561	$ 122,211	$ 122,211
Securities	457,904	455,928	444,016	442,100
Loans and loans held for sale	2,155,955	2,114,669	2,107,479	2,099,335
	$ 2,716,420	$ 2,673,158	$ 2,673,706	$ 2,663,646
Financial liabilities				
Deposits	$ 2,279,705	$ 2,264,941	$ 2,246,551	$ 2,236,357

Short-term borrowings	163,999	164,487	146,641	146,308
Advances from Federal Home Loan Bank	81,395	77,887	122,835	117,260
Long-term debt	61,341	60,444	61,341	61,412
	$ 2,586,440	$ 2,567,759	$ 2,577,368	$ 2,561,337

The changes in the estimated fair values from December 31, 2005 to September 30, 2006 are due to interest rate changes and not impairment of any financial instruments.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

Community Trust Bancorp, Inc. (the "Corporation") is a bank holding company headquartered in Pikeville, Kentucky. At September 30, 2006, the Corporation owned one commercial bank and one trust company. Through its subsidiaries, the Corporation has seventy-nine banking locations in eastern, northeast, central, and south central Kentucky and southern West Virginia, one loan production office in Kentucky, and five trust offices across Kentucky. The Corporation had total assets of $2.9 billion and total shareholders' equity of $274.9 million as of September 30, 2006. The Corporation's common stock is listed on NASDAQ under the symbol CTBI. Current market participants are FTN Midwest Research Securities Corp., Cleveland, Ohio; Goldman, Sachs & Co., New York, New York; Howe Barnes Investments, Inc., Chicago, Illinois; J.J.B. Hilliard, W.L. Lyons, Inc., Louisville, Kentucky; Keefe, Bruyette & Woods, Inc., New York, New York; Merrill Lynch, Pierce, Fenner & Smith Incorporated, New York, New York; Monroe Securities, Inc., Chicago, Illinois; Morgan Stanley & Co., Incorporated, New York, New York; and Sandler O'Neill & Partners, New York, New York.

Critical Accounting Policies and Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires the appropriate application of certain accounting policies, many of which require us to make estimates and assumptions about future events and their impact on amounts reported in our consolidated financial statements and related notes. Since future events and their impact cannot be determined with certainty, the actual results will inevitably differ from our estimates. Such differences could be material to the consolidated financial statements.

We believe the application of accounting policies and the estimates required therein are reasonable. These accounting policies and estimates are constantly reevaluated, and adjustments are made when facts and circumstances dictate a change. Historically, we have found our application of accounting policies to be appropriate, and actual results have not differed materially from those determined using necessary estimates.

Our accounting policies are more fully described in the consolidated financial statements and footnotes thereto for the year ended December 31, 2005, included in the Corporation's Annual Report on Form 10-K. We have identified the following critical accounting policies:

Loans - Loans are reported at the carrying value of unpaid principal reduced by unearned interest and an allowance for loan losses. Income is recorded on the level yield basis. Interest accrual is discontinued when management believes, after considering economic and business conditions, collateral value, and collection efforts, that the borrower's financial condition is such that collection of interest is doubtful. Any loan greater than 90 days past due must be well secured and in the process of collection to continue accruing interest. Cash payments received on nonaccrual loans generally are applied against principal, and interest income is only recorded once principal recovery is reasonably assured. Loans are not reclassified as accruing until principal and interest payments are brought current and future payments appear reasonably certain.

Allowance for Loan Losses - The adequacy of the allowance is reviewed quarterly by management using a methodology that includes several key factors. The Corporation utilizes an internal risk grading system for commercial credits, and those larger commercial credits identified through this grading system as having weaknesses are individually reviewed for the customer's ability and potential to repay their loans. The customer's cash flow, adequacy of collateral held for the loan, and other options available to the Corporation including legal avenues are all evaluated. Based upon this individual credit evaluation, a specific allocation to the allowance may be made for the loan.

For other commercial loans that are not individually evaluated, an allowance allocation is determined by applying an eight-quarter moving average historical loss rate for this group of loans. Consumer installment and residential mortgage loans are not individually risk graded. Allowance allocations are provided for these pools of loans based upon an eight-quarter moving average historical loss rate for each of these categories of loans.

Management's best estimate within a range of possible credit losses is determined in recognition of the inherent inability to precisely determine the loss potential in any particular loan or pool of loans. The factors considered by management in determining this amount of inherent risk include delinquency trends, current economic conditions and trends, strength of the supervision and administration of the loan portfolio, level of nonperforming loans, trend in loan losses, recovery rates associated with previously charged-off loans, concentrations within commercial credits, problem loan identification strengths and weaknesses, collateral evaluation strengths and weaknesses, and the level of financial statement exceptions. These factors are reviewed quarterly and weighted as deemed appropriate by management. The total of these weighted factors is then applied against the total loan portfolio and the allowance is adjusted accordingly.

Investments - Management determines the classification of securities at purchase. In accordance with Statement of Financial Accounting Standards ("SFAS") No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, the Corporation classifies securities into held-to-maturity or available-for-sale categories. Held-to-maturity securities are those which the Corporation has the positive intent and ability to hold to maturity and are reported at amortized cost. Available-for-sale securities are those the Corporation may decide to sell if needed for liquidity, asset/liability management, or other reasons. Available-for-sale securities are reported at fair value, with unrealized gains and losses included as a separate component of shareholders’ equity, net of tax. If declines in fair value are not temporary, the carrying value of the securities is written down to fair value as a realized loss.

Gains or losses on disposition of securities are computed by specific identification for all securities except for shares in mutual funds, which are computed by average cost. Interest and dividend income, adjusted by amortization of purchase premium or discount, is included in earnings.

Loans Held for Sale - Mortgage loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated market value in the aggregate. Net unrealized losses, if any, are recognized in a valuation allowance by charges to income.

Goodwill - The Corporation evaluates total goodwill for impairment, based upon SFAS No. 142, *Goodwill and Other Intangible Assets* and SFAS No. 147, *Acquisitions of Certain Financial Institutions*, using fair value techniques including multiples of price/equity. Goodwill is evaluated for impairment on an annual basis.

Segments - Management analyzes the operation of the Corporation assuming one operating segment, community banking services. The Corporation, through its operating subsidiaries, offers a wide range of consumer and commercial community banking services. These services include: (i) residential and commercial real estate loans; (ii) checking accounts; (iii) regular and term savings accounts and savings certificates; (iv) full service securities brokerage services; (v) consumer loans; (vi) debit cards; (vii) annuity and life insurance products; (viii) Individual Retirement Accounts and Keogh plans; (ix) commercial loans; (x) trust services; and (xi) commercial demand deposit accounts.

Dividends

The following schedule shows the quarterly cash dividends paid for the past six quarters:

Pay Date	Record Date	Amount Per Share

October 1, 2006	September 15, 2006	$0.26
July 1, 2006	June 15, 2006	$0.26
April 1, 2006	March 15, 2006	$0.26
January 1, 2006	December 15, 2005	$0.26
October 1, 2005	September 15, 2005	$0.24
July 1, 2005	June 15, 2005	$0.24

On October 26, 2006, the Corporation announced an increase in the cash dividend to $0.27 per share to be paid on January 1, 2007, to shareholders of record on December 15, 2006.

Statement of Income Review

The Corporation reported earnings for the third quarter 2006 of $9.9 million or $0.65 per share compared to $9.1 million or $0.61 per share earned during the third quarter of 2005 and $9.9 million or $0.66 per share earned during the second quarter of 2006. Earnings for the nine months ended September 30, 2006 were $29.5 million or $1.96 per share compared to $25.5 million or $1.71 per share earned during the nine months ended September 30, 2005. Basic earnings per share for the third quarter 2006 reflects an increase of 6.6% over the third quarter 2005 and a 1.5% decrease from the second quarter 2006. The 1.5% decrease in earnings per share quarter over quarter is primarily due to the increase in weighted average shares outstanding quarter over quarter. Year-to-date earnings per share increased 14.6% from prior year.

The Corporation had basic weighted average shares outstanding of 15.1 million and 14.9 million, respectively, for the three months ended September 30, 2006 and 2005 and 15.1 million and 14.9 million, respectively, for the nine months ended September 30, 2006 and 2005. The following table sets forth on an annualized basis the return on average assets and return on average shareholders' equity for the three and nine months ended September 30, 2006 and 2005:

	Three Months Ended September 30		**Nine Months Ended September 30**	
	2006	**2005**	**2006**	**2005**
Return on average shareholders' equity	14.40%	14.50%	14.89%	14.00%
Return on average assets	1.34%	1.26%	1.34%	1.22%

Net Interest Income

The Corporation's net interest margin for the third quarter 2006 was 4.06% compared to 4.07% for the third quarter 2005 and 4.01% for the second quarter 2006. As rates stabilize in the latter part of the year, management expects some margin compression during the fourth quarter of 2006.

Net interest income for the quarter of $27.0 million was an increase of 2.5% from the $26.4 million for the third quarter 2005 and a 0.9% increase from the $26.8 million for the second quarter 2006. Year-to-date net interest income increased 6.1% or $4.6 million from the nine months ended September 30, 2005. Average earnings assets increased 2.6% from the quarter ended September 30, 2005 to $2.7 billion for the quarter ended September 30, 2006 but decreased 1.4% from prior quarter. The decrease from prior quarter was due to a reduction in the investment portfolio to provide funding for loan growth and payment of a maturing Federal Home Loan Bank advance which was acquired in the third quarter 2004 to fund growth in our investment portfolio. Average earning assets for the nine months ended September 30, 2006 increased 4.8% or $123.0 million over the nine months ended September 30, 2005.

The following table summarizes the annualized net interest spread and net interest margin for the three and nine months ended September 30, 2006 and 2005.

	Three Months Ended	**Nine Months Ended**

	September 30		September 30	
	2006	2005	2006	2005
Yield on interest earning assets	7.18%	6.32%	6.97%	6.10%
Cost of interest bearing funds	3.78%	2.73%	3.57%	2.56%
Net interest spread	3.40%	3.59%	3.40%	3.54%
Net interest margin	4.06%	4.07%	4.03%	3.98%

Provision for Loan Losses

The analysis of the changes in the allowance for loan losses and selected ratios is set forth below:

	Nine Months Ended September 30	
(in thousands)	2006	2005
Allowance balance at January 1	$ 29,506	$ 27,017
Allowance of acquired banks	0	1,759
Additions to allowance charged against operations	3,105	5,537
Recoveries credited to allowance	2,412	2,537
Losses charged against allowance	(7,017)	(7,151)
Allowance balance at September 30	$ 28,006	$ 29,699
Allowance for loan losses to period-end loans	1.30%	1.41%
Average loans, net of unearned income	$ 2,122,011	$ 1,996,950
Provision for loan losses to average loans, annualized	0.20%	0.37%
Loan charge-offs net of recoveries, to average loans, annualized	0.29%	0.31%

Net loan charge-offs for the quarter ended September 30, 2006 were $1.6 million, or 0.3% of average loans annualized, compared to $1.9 million, or 0.4% of average loans annualized, for the quarter ended September 30, 2005 and $1.7 million, or 0.3% of average loans annualized, for the quarter ended June 30, 2006. As a result of the improvement in credit quality trends, our reserve for losses on loans as a percentage of total loans outstanding at September 30, 2006 decreased to 1.30% from the 1.41% at September 30, 2005 and remained flat to June 30, 2006.

Noninterest Income

Noninterest income for the quarter ended September 30, 2006 decreased 4.5% from the quarter ended September 30, 2005 but increased 1.7% from the quarter ended June 30, 2006. Year-to-date noninterest income decreased 2.7% to $25.3 million for the nine months ended September 30, 2006 from the $26.0 million for the same period last year.

The following table displays the quarterly activity in the various significant noninterest income accounts.

Noninterest Income Summary					
(in thousands)	3Q 2006	2Q 2006	3Q 2005	9 Months 2006	9 Months 2005
Deposit related fees	$ 5,220	$ 5,309	$ 4,723	$ 15,081	$ 13,230
Loan related fees	661	488	1,489	1,774	4,131
Trust revenue	927	861	751	2,669	2,231
Gains on sales of loans	265	316	440	885	1,092
Other revenue	1,556	1,510	1,637	4,868	5,300
Total noninterest income	$ 8,629	$ 8,484	$ 9,040	$ 25,277	$ 25,984

Noninterest Expense

Noninterest expense for the quarter ended September 30, 2006 of $20.0 million was a 0.8% increase from the $19.8 million for the third quarter 2005 and a 0.5% increase from the $19.9 million for the second quarter 2006. Year-to-date noninterest expense increased 2.1% from $58.7 million to $59.9 million primarily due to increases in personnel expense associated with annual salary adjustments and staffing of new branches as well as increases in occupancy and equipment related to new branch openings.

Balance Sheet Review

The Corporation's total assets at September 30, 2006 were $2.9 billion compared to $2.9 billion at December 31, 2005 and $3.0 billion at June 30, 2006. Loans outstanding grew $46.8 million from December 31, 2005 representing an annualized increase of 3.0%. Loan growth for the quarter was $15.3 million, an annualized growth rate of 2.8%. The investment portfolio increased an annualized 4.2% or $13.9 million from December 31, 2005 to September 30, 2006 but decreased an annualized 45.5% or $59.3 million during the quarter. The decrease in the investment portfolio quarter over quarter primarily consisted of a $57.0 million reduction in securities available-for-sale to provide funding for loan growth and payment of a maturing Federal Home Loan Bank advance which was acquired in the third quarter 2004 to fund growth in our investment portfolio. Deposits including repurchase agreements of $2.4 billion at September 30, 2006 increased an annualized 3.5% or $62.1 million from December 31, 2005 but decreased an annualized 6.5% or $40.9 million from June 30, 2006.

In the third quarter 2006, the Corporation finalized its 2005 corporate income tax return. As a result, a final goodwill adjustment was booked in the amount of $1.5 million relating to the 2005 acquisition of Heritage Community Bank of Danville.

Shareholders' equity of $274.9 million on September 30, 2006 was an annualized 11.0% increase from the $253.9 million on December 31, 2005 and an annualized increase of 15.5% from the $264.6 million on June 30, 2006. The Corporation's annualized dividend yield to shareholders as of September 30, 2006 was 2.76%.

Loans

Loan growth has occurred in all three major loan categories—commercial, consumer, and residential real estate—from prior year-end; however, the commercial portfolio decreased slightly from June 30, 2006. At September 30, 2006, the commercial loan portfolio increased $11.3 million from prior year-end but decreased $6.4 million from prior quarter. Residential real estate loan growth from prior year-end and prior quarter was $30.2 million and $16.0 million, respectively. Consumer loan growth from prior year-end and prior quarter was $5.2 million and $5.8 million, respectively.

The following tables summarize the Corporation's nonperforming loans as of September 30, 2006 and December 31, 2005.

(in thousands)	Nonaccrual Loans	As a % of Loan Balances by Category	Restructured Loans	As a % of Loan Balances by Category	Accruing Loans Past Due 90 Days or More	As a % of Loan Balances by Category	Total Loan Balances
September 30, 2006							
Commercial construction	$ 23	0.02%	$ 0	0.00%	$ 538	0.41%	$ 131,838
	3,819	0.60	26	0.00	2,972	0.47	638,324

Commercial secured by real estate							
Commercial other	2,350	0.72	58	0.02	639	0.20	327,557
Consumer real estate construction	238	0.47	0	0.00	252	0.50	50,540
Consumer real estate secured	2,493	0.43	0	0.00	1,836	0.32	573,739
Consumer other	3	0.00	0	0.00	411	0.10	420,122
Equipment lease financing	0	0.00	0	0.00	0	0.00	12,009
Total	$ 8,926	0.41%	$ 84	0.00%	$ 6,648	0.31%	$ 2,154,129

(in thousands)	**Nonaccrual Loans**	**As a % of Loan Balances by Category**	**Restructured Loans**	**As a % of Loan Balances by Category**	**Accruing Loans Past Due 90 Days or More**	**As a % of Loan Balances by Category**	**Total Loan Balances**
December 31, 2005							
Commercial construction	$ 0	0.00%	$ 0	0.00%	$ 0	0.00%	$ 115,721
Commercial secured by real estate	4,150	0.62	819	0.12	4,706	0.71	665,911
Commercial other	3,918	1.30	80	0.03	858		