CITY HOLDING CO
Form 10-Q
November 06, 2006

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

FORM 10-Q

(Mark One)

x QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For The Quarterly Period Ended September 30, 2006
OR
o TRANSITION REPORT PURSANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For The Transition Period From ____________To_____________.

Commission File number **0-11733**

CITY HOLDING COMPANY
(Exact name of registrant as specified in its charter)

West Virginia	**55-0619957**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
25 Gatewater Road Charleston, West Virginia	**25313**
(Address of principal executive offices)	(Zip Code)

(304) 769-1100
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant has (1) 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 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. (Check one):

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No x

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

Common stock, $2.50 Par Value - 17,560,399 shares as of November 3, 2006.

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FORWARD-LOOKING STATEMENTS

All statements other than statements of historical fact included in this Quarterly Report on Form 10-Q, including statements in Management's Discussion and Analysis of Financial Condition and Result of Operations are, or may be deemed to be, forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Such information involves risks and uncertainties that could result in the Company's actual results differing from those projected in the forward-looking statements. Important factors that could cause actual results to differ materially from those discussed in such forward-looking statements include, but are not limited to: (1) the Company may incur additional provision for loan losses due to negative credit quality trends in the future that may lead to a deterioration of asset quality; (2) the Company may incur increased charge-offs in the future; (3) the Company may experience increases in the default rates on previously securitized loans that would result in impairment losses or lower the yield on such loans; (4) the Company may continue to benefit from strong recovery efforts on previously securitized loans resulting in improved yields on this asset; (5) the Company could have adverse legal actions of a material nature; (6) the Company may face competitive loss of customers; (7) the Company may be unable to manage its expense levels; (8) the Company may have difficulty retaining key employees; (9) changes in the interest rate environment may have results on the Company's operations materially different from those anticipated by the Company's market risk management functions; (10) changes in general economic conditions and increased competition could adversely affect the Company's operating results; (11) changes in other regulations and government policies affecting bank holding companies and their subsidiaries, including changes in monetary policies, could negatively impact the Company's operating results; and (12) the Company may experience difficulties growing loan and deposit balances. Forward-looking statements made herein reflect management's expectations as of the date such statements are made. Such information is provided to assist stockholders and potential investors in understanding current and anticipated financial operations of the Company and is included pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. The Company undertakes no obligation to update any forward-looking statement to reflect events or circumstances that arise after the date such statements are made.

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City Holding Company and Subsidiaries

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PART I, ITEM 1 - FINANCIAL STATEMENTS
Consolidated Balance Sheets
City Holding Company and Subsidiaries
(in thousands, except share and per share data)

		September 30 2006 (Unaudited)		December 31 2005 (Note A)
Assets				
Cash and due from banks	$	51,460	$	81,822
Interest-bearing deposits in depository institutions		35,800		4,451
Federal funds sold		15,000		-
Cash and Cash Equivalents		102,260		86,273
-				
Securities available for sale, at fair value		465,752		549,966
Securities held-to-maturity, at amortized cost (approximate fair value at September 30, 2006 and December 31, 2005 - $56,452 and $58,892)		53,791		55,397
Total Securities		519,543		605,363
Gross loans		1,697,201		1,612,827
Allowance for loan losses		(15,557)		(16,790)
Net Loans		1,681,644		1,596,037
Bank owned life insurance		54,619		52,969
Premises and equipment		43,545		42,542
Accrued interest receivable		12,934		13,134
Net deferred tax asset		26,308		27,929
Intangible assets		59,038		59,559
Other assets		27,665		18,791
Total Assets	$	2,527,556	$	2,502,597
Liabilities				
Deposits:				
Noninterest-bearing	$	335,887	$	376,076
Interest-bearing:				
Demand deposits		420,613		437,639
Savings deposits		316,300		302,571
Time deposits		907,025		812,134
Total Deposits		1,979,825		1,928,420
Short-term borrowings		135,960		152,255
Long-term debt		76,669		98,425
Other liabilities		36,775		31,356
Total Liabilities		2,229,229		2,210,456
Shareholders' Equity				
Preferred stock, par value $25 per share: 500,000 shares authorized; none issued		-		-
		46,249		46,249

Common stock, par value $2.50 per share: 50,000,000 shares authorized; 18,499,282 shares issued and outstanding at September 30, 2006 and December 31, 2005, less 938,883 and 395,465 shares in treasury, respectively				
Capital surplus		**104,082**		104,435
Retained earnings		**186,171**		160,747
Cost of common stock in treasury		**(30,893)**		(11,278)
Accumulated other comprehensive income:				
Unrealized loss on securities available-for-sale		**(4,562)**		(4,839)
Unrealized gain on derivative instruments		**453**		-
Underfunded pension liability		**(3,173)**		(3,173)
Total Accumulated Other Comprehensive Loss		**(7,282)**		(8,012)
Total Shareholders' Equity		**298,327**		292,141
Total Liabilities and Shareholders' Equity	**$**	**2,527,556**	$	2,502,597

See notes to consolidated financial statements.

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Consolidated Statements of Income *(Unaudited)*
City Holding Company and Subsidiaries
(in thousands, except per share data)

	Three Months Ended September 30		Nine Months Ended September 30	
	2006	2005	**2006**	2005
Interest Income				
Interest and fees on loans	**$ 31,774**	$ 28,083	**$ 91,788**	$ 74,796
Interest on investment securities:				
Taxable	**6,870**	7,288	**21,618**	22,616
Tax-exempt	**437**	508	**1,359**	1,390
Interest on loans held for sale	**122**	-	**322**	-
Interest on deposits in depository institutions	**452**	31	**1,018**	73
Interest on federal funds sold	**92**	-	**92**	4
Total Interest Income	**39,747**	35,910	**116,197**	98,879
Interest Expense				
Interest on deposits	**11,782**	7,763	**31,503**	20,236
Interest on short-term borrowings	**1,343**	956	**3,795**	2,320
Interest on long-term debt	**1,108**	1,571	**3,607**	4,818
Total Interest Expense	**14,233**	10,290	**38,905**	27,374
Net Interest Income	**25,514**	25,620	**77,292**	71,505
Provision for loan losses	**1,225**	600	**2,900**	600
Net Interest Income After Provision for Loan Losses	**24,289**	25,020	**74,392**	70,905
Non-Interest Income				
Investment securities (losses) gains	**(2,067)**	5	**(2,067)**	26
Service charges	**10,833**	10,433	**31,597**	28,561
Insurance commissions	**526**	595	**1,661**	1,732
Trust and investment management fee income	**572**	468	**1,642**	1,521
Bank owned life insurance	**561**	552	**1,776**	2,088
Gain on sale of credit card portfolio	**3,563**	-	**3,563**	-
Other income	**778**	959	**2,445**	2,626
Total Non-Interest Income	**14,766**	13,012	**40,617**	36,554
Non-Interest Expense				
Salaries and employee benefits	**8,733**	8,739	**26,129**	25,063
Occupancy and equipment	**1,602**	1,687	**4,825**	4,726
Depreciation	**1,061**	1,096	**3,182**	3,034
Professional fees and litigation expense	**379**	456	**1,345**	1,535
Postage, delivery, and statement mailings	**765**	670	**2,098**	1,938
Advertising	**810**	764	**2,339**	2,231
Telecommunications	**498**	702	**1,499**	1,688
Bankcard expenses	**485**	512	**1,486**	1,597
Insurance and regulatory	**384**	385	**1,153**	1,116

Office supplies		**417**		327		**1,171**		805
Repossessed asset gains, net of expenses		**20**		(35)		**(105)**		(50)
Loss on repurchase of trust preferred securities		**379**		-		**661**		-
Other expenses		**2,600**		2,619		**7,402**		7,091
Total Non-Interest Expense		**18,133**		17,922		**53,185**		50,774
Income Before Income Taxes		**20,922**		20,110		**61,824**		56,685
Income tax expense		**7,302**		6,938		**21,577**		19,486
Net Income	**$**	**13,620**	$	13,172	**$**	**40,247**	$	37,199
Basic earnings per common share	**$**	**0.78**	$	0.73	**$**	**2.27**	$	2.15
Diluted earnings per common share	**$**	**0.77**	$	0.72	**$**	**2.26**	$	2.12
Dividends declared per common share	**$**	**0.28**	$	0.25	**$**	**0.84**	$	0.75
Average common shares outstanding:								
Basic		**17,557**		18,052		**17,759**		17,314
Diluted		**17,619**		18,238		**17,817**		17,514

See notes to consolidated financial statements.

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Consolidated Statements of Changes in Shareholders' Equity *(Unaudited)*
City Holding Company and Subsidiaries
Nine Months Ended September 30, 2006 and 2005
(in thousands)

	Common Stock	Capital Surplus	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
Balances at December 31, 2004	$ 42,298	$ 55,512	$ 128,175	$ (8,761)	$ (1,144)	$ 216,080
Comprehensive income:						
Net income			37,199			37,199
Other comprehensive income, net of deferred income taxes of $1,975:						
Net unrealized losses on available-for-sale securities of $4,032, net of taxes and reclassification adjustment for gains included in net income of $26					(2,419)	(2,419)
Net unrealized loss on interest rate floors of $905					(543)	(543)
Total comprehensive income						34,237
Cash dividends declared ($0.75 per share)			(13,194)			(13,194)
Issuance of 1,580,034 shares for acquisition of Classic Bancshares, net 108,173 shares owned and transferred to treasury	3,951	53,739		(3,351)		54,339
Issuance of stock awards net		(403)		550		147
Exercise of 262,709 stock options		(3,851)		8,506		4,655
Purchase of 173,876 shares for treasury				(5,832)		(5,832)
Balances at September 30, 2005	$ 46,249	$ 104,997	$ 152,180	$ (8,888)	$ (4,106)	$ 290,432

	Common Stock	Capital Surplus	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
Balances at December 31, 2005	**$ 46,249**	**$ 104,435**	**$ 160,747**	**$ (11,278)**	**$ (8,012)**	**$ 292,141**
Comprehensive income:						
Net income			**40,247**			**40,247**

Other comprehensive gain, net of deferred income taxes of $487:						
Unrealized gains on available-for-sale securities of $462, net of taxes and reclassification adjustment for losses included in net income of $2,067					**277**	**277**
Net unrealized gain on interest rate floors of $755					**453**	**453**
Total comprehensive income						**40,977**
Cash dividends declared ($0.84 per share)			**(14,823)**			**(14,823)**
Issuance of stock awards net		**227**		**244**		**471**
Exercise of 39,935 stock options		**(802)**		**1,455**		**653**
Excess tax benefit on stock -based compensation		**222**				**222**
Purchase of 590,053 treasury shares				**(21,314)**		**(21,314)**
Balances at September 30, 2006	**$ 46,249**	**$ 104,082**	**$ 186,171**	**$ (30,893)**	**$ (7,282)**	**$ 298,327**

See notes to consolidated financial statements.

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Consolidated Statements of Cash Flows *(Unaudited)*
City Holding Company and Subsidiaries
(in thousands)

	Nine Months Ended September 30 **2006**	2005
Operating Activities		
Net income	$ **40,247**	$ 37,199
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization and accretion	**(2,059)**	800
Provision for loan losses	**2,900**	600
Depreciation of premises and equipment	**3,182**	3,034
Deferred income tax expense	**1,027**	2,683
Net periodic employee benefit cost	**184**	37
Loss on repurchase of trust preferred securities	**661**	-
Realized investment securities losses (gains)	**2,067**	(26)
Gain on sale of credit card portfolio	**(3,563)**	-
Loss (gain) on sale of premises and equipment	**15**	(70)
Proceeds from bank-owned life insurance	**126**	910
Increase in value of bank-owned life insurance	**(1,776)**	(2,088)
Decrease (increase) in accrued interest receivable	**200**	(1,424)
Increase in other assets	**(8,374)**	(2,442)
Increase (decrease) in other liabilities	**5,400**	(3,212)
Net Cash Provided by Operating Activities	**40,237**	36,001
Investing Activities		
Proceeds from maturities and calls of securities held-to-maturity	**1,437**	3,072
Proceeds from sale of money market and mutual fund securities available-for-sale	**757,150**	960,201
Purchases of money market and mutual fund securities available-for-sale	**(754,842)**	(1,001,150)
Proceeds from sales of securities available-for-sale	**33,219**	2,527
Proceeds from maturities and calls of securities available-for-sale	**57,673**	105,756
Purchases of securities available-for-sale	**(11,604)**	(12,285)
Net (increase) in loans	**(81,230)**	(36,959)
Sales of premises and equipment	**-**	210
Purchases of premises and equipment	**(4,200)**	(3,456)
Acquisition, net cash received	**-**	(7,121)
Net Cash (Used in) Provided by Investing Activities	**(2,397)**	10,795
Financing Activities		
Net (decrease) in noninterest-bearing deposits	**(40,189)**	(3,572)
Net increase (decrease) in interest-bearing deposits	**91,691**	(24,400)
Net (decrease) increase in short-term borrowings	**(19,016)**	1,562
Repayment of long-term debt	**(12,991)**	(1,542)
Redemption of trust preferred securities	**(6,477)**	-
Purchases of treasury stock	**(21,314)**	(5,832)
Exercise of stock options	**653**	2,232
Excess tax benefits from stock-based compensation arrangements	**222**	-

Dividends paid		**(14,432)**		(12,301)
Net Cash Used in Financing Activities		**(21,853)**		(43,853)
Increase in Cash and Cash Equivalents		**15,987**		2,943
Cash and cash equivalents at beginning of period		**86,273**		56,084
Cash and Cash Equivalents at End of Period	**$**	**102,260**	$	59,027

See notes to consolidated financial statements.

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Notes to Consolidated Financial Statements(Unaudited)
September 30, 2006
Note A - Basis of Presentation

The accompanying consolidated financial statements, which are unaudited, include all of the accounts of City Holding Company ("the Parent Company") and its wholly-owned subsidiaries (collectively, "the Company"). All material intercompany transactions have been eliminated. The consolidated financial statements include all adjustments that, in the opinion of management, are necessary for a fair presentation of the results of operations and financial condition for each of the periods presented. Such adjustments are of a normal recurring nature. The results of operations for the nine months ended September 30, 2006 are not necessarily indicative of the results of operations that can be expected for the year ending December 31, 2006. The Company's accounting and reporting policies conform with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Such policies require management to make estimates and develop assumptions that affect the amounts reported in the consolidated financial statements and related footnotes. Actual results could differ from management's estimates.

The consolidated balance sheet as of December 31, 2005 has been extracted from audited financial statements included in the Company's 2005 Annual Report to Stockholders. Certain information and footnote disclosures normally included in the annual financial statements prepared in accordance with U.S. generally accepted accounting principles have been omitted. These financial statements should be read in conjunction with the financial statements and notes thereto included in the 2005 Annual Report of the Company.

Certain amounts in the 2005 financial statements have been reclassified to conform to the 2006 presentation. Such reclassifications had no impact on net income or shareholders' equity.

Note B -Previously Securitized Loans

Between 1997 and 1999, the Company completed six securitization transactions involving approximately $760 million in 125% of fixed rate, junior-lien underlying mortgages. The Company retained a financial interest in each of the securitizations. Principal amounts owed to investors were evidenced by securities ("Notes"). The Notes were subject to redemption, in whole but not in part, at the option of the Company, as owner of the retained interests in the securitization transactions, or at the option of the Note insurer, on or after the date on which the related Note balance declined to 5% or less of the original Note balance. Once the Notes were redeemed, the Company became the beneficial owner of the mortgage loans and recorded the loans as assets of the Company within the loan portfolio. During 2003 and 2004, the outstanding Note balances of the six securitizations declined below this 5% threshold and the Company exercised its redemption options on each of those securitizations. The table below summarizes information regarding delinquencies, net credit recoveries, and outstanding collateral balances of previously securitized loans for the dates presented:

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(in thousands)	As of and for the Nine Months Ended September 30, **2006**	2005	As of and for the Year Ended December 31, 2005
Previously Securitized Loans:			
Total principal amount of loans outstanding	**$ 36,291**	$ 53,320	$ 48,061
Discount	**(17,771)**	(17,721)	(17,805)
Net book value	**$ 18,520**	$ 35,599	$ 30,256
Principal amount of loans between 30 and 89 days past due	**$ 827**	$ 1,843	$ 1,848
Principal amount of loans 90 days and above past due	**387**	381	268
Net credit recoveries during the period	**3,817**	2,237	3,225

The Company accounts for the difference between the carrying value and the total expected cash flows from these loans as an adjustment of the yield earned on the loans over their remaining lives. The discount is accreted to income over the period during which payments are probable of collection and are reasonably estimable. Additionally, the collectibility of previously securitized loans is evaluated over the remaining lives of the loans. An impairment charge on previously securitized loans would be provided through the Company's provision for loan losses if the discounted present value of estimated future cash flows declines below the recorded value of previously securitized loans. No such impairment charges were recorded for the nine months ended September 30, 2006, or for the year ending December 31, 2005.

As of September 30, 2006, the Company reported a book value of previously securitized loans of $18.5 million whereas the actual contractual outstanding balance of previously securitized loans at September 30, 2006, was $36.3 million. The difference ("the discount") between the book value and the expected total cash flows from previously securitized loans is accreted into interest income over the life of the loans.

During the first nine months of 2006 and 2005, the Company recognized $7.4 million and $8.8 million, respectively, of interest income from its previously securitized loans.

Note C -Derivative Instruments

The Company utilizes interest rate floors to mitigate exposure to interest rate risk. As of September 30, 2006, the Company has entered into eight interest rate floor contracts with a total notional amount of $600 million, seven of which (total notional amount of $500 million) are designated as cash flow hedges. The objective of these interest rate floors is to protect the overall cash flows from the Company's portfolio of $500 million of variable-rate loans outstanding from the risk of a decrease in those cash flows.

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The notional amounts and estimated fair values of interest rate floor derivative positions outstanding at period end are presented in the following table. The estimated fair values of the interest rate floors on variable-rate loans are based on quoted market prices.

	September 30, 2006		December 31, 2005	
(*in thousands*)	**Notional Value**	**Estimated Fair Value**	Notional Value	Estimated Fair Value
Interest rate floors on variable-rate loans	**$ 500,000**	**$ 5,371**	$ 400,000	$ 1,270

The weighted-average strike rates for interest rate floors outstanding at September 30, 2006 range from 6.00% to 8.00%.

Interest rate contracts involve the risk of dealing with counterparties and their ability to meet contractual terms. These counterparties must have an investment grade credit rating and be approved by the Company's Asset and Liability Committee.

For cash flow hedges, the effective portion of the gain or loss on the derivative hedging instrument is reported in other comprehensive income, while the ineffective portion (indicated by the excess of the cumulative change in the fair value of the derivative over that which is necessary to offset the cumulative change in expected future cash flows on the hedge transaction) is recorded in current earnings as other income or other expense. The Company recognized the increase in fair value of $0.5 million, net of taxes, in Other Comprehensive Income for the nine months ending September 30, 2006 on these derivative instruments.

During the second quarter of 2006, the Company redesignated an interest rate floor contract with a total notional amount of $100 million that had previously been accounted for as a cash flow hedge as a freestanding derivative. The Company recorded a $0.1 million charge to expense to reflect changes in fair value of this instrument during the second quarter of 2006. This interest rate floor has no fair value at September 30, 2006, matures in 20 months and has a strike rate of 6.00%.

Note D - Short-term borrowings

The components of short-term borrowings are summarized below:

(*in thousands*)	**September 30, 2006**	December 31, 2005
Security repurchase agreements	**$ 104,381**	$ 76,443
Short-term FHLB advances	**31,579**	75,812
Total short-term borrowings	**$ 135,960**	$ 152,255

Securities sold under agreements to repurchase were sold to corporate and government customers as an alternative to available deposit products. The underlying securities included in repurchase agreements remain under the Company's control during the effective period of the agreements.

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Note E - Long-Term Debt

The components of long-term debt are summarized below:

(dollars in thousands)	Maturity		September 30, 2006	Weighted Average Interest Rate
FHLB Advances	2008	$	**46,349**	**3.55%**
FHLB Advances	2010		**3,000**	**6.05%**
FHLB Advances	2011		**1,000**	**5.98%**
FHLB Advances	Thereafter		**3,484**	**4.90%**
Junior subordinated debentures owed to City Holding Capital Trust	2028 (a)		**22,836**	**9.15%**
Total long-term debt		$	**76,669**	

(a) Junior Subordinated Debentures owed to City Holding Capital Trust are redeemable prior to maturity at the option of the Company (i) on or after April 1, 2008, in whole at any time or in part from time-to-time, at declining redemption prices ranging from 104.58% to 100.00% on April 1, 2018, and thereafter, or (ii) in whole, but not in part, at any time within 90 days following the occurrence and during the continuation of certain pre-defined events.

The Company formed a statutory business trust, City Holding Capital Trust ("the Capital Trust"), under the laws of Delaware. The Capital Trust was created for the exclusive purpose of (i) issuing trust-preferred capital securities ("Capital Securities"), which represent preferred undivided beneficial interests in the assets of the trust, (ii) using the proceeds from the sale of the Capital Securities to acquire junior subordinated debentures ("Debentures") issued by the Company, and (iii) engaging in only those activities necessary or incidental thereto. The trust is considered a variable interest entity for which the Company is not the primary beneficiary. Accordingly, the accounts of the trusts are not included in the Company's consolidated financial statements. During the nine months ended September 30, 2006, the Company incurred a $0.7 million charge related to the early extinguishment of debt through the repurchase of $6 million of its trust preferred securities.

The Capital Securities issued by the statutory business trust qualify as Tier 1 capital for the Company under the Federal Reserve Board guidelines. In March 2005, the Federal Reserve Board issued a final rule that allows the inclusion of trust preferred securities issued by unconsolidated subsidiary trusts in Tier 1 capital, but with stricter limits. Under this ruling, after a five-year transition period, the aggregate amount of trust preferred securities and certain other capital elements would be limited to 25% of Tier 1 capital elements, net of goodwill. The amount of trust preferred securities and certain other elements in excess of the limit could be included in Tier 2 capital, subject to restrictions. The Company expects to include all of its $22.0 million in trust preferred securities in Tier 1 capital. The trust preferred securities could be redeemed without penalty if they were no longer permitted to be included in Tier 1 capital.

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Note F - Employee Benefit Plans

On January 1, 2006, the Company adopted SFAS No. 123R, "Share-Based Payment," which is a revision of SFAS No. 123, "Accounting for Stock Issued for Employees." SFAS No. 123R establishes accounting requirements for share-based compensation to employees and carries forward prior guidance on accounting for awards to non-employees. Prior to the adoption of SFAS No. 123R, the Company reported employee compensation expense under stock option plans only if options were granted below market prices at grant date in accordance with the intrinsic value method of Accounting Principles Board Opinion ("APB") No. 25, "Accounting for Stock Issued to Employees," and related interpretations. In accordance with APB No. 25, the Company reported no compensation expense on options granted as the exercise price of the options granted always equaled the market price of the underlying stock on the date of grant. SFAS No. 123R eliminated the ability to account for stock-based compensation using APB No. 25 and requires that such transactions be recognized as compensation cost in the income statement based on their fair values on the measurement date, which is generally the date of the grant.

The Company transitioned to SFAS No. 123R using the modified prospective application method ("modified prospective application"). As permitted under modified prospective application, as it is applicable to the Company, SFAS No. 123R applies to new awards and to awards modified, repurchased, or cancelled after January 1, 2006. Additionally, compensation cost for non-vested awards that were outstanding as of January 1, 2006 will be recognized as the remaining requisite service is rendered during the period of and/or the periods after the adoption of SFAS No. 123R, adjusted for estimated forfeitures. The recognition of compensation cost for those earlier awards is based on the same method and on the same grant-date fair values previously determined for the pro forma disclosures reported by the Company for periods prior to January 1, 2006.

The fair value of the Company's employee stock options granted is estimated at the date of grant using the Black-Scholes option-pricing model. This model requires the input of highly subjective assumptions, changes to which can materially affect the fair value estimate. Additionally, there may be other factors that would otherwise have a significant effect on the value of employee stock options granted, but are not considered by the model. Because the Company's employee stock options have characteristics significantly different from those of traded options and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options at the time of grant. The assumptions used in the Black-Scholes option-pricing model are as follows:

	For the Nine Months Ended September 30,	
	2006	2005
Risk-free interest rate	**3.93%**	3.71%
Expected dividend yield	**2.98%**	3.11%
Volatility factor	**0.384**	0.388
Expected life of option	**5 years**	5 years

As the Company has not issued any options during the nine months ended September 30, 2006, the factors for September 30, 2006 are consistent with amounts at December 31, 2005 reported in the Company's 2005 Annual Report.

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There was no material impact on the Company's income before income taxes and net income from the adoption of SFAS No. 123R. Prior to the adoption of SFAS No. 123R, the Company presented all tax benefits of deductions resulting from the exercise of stock options as operating cash flows in the Consolidated Statements of Cash Flows. SFAS No. 123R requires the cash flows from the tax benefits resulting from tax deductions in excess of the compensation expense recognized for those options to be classified as financing cash flows. An excess tax benefit totaling $0.2 million is classified as a financing cash inflow for the nine months ended September 30, 2006.

Stock-based compensation expense is recognized ratably over the requisite service period for all awards. Unrecognized stock-based compensation expense related to stock options totaled $0.3 million at September 30, 2006. At September 30, 2006, this unrecognized expense is expected to be recognized over 16 months based on the weighted average-life of the option.

The following pro forma information presents net income, earnings per share, and diluted earnings per share for the three and nine months ended September 30, 2005 as if the fair value method of SFAS No. 123R had been used to measure compensation cost for stock-based compensation plans. For purposes of these pro forma disclosures, the estimated fair value of options is amortized to expense over the options' vesting periods.

(in thousands, except earnings per share data)	For the Three Months Ended September 30, 2005	For the Nine Months Ended September 30, 2005
Net income, as reported	$ 13,172	$ 37,199
Pro forma stock-based employee compensation expense, net of tax	(133)	(337)
Net income, pro forma	$ 13,039	$ 36,862
Basic earnings per share, as reported	$ 0.73	$ 2.15
Basic earnings per share, pro forma	$ 0.72	$ 2.13
Diluted earnings per share, as reported	$ 0.72	$ 2.12
Diluted earnings per share, pro forma	$ 0.71	$ 2.10

A summary of the Company's stock option activity and related information is presented below for the nine months ended September 30:

	2006		2005	
	Options	**Weighted-Average Exercise Price**	Options	Weighted-Average Exercise Price
Outstanding at January 1	**318,132**	**$ 28.56**	602,307	$ 16.51
Granted	**-**	**-**	101,500	32.23
Exercised	**(39,935)**	**16.36**	(262,709)	8.50
Forfeited	**-**	**-**	(60,750)	33.90

Outstanding at September 30	**278,197**	**$**	**30.32**	380,348	$ 23.46

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Additional information regarding stock options outstanding and exercisable at September 30, 2006, is provided in the following table:

Ranges of Exercise Prices	No. of Options Outstanding	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life (Months)	Aggregate Intrinsic Value (in thousands)	No. of Options Currently Exercisable	Weighted-Average Exercise Price of Options Currently Exercisable	Aggregate Intrinsic Value of Options Currently Exercisable (in thousands)
$13.30	24,100	$ 13.30	64	$ 640	24,100	$ 13.30	$ 640
$28.00 - $36.90	254,097	31.93	94	2,018	181,472	31.79	1,467
	278,197			$ 2,658	205,572		$ 2,107

In addition to stock options, the Company also grants restricted stock awards to certain officers and employees. The Company records compensation expense with respect to such awards in an amount equal to the fair market value of the common stock covered by each award on the date of grant. The restricted shares awarded become fully vested after various periods of continued employment from the respective dates of grant. The Company is entitled to an income tax deduction in an amount equal to the taxable income reported by the holders of the restricted shares when the restrictions are released and the shares are issued. Compensation is being charged to expense over the respective vesting periods. Restricted shares are forfeited if officers and employees terminate prior to the lapsing of restrictions. The Company records forfeitures of restricted stock as treasury share repurchases and any compensation cost previously recognized is reversed in the period of forfeiture. Stock-based compensation expense associated with stock awards, included in salaries and employee benefits, was $0.1 million for the nine month period ended September 30, 2006. There was no expense associated with stock awards for the 2005 reporting period. Unrecognized stock-based compensation expense related to non-vested stock awards was $0.2 million at September 30, 2006. At September 30, 2006, this unrecognized expense is expected to be recognized over 4 years based on the weighted average-life of the options.

The Company provides retirement benefits to its employees through the City Holding Company 401(k) Plan and Trust ("the 401(k) Plan"), which is intended to be compliant with Employee Retirement Income Security Act (ERISA) section 404(c). Any employee who has attained age 21 is eligible to participate beginning the first day of the month following employment. Unless otherwise specifically chosen, every employee is automatically enrolled in the 401(k) Plan and may make before-tax contributions of between 1% and 15% of eligible pay up to the dollar limit imposed by Internal Revenue Service regulations. The first 6% of an employee's contribution is matched 50% by the Company. The employer matching contribution is invested according to the investment elections chosen by the employee. Employees are 100% vested in both employee and employer contributions and the earnings they generate. The Company's total expense associated with the retirement benefit plan approximated $0.4 million for both of the nine month periods ended September 30, 2006 and September 30, 2005 and approximated $0.1 million for both of the three month periods ended September 30, 2006 and September 30, 2005.

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The Company also maintains a defined benefit pension plan ("the Defined Benefit Plan") that covers approximately 300 current and former employees. The Defined Benefit Plan was frozen in 1999 subsequent to the Company's acquisition of the plan sponsor. The Defined Benefit Plan maintains an October 31 year-end for purposes of computing its benefit obligations. The Company made contributions to the Defined Benefit Plan approximating $0.1 million for both of the nine month periods ended September 30, 2006 and 2005.
The following table presents the components of the net periodic pension cost of the Defined Benefit Plan:

(in thousands)	Three months ended September 30, **2006**	Three months ended September 30, 2005	Nine months ended September 30, **2006**	Nine months ended September 30, 2005
Components of net periodic cost:				
Interest cost	**$ 162**	$ 166	**$ 503**	$ 497
Expected return on plan assets	**(180)**	(190)	**(561)**	(571)
Net amortization and deferral	**79**	37	**242**	111
Net Periodic Pension Cost	**$ 61**	$ 13	**$ 184**	$ 37

Note G - Commitments and Contingencies
The Company is a party to certain financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. The Company has entered into agreements with its customers to extend credit or provide a conditional commitment to provide payment on drafts presented in accordance with the terms of the underlying credit documents. The Company also provides overdraft protection to certain demand deposit customers that represent an unfunded commitment. Overdraft protection commitments, which are included with other commitments below, are uncollateralized and are paid at the Company's discretion. Conditional commitments generally include standby and commercial letters of credit. Standby letters of credit represent an obligation of the Company to a designated third party contingent upon the failure of a customer of the Company to perform under the terms of the underlying contract between the customer and the third party. Commercial letters of credit are issued specifically to facilitate trade or commerce. Under the terms of a commercial letter of credit, drafts will be drawn when the underlying transaction is consummated, as intended, between the customer and a third party. The funded portion of these financial instruments is reflected in the Company's balance sheet, while the unfunded portion of these commitments is not reflected in the balance sheet. The table below presents a summary of the contractual obligations of the Company resulting from significant commitments:

(in thousands)	**September 30, 2006**	December 31, 2005
Commitments to extend credit:		
Home equity lines	**$ 140,418**	$ 148,259
Credit card lines	**-**	39,646
Commercial real estate	**45,904**	65,966
Other commitments	**133,268**	145,535
Standby letters of credit	**12,520**	7,250
Commercial letters of credit	**614**	312

Loan commitments and standby and commercial letters of credit have credit risks essentially the same as that involved in extending loans to customers and are subject to the Company's standard credit policies. Collateral is obtained based on management's credit assessment of the customer. Management does not anticipate any material losses as a result of these commitments.

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Note H - Total Comprehensive Income

The following table sets forth the computation of total comprehensive income:

(in thousands)	Nine months ended September 30, **2006**	2005
Net income	**$ 40,247**	$ 37,199
Unrealized security (losses) arising during the period	**(1,605)**	(4,006)
Reclassification adjustment for losses (gains) included in income	**2,067**	(26)
	462	(4,032)
Unrealized gain (loss) on interest rate floors	**755**	(905)
Other comprehensive income before income taxes	**1,217**	(4,937)
Tax effect	**(487)**	1,975
Total comprehensive income	**$ 40,977**	$ 34,237

Note I - Earnings per Share

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

(in thousands, except per share data)	Three months ended September 30, **2006**	Three months ended September 30, 2005	Nine months ended September 30, **2006**	Nine months ended September 30, 2005
Net income	**$ 13,620**	$ 13,172	**$ 40,247**	$ 37,199
Average shares outstanding	**17,557**	18,052	**17,759**	17,314
Effect of dilutive securities:				
Employee stock options	**62**	186	**58**	200
Shares for diluted earnings per share	**17,619**	18,238	**17,817**	17,514
Basic earnings per share	**$ 0.78**	$ 0.73	**$ 2.27**	$ 2.15
Diluted earnings per share	**$ 0.77**	$ 0.72	**$ 2.26**	$ 2.12

Options to purchase 90,000 shares of common stock at exercise prices between $32.89 and $33.90 per share were outstanding during the third quarter of 2005, respectively, but were not included in the computation of diluted earnings per share because the options' exercise price was greater than the average market price of the common shares and therefore, the effect would have been anti-dilutive.

Note J - Acquisitions

On May 20, 2005, City completed the acquisition of Classic Bancshares ("Classic") and the merger of Classic's subsidiary, Classic Bank, into City National Bank. On May 20, 2005, Classic had total assets of $338 million, net loans of $254 million, deposits of $252 million, and $38 million of shareholders' equity. The acquisition was accounted for using the purchase accounting method and the results of operations of Classic are included in City's consolidated statement of income from the date of acquisition forward.

Pro forma information regarding the acquisition has not been presented as the acquisition is not deemed to be significant, and pro forma results assuming that the acquisition had occurred at the beginning of 2005 would not be materially different than the results reported herein.

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Note K - Disposition

On August 4, 2006, the Company sold its credit card portfolio of approximately $11.5 million to Elan Financial Services (Elan), a wholly owned subsidiary of U.S. Bancorp. As part of this agreement, the Company and Elan have entered into an agent marketing agreement that will enable the Company's customers to continue to receive credit card products, while allowing Elan the exclusive marketing rights to the Company's current and prospective customer base. This transaction was completed during the third quarter of 2006 and resulted in a pre-tax gain of approximately $3.6 million for the Company. These loans were previously reported as loans held for sale at June 30, 2006.

Note L - Recent Accounting Pronouncements

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes--an interpretation of FASB Statement No. 109 (FIN 48), which clarifies the accounting and disclosure for uncertain in tax positions, as defined. FIN 48 requires that a tax position meet a "probable recognition threshold" for the benefit of the uncertain tax position to be recognized in the financial statements. A tax position that fails to meet the probable recognition threshold will result in either reduction of a current or deferred tax asset or receivable, or recording a current or deferred tax liability. FIN 48 also provides guidance on measurement, derecognition of tax benefits, classification, interim period accounting disclosure, and transition requirements in accounting for uncertain tax positions. This interpretation is effective for fiscal years beginning after December 15, 2006. The Company is assessing the impact of adopting the new pronouncement and is currently unable to estimate its impact, if any, on the Company's consolidated financial statements.

In September 2006, the FASB issued Statement No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans (Statement 158), an amendment of FASB Statements No. 87, 88, 106, and 132(R) Statement 158 requires recognition of the funded status (the difference between the fair value of the plan assets and the benefit obligation) of a benefit plan as an asset or liability in the employers' financial statements, requires the measurement of benefit plan assets and obligations as of the end of the employer's fiscal year-end, and requires recognition of the funded status of a benefit plan in other comprehensive income in the year in which the changes occur. Statement 158 is effective for fiscal years ending after December 15, 2006, and early application is encouraged. The requirement to measure the plan assets and benefit obligation as of the date of the employers' fiscal year-end financial statements is effective for fiscal years ending after December 15, 2008. The Company does not anticipate that the adoption of this statement will have a material effect on its financial statements.

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

Critical Accounting Policies

The accounting policies of the Company conform with U.S. generally accepted accounting principles and require management to make estimates and develop assumptions that affect the amounts reported in the financial statements and related footnotes. These estimates and assumptions are based on information available to management as of the date of the financial statements. Actual results could differ from management's estimates. As this information changes, management's estimates and assumptions used to prepare the Company's financial statements and related disclosures may also change. The most significant accounting policies followed by the Company are presented in Note One to the audited financial statements included in the Company's 2005 Annual Report to Stockholders. The information included in this Quarterly Report on Form 10-Q, including the Consolidated Financial Statements, Notes to Consolidated Financial Statements, and Management's Discussion and Analysis of Financial Condition and Results of Operations, should be read in conjunction with the financial statements and notes thereto included in the 2005 Annual Report of the Company. Based on the valuation techniques used and the sensitivity of financial statement amounts to the methods, assumptions, and estimates underlying those amounts, management has identified the determination of the allowance for loan losses, income taxes, and previously securitized loans to be the accounting areas that require the most subjective or complex judgments and, as such, could be most subject to revision as new information becomes available.

Pages 25 - 29 of this Quarterly Report on Form 10-Q provide management's analysis of the Company's allowance for loan losses and related provision. The allowance for loan losses is maintained at a level that represents management's best estimate of probable losses in the loan portfolio. Management's determination of the adequacy of the allowance for loan losses is based upon an evaluation of individual credits in the loan portfolio, historical loan loss experience, current economic conditions, and other relevant factors. This determination is inherently subjective as it requires material estimates including the amounts and timing of future cash flows expected to be received on impaired loans that may be susceptible to significant change. The allowance for loan losses related to loans considered to be impaired is generally evaluated based on the discounted cash flows using the impaired loan's initial effective interest rate or the fair value of the collateral for certain collateral dependent loans.

The Company is subject to federal and state income taxes in the jurisdictions in which it conducts business. In computing the provision for income taxes, management must make judgments regarding interpretation of laws in those jurisdictions. Because the application of tax laws and regulations for many types of transactions is susceptible to varying interpretations, amounts reported in the financial statements could be changed at a later date upon final determinations by taxing authorities. On a quarterly basis, the Company estimates its annual effective tax rate for the year and uses that rate to provide for income taxes on a year-to-date basis.

Note B, beginning on page 8 of this Quarterly Report on Form 10-Q, and pages 29 and 30 provide management's analysis of the Company's previously securitized loans. Amounts reported in the Consolidated Balance Sheets as "previously securitized loans" represent the carrying value of loans beneficially owned by the Company as a result of having fully redeemed the obligations owed to investors ("Notes") in certain of the Company's securitization transactions. The carrying value of previously securitized loans is determined using assumptions with regard to loan prepayment and default rates. Using cash flow modeling techniques that incorporate these assumptions, the Company estimated total future cash collections expected to be received from these loans and determined the yield at which the resulting discount would be accreted into income.

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If, upon periodic evaluation, the estimate of the total probable collections is increased or decreased but is still greater than the sum of the original carrying amount less subsequent collections plus the discount accreted to date, and it is probable that collection will occur, the amount of the discount to be accreted is adjusted accordingly and the amount of periodic accretion is adjusted over the remaining lives of the loans. If, upon periodic evaluation, the discounted present value of estimated future cash flows declines below the recorded value of previously securitized loans, an impairment charge would be provided through the Company's provision for loan losses. Please refer to Note B of Notes to Consolidated Financial Statements, on pages 8 - 9 for further discussion of SOP 03-3.

Financial Summary

Nine Months Ended September 30, 2006 vs. 2005

The Company reported consolidated net income of $40.2 million, or $2.26 per diluted common share, for the nine months ended September 30, 2006, compared to $37.2 million, or $2.12 per diluted common share for the nine months ended September 30, 2005. Return on average assets ("ROA") was 2.13% and return on average equity ("ROE") was 18.3% for the first nine months of 2006, compared to 2.09% and 19.5%, respectively, for the first nine months of 2005.

Net interest income increased $5.8 million from $71.5 million for the nine months ended September 30, 2005, to $77.3 million for the nine months ended September 30, 2006 due to both internal growth and the acquisition of Classic that was completed during the second quarter of 2005 (see *Net Interest Income*). For the first nine months of 2006, the Company has recorded a provision for loan losses of $2.9 million, compared to $0.6 million for the first nine months of 2005 (see *Allowance and Provision for Loan Losses*). Primarily on the strength of increased service charge revenues, ($3.0 million or 10.6%), non-interest income increased $4.1 million from the nine months ended September 30, 2005 to the nine months ended September 30, 2006. Additionally, the Company recognized a gain of $3.6 million from the sale of its credit card portfolio, which was partially offset by $2.1 million of realized investment losses (see *Non-Interest Income*). Non-interest expenses increased $2.4 million primarily due to the acquisition of Classic, which was completed during the second quarter of 2005.

Three Months Ended September 30, 2006 vs. 2005

The Company reported consolidated net income of $13.6 million, or $0.77 per diluted common share, for the three months ended September 30, 2006, compared to $13.2 million, or $0.72 per diluted common share, for the third quarter of 2005. Return on average assets ("ROA") was 2.17% and return on average equity ("ROE") was 18.6% for the third quarter of 2006, compared to 2.09% and 18.2%, respectively, for the third quarter of 2005.

The Company's tax equivalent net interest income was essentially flat from the third quarter of 2005 to the third quarter of 2006 as increased yields on interest earning assets were more than offset by increases in the rates paid on interest-bearing liabilities. Compared to the third quarter of 2005, interest income decreased $1.4 million due to volume (primarily related to previously securitized loans) that was offset by an increase of $1.3 million due to rates increases. The Company recorded a provision for loan losses of $1.2 million for the third quarter of 2006 while $0.6 million was recorded for the third quarter of 2005 (see Allowance and Provision for Loan Losses). As further discussed under the caption Non-Interest Income and Expense, non-interest income increased $1.8 million from the quarter ended September 30, 2005, to the quarter ended September 30, 2006. During the third quarter of 2006, a gain of $3.6 million from the Company's sale of its credit card portfolio was offset by $2.1 million of realized investment losses. Non-interest expenses increased $0.2 million principally due to a $0.4 million charge associated with the early extinguishment of debt through the repurchase of $3.5 million of the Company's trust preferred securities.

Net Interest Income

Nine Months Ended September 30, 2006 vs. 2005

On a tax equivalent basis, net interest income increased $5.8 million, or 8.0%, from $72.3 million in the first nine months of 2005 to $78.0 million in the first nine months of 2006. This increase was primarily due to a widening of the Company's net interest margin that increased net interest income by $5.6 million from the first nine months of 2005. Interest income from the Company's loan portfolio excluding Previously Securitized Loans increased $10.6 million from the nine months ended September 30, 2005 as the yield on these loans increased 84 basis points. In addition to benefiting from increased yields on loans, the Company has also been able to increase the average balances of its traditional loan portfolio (residential real estate, home equity, commercial and consumer loans) due to both internal growth and the acquisition of Classic during the second quarter of 2005. The increase in average balances of $179 million, or 12.5%, from the first nine months of 2005 increased interest income associated with these loans by $5.2 million.

These increases were partially offset by increased interest expenses associated with higher rates paid on interest-bearing deposit accounts and increased balances of interest-bearing deposits. As a result of an increase of 74 basis points in the rate paid on interest-bearing deposits, interest expense increased $7.9 million from the first nine months ended September 30, 2005. In addition, as a result of an increase in the average balances of interest-bearing deposits of $170 million, or 11.7%, interest expense increased $3.3 million from the first nine months of 2005. The increase in the average balance of interest-bearing deposits from the nine months ended September 30, 2005 is attributable to the Classic acquisition and internal growth.

In addition to increased deposit interest expense, the Company's increase in interest income was also partially offset by a decrease in interest income from Previously Securitized Loans of $1.4 million from the nine months ended September 30, 2005. This decrease is due to a decrease in the average balances of these loans of $22.1 million, or 48.0%, from $46.2 million for the nine months ended September 30, 2005 to $24.1 million for the nine months ended September 30, 2006. As a result of this decrease, interest income from Previously Securitized Loans decreased $4.2 million from the nine months ended September 30, 2005. This reduction was partially mitigated by an increase in the yield on these assets from 25.54% for the first nine months of 2005 to 41.19% for the first nine months of 2006 (see *Previously Securitized Loans*).

The net interest margin for the first nine months of 2006 of 4.60% represented a 14 basis point increase from the first nine months of 2005's net interest margin of 4.46%. In order to offset the decreasing balances of high yielding previously securitized loans and resultant lower levels of interest income from these assets, the Company positioned its balance sheet to benefit from rising interest rates by emphasizing variable rate loan products. Excluding the impact of previously securitized loans and the Classic acquisition, the Company's net interest margin increased 28 basis points, or $4.6 million, for the nine months ended September 30, 2005 when compared to the nine months ended September 30, 2006.

Three Months Ended September 30, 2006 vs. 2005

The Company's tax equivalent net interest income was essentially flat from the third quarter of 2005 to the third quarter of 2006 as increased yields on interest earning assets were more than offset by increases in the rates paid on interest-bearing liabilities. Compared to the third quarter of 2005, interest income decreased $1.4 million due to volume (primarily related to previously securitized loans) that was offset by an increase of $1.3 million due to rates increases.

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Interest income on earning assets increased by $3.8 million, driven primarily by an increase in interest income on loans of $3.7 million despite a decrease of $0.7 million in interest income from previously securitized loans from the third quarter of 2005. The decrease in interest income from previously securitized loans was related to the continued decline in the average balance of these loans from $38.4 million for the quarter ended September 30, 2005, to $20.3 million for the quarter ended September 30, 2006. However, this reduction in average outstanding balances was partially mitigated as the yield on these loans rose from an average of 30.1% for the third quarter of 2005 to 43.2% for the third quarter of 2006 (see Previously Securitized Loans section for further discussion). The yield for the immediately preceding quarter was 41.9%. Interest income on all other loans (commercial, residential, home equity, and consumer) increased by $4.4 million as the average yield on these loans increased by 80 basis points and the average balance on outstanding loans increased by $68.7 million (excluding previously securitized loans). Additionally, interest income from loans was impacted by the sale of the Company's credit card portfolio which reduced interest income by $0.4 million from the third quarter of 2005.

Offsetting the increase in interest income on earning assets was an increase in interest expense on deposits of $3.3 million due primarily to an 87 basis point increase in the rates paid on interest bearing deposits from the third quarter of 2005. In addition, increases in average outstanding deposit balances of $87 million, or 5.6%, drove up interest expense by $0.7 million. The increase in rates and balances was primarily associated with time deposits, which experienced an increase of 107 basis points while outstanding time deposit balances grew $105 million as compared to the third quarter of 2005.

The net interest margin was 4.51% for the quarters ended September 30, 2006 and 2005 and 4.58% during the quarter ended June 30, 2006. The decrease in the net interest margin between the second quarter of 2006 and the third quarter of 2006 can primarily be attributed to lower balances on previously securitized loans and the sale of the credit card portfolio during the third quarter.

Table One
Average Balance Sheets and Net Interest Income
(in thousands)

	Nine months ended September 30,					
	2006			2005		
	Average Balance	**Interest**	**Yield/ Rate**	Average Balance	Interest	Yield/ Rate
Assets						
Loan portfolio (1):						
Residential real estate	**$ 597,223**	**$ 25,630**	**5.74%**	$ 528,420	$ 22,205	5.62%
Home equity	**309,007**	**17,945**	**7.76**	306,047	13,770	6.02
Commercial financial and agriculture	**656,688**	**36,581**	**7.45**	543,809	25,359	6.23
Installment loans to individuals	**49,381**	**4,211**	**11.40**	54,695	4,630	11.32
Previously securitized loans	**24,090**	**7,422**	**41.19**	46,232	8,832	25.54
Total loans	**1,636,389**	**91,789**	**7.50**	1,479,203	74,796	6.76
Securities:						
Taxable	**554,884**	**21,618**	**5.21**	637,413	22,616	4.74
Tax-exempt (2)	**42,823**	**2,091**	**6.53**	42,450	2,138	6.73
Total securities	**597,707**	**23,709**	**5.30**	679,863	24,754	4.87
Loans held for sale	**3,337**	**322**	**12.90**	-	-	-
Deposits in depository institutions	**28,208**	**1,018**	**4.83**	4,415	73	2.21
Federal funds sold	**2,571**	**92**	**4.78**	141	4	3.79
Total interest-earning assets	**2,268,212**	**116,930**	**6.89**	2,163,622	99,627	6.16
Cash and due from banks	**51,077**			47,124		
Bank premises and equipment	**42,787**			37,989		
Other assets	**170,710**			138,319		
Less: allowance for loan losses	**(16,135)**			(17,597)		
Total assets	**$ 2,516,651**			$ 2,369,457		
Liabilities						
Interest-bearing demand deposits	**$ 435,505**	**$ 3,917**	**1.20%**	$ 431,035	$ 2,659	0.82%
Savings deposits	**314,057**	**2,776**	**1.18**	292,396	1,386	0.63
Time deposits	**864,972**	**24,810**	**3.83**	721,582	16,191	3.00
Short-term borrowings	**149,858**	**3,795**	**3.39**	156,617	2,320	1.98
Long-term debt	**89,834**	**3,607**	**5.37**	145,006	4,818	4.44
Total interest-bearing liabilities	**1,854,226**	**38,905**	**2.81**	1,746,636	27,374	2.10
Noninterest-bearing demand deposits	**338,994**			339,884		
Other liabilities	**29,393**			28,612		
Stockholders' equity	**294,038**			254,325		

Total liabilities and stockholders’ equity	**$ 2,516,651**			$ 2,369,457		
Net interest income		**$ 78,025**			$ 72,253	
Net yield on earning assets			**4.60%**			4.46%

(1) For purposes of this table, non-accruing loans have been included in average balances and loan fees, which are immaterial, have been included in interest income.

(2) Computed on a fully federal tax-equivalent basis assuming a tax rate of approximately 35%.

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Table Two
Rate Volume Analysis of Changes in Interest Income and Interest Expense
(in thousands)

	Nine months ended September 30, 2006 vs. 2005 Increase (Decrease) Due to Change In:		
	Volume	Rate	Net
Interest-earning assets:			
Loan portfolio			
Residential real estate	$ 2,891	$ 534	$ 3,425
Home equity	133	4,042	4,175
Commercial, financial, and agriculture	5,264	5,958	11,222
Installment loans to individuals	(450)	31	(419)
Previously securitized loans	(4,230)	2,820	(1,410)
Total loans	3,608	13,385	16,993
Securities:			
Taxable	(2,928)	1,930	(998)
Tax-exempt (1)	19	(66)	(47)
Total securities	(2,909)	1,864	(1,045)
Loans held for sale	200	-	200
Deposits in depository institutions	393	552	945
Federal funds sold	69	19	88
Total interest-earning assets	$ 1,361	$ 15,820	$ 17,181
Interest-bearing liabilities:			
Demand deposits	$ 28	$ 1,230	$ 1,258
Savings deposits	103	1,287	1,390
Time deposits	3,217	5,402	8,619
Short-term borrowings	(100)	1,575	1,475
Long-term debt	(1,833)	622	(1,211)
Total interest-bearing liabilities	$ 1,415	$ 10,116	$ 11,531
Net Interest Income	$ (54)	$ 5,704	$ 5,650

(1) Fully federal taxable equivalent using a tax rate of 35%.

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Table Three
Average Balance Sheets and Net Interest Income
(in thousands)

	Three months ended September 30,					
	2006			2005		
	Average Balance	**Interest**	**Yield/ Rate**	Average Balance	Interest	Yield/ Rate
Assets						
Loan portfolio (3):						
Residential real estate	**$ 601,686**	**$ 8,766**	**5.78%**	$ 594,233	$ 8,396	5.61%
Home equity	**315,341**	**6,389**	**8.04**	307,302	4,894	6.32
Commercial financial and agriculture	**682,793**	**13,196**	**7.67**	607,033	10,118	6.61
Installment loans to individuals	**42,848**	**1,219**	**11.29**	65,408	1,760	10.68
Previously securitized loans	**20,261**	**2,205**	**43.18**	38,368		