NBT BANCORP INC
Form 10-K
March 01, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-K

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

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

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

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

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

Stock Purchase Rights Pursuant to Stockholders Rights Plan

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark if disclosure of delinquent filers pursuant to item 405 of Regulation S-K (Section 299.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant’s knowledge, in definitive

proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K o.

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

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

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

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

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

DOCUMENTS INCORPORATED BY REFERENCE

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

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

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	(c) Refer to item 15(a)(2) above.

SIGNATURES

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

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PART I

ITEM 1. BUSINESS

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

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

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

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

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

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

CNBF Capital Trust I (“Trust I”), a Delaware statutory business trust formed in 1999 and NBT Statutory Trust I, a Delaware statutory business trust formed in 2005, for the purpose of issuing trust preferred securities and lending the proceeds to the Company. In connection with acquisition of CNB Bancorp, Inc. mentioned below, the Company

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

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

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

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

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

COMPETITION

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

SUPERVISION AND REGULATION

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

EMPLOYEES

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

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AVAILABLE INFORMATION

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

ITEM 1A. RISK FACTORS

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

The Company is Subject to Interest Rate Risk

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

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

The Company is Subject to Lending Risk

There are inherent risks associated with the Company's lending activities. These risks include, among other things, the impact of changes in interest rates and changes in the economic conditions in the markets where the Company operates as well as those across the States of New York and Pennsylvania, as well as the entire United States. Increases in interest rates and/or weakening economic conditions could adversely impact the ability of borrowers to repay outstanding loans or the value of the collateral securing these loans. The Company is also subject to various

laws and regulations that affect its lending activities. Failure to comply with applicable laws and regulations could subject the Company to regulatory enforcement action that could result in the assessment of significant civil money penalties against the Company.

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

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

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

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

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

domestic occurrences, unemployment, changes in securities markets or other factors could impact these local economic conditions and, in turn, have a material adverse effect on the Company's financial condition and results of operations.

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The Company Operates In a Highly Competitive Industry and Market Area

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

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

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

The Company Is Subject To Extensive Government Regulation and Supervision

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

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

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

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

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

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

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

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

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

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

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

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

The Company Continually Encounters Technological Change

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

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

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

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

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

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ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

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

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

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

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

ITEM 3. LEGAL PROCEEDINGS

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

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

None.

PART II

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

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

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

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

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

Stock Repurchases

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

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

(1)

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

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Performance Graph

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

Dividends

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

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

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ITEM 6. SELECTED FINANCIAL DATA

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

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

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

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Selected Quarterly Financial Data

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

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

GENERAL

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

years in the three-year period ended December 31, 2006 should be read in conjunction with this review. Amounts in prior period consolidated financial statements are reclassified whenever necessary to conform to the 2006 presentation.

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

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

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

CRITICAL ACCOUNTING POLICIES

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

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

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

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

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FORWARD LOOKING STATEMENTS

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

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

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

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OVERVIEW

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

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

ASSET/LIABILITY MANAGEMENT

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

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

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Table 1. Average Balances and Net Interest Income

(Dollars in thousands)	**2006** Average Balance	**2006** Interest	**2006** Yield/Rate	2005 Average Balance	2005 Interest	2005 Yield/Rate	2004 Average Balance	2004 Interest	2004 Yield/Rate
Assets									
Short-term interest bearing accounts	**$ 8,116**	**$ 395**	**4.87%**	$ 7,298	$ 229	3.14%	$ 7,583	$ 222	2.93%
Securities available for sale 1	**1,110,405**	**53,992**	**4.86**	954,461	43,113	4.52	970,024	44,633	4.60
Securities held to maturity 1	**115,636**	**7,071**	**6.11**	88,244	5,035	5.71	85,771	4,385	5.11
Investment in FRB and FHLB Banks	**39,437**	**2,076**	**5.26**	37,607	1,898	5.05	34,813	854	2.45
Loans and leases 2	**3,302,080**	**230,800**	**6.99**	2,959,256	190,331	6.43	2,743,753	164,285	5.99
Total earning assets	**4,575,674**	**294,334**	**6.43**	4,046,866	240,606	5.95	3,841,944	214,379	5.58
Other non-interest earning assets	**349,396**			279,289			278,603		
Total assets	**$ 4,925,070**			$ 4,326,155			$ 4,120,547		
Liabilities and stockholders' equity									
Money market deposit accounts	**$ 543,323**	**18,050**	**3.32%**	$ 399,056	7,312	1.83%	$ 438,819	5,327	1.21%
NOW deposit accounts	**443,339**	**3,297**	**0.74**	439,751	2,305	0.52	462,509	2,230	0.48
Savings deposits	**532,788**	**4,597**	**0.86**	559,584	3,985	0.71	574,386	3,846	0.67
Time deposits	**1,534,556**	**61,854**	**4.03**	1,217,442	36,330	2.98	1,079,670	28,358	2.63
Total interest-bearing deposits	**3,054,006**	**87,798**	**2.87**	2,615,833	49,932	1.91	2,555,384	39,761	1.56
Short-term borrowings	**331,255**	**15,448**	**4.66**	353,644	10,983	3.11	302,276	4,086	1.35
Trust preferred debentures	**70,055**	**4,700**	**6.71**	19,596	1,227	6.26	18,297	823	4.50
Long-term debt	**414,976**	**17,063**	**4.11**	410,891	16,114	3.92	381,756	15,022	3.93
Total interest-bearing liabilities	**3,870,292**	**125,009**	**3.23**	3,399,964	78,256	2.30	3,257,713	59,692	1.83
Demand deposits	**614,055**			543,077			492,746		
Other non-interest-bearing liabilities	**54,170**			52,438			51,187		
Stockholders' equity	**386,553**			330,676			318,901		
Total liabilities and stockholders' equity	**$ 4,925,070**			$ 4,326,155			$ 4,120,547		
Interest rate spread			**3.20%**			3.64%			3.75%
Net interest income-FTE		**169,325**			162,350			154,687	
Net interest margin			**3.70%**			4.01%			4.03%
Taxable equivalent adjustment		**5,492**			4,239			4,200	

Net interest income	**$ 163,833**	$ 158,111	$ 150,487

1. Securities are shown at average amortized cost.
2. For purposes of these computations, nonaccrual loans are included in the average loan balances outstanding. The interest collected thereon is included in interest income based upon the characteristics of the related loans.

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NET INTEREST INCOME

On a tax equivalent basis, the Company's net interest income for 2006 was $169.3 million, up from $162.4 million for 2005. The Company's net interest margin declined to 3.70% for 2006 from 4.01% for 2005. The decline in the net interest margin resulted primarily from interest-bearing liabilities repricing up faster than earning assets, offset somewhat by the increase in average demand deposits, which increased $71.0 million or 13% during the period. Earning assets, particularly those tied to a fixed rate, have not realized the benefit of the higher interest rate environment, since rates for earning assets with terms three years or longer have remained relatively flat during this period due to the flat/inverted yield curve. The yield on earning assets increased 48 basis points (bp), from 5.95% for 2005 to 6.43% for 2006. Meanwhile, the rate paid on interest bearing liabilities increased 93 bp, from 2.30% for 2005 to 3.23% for 2006. Additionally, offsetting the decline in net interest margin was an increase in average earning assets of $528.8 million or 13.1%, driven primarily by a $342.8 million increase in average loans and leases. The increase in average loans and leases was due to organic loan growth as well as the merger with CNB. The following table presents changes in interest income, on a FTE basis, and interest expense attributable to changes in volume (change in average balance multiplied by prior year rate), changes in rate (change in rate multiplied by prior year volume), and the net change in net interest income. The net change attributable to the combined impact of volume and rate has been allocated to each in proportion to the absolute dollar amounts of change.

Table 2. Analysis of Changes in Taxable Equivalent Net Interest Income

	Increase (Decrease) 2006 over 2005			Increase (Decrease) 2005 over 2004		
(In thousands)	**Volume**	**Rate**	**Total**	Volume	Rate	Total
Short-term interest-bearing accounts	**$ 28**	**$ 138**	**$ 166**	$ (9)	$ 16	$ 7
Securities available for sale	**7,411**	**3,468**	**10,879**	(710)	(810)	(1,520)
Securities held to maturity	**1,654**	**382**	**2,036**	129	521	650
Investment in FRB and FHLB Banks	**94**	**84**	**178**	74	970	1,044
Loans and leases	**23,143**	**17,326**	**40,469**	13,396	12,650	26,046
Total interest income	**33,023**	**20,705**	**53,728**	11,771	14,456	26,227
Money market deposit accounts	**3,305**	**7,433**	**10,738**	(520)	2,505	1,985
NOW deposit accounts	**19**	**973**	**992**	(113)	188	75
Savings deposits	**(198)**	**810**	**612**	(101)	240	139
Time deposits	**10,878**	**14,646**	**25,524**	3,857	4,115	7,972
Short-term borrowings	**(734)**	**5,198**	**4,464**	799	6,098	6,897
Trust preferred debentures	**3,379**	**95**	**3,474**	62	342	404
Long-term debt	**162**	**787**	**949**	1,143	(51)	1,092
Total interest expense	**11,940**	**34,813**	**46,753**	2,704	15,860	18,564
Change in FTE net interest income	**$ 21,083**	**$ (14,108)**	**$ 6,975**	$ 9,067	$ (1,404)	$ 7,663

LOANS AND LEASES AND CORRESPONDING INTEREST AND FEES ON LOANS

The average balance of loans and leases increased 11.6%, totaling $3.3 billion in 2006 compared to $3.0 billion in 2005. The yield on average loans and leases increased from 6.43% in 2005 to 6.99% in 2006, as loans, particularly

loans indexed to Prime and other short-term variable rate indices, benefited from the rising rate environment in 2006. Interest income from loans and leases on a FTE basis increased 21.3%, from $190.3 million in 2005 to $230.8 million in 2006. The increase in interest income from loans and leases was due primarily to the increase in the average balance of loans and leases from organic loan growth and the merger with CNB, as well as the increase in yield on loans and leases in 2006 compared to 2005 noted above.

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Total loans and leases increased 12.9% at December 31, 2006, totaling $3.4 billion from $3.0 billion at December 31, 2005. The increase in loans and leases was driven by strong growth in commercial and commercial real estate loans, consumer loans, and home equity loans. Residential real estate mortgages increased $37.9 million or 5.4% at December 31, 2006 compared to December 31, 2005, primarily due to the acquisition of CNB in February 2006, which contributed approximately $69.8 million. Commercial and commercial real estate increased $112.7 million at December 31, 2006 when compared to December 31, 2005, due in large part to an increase in organic loan originations, as well as the acquisition of CNB which contributed approximately $61.9 million. Real estate construction and development loans increased $25.4 million or 36.7% from $69.1 million at December 31, 2005 to $94.5 million at December 31, 2006. Consumer loans increased $123.0 million or 26.5%, from $464.0 million at December 31, 2005 to $586.9 million at December 31, 2006. The increase in consumer loans was driven primarily by an increase in indirect loans of $91.9 million, from $365.5 million in 2005 to $457.4 million in 2006. Home equity loans increased $82.9 million or 17.9% from $463.8 million at December 31, 2005 to $546.7 million at December 31, 2006. The increase in home equity loans was due to strong product demand and successful marketing of home equity products.

The following table reflects the loan and lease portfolio by major categories as of December 31 for the years indicated:

Table 3. Composition of Loan and Lease Portfolio

	December 31,				
(In thousands)	**2006**	2005	2004	2003	2002
Residential real estate mortgages	**$ 739,607**	$ 701,734	$ 721,615	$ 703,906	$ 579,638
Commercial and commercial real estate	**1,240,383**	1,127,705	1,069,451	983,640	942,086
Real estate construction and development	**94,494**	69,135	86,031	56,430	42,269
Agricultural and agricultural real estate	**118,278**	114,043	108,181	106,310	104,078
Consumer	**586,922**	463,955	412,139	390,413	357,214
Home equity	**546,719**	463,848	391,807	336,547	269,553
Lease financing	**86,251**	82,237	80,697	62,730	61,094
Total loans and leases	**$ 3,412,654**	$ 3,022,657	$ 2,869,921	$ 2,639,976	$ 2,355,932

Real estate construction and development loans presented in prior years have been reclassified to conform with current year presentation which represents the conversion of construction loans to permanent financing.

Real estate mortgages consist primarily of loans secured by first or second deeds of trust on primary residences. Loans in the commercial and agricultural category, as well as commercial and agricultural real estate mortgages, consist primarily of short-term and/or floating rate loans made to small to medium-sized entities. Consumer loans consist primarily of installment credit to individuals secured by automobiles and other personal property including manufactured housing. Indirect installment loans represent $457.4 million of total consumer loans. Real estate construction and development loans include commercial construction and development and residential construction loans. Commercial construction loans are for small and medium sized office buildings and other commercial properties and residential construction loans are primarily for projects located in upstate New York and northeastern Pennsylvania.

The Company's automobile lease financing portfolio totaled $86.3 million at December 31, 2006 and $82.2 million at December 31, 2005. Lease receivables primarily represent automobile financing to customers through direct financing

leases and are carried at the aggregate of the lease payments receivable and the estimated residual values, net of unearned income and net deferred lease origination fees and costs. Net deferred lease origination fees and costs are amortized under the effective interest method over the estimated lives of the leases. The estimated residual value related to the total lease portfolio is reviewed quarterly, and if there had been a decline in the estimated fair value of the residual that is judged by management to be other-than-temporary, including consideration of residual value insurance, a loss would be recognized.

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Adjustments related to such other-than-temporary declines in estimated fair value are recorded with other noninterest expenses in the consolidated statements of income. One of the most significant risks associated with leasing operations is the recovery of the residual value of the leased vehicles at the termination of the lease. A lease receivable asset includes the estimated residual value of the leased vehicle at the termination of the lease. At termination, the lessor has the option to purchase the vehicle or may turn the vehicle over to the Company. The residual values included in lease financing receivables totaled $59.2 million and $55.5 million at December 31, 2006 and 2005, respectively.

The Company has acquired residual value insurance protection in order to reduce the risk related to residual values. Based on analysis performed by management, the Company has concluded that no other-than-temporary impairment exists which would warrant a charge to earnings during the years ended December 31, 2006 and 2005.

The following table, Maturities and Sensitivities of Certain Loans to Changes in Interest Rates, are the maturities of the commercial and agricultural and real estate and construction development loan portfolios and the sensitivity of loans to interest rate fluctuations at December 31, 2006. Scheduled repayments are reported in the maturity category in which the contractual payment is due.

Table 4. Maturities and Sensitivities of Certain Loans to Changes in Interest Rates

	Remaining maturity at December 31, 2006			
(In thousands)	Within One Year	After One Year But Within Five Years	After Five Years	Total
Floating/adjustable rate				
Commercial, commercial real estate, agricultural, and agricultural real estate	**$ 382,864**	**$ 123,484**	**$ 1,133**	**$ 507,481**
Real estate construction and development	**59,085**	**987**	**-**	**60,072**
Total floating rate loans	**441,949**	**124,471**	**1,133**	**567,553**
Fixed rate				
Commercial, commercial real estate, agricultural, and agricultural real estate	**324,754**	**439,883**	**86,543**	**851,180**
Real estate construction and development	**644**	**6,522**	**27,256**	**34,422**
Total fixed rate loans	**325,398**	**446,405**	**113,799**	**885,602**
Total	**$ 767,347**	**$ 570,876**	**$ 114,932**	**$ 1,453,155**

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SECURITIES AND CORRESPONDING INTEREST AND DIVIDEND INCOME

The average balance of the amortized cost for securities available for sale in 2006 was $1.1 billion, an increase of $155.9 million, or 16.3%, from $954.5 million in 2005. The yield on average securities available for sale was 4.86% for 2006 compared to 4.52% in 2005. The increase in yield on securities available for sale resulted from the increasing rate environment.

The average balance of securities held to maturity increased from $88.2 million in 2005 to $115.6 million in 2006. At December 31, 2006, securities held to maturity were comprised primarily of tax-exempt municipal securities. The yield on securities held to maturity increased from 5.71% in 2005 to 6.11% in 2006 from higher yields for tax-exempt securities purchased during 2006. Investments in FRB and Federal Home Loan Bank (FHLB) stock increased to $39.4 million in 2006 from $37.7 million in 2005. This increase was driven primarily by an increase in the investment in FHLB resulting from an increase in the Company's borrowing capacity at FHLB. The yield from investments in FRB and FHLB Banks increased from 5.05% in 2005 to 5.26% in 2006. In 2003, the FHLB disclosed it had capital concerns and credit issues in their investment security portfolio. As a result of these issues, the FHLB reduced their dividend rate in 2005 and increased the rate back to normal in 2006.

The Company classifies its securities at date of purchase as either available for sale, held to maturity or trading. Held to maturity debt securities are those that the Company has the ability and intent to hold until maturity. Available for sale securities are recorded at fair value. Unrealized holding gains and losses, net of the related tax effect, on available for sale securities are excluded from earnings and are reported in stockholders' equity as a component of accumulated other comprehensive income or loss. Held to maturity securities are recorded at amortized cost. Trading securities are recorded at fair value, with net unrealized gains and losses recognized currently in income. Transfers of securities between categories are recorded at fair value at the date of transfer. A decline in the fair value of any available for sale or held to maturity security below cost that is deemed other-than-temporary is charged to earnings resulting in the establishment of a new cost basis for the security. Securities with an other than temporary impairment are generally placed on non-accrual status.

Non-marketable equity securities are carried at cost, with the exception of small business investment company (SBIC) investments, which are carried at fair value in accordance with SBIC rules.

Premiums and discounts are amortized or accreted over the life of the related security as an adjustment to yield using the interest method. Dividend and interest income are recognized when earned. Realized gains and losses on securities sold are derived using the specific identification method for determining the cost of securities sold.

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Table 5. Securities Portfolio

	As of December 31,					
	2006		2005		2004	
(In thousands)	**Amortized Cost**	**Fair Value**	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Securities available for sale						
U.S. Treasury	**$ 10,516**	**$ 10,487**	$ 10,005	$ 10,005	$ 10,037	$ 9,977
Federal Agency and mortgage-backed	**744,078**	**731,754**	684,907	672,602	694,928	696,835
State & Municipal, collateralized mortgage Obligations, corporate and other securities	**361,854**	**364,081**	269,826	271,867	238,770	245,730
Total securities available for sale	**$ 1,116,448**	**$ 1,106,322**	$ 964,738	$ 954,474	$ 943,735	$ 952,542
Securities held to maturity						
Federal Agency and mortgage-backed	**$ 3,434**	**$ 3,497**	$ 4,354	$ 4,482	$ 6,412	$ 6,706
State & Municipal	**132,213**	**132,123**	87,582	87,446	75,128	75,764
Other securities	**667**	**667**	1,773	1,773	242	242
Total securities held to maturity	**$ 136,314**	**$ 136,287**	$ 93,709	$ 93,701	$ 81,782	$ 82,712

In the available for sale category at December 31, 2006, federal agency securities were comprised of Government-Sponsored Enterprise ("GSE") securities; Mortgaged-backed securities were comprised of GSEs with an amortized cost of $352.0 million and a fair value of $341.8 million and US Government Agency securities with an amortized cost of $48.5 million and a fair value of $48.2 million; Collateralized mortgage obligations were comprised of GSEs with an amortized cost of $164.8 million and a fair value of $163.0 million and US Government Agency securities with an amortized cost of $77.1 million and a fair value of $75.8 million. At December 31, 2006, all of the mortgaged-backed securities held to maturity were comprised of US Government Agency securities.

The following tables set forth information with regard to contractual maturities of debt securities at December 31, 2006:

(In thousands)	Amortized cost	Estimated fair value	Weighted Average Yield
Debt securities classified as available for sale			
Within one year	$ 61,314	$ 61,107	4.54%
From one to five years	266,686	264,821	4.81%
From five to ten years	162,935	163,074	4.99%
After ten years	608,604	597,075	4.92%
	$ 1,099,539	$ 1,086,077	
Debt securities classified as held to maturity			

Within one year	$ 63,308	$ 63,301	4.21%
From one to five years	34,850	34,632	3.67%
From five to ten years	29,479	29,453	3.89%
After ten years	14,817	15,042	5.04%
	$ 142,454	$ 142,428	

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FUNDING SOURCES AND CORRESPONDING INTEREST EXPENSE

The Company utilizes traditional deposit products such as time, savings, NOW, money market, and demand deposits as its primary source for funding. Other sources, such as short-term FHLB advances, federal funds purchased, securities sold under agreements to repurchase, brokered time deposits, and long-term FHLB borrowings are utilized as necessary to support the Company's growth in assets and to achieve interest rate sensitivity objectives. The average balance of interest-bearing liabilities increased $470.3 million, totaling $3.9 billion in 2006 from $3.4 billion in 2005. The rate paid on interest-bearing liabilities increased from 2.30% in 2005 to 3.23% in 2006. Increases in the rate paid on and the average balance of interest bearing liabilities caused an increase in interest expense of $46.8 million, or 59.8%, from $78.3 million in 2005 to $125.0 million in 2006.

DEPOSITS

Average interest bearing deposits increased $438.2 million during 2006 compared to 2005. The increase resulted primarily from increases in time deposits and money market deposits, partially offset by a decrease in savings deposits. Average time deposits increased $317.1 million or 26.0% during 2006 when compared to 2005. The increase in average time deposits resulted primarily from increases in retail and municipal and negotiated rate time deposits. In addition, the acquisition of CNB contributed approximately $129.3 million in time deposits. Average money market deposits increased $144.3 million or 36.2% during 2006 when compared to 2005. The increase in average money market deposits resulted primarily from an increase in personal money market deposits, as well as the acquisition of CNB which contributed approximately $52.3 million to money market deposits. The average balance of savings and NOW accounts decreased collectively $23.2 million or 2.3% during 2006 when compared to 2005. The decrease in savings and NOW accounts was driven primarily from municipal customers shifting their funds into higher paying money market and time deposits in 2006. As a result of the flat/inverted yield curve, money market accounts and time deposits reprice in a higher interest rate environment. The average balance of demand deposits increased $71.0 million, or 13.1%, from $543.1 million in 2005 to $614.1 million in 2006. Solid growth in demand deposits was driven principally by increases in accounts from retail and business customers, in large part due to the acquisition of CNB which contributed approximately $48.0 million to demand deposits.

The rate paid on average interest-bearing deposits increased 96 bp from 1.91% during 2005 to 2.87% in 2006. The increase in rate on interest-bearing deposits was driven primarily by pricing increases from money market accounts and time deposits. These deposit products are more sensitive to interest rate changes. The pricing increases for these products resulted from several increases in short-term rates by the FRB during 2006 combined with competitive pricing for market competitors. The Company expects this trend to continue for money market accounts and time deposits in 2006. The rates paid for NOW accounts increased from 0.52% in 2005 to 0.74% in 2006, while rates paid for savings deposits increased from 0.71% in 2005 to 0.86% in 2006.

The following table presents the maturity distribution of time deposits of $100,000 or more at December 31, 2006:

Table 6. Maturity Distribution of Time Deposits of $100,000 or More

(In thousands)		**December 31, 2006**
Within three months	**$**	**380,862**
After three but within twelve months		**299,727**
After one but within three years		**135,113**
Over three years		**8,634**
Total	**$**	**824,336**

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BORROWINGS

Average short-term borrowings decreased $22.4 million to $331.3 million in 2006 as a result of the balance sheet changes due to the acquisition of CNB. The average rate paid on short-term borrowings increased from 3.11% in 2005 to 4.66% in 2006, which was primarily driven by the Federal Reserve Bank increasing the Fed Funds target rate (which directly impacts short-term borrowing rates) 100 bp in 2006 and 200 bp in 2005. The increases in the average rate paid caused interest expense on short-term borrowings to increase $4.5 million from $11.0 million in 2005 to $15.4 million in 2006. Average long-term debt increased slightly from $410.9 million in 2005 to $415.0 million in 2006.

The average balance of trust preferred debentures increased $50.5 million in 2006 compared to 2005. The average rate paid for trust preferred debentures in 2006 was 6.71%, up 45 bp from 6.26% in 2005. The increase in rate on the trust preferred debentures is due primarily to the previously mentioned increase in short-term rates during 2006. The increase in the average balance of trust preferred debentures is due primarily to the issuance of $51.5 million of trust preferred debentures in February 2006 at a fixed rate of 6.195%.

Short-term borrowings consist of Federal funds purchased and securities sold under repurchase agreements, which generally represent overnight borrowing transactions, and other short-term borrowings, primarily FHLB advances, with original maturities of one year or less. The Company has unused lines of credit and access to brokered deposits available for short-term financing of approximately $849 million and $594 million at December 31, 2006 and 2005, respectively. Securities collateralizing repurchase agreements are held in safekeeping by non-affiliated financial institutions and are under the Company’s control. Long-term debt, which is comprised primarily of FHLB advances, are collateralized by the FHLB stock owned by the Company, certain of its mortgage-backed securities and a blanket lien on its residential real estate mortgage loans.

RISK MANAGEMENT-CREDIT RISK

Credit risk is managed through a network of loan officers, credit committees, loan policies, and oversight from the senior credit officers and Board of Directors. Management follows a policy of continually identifying, analyzing, and grading credit risk inherent in each loan portfolio. An ongoing independent review, subsequent to management’s review, of individual credits in the commercial loan portfolio is performed by the independent loan review function. These components of the Company’s underwriting and monitoring functions are critical to the timely identification, classification, and resolution of problem credits.

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NONPERFORMING ASSETS

Table 7. Nonperforming Assets

	As of December 31,				
(Dollars in thousands)	**2006**	2005	2004	2003	2002
Nonaccrual loans					
Commercial and agricultural loans and real estate	**$ 9,346**	$ 9,373	$ 10,550	$ 8,693	$ 16,980
Real estate mortgages	**2,338**	2,009	2,553	2,483	5,522
Consumer	**1,981**	2,037	1,888	2,685	1,507
Total nonaccrual loans	**13,665**	13,419	14,991	13,861	24,009
Loans 90 days or more past due and still accruing					
Commercial and agricultural loans and real estate	**138**	-	-	242	237
Real estate mortgages	**682**	465	737	244	1,325
Consumer	**822**	413	449	482	414
Total loans 90 days or more past due and still accruing	**1,642**	878	1,186	968	1,976
Restructured loans	**-**	-	-	-	409
Total nonperforming loans	**15,307**	14,297	16,177	14,829	26,394
Other real estate owned	**389**	265	428	1,157	2,947
Total nonperforming loans and other real estate owned	**15,696**	14,562	16,605	15,986	29,341
Nonperforming securities	**-**	-	-	395	1,122
Total nonperforming loans, securities, and other real estate owned	**$ 15,696**	$ 14,562	$ 16,605	$ 16,381	$ 30,463
Total nonperforming loans to loans and leases	**0.45%**	0.47%	0.56%	0.56%	1.12%
Total nonperforming loans and other real estate owned to total assets	**0.31%**	0.33%	0.39%	0.40%	0.79%
Total nonperforming loans, securities, and other real estate owned to total assets	**0.31%**	0.33%	0.39%	0.40%	0.82%
Total allowance for loan and lease losses to nonperforming loans	**330.48%**	331.92%	277.75%	287.62%	152.18%

The allowance for loan and lease losses is maintained at a level estimated by management to provide adequately for risk of probable losses inherent in the current loan and lease portfolio. The adequacy of the allowance for loan and lease losses is continuously monitored. It is assessed for adequacy using a methodology designed to ensure the level of the allowance reasonably reflects the loan and lease portfolio's risk profile. It is evaluated to ensure that it is sufficient to absorb all reasonably estimable credit losses inherent in the current loan and lease portfolio.

Management considers the accounting policy relating to the allowance for loan and lease losses to be a critical accounting policy given the inherent uncertainty in evaluating the levels of the allowance required to cover credit losses in the portfolio and the material effect that such judgments can have on the consolidated results of operations.

For purposes of evaluating the adequacy of the allowance, the Company considers a number of significant factors that affect the collectibility of the portfolio. For individually analyzed loans, these include estimates of loss exposure, which reflect the facts and circumstances that affect the likelihood of repayment of such loans as of the evaluation date. For homogeneous pools of loans and leases, estimates of the Company's exposure to credit loss reflect a current assessment of a number of factors, which could affect collectibility. These factors include: past loss experience; size, trend, composition, and nature of loans; changes in lending policies and procedures, including underwriting standards and collection, charge-offs and recoveries; trends experienced in nonperforming and delinquent loans; current economic conditions in the Company's market; portfolio concentrations that may affect loss experienced across one or more components of the portfolio; the effect of external factors such as competition, legal and regulatory requirements; and the experience, ability, and depth of lending management and staff. In addition, various regulatory agencies as an integral component of their examination process periodically review the Company's allowance for loan and lease losses. Such agencies may require the Company to recognize additions to the allowance based on their examination.

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After a thorough consideration of the factors discussed above, any required additions to the allowance for loan and lease losses are made periodically by charges to the provision for loan and lease losses. These charges are necessary to maintain the allowance at a level which management believes is reasonably reflective of overall inherent risk of probable loss in the portfolio. While management uses available information to recognize losses on loans and leases, additions to the allowance may fluctuate from one reporting period to another. These fluctuations are reflective of changes in risk associated with portfolio content and/or changes in management's assessment of any or all of the determining factors discussed above.

Total nonperforming assets were $15.7 million at December 31, 2006, compared to $14.6 million at December 31, 2005. Credit quality remained stable in 2006, as nonperforming loans totaled $15.3 million at December 31, 2006, up from the $14.3 million outstanding at December 31, 2005. Nonperforming loans as a percentage of total loans and leases decreased to 0.45% for December 31, 2006 from 0.47% at December 31, 2005. The total allowance for loan and lease losses is 330.48% of non-performing loans at December 31, 2006 as compared to 331.92% at December 31, 2005.

Impaired loans, which primarily consist of nonaccruing commercial type loans, decreased slightly, totaling $9.3 million at December 31, 2006 as compared to $9.4 million at December 31, 2005. At December 31, 2006, $2.2 million of the total impaired loans had a specific reserve allocation of $0.2 million or 10% compared to $2.9 million of total impaired loans at December 31, 2005 which had no specific reserve allocation.

Total net charge-offs for 2006 totaled $8.7 million as compared to $6.9 million for 2005. The ratio of net charge-offs to average loans and leases was 0.26% for 2006 compared to 0.23% for 2005. Gross charge-offs increased $2.4 million, totaling $13.4 million for 2006 compared to $11.0 million for 2005. Recoveries increased from $4.1 million in 2005 to $4.7 million in 2006. The provision for loan and lease losses decreased slightly to $9.4 million in 2006 from $9.5 million in 2005. The allowance for loan and lease losses as a percentage of total loans and leases was 1.48% at December 31, 2006 and 1.57% at December 31, 2005. While potential problem loans have increased slightly, potential problem loans have decreased as a percentage of the loan portfolio, offset by an increase in net charge-offs.

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Table 8. Allowance for Loan and Lease Losses

(Dollars in thousands)	**2006**	2005	2004	2003	2002
Balance at January 1	**$ 47,455**	$ 44,932	$ 42,651	$ 40,167	$ 44,746
Loans and leases charged-off					
Commercial and agricultural	**6,132**	3,403	4,595	5,619	9,970
Real estate mortgages	**542**	741	772	362	2,547
Consumer*	**6,698**	6,875	6,239	5,862	5,805
Total loans and leases charged-off	**13,372**	11,019	11,606	11,843	18,322
Recoveries					
Commercial and agricultural	**1,939**	1,695	2,547	3,185	3,394
Real estate mortgages	**239**	438	215	430	104
Consumer*	**2,521**	1,945	1,510	1,601	1,172
Total recoveries	**4,699**	4,078	4,272	5,216	4,670
Net loans and leases charged-off	**8,673**	6,941	7,334	6,627	13,652
Allowance related to purchase acquisitions	**2,410**	-	-	-	-
Provision for loan and lease losses	**9,395**	9,464	9,615	9,111	9,073
Balance at December 31	**$ 50,587**	$ 47,455	$ 44,932	$ 42,651	$ 40,167
Allowance for loan and lease losses to loans and leases outstanding at end of year	**1.48%**	1.57%	1.57%	1.62%	1.70%
Net charge-offs to average loans and leases outstanding	**0.26%**	0.23%	0.27%	0.27%	0.58%

* Consumer charge-off and recoveries include consumer, home equity, and lease financing.

Total nonperforming assets were $14.6 million at December 31, 2005, compared to $16.6 million at December 31, 2004. Credit quality remained stable in 2005, as nonperforming loans totaled $14.3 million at December 31, 2005, down from the $16.2 million outstanding at December 31, 2004. Nonperforming loans as a percentage of total loans and leases decreased to 0.47% for December 31, 2005 from 0.56% at December 31, 2004. The total allowance for loan and lease losses was 331.92% of nonperforming loans at December 31, 2005 as compared to 277.75% at December 31, 2004.

Total net charge-offs for 2005 totaled $6.9 million as compared to $7.3 million for 2004. The ratio of net charge-offs to average loans and leases was 0.23% for 2005 compared with 0.27% for 2004. Gross charge-offs decreased $0.6 million, totaling $11.0 million for 2005 compared to $11.6 million for 2004. Recoveries decreased slightly, from $4.3 million in 2004 to $4.1 million in 2005. The provision for loan and lease losses decreased slightly to $9.5 million in 2005 from $9.6 million in 2004. The allowance for loan and lease losses as a percentage of total loans and leases was 1.57% at December 31, 2005 and 2004. The slight increase in the provision for loan and lease losses in 2005 compared to 2004 resulted mainly from loan growth and an increase in potential problem loans discussed below, offset by decreases in net charge-offs and nonperforming loans.

In addition to the nonperforming loans discussed above, the Company has also identified approximately $69.8 million in potential problem loans at December 31, 2006 as compared to $69.5 million at December 31, 2005. Potential problem loans are loans that are currently performing, but where known information about possible credit problems of

the related borrowers causes management to have doubts as to the ability of such borrowers to comply with the present loan repayment terms and which may result in disclosure of such loans as nonperforming at some time in the future. At the Company, potential problem loans are typically loans that are performing but are classified by the Company's loan rating system as "substandard." At December 31, 2006 and 2005, potential problem loans primarily consisted of commercial and agricultural loans. At December 31, 2006, there were nineteen potential problem loans that exceeded $1.0 million, totaling $31.1 million in aggregate compared to fifteen potential problem loans exceeding $1.0 million, totaling $38.3 million at December 31, 2005. Management cannot predict the extent to which economic conditions may worsen or other factors which may impact borrowers and the potential problem loans. Accordingly, there can be no assurance that other loans will not become 90 days or more past due, be placed on nonaccrual, become restructured, or require increased allowance coverage and provision for loan losses.

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The following table sets forth the allocation of the allowance for loan losses by category, as well as the percentage of loans and leases in each category to total loans and leases, as prepared by the Company. This allocation is based on management's assessment of the risk characteristics of each of the component parts of the total loan portfolio as of a given point in time and is subject to changes as and when the risk factors of each such component part change. The allocation is not indicative of either the specific amounts of the loan categories in which future charge-offs may be taken, nor should it be taken as an indicator of future loss trends. The allocation of the allowance to each category does not restrict the use of the allowance to absorb losses in any category. The following table sets forth the allocation of the allowance for loan losses by loan category:

Table 9. Allocation of the Allowance for Loan and Lease Losses

	December 31,									
	2006		2005		2004		2003		2002	
(Dollars in thousands)	**Allowance**	**Category Percent of Loans**	Allowance	Category Percent of Loans	Allowance	Category Percent of Loans	Allowance	Category Percent of Loans	Allowance	Category Percent of Loans
Commercial and agricultural	**$ 28,149**	**43%**	$ 30,257	43%	$ 28,158	44%	$ 25,502	43%	$ 25,589	46%
Real estate mortgages	**3,377**	**22%**	3,148	23%	4,029	25%	4,699	27%	3,884	25%
Consumer	**17,327**	**35%**	12,402	34%	10,887	31%	9,357	30%	7,654	29%
Unallocated	**1,734**	**0%**	1,648	0%	1,858	0%	3,093	0%	3,040	0%
Total	**$ 50,587**	**100%**	$ 47,455	100%	**$ 44,932**	**100%**	**$ 42,651**	**100%**	**$ 40,167**	**100%**

In 2006, the Company updated its historical charge-off factors for graded commercial and agricultural loans, as well as revising its environmental risk factors for all loan types. This was done to be consistent with the *Interagency Policy Statement on the Allowance for Loan and Lease Losses*, issued in December 2006. As a result, there was a decrease in the amount of allowance for loan and lease losses allocated to the commercial and agricultural portfolio and an increase in the amount allocated to the consumer loan portfolio. The unallocated reserve was relatively flat year over year.

For 2005, the reserve allocation for commercial and agricultural loans increased as a decrease in net charge-off experience was offset by an increase in potential problem loans. The reserve allocation for real estate mortgages decreased, consistent with the decline in real estate mortgages and continued low charge-off experience. The reserve allocation for consumer loans increased from increases in net charge-offs and strong loan growth. The unallocated reserve decreased slightly to $1.6 million for 2005 from $1.9 million for 2004.

At December 31, 2006, approximately 58.6% of the Company's loans are secured by real estate located in central and northern New York and northeastern Pennsylvania. Accordingly, the ultimate collectibility of a substantial portion of the Company's portfolio is susceptible to changes in market conditions of those areas. Management is not aware of any material concentrations of credit to any industry or individual borrowers.

LIQUIDITY RISK

Liquidity involves the ability to meet the cash flow requirements of customers who may be depositors wanting to withdraw funds or borrowers needing assurance that sufficient funds will be available to meet their credit needs. The Asset Liability Committee (ALCO) is responsible for liquidity management and has developed guidelines which cover all assets and liabilities, as well as off balance sheet items that are potential sources or uses of liquidity. Liquidity policies must also provide the flexibility to implement appropriate strategies and tactical actions.

Requirements change as loans and leases grow, deposits and securities mature, and payments on borrowings are made. Liquidity management includes a focus on interest rate sensitivity management with a goal of avoiding widely fluctuating net interest margins through periods of changing economic conditions.

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The primary liquidity measurement the Company utilizes is called Basic Surplus which captures the adequacy of its access to reliable sources of cash relative to the stability of its funding mix of average liabilities. This approach recognizes the importance of balancing levels of cash flow liquidity from short and long-term securities with the availability of dependable borrowing sources which can be accessed when necessary. At December 31, 2006, the Company’s Basic Surplus measurement was 7.9% of total assets or $399 million, which was above the Company’s minimum of 5% (calculated at $253 million of period end total assets at December 31, 2006) set forth in its liquidity policies.

This Basic Surplus approach enables the Company to adequately manage liquidity from both operational and contingency perspectives. By tempering the need for cash flow liquidity with reliable borrowing facilities, the Company is able to operate with a more fully invested and, therefore, higher interest income generating, securities portfolio. The makeup and term structure of the securities portfolio is, in part, impacted by the overall interest rate sensitivity of the balance sheet. Investment decisions and deposit pricing strategies are impacted by the liquidity position. At December 31, 2006, the Company considered its Basic Surplus position to be adequate. However, certain events may adversely impact the Company’s liquidity position in 2007. Continued improvement in the economy may increase demand for equity related products or increase competitive pressure on deposit pricing, which in turn, could result in a decrease in the Company’s deposit base or increase funding costs. Additionally, liquidity will come under additional pressure if loan growth exceeds deposit growth in 2007. These scenarios could lead to a decrease in the Company’s basic surplus measure below the minimum policy level of 5%. To manage this risk, the Company has the ability to purchase brokered time deposits, established borrowing facilities with other banks (Federal funds), and has the ability to enter into repurchase agreements with investment companies. The additional liquidity that could be provided by these measures amounted to $849 million at December 31, 2006.

At December 31, 2006, a portion of the Company’s loans and securities were pledged as collateral on borrowings. Therefore, future growth of earning assets will depend upon the Company’s ability to obtain additional funding, through growth of core deposits and collateral management, and may require further use of brokered time deposits, or other higher cost borrowing arrangements.

Net cash flows provided by operating activities totaled $64.2 million in 2006 and $65.1 million in 2005. The critical elements of net operating cash flows include net income, after adding back provision for loan and lease losses, and depreciation and amortization.

Net cash used in investing activities totaled $276.2 million in 2006 and $206.1 million in 2005. Critical elements of investing activities are loan and investment securities transactions. The increase in cash used in investing activities in 2006 was primarily due to cash used in the CNB merger and a net increase in loans, which totaled $211.3 million in 2006 compared to $157.0 million in 2005.

Net cash flows provided by financing activities totaled $208.3 million in 2006 and $176.8 million in 2005. The critical elements of financing activities are proceeds from deposits, short-term borrowings, and stock issuances. In addition, financing activities are impacted by dividends and treasury stock transactions.

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In connection with its financing and operating activities, the Company has entered into certain contractual obligations. The Company's future minimum cash payments, excluding interest, associated with its contractual obligations pursuant to its borrowing agreements and operating leases at December 31, 2006 are as follows:

Contractual Obligations
(In thousands)

	Payments Due by Period						
	2007	**2008**	**2009**	**2010**	**2011**	**Thereafter**	**Total**
Long-term debt obligations	$ 93,700	$ 115,209	$ 75,000	$ 31,000	$ 3,815	$ 99,004	**$ 417,728**
Trust preferred debentures	-	-	-	-	-	75,422	**75,422**
Operating lease obligations	2,931	2,460	2,007	1,651	1,576	11,006	**21,631**
Retirement plan obligations	4,114	4,093	4,212	4,229	4,212	22,878	**43,738**
Data processing commitments	7,467	7,205	6,737	6,737	437	109	**28,692**
Total contractual obligations	**$ 108,212**	**$ 128,967**	**$ 87,956**	**$ 43,617**	**$ 10,040**	**$ 208,419**	**$ 587,211**

OFF-BALANCE SHEET RISK COMMITMENTS TO EXTEND CREDIT

The Company makes contractual commitments to extend credit, which include unused lines of credit, which are subject to the Company's credit approval and monitoring procedures. At December 31, 2006 and 2005, commitments to extend credit in the form of loans, including unused lines of credit, amounted to $536.3 million and $497.1 million, respectively. In the opinion of management, there are no material commitments to extend credit, including unused lines of credit, that represent unusual risks. All commitments to extend credit in the form of loans, including unused lines of credit, expire within one year.

STAND-BY LETTERS OF CREDIT

The Company does not issue any guarantees that would require liability-recognition or disclosure, other than its stand-by letters of credit. The Company guarantees the obligations or performance of customers by issuing stand-by letters of credit to third parties. These stand-by letters of credit are frequently issued in support of third party debt, such as corporate debt issuances, industrial revenue bonds, and municipal securities. The risk involved in issuing stand-by letters of credit is essentially the same as the credit risk involved in extending loan facilities to customers, and they are subject to the same credit origination, portfolio maintenance and management procedures in effect to monitor other credit and off-balance sheet products. Typically, these instruments have terms of five years or less and expire unused; therefore, the total amounts do not necessarily represent future cash requirements. At December 31, 2006 and 2005, outstanding stand-by letters of credit were approximately $30.8 million and $42.9 million, respectively. The fair value of the Company's stand-by letters of credit at December 31, 2006 and 2005 was not significant. The following table sets forth the commitment expiration period for stand-by letters of credit at December 31, 2006:

Commitment Expiration of Stand-by Letters of Credit	
Within one year	$ 24,643
After one but within three years	2,061
After three but within five years	48
After five years	4,000
Total	$ 30,752

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LOANS SERVICED FOR OTHERS AND LOANS SOLD WITH RECOURSE

The total amount of loans serviced by the Company for unrelated third parties was approximately $105.0 million and $81.2 million at December 31, 2006 and 2005, respectively. At December 31, 2006 and 2005, the Company serviced $5.7 million and $5.8 million, respectively, of loans sold with recourse. Due to collateral on these loans, no reserve is considered necessary at December 31, 2006 and 2005.

CAPITAL RESOURCES

Consistent with its goal to operate a sound and profitable financial institution, the Company actively seeks to maintain a “well-capitalized” institution in accordance with regulatory standards. The principal source of capital to the Company is earnings retention. The Company’s capital measurements are in excess of both regulatory minimum guidelines and meet the requirements to be considered well capitalized.

The Company’s principal source of funds to pay interest on trust preferred debentures and pay cash dividends to its shareholders is dividends from its subsidiaries. Various laws and regulations restrict the ability of banks to pay dividends to their shareholders. Generally, the payment of dividends by the Company in the future as well as the payment of interest on the capital securities will require the generation of sufficient future earnings by its subsidiaries.

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

STOCK REPURCHASE PLAN

On January 24, 2005, the Company’s Board of Directors adopted a new repurchase program whereby the Company is authorized to repurchase up to 1,500,000 shares (approximately 5%) of its outstanding common stock. At that time, there were 719,800 shares remaining under the January 26, 2004 authorization that was superseded by the new repurchase program. On January 23, 2006, the Company’s Board of Directors adopted a new repurchase program whereby the Company is authorized to repurchase up to an additional 1,000,000 shares (approximately 3%) of its outstanding common stock. The shares remaining under the 2005 authorization will be combined with the 2006 authorization, increasing the total shares available for repurchase to 1,503,151. During 2006, the Company repurchased 766,004 shares of its own commons stock for $17.1 million at an average price of $22.34 per share. At December 31, 2006, there were 737,147 shares available for repurchase under previously announced plans.

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NONINTEREST INCOME

Noninterest income is a significant source of revenue for the Company and an important factor in the Company's results of operations. The following table sets forth information by category of noninterest income for the years indicated:

	Years ended December 31,		
(In thousands)	**2006**	2005	2004
Service charges on deposit accounts	**$ 17,590**	$ 16,894	$ 16,470
Broker/dealer and insurance revenue	**3,936**	3,186	6,782
Trust	**5,629**	5,029	4,605
Bank owned life insurance income	**1,629**	1,347	1,487
ATM fees	**7,086**	6,162	5,530
Retirement plan administration fees	**5,536**	4,426	-
Other	**8,098**	6,741	5,799
Total before net securities (losses) gains	**49,504**	43,785	40,673
Net securities (losses) gains	**(875)**	(1,236)	216
Total	**$ 48,629**	$ 42,549	$ 40,889

Noninterest income for the year ended December 31, 2006 was $48.6 million, up $6.1 million or 14.3% from $42.5 million for the same period in 2005. Fees from service charges on deposit accounts and ATM and debit cards collectively increased $1.6 million from solid growth in demand deposit accounts and debit card base. Retirement plan administration fees for the year ended December 31, 2006 increased $1.1 million, compared with the same period in 2005, as a result of our growing client base. Trust administration income increased $0.6 million for the year ended December 31, 2006, compared with the same period in 2005. This increase stems from the increased market value of accounts, an increase in customer accounts as a result of the acquisition of CNB and successful business development. Broker/dealer and insurance revenue for the year ended December 31, 2006 increased $0.8 million in large part due to the growth in brokerage income from retail financial services as well as the addition of Hathaway Agency as part of the acquisition of CNB. Other noninterest income for the year ended December 31, 2006 increased $1.4 million, compared with the same period in 2005, as a result of a gain on the sale of a branch, an increase in title insurance revenue, and an increase in interest income earned from our payment services vendor. Net securities losses for the year ended December 31, 2006 were $0.9 million, compared with net securities losses of $1.2 million for the year ended December 31, 2005. Excluding the effect of these securities transactions, noninterest income increased $5.7 million, or 13.1%, for the year ended December 31, 2006, compared with the same period in 2005.

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NONINTEREST EXPENSE

Noninterest expenses are also an important factor in the Company's results of operations. The following table sets forth the major components of noninterest expense for the years indicated:

	Years ended December 31,		
(In thousands)	**2006**	2005	2004
Salaries and employee benefits	**$ 62,877**	$ 60,005	$ 55,204
Occupancy	**11,518**	10,452	9,905
Equipment	**8,332**	8,118	7,573
Data processing and communications	**10,454**	10,349	10,972
Professional fees and outside services	**7,761**	6,087	6,175
Office supplies and postage	**5,330**	4,628	4,459
Amortization of intangible assets	**1,649**	544	284
Loan collection and other real estate owned	**1,351**	1,002	1,241
Goodwill impairment	**-**	-	1,950
Other	**13,694**	14,120	12,014
Total noninterest expense	**$ 122,966**	$ 115,305	$ 109,777

Noninterest expense for the year ended December 31, 2006 was $123.0 million, up from $115.3 million for the same period in 2005. Office expenses, such as supplies and postage, occupancy, equipment and data processing and communications charges, increased by $2.1 million for the year ended December 31, 2006, compared with the same period in 2005. This 6.2% increase resulted primarily from the acquisition of CNB. Salaries and employee benefits increased $2.9 million for the year ended December 31, 2006 over the same period in 2005. This increase was due primarily to the adoption of FAS 123R in 2006, which contributed $1.8 million to the increase in salaries and employee benefits, as well as higher salaries from merit increases and the acquisition of CNB. Professional fees and services increased $1.7 million for the year ended December 31, 2006, compared with the same period in 2005. Legal fees incurred in 2006 increased over 2005 because the Company was reimbursed during the second quarter of 2005 for legal fees associated with a prior litigation. Item processing fees during the year ended December 31, 2006 increased over the same period in 2005 because the Company outsourced a portion of its item processing work as a result of flood-related damage to one of its processing centers. Amortization expense increased $1.1 million for the year ended December 31, 2006 over the same period in 2005. This increase was due primarily to the acquisition of CNB. Loan collection and other real estate owned expenses increased $0.3 million for the year ended December 31, 2006 over the same period in 2005. This increase was due primarily to an increase in the number of foreclosures in 2006 as compared to 2005. Other operating expense for the year ended December 31, 2006 decreased $0.4 million compared with the same period in 2005, primarily due to flood-related insurance recoveries.

INCOME TAXES

Income tax expense for the year ended December 31, 2006 was $24.2 million, up from $23.5 million for the same period in 2005. The effective rate for the year ended December 31, 2006 was 30.2%, down from 30.9% for the same period in 2005. The decrease in the effective tax rate for the year ended December 31, 2006 versus the same period in 2005 resulted primarily from an increase in interest income from tax-exempt sources.

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The proposed 2007 New York State budget bill contains a provision that would disallow the exclusion of dividends paid by a real estate investment trust subsidiary ("REIT"). The bill, if enacted as proposed would be effective for taxable years beginning on or after January 1, 2007, and the Company would lose the tax benefit associated with the REIT. Additionally, the proposed legislation would disallow the deduction for bad debts in excess of bank losses that had been written off, require the add back of expenses related to the 22.5% deduction of interest income from NYS and US obligations and eliminate the 20% reduction in the wage factor of the apportionment formula. Had the provision been effective in 2006, it would have resulted in an increase in income tax expense of $0.7 million.

We calculate our current and deferred tax provision based on estimates and assumptions that could differ from the actual results reflected in income tax returns filed during the subsequent year. Adjustments based on filed returns are recorded when identified, which is generally in the third quarter of the subsequent year for U.S. federal and state provisions.

The amount of income taxes we pay is subject at times to ongoing audits by federal and state tax authorities, which often result in proposed assessments. Our estimate for the potential outcome for any uncertain tax issue is highly judgmental. We believe we have adequately provided for any reasonably foreseeable outcome related to these matters. However, our future results may include favorable or unfavorable adjustments to our estimated tax liabilities in the period the assessments are proposed or resolved or when statutes of limitation on potential assessments expire. As a result, our effective tax rate may fluctuate significantly on a quarterly or annual basis.

2005 OPERATING RESULTS AS COMPARED TO 2004 OPERATING RESULTS

NET INTEREST INCOME

On a tax equivalent basis, the Company's net interest income for 2005 was $162.4 million, up from $154.7 million for 2004. The Company's net interest margin declined slightly to 4.01% for 2005 from 4.03% for 2004. The decline in the net interest margin resulted primarily from interest-bearing liabilities repricing up faster than earning assets, offset somewhat by the increase in average demand deposits, which increased $50.3 million or 10% during the period. The yield on earning assets increased 37 basis points (bp), from 5.58% for 2004 to 5.95% for 2005. Meanwhile, the rate paid on interest bearing liabilities increased 47 bp, from 1.83% for 2004 to 2.30% for 2005. Additionally, offsetting the decline in net interest margin was an increase in average earning assets of $204.9 million or 5%, driven primarily by a $215.5 million increase in average loans and leases.

LOANS AND LEASES AND CORRESPONDING INTEREST AND FEES ON LOANS

The average balance of loans and leases increased 8%, totaling $3.0 billion in 2005 compared to $2.7 billion in 2004. The yield on average loans and leases increased from 5.99% in 2004 to 6.43% in 2005, as loans, particularly loans indexed to Prime and other short-term variable rate indices, benefited from the rising rate environment in 2005. Interest income from loans and leases on a FTE basis increased 16%, from $164.3 million in 2004 to $190.3 million in 2005. The increase in interest income from loans and leases was due primarily to the increase in the average balance of loans and leases as well as the increase in yield on loans and leases in 2005 compared to 2004 noted above.

Total loans and leases increased 5% at December 31, 2005, totaling $3.0 billion from $2.9 billion at December 31, 2004. The increase in loans and leases was driven by strong growth in home equity loans, consumer loans, and real estate construction and development (primarily comprised of commercial real estate.) Home equity loans increased $72.0 million or 18% from $391.8 million at December 31, 2004 to $463.8 million at December 31, 2005. The increase in home equity loans was due to strong product demand and successful marketing of home equity products in newer markets. Consumer loans increased $51.8 million or 13%, from $412.1 million at December 31, 2004 to $464.0 million at December 31, 2005. The increase in consumer loans was driven primarily by strong growth in indirect auto

lending from an expanded presence in Pennsylvania and newer markets in New York. Real estate construction and development loans increased $26.9 million or 20% from $136.9 million at December 31, 2004 to $163.9 million at December 31, 2005, as the Bank originated several large commercial construction development loans in 2005 in its newer markets. Commercial and commercial real estate remained relatively unchanged at December 31, 2005 when compared to December 31, 2004, as new loan originations were offset by prepayments as competition for these loan types was particularly strong across all of the Company's markets in 2005. Residential real estate mortgages declined $19.9 million or 3% at December 31, 2005 compared to December 31, 2004 as the Company began selling real estate mortgages in the secondary market during the second half of 2005 as a means of limiting its exposure to long-term interest rate risk.

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SECURITIES AND CORRESPONDING INTEREST AND DIVIDEND INCOME

The average balance of the amortized cost for securities available for sale in 2005 was $954.5 million, a decrease of $15.6 million, or 2%, from $970.0 million in 2004. The yield on average securities available for sale was 4.52% for 2005 compared to 4.60% in 2004. The slight decrease in yield on securities available for sale resulted from continued efforts to shorten the duration and weighted average life of the securities available for sale portfolio in 2005. At December 31, 2005, approximately 53% of total securities were comprised of fifteen/ten year mortgage-backed securities and collateralized mortgage obligations (CMOs), 22% were comprised of US Agency notes and bonds and 5% were comprised of thirty/twenty year mortgaged-backed securities. At December 31, 2004, the mix was 67% fifteen/ten year mortgage-backed securities and CMOs, 11% US Agency notes and bonds and 9% of thirty/twenty year mortgaged-backed securities. Furthermore, the Company shortened the estimated weighted average life of the total securities portfolio from 4.6 years at December 31, 2004 to 4.1 years at December 31, 2005. In the event of a rising rate environment, the Company should be positioned to reinvest cash flows at a faster rate from shortening the expected life of the portfolio.

The average balance of securities held to maturity increased from $85.8 million in 2004 to $88.2 million in 2005. At December 31, 2005, securities held to maturity were comprised primarily of tax-exempt municipal securities. The yield on securities held to maturity increased from 5.11% in 2004 to 5.71% in 2005 from higher yields for tax-exempt securities purchased during 2005. Investments in FRB and Federal Home Loan Bank (FHLB) stock increased to $37.7 million in 2005 from $34.8 million in 2004. This increase was driven primarily by an increase in the investment in FHLB resulting from an increase in the Company’s borrowing capacity at FHLB. The yield from investments in FRB and FHLB Banks increased from 2.45% in 2004 to 5.05% in 2005. In 2003, the FHLB disclosed it had capital concerns and credit issues in their investment security portfolio. As a result of these issues, the FHLB reduced their dividend rate in 2004.

DEPOSITS

Average interest bearing deposits increased $60.4 million during 2005 compared to 2004. The increase resulted primarily from increases in time deposits offset by declines in money market, savings and NOW accounts. Average time deposits increased $137.8 million or 13% during 2005 when compared to 2004. The increase in average time deposits resulted primarily from increases in municipal, jumbo and brokered time deposits. The average balance of money market, savings and NOW accounts decreased collectively $77.3 million or 5% during 2005 when compared to 2004. The decrease in money market and NOW accounts was driven primarily from municipal customers shifting their funds into higher paying time deposits in 2005. The decrease in savings was driven primarily from retail customers shifting funds into higher paying money market accounts and time deposits. The average balance of demand deposits increased $50.3 million, or 10%, from $492.7 million in 2004 to $543.1 million in 2005. Solid growth in demand deposits was driven principally by increases in accounts from retail and business customers in newer markets. The ratio of average demand deposits to total average deposits increased from 16.2% in 2004 to 17.2% in 2005.

The rate paid on average interest-bearing deposits increased 35 bp from 1.56% during 2004 to 1.91% in 2005. The increase in rate on interest-bearing deposits was driven primarily by pricing increases from money market accounts and time deposits. These deposit products are more sensitive to interest rate changes. The pricing increases for these products resulted from several increases in short-term rates by the FRB during 2005 combined with competitive pricing for market competitors. The Company expects this trend to continue for money market accounts and time deposits in 2006. The rates paid for NOW and savings accounts remained relatively unchanged for 2005 compared to 2004. These product types are not as sensitive to rate changes and pricing pressure from competitors was low.

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BORROWINGS

Average short-term borrowings increased $51.4 million to $353.6 million in 2005. The average rate paid on short-term borrowings increased from 1.35% in 2004 to 3.11% in 2005, as the Federal Reserve Bank increased the discount rate (which directly impacts short-term borrowing rates) 200 bp in 2005. The increases in the average balance and the average rate paid caused interest expense on short-term borrowings to increase $6.9 million from $4.1 million in 2004 to $11.0 million in 2005. Average long-term debt increased $29.1 million from $381.8 million in 2004 to $410.9 million in 2005. The increases in long-term debt and short-term borrowings resulted primarily from loan growth exceeding deposit growth in 2005.

NONINTEREST INCOME

Noninterest income for the year ended December 31, 2005, was $42.5 million, up $1.6 million from $40.9 million for the same period in 2004. Excluding net securities losses of $1.2 million for 2005 and net securities gains of $216 thousand in 2004, total noninterest income increased $2.9 million or 7% from the same period in 2004. Net securities losses of $1.2 million resulted from the sale of $47.8 million in securities available for sale to improve investment portfolio yield going forward. Retirement plan administration fees were $4.4 million. This is a new service from the acquisition of EPIC Advisors, Inc. in January 2005. ATM and debit card fees increased $0.6 million compared with the same period a year ago, due to growth from transaction deposit accounts, which has led to an increase in the Company’s debit card base. Other income increased $0.9 million from increases in consumer banking fees, mortgage banking income and title insurance revenue. Offsetting these increases was a $3.6 million decrease in broker/dealer and insurance revenue due to the sale of the Company’s broker/dealer subsidiary, M. Griffith, Inc. in March 2005.

NONINTEREST EXPENSE

Noninterest expense for the year ended December 31, 2005, was $115.3 million, up $5.5 million or 5% from $109.8 million for the same period in 2004. The increase in noninterest expense was due largely to increases in salaries and employee benefits, occupancy, equipment and other expense offset by a decrease in data processing and communications expense. Also, 2004 included a $2.0 million goodwill impairment charge. Salaries and employee benefits increased $4.8 million primarily from merit increases as well as an increase in retirement costs and incentive compensation. Occupancy expense increased $0.5 million, driven principally by branch expansion and rising energy costs. Equipment expense increased $0.5 million from various technology upgrades. Other operating expense increased $2.1 million, principally from the reversal of a previously accrued $1.4 million liability that was determined in the fourth quarter of 2004 to no longer be required. The $2.0 million goodwill impairment charge in 2004 resulted from the expected sale of the Company’s broker/dealer subsidiary, M Griffith, Inc. in the first quarter of 2005. The decrease in data processing and communications of $0.6 million was driven by a contract renewal with the Company’s core data system service provider in 2005.

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IMPACT OF INFLATION AND CHANGING PRICES

ITEM7A. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

Interest rate risk is the most significant market risk affecting the Company. Other types of market risk, such as foreign currency exchange rate risk and commodity price risk, do not arise in the normal course of the Company’s business activities or are immaterial to the results of operations.

Interest rate risk is defined as an exposure to a movement in interest rates that could have an adverse effect on the Company’s net interest income. Net interest income is susceptible to interest rate risk to the degree that interest-bearing liabilities mature or reprice on a different basis than earning assets. When interest-bearing liabilities mature or reprice more quickly than earning assets in a given period, a significant increase in market rates of interest could adversely affect net interest income. Similarly, when earning assets mature or reprice more quickly than interest-bearing liabilities, falling interest rates could result in a decrease in net interest income.

In an attempt to manage the Company’s exposure to changes in interest rates, management monitors the Company’s interest rate risk. Management’s asset/liability committee (ALCO) meets monthly to review the Company’s interest rate risk position and profitability, and to recommend strategies for consideration by the Board of Directors. Management also reviews loan and deposit pricing, and the Company’s securities portfolio, formulates investment and funding strategies, and oversees the timing and implementation of transactions to assure attainment of the Board’s objectives in the most effective manner. Notwithstanding the Company’s interest rate risk management activities, the potential for changing interest rates is an uncertainty that can have an adverse effect on net income.

In adjusting the Company’s asset/liability position, the Board and management attempt to manage the Company’s interest rate risk while minimizing the net interest margin compression. At times, depending on the level of general interest rates, the relationship between long and short-term interest rates, market conditions and competitive factors, the Board and management may determine to increase the Company’s interest rate risk position somewhat in order to increase its net interest margin. The Company’s results of operations and net portfolio values remain vulnerable to changes in interest rates and fluctuations in the difference between long and short-term interest rates.

The primary tool utilized by ALCO to manage interest rate risk is a balance sheet/income statement simulation model (interest rate sensitivity analysis). Information such as principal balance, interest rate, maturity date, cash flows, next repricing date (if needed), and current rates is uploaded into the model to create an ending balance sheet. In addition, ALCO makes certain assumptions regarding prepayment speeds for loans and leases and mortgage related investment securities along with any optionality within the deposits and borrowings. The model is first run under an assumption of a flat rate scenario (i.e. no change in current interest rates) with a static balance sheet over a 12-month period. Two additional models are run in which a gradual increase of 200 bp and a gradual decrease of 200 bp takes place over a 12 month period with a static balance sheet. Under these scenarios, assets subject to prepayments are adjusted to account for faster or slower prepayment assumptions. Any investment securities or borrowings that have callable options embedded into them are handled accordingly based on the interest rate scenario. The resultant changes in net interest income are then measured against the flat rate scenario.

In the declining rate scenario, net interest income is projected to increase slightly when compared to the forecasted net interest income in the flat rate scenario through the simulation period. The increase in net interest income is a result of interest-bearing liabilities repricing downward slightly faster than earning assets. However, the inability to effectively lower deposit rates will likely reduce or eliminate the otherwise normal expected benefit of lower interest rates. In the rising rate scenarios, net interest income is projected to experience a decline from the flat rate scenario. The potential impact on earnings is dependent on the ability to lag deposit repricing. Net interest income for the next twelve months

in the +200/-200 bp scenarios, as described above, is within the internal policy risk limits of not more than a 7.5% change in net interest income. The following table summarizes the percentage change in net interest income in the rising and declining rate scenarios over a 12-month period from the forecasted net interest income in the flat rate scenario using the December 31, 2006 balance sheet position:

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Table 10. Interest Rate Sensitivity Analysis

Change in interest rates *(In basis points)*	Percent change in net interest income
+200	(4.01%)
-200	0.22%

Under the flat rate scenario with a static balance sheet, net interest income is anticipated to decrease approximately 1.4% from total net interest income for 2006. The Company anticipates under current conditions, interest expense is expected to increase at a faster rate that interest income as the Company is somewhat liability sensitive. In order to protect net interest income from anticipated net interest margin compression, the Company will continue to focus on increasing earning assets through loan growth and leverage opportunities. However, if the Company cannot maintain the level of earning assets at December 31, 2006, the Company expects net interest income to decline in 2007.

The Company has taken several measures to mitigate net interest margin compression. The Company began originating 20-year and 30-year residential real estate mortgages with the intent to sell at the end of the second quarter of 2005, limiting its exposure to long-term fixed rate assets. The Company has also shortened the average life of its investment securities portfolio by limiting purchases of mortgage-backed securities and redirecting proceeds into short-duration CMOs and US Agency notes and bonds. Lastly, from time to time during 2006, the Company has increased its long-term debt to offset exposure to long-term earning assets.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
NBT Bancorp Inc.:

We have audited the accompanying consolidated balance sheets of NBT Bancorp Inc. and subsidiaries (the Company) as of December 31, 2006 and 2005, and the related consolidated statements of income, changes in stockholders' equity, cash flows and comprehensive income for each of the years in the three-year period ended December 31, 2006. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of NBT Bancorp Inc. and subsidiaries at December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of NBT Bancorp Inc.'s internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 27, 2007 expressed an unqualified opinion on management's assessment of, and effective operation of, internal control over financial reporting.

/S/ KPMG LLP

Albany, New York
February 27, 2007

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Consolidated Balance Sheets

(In thousands, except share and per share data)	As of December 31, 2006	2005
Assets		
Cash and due from banks	$ 130,936	$ 134,501
Short-term interest bearing accounts	7,857	7,987
Securities available for sale, at fair value	1,106,322	954,474
Securities held to maturity (fair value $136,287 and $93,701)	136,314	93,709
Federal Reserve and Federal Home Loan Bank stock	38,812	40,259
Loans and leases	3,412,654	3,022,657
Less allowance for loan and lease losses	50,587	47,455
Net loans and leases	3,362,067	2,975,202
Premises and equipment, net	66,982	63,693
Goodwill	103,356	47,544
Intangible assets, net	11,984	3,808
Bank owned life insurance	41,783	33,648
Other assets	81,159	71,948
Total assets	$ 5,087,572	$ 4,426,773
Liabilities		
Deposits:		
Demand (noninterest bearing)	$ 646,377	$ 593,422
Savings, NOW, and money market	1,566,557	1,325,166
Time	1,583,304	1,241,608
Total deposits	3,796,238	3,160,196
Short-term borrowings	345,408	444,977
Long-term debt	417,728	414,330
Trust preferred debentures	75,422	23,875
Other liabilities	48,959	49,452
Total liabilities	4,683,755	4,092,830
Stockholders' equity		
Preferred stock, $0.01 par value; authorized 2,500,000 shares at December 31, 2006 and 2005.	-	-
Common stock, $0.01 par value. Authorized 50,000,000 shares at December 31, 2006 and 2005; issued 36,459,491 and 34,400,925 at December 31, 2006 and 2005, respectively	365	344
Additional paid-in-capital	271,528	219,157
Unvested restricted stock	-	(457)
Retained earnings	191,770	163,989
Accumulated other comprehensive loss	(14,014)	(6,477)
Common stock in treasury, at cost, 2,203,549 and 2,101,382 shares	(45,832)	(42,613)
Total stockholders' equity	403,817	333,943
Total liabilities and stockholders' equity	$ 5,087,572	$ 4,426,773

See accompanying notes to consolidated financial statements.

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Consolidated Statements of Income

	Years ended December 31,		
(In thousands, except per share data)	**2006**	2005	2004
Interest, fee, and dividend income			
Interest and fees on loans and leases	**$ 230,042**	$ 189,714	$ 163,795
Securities available for sale	**51,599**	41,120	42,264
Securities held to maturity	**4,730**	3,407	3,044
Other	**2,471**	2,126	1,076
Total interest, fee, and dividend income	**288,842**	236,367	210,179
Interest expense			
Deposits	**87,798**	49,932	39,761
Short-term borrowings	**15,448**	10,984	4,086
Long-term debt	**17,063**	16,114	15,022
Trust preferred debentures	**4,700**	1,226	823
Total interest expense	**125,009**	78,256	59,692
Net interest income	**163,833**	158,111	150,487
Provision for loan and lease losses	**9,395**	9,464	9,615
Net interest income after provision for loan and lease losses	**154,438**	148,647	140,872
Noninterest income			
Service charges on deposit accounts	**17,590**	16,894	16,470
Broker/ dealer and insurance revenue	**3,936**	3,186	6,782
Trust	**5,629**	5,029	4,605
Net securities (losses) gains	**(875)**	(1,236)	216
Bank owned life insurance	**1,629**	1,347	1,487
ATM Fees	**7,086**	6,162	5,530
Retirement plan administration fees	**5,536**	4,426	-
Other	**8,098**	6,741	5,799
Total noninterest income	**48,629**	42,549	40,889
Noninterest expense			
Salaries and employee benefits	**62,877**	60,005	55,204
Occupancy	**11,518**	10,452	9,905
Equipment	**8,332**	8,118	7,573
Data processing and communications	**10,454**	10,349	10,972
Professional fees and outside services	**7,761**	6,087	6,175
Office supplies and postage	**5,330**	4,628	4,459
Amortization of intangible assets	**1,649**	544	284
Loan collection and other real estate owned	**1,351**	1,002	1,241
Goodwill impairment	**-**	-	1,950
Other	**13,694**	14,120	12,014
Total noninterest expense	**122,966**	115,305	109,777
Income before income tax expense	**80,101**	75,891	71,984
Income tax expense	**24,154**	23,453	21,937
Net income	**$ 55,947**	$ 52,438	$ 50,047

Earnings per share						
Basic	**$**	**1.65**	$	1.62	$	1.53
Diluted		**1.64**		1.60		1.51

See accompanying notes to consolidated financial statements.

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Consolidated Statements of Changes in Stockholders' Equity

Years ended December 31, 2006, 2005, and 2004 *(In thousands except share and per share data)*	Common stock	Additional Paid-in-capital	Unvested Restricted Stock	Retained earnings	Accumulated other comprehensive (loss)/ income	Common stock in treasury	Total
Balance at December 31, 2003	344	216,636	(197)	112,647	7,933	(27,329)	310,034
Net income	-	-	-	50,047	-	-	50,047
Cash dividends- $0.74 per share	-	-	-	(24,251)	-	-	(24,251)
Purchase of 423,989 treasury shares	-	-	-	-	-	(9,149)	(9,149)
Net issuance of 458,593 shares to employee benefit plans and other stock plans, including tax benefit	-	1,317	-	(1,120)	-	8,103	8,300
Grant of 14,547 shares of restricted stock awards	-	59	(312)	-	-	253	-
Amortization of restricted stock awards	-	-	196	-	-	-	196
Forfeited 963 shares of restricted stock	-	-	17	-	-	(17)	-
Other comprehensive loss	-	-	-	-	(2,944)	-	(2,944)
Balance at December 31, 2004	$ 344	$ 218,012	$ (296)	$ 137,323	$ 4,989	$ (28,139)	$ 332,233
Net income	-	-	-	52,438	-	-	52,438
Cash dividends- $0.76 per share	-	-	-	(24,673)	-	-	(24,673)
Purchase of 1,008,114 treasury shares	-	-	-	-	-	(23,165)	(23,165)
Net issuance of 415,976 shares to employee benefit plans and other stock plans, including tax benefit	-	1,292	-	(1,099)	-	8,025	8,218
Grant of 35,003 shares of restricted stock awards	-	(147)	(519)	-	-	666	-
Amortization of restricted stock awards	-	-	358	-	-	-	358
Other comprehensive loss	-	-	-	-	(11,466)	-	(11,466)
Balance at December 31, 2005	**$ 344**	**$ 219,157**	**$ (457)**	**$ 163,989**	**$ (6,477)**	**$ (42,613)**	**$ 333,943**
Net income	-	-	-	55,947	-	-	55,947
Cash dividends- $0.76 per share	-	-	-	(26,018)	-	-	(26,018)

Purchase of 766,004 treasury shares	-	-	-	-	-	(17,111)	(17,111)
Issuance of 2,058,661 shares of common stock in connection with purchase business combination	21	48,604	-	-	-	-	48,625
Issuance of 237,278 incentive stock options in purchase transaction	-	1,955	-	-	-	-	1,955
Acquisition of 2,500 shares of company stock in purchase transaction	-	-	-	-	-	(55)	(55)
Net issuance of 595,447 shares to employee benefit plans and other stock plans, including tax benefit	-	1,244	-	(2,148)	-	12,508	11,604
Reclassification adjustment from the adoption of FAS123R	-	(457)	457	-	-	-	-
Stock-based compensation expense	-	2,509	-	-	-	-	2,509
Grant of 73,515 shares of restricted stock awards	-	(1,499)	-	-	-	1,499	-
Forfeit 2,625 shares of restricted stock	-	15	-	-	-	(60)	(45)
Other comprehensive loss	-	-	-	-	84	-	84
Adjustment to initially apply SFAS No. 158, net of tax	-	-	-	-	(7,621)	-	(7,621)
Balance at December 31, 2006	**$ 365**	**$ 271,528**	**$ -**	**$ 191,770**	**$ (14,014)**	**$ (45,832)**	**$ 403,817**

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Consolidated Statements of Cash Flows

(In thousands, except per share data)	Years ended December 31, 2006	2005	2004
Operating activities			
Net income	$ **55,947**	$ 52,438	$ 50,047
Adjustments to reconcile net income to net cash provided by operating activities			
Provision for loan and lease losses	**9,395**	9,464	9,615
Depreciation and amortization of premises and equipment	**6,074**	6,296	6,057
Net accretion on securities	**178**	1,362	2,406
Amortization of intangible assets	**1,649**	544	284
Stock-based compensation expense	**2,509**	358	196
Bank owned life insurance income	**(1,629)**	(1,347)	(1,487)
Deferred income tax expense	**9,767**	743	7,602
Proceeds from sale of loans held for sale	**36,407**	24,690	19,541
Originations and purchases of loans held for sale	**(33,601)**	(27,674)	(2,631)
Net gains on sales of loans held for sale	**(85)**	(55)	(89)
Net security losses (gains)	**875**	1,236	(216)
Net gain on sales of other real estate owned	**(374)**	(351)	(909)
Net gain on sale of branch	**(470)**	-	-
Tax benefit from exercise of stock options	-	1,057	1,336
Goodwill impairment	**-**	-	1,950
Net (increase) decrease in other assets	**(18,800)**	1,803	2,164
Net (decrease) increase in other liabilities	**(2,325)**	(5,506)	696
Net cash provided by operating activities	**65,517**	65,058	96,562
Investing activities			
Cash paid for the acquisition of EPIC Advisors, Inc.	**-**	(6,129)	-
Net cash paid for sale of branch	**(2,307)**	-	-
Cash received for the sale of M. Griffith Inc.	**-**	1,016	-
Net cash used in CNB Bancorp, Inc. merger	**(21,223)**	-	-
Securities available for sale:			
Proceeds from maturities, calls, and principal paydowns	**217,232**	173,460	262,999
Proceeds from sales	**42,292**	53,044	12,950
Purchases	**(265,052)**	(250,003)	(253,469)
Securities held to maturity:			
Proceeds from maturities, calls, and principal paydowns	**45,990**	44,624	55,770
Purchases	**(80,485)**	(56,654)	(40,388)
Net increase in loans	**(211,280)**	(156,998)	(254,985)
Net decrease (increase) in Federal Reserve and FHLB stock	**1,447**	(3,417)	(2,799)
Purchases of premises and equipment, net	**(4,176)**	(6,055)	(7,357)
Proceeds from sales of other real estate owned	**1,028**	1,022	2,582
Net cash used in investing activities	**(276,534)**	(206,090)	(224,697)

Financing activities			
Net increase in deposits	**307,033**	86,358	72,487
Net (decrease) increase in short-term borrowings	**(99,569)**	106,154	35,892
Proceeds from issuance of long-term debt	**-**	60,000	30,000
Repayments of long-term debt	**(19,157)**	(40,193)	(5,177)
Proceeds from the issuance of trust preferred debentures	**51,547**	5,155	-
Tax benefit from exercise of stock options	**466**	-	-
Proceeds from the issuance of shares to employee benefit plans and other stock plans	**10,131**	7,161	6,964
Purchase of treasury stock	**(17,111)**	(23,165)	(9,149)
Cash dividends and payment for fractional shares	**(26,018)**	(24,673)	(24,251)
Net cash provided by financing activities	**207,322**	176,797	106,766
Net (decrease) increase in cash and cash equivalents	**(3,695)**	35,765	(21,369)
Cash and cash equivalents at beginning of year	**142,488**	106,723	128,092
Cash and cash equivalents at end of year	**$ 138,793**	$ 142,488	$ 106,723

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Supplemental disclosure of cash flow information						
Cash paid during the year for:						
Interest	**$**	**121,447**	$	76,563	$	60,181
Income taxes		**19,914**		23,582		10,696
Noncash investing activities:						
Loans transferred to OREO	**$**	**778**	$	360	$	885
Adjustment to initially apply SFAS No. 158, net of tax		**(7,621)**		-		-
Dispositions:						
Fair value of assets sold	**$**	**3,453**	$	1,405	$	-
Fair value of liabilities transferred		**5,760**		389		-
Acquisitions:						
Fair value of assets acquired	**$**	**422,097**	$	6,565	$	-
Goodwill and identifiable intangible assets recognized in purchase combination		**65,637**		-		-
Fair value of liabilities assumed		**360,648**		435		-
Fair value of equity issued in purchase combination		**50,525**		-		-

See accompanying notes to consolidated financial statements.

Consolidated Statements of Comprehensive Income

	Years ended December 31,					
(In thousands)		**2006**		2005		2004
Net income	**$**	**55,947**	$	52,438	$	50,047
Other comprehensive income (loss), net of tax						
Unrealized net holding losses arising during the year (pre-tax amounts of $737, $20,308, and $4,531)		**(442)**		(12,209)		(2,724)
Less reclassification adjustment for net losses (gains) related to securities available for sale included in net income (pre-tax amounts of $875, $1,236, and ($216))		**526**		743		(131)
Minimum pension liability adjustment (pre-tax amounts of $0, $0, and $147)		**-**		-		(89)
Total other comprehensive income (loss)		**84**		(11,466)		(2,944)
Comprehensive income	**$**	**56,031**	$	40,972	$	47,103

See accompanying notes to consolidated financial statements

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NBT BANCORP INC. AND SUBSIDIARIES:

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2006 AND 2005

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting and reporting policies of NBT Bancorp Inc. (Bancorp) and its subsidiaries, NBT Bank, N.A. (NBT Bank) and NBT Financial Services, Inc., conform, in all material respects, to accounting principles generally accepted in the United States of America (GAAP) and to general practices within the banking industry. Collectively, Bancorp and its subsidiaries are referred to herein as "the Company."

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan and lease losses and the valuation of other real estate owned acquired in connection with foreclosures. In connection with the determination of the allowance for loan and lease losses and the valuation of other real estate owned, management obtains appraisals for properties.

The following is a description of significant policies and practices:

CONSOLIDATION

The accompanying consolidated financial statements include the accounts of Bancorp and its wholly owned subsidiaries mentioned above. All material intercompany transactions have been eliminated in consolidation. Amounts previously reported in the consolidated financial statements are reclassified whenever necessary to conform with the current year's presentation. In the "Parent Company Financial Information," the investment in subsidiaries is carried under the equity method of accounting.

The Company determines whether it has a controlling financial interest in an entity by first evaluating whether the entity is a voting interest entity or a variable interest entity under accounting principles generally accepted in the United States. Voting interest entities are entities in which the total equity investment at risk is sufficient to enable the entity to finance itself independently and provides the equity holders with the obligation to absorb losses, the right to receive residual returns and the right to make decisions about the entity's activities. The Company consolidates voting interest entities in which it has all, or at least a majority of, the voting interest. As defined in applicable accounting standards, variable interest entities (VIEs) are entities that lack one or more of the characteristics of a voting interest entity. A controlling financial interest in an entity is present when an enterprise has a variable interest, or a combination of variable interests, that will absorb a majority of the entity's expected losses, receive a majority of the entity's expected residual returns, or both. The enterprise with a controlling financial interest, known as the primary beneficiary, consolidates the VIE. The Company's wholly owned subsidiaries CNBF Capital Trust I, NBT Statutory Trust I and NBT Statutory Trust II are VIEs for which the Company is not the primary beneficiary. Accordingly, the accounts of these entities are not included in the Company's consolidated financial statements.

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SEGMENT REPORTING

The Company’s operations are primarily in the community banking industry and include the provision of traditional banking services. The Company operates solely in the geographical regions of central and northern New York and northeastern Pennsylvania. The Company has identified separate operating segments; however, these segments did not meet the quantitative thresholds for separate disclosure.

CASH EQUIVALENTS

The Company considers amounts due from correspondent banks, cash items in process of collection, and institutional money market mutual funds to be cash equivalents for purposes of the consolidated statements of cash flows.

SECURITIES

The Company classifies its securities at date of purchase as either available for sale, held to maturity, or trading. Held to maturity debt securities are those that the Company has the ability and intent to hold until maturity. Available for sale securities are recorded at fair value. Unrealized holding gains and losses, net of the related tax effect, on available for sale securities are excluded from earnings and are reported in stockholders’ equity as a component of accumulated other comprehensive income or loss. Held to maturity securities are recorded at amortized cost. Trading securities are recorded at fair value, with net unrealized gains and losses recognized currently in income. Transfers of securities between categories are recorded at fair value at the date of transfer. A decline in the fair value of any available for sale or held to maturity security below cost that is deemed other-than-temporary is charged to earnings resulting in the establishment of a new cost basis for the security. Securities with other-than-temporary impairment are generally placed on non-accrual status.

Nonmarketable equity securities are carried at cost, with the exception of investments owned by NBT Bank’s small business investment company (SBIC) subsidiary, which are carried at fair value in accordance with SBIC rules.

Premiums and discounts are amortized or accreted over the life of the related security as an adjustment to yield using the interest method. Dividend and interest income are recognized when earned. Realized gains and losses on securities sold are derived using the specific identification method for determining the cost of securities sold.

Investments in Federal Reserve and Federal Home Loan Bank stock are required for membership in those organizations and are carried at cost since there is no market value available.

LOANS AND LEASES

Loans are recorded at their current unpaid principal balance, net of unearned income and unamortized loan fees and expenses, which are amortized under the effective interest method over the estimated lives of the loans. Interest income on loans is accrued based on the principal amount outstanding.

Lease receivables primarily represent automobile financing to customers through direct financing leases and are carried at the aggregate of the lease payments receivable and the estimated residual values, net of unearned income and net deferred lease origination fees and costs. Net deferred lease origination fees and costs are amortized under the effective interest method over the estimated lives of the leases. The estimated residual value related to the total lease portfolio is reviewed quarterly, and if there has been a decline in the estimated fair value of the total residual value that is judged by management to be other-than-temporary, a loss is recognized. Adjustments related to such other-than-temporary declines in estimated fair value are recorded in noninterest expense in the consolidated statements of income.

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Loans and leases are placed on nonaccrual status when timely collection of principal and interest in accordance with contractual terms is doubtful. Loans and leases are transferred to a nonaccrual basis generally when principal or interest payments become ninety days delinquent, unless the loan is well secured and in the process of collection, or sooner when management concludes circumstances indicate that borrowers may be unable to meet contractual principal or interest payments. When a loan or lease is transferred to a nonaccrual status, all interest previously accrued in the current period but not collected is reversed against interest income in that period. Interest accrued in a prior period and not collected is charged-off against the allowance for loan and lease losses.

If ultimate repayment of a nonaccrual loan is expected, any payments received are applied in accordance with contractual terms. If ultimate repayment of principal is not expected, any payment received on a nonaccrual loan is applied to principal until ultimate repayment becomes expected. Nonaccrual loans are returned to accrual status when they become current as to principal and interest or demonstrate a period of performance under the contractual terms and, in the opinion of management, are fully collectible as to principal and interest. When in the opinion of management the collection of principal appears unlikely, the loan balance is charged-off in total or in part.

Commercial type loans are considered impaired when it is probable that the borrower will not repay the loan according to the original contractual terms of the loan agreement, and all loan types are considered impaired if the loan is restructured in a troubled debt restructuring.

A loan is considered to be a trouble debt restructured loan (TDR) when the Company grants a concession to the borrower because of the borrower’s financial condition that it would not otherwise consider. Such concessions include the reduction of interest rates, forgiveness of principal or interest, or other modifications at interest rates that are less than the current market rate for new obligations with similar risk. TDR loans that are in compliance with their modified terms and that yield a market rate may be removed from the TDR status after a period of performance.

ALLOWANCE FOR LOAN AND LEASE LOSSES

The allowance for loan and lease losses is the amount which, in the opinion of management, is necessary to absorb probable losses inherent in the loan and lease portfolio. The allowance is determined based upon numerous considerations, including local economic conditions, the growth and composition of the loan portfolio with respect to the mix between the various types of loans and their related risk characteristics, a review of the value of collateral supporting the loans, comprehensive reviews of the loan portfolio by the independent loan review staff and management, as well as consideration of volume and trends of delinquencies, nonperforming loans, and loan charge-offs. As a result of the test of adequacy, required additions to the allowance for loan and lease losses are made periodically by charges to the provision for loan and lease losses.

The allowance for loan and lease losses related to impaired loans is based on discounted cash flows using the loan’s initial effective interest rate or the fair value of the collateral for certain loans where repayment of the loan is expected to be provided solely by the underlying collateral (collateral dependent loans). The Company’s impaired loans are generally collateral dependent. The Company considers the estimated cost to sell, on a discounted basis, when determining the fair value of collateral in the measurement of impairment if those costs are expected to reduce the cash flows available to repay or otherwise satisfy the loans.

Management believes that the allowance for loan and lease losses is adequate. While management uses available information to recognize loan and lease losses, future additions to the allowance for loan and lease losses may be necessary based on changes in economic conditions or changes in the values of properties securing loans in the process of foreclosure. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Company’s allowance for loan and lease losses. Such agencies may require the Company to recognize additions to the allowance for loan and lease losses based on their judgments about information available to

them at the time of their examination which may not be currently available to management.

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PREMISES AND EQUIPMENT

Premises and equipment are stated at cost, less accumulated depreciation. Depreciation of premises and equipment is determined using the straight-line method over the estimated useful lives of the respective assets. Expenditures for maintenance, repairs, and minor replacements are charged to expense as incurred.

OTHER REAL ESTATE OWNED

Other real estate owned (OREO) consists of properties acquired through foreclosure or by acceptance of a deed in lieu of foreclosure. These assets are recorded at the lower of fair value of the asset acquired less estimated costs to sell or "cost" (defined as the fair value at initial foreclosure). At the time of foreclosure, or when foreclosure occurs in-substance, the excess, if any, of the loan over the fair market value of the assets received, less estimated selling costs, is charged to the allowance for loan losses and any subsequent valuation write-downs are charged to other expense. Operating costs associated with the properties are charged to expense as incurred. Gains on the sale of OREO are included in income when title has passed and the sale has met the minimum down payment requirements prescribed by GAAP.

GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill and intangible assets that have indefinite useful lives are not amortized, but are tested at least annually for impairment. Intangible assets that have finite useful lives, such as core deposit intangibles, continue to be amortized over their useful lives. Core deposit intangibles are amortized over a maximum of 10 years using the straight-line methods for all periods presented.

When facts and circumstances indicate potential impairment of amortizable intangible assets, the Company evaluates the recoverability of the asset carrying value, using estimates of undiscounted future cash flows over the remaining asset life. Any impairment loss is measured by the excess of carrying value over fair value. Goodwill impairment tests are performed on an annual basis or when events or circumstances dictate. In these tests, the fair values of each reporting unit, or segment, is compared to the carrying amount of that reporting unit in order to determine if impairment is indicated. If so, the implied fair value of the reporting unit's goodwill is compared to its carrying amount and the impairment loss is measured by the excess of the carrying value over fair value.

TREASURY STOCK

Treasury stock acquisitions are recorded at cost. Subsequent sales of treasury stock are recorded on an average cost basis. Gains on the sale of treasury stock are credited to additional paid-in-capital. Losses on the sale of treasury stock are charged to additional paid-in-capital to the extent of previous gains, otherwise charged to retained earnings.

INCOME TAXES

Income taxes are accounted for under the asset and liability method. The Company files a consolidated tax return on the accrual basis. Deferred income taxes are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred taxes of a change in tax rates is recognized in income in the period that includes the enactment date.

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STOCK-BASED COMPENSATION

Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards (SFAS") No. 123 (revised 2004), "Share-Based Payment", ("SFAS No. 123R") using the modified-prospective transition method. Under this transition method, compensation cost in 2006 includes costs for stock options granted prior to but not vested as of December 31, 2005, and options vested in 2006. Therefore, results for prior periods have not been restated.

Previous to the adoption of SFAS No. 123R, the Company accounted for its stock-based compensation plans in accordance with the provisions of Accounting Principles board (APB) Opinion No. 25, "*Accounting for Stock Issued to Employees,"* and related interpretations. On January 1, 1996, the Company adopted SFAS No. 123, *"Accounting for Stock-Based Compensation"* which permits entities to recognize as expense over the vesting period the estimated fair value of all stock based awards measured on the date of grant. Alternatively, SFAS No. 123 allowed entities to continue to apply the provisions of APB Opinion No. 25 and provide pro forma net income and pro forma net income per share disclosures for employee stock-based grants made in 1995 and thereafter as if the fair value based method defined in SFAS No. 123 had been applied. The Company elected to continue to apply the provisions of APB Opinion No. 25 and provide the pro forma disclosures of SFAS No. 123.

EARNINGS PER SHARE

Basic earnings per share (EPS) excludes dilution and is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity (such as the Company's dilutive stock options and restricted stock).

OTHER FINANCIAL INSTRUMENTS

The Company is a party to certain other financial instruments with off-balance-sheet risk such as commitments to extend credit, unused lines of credit, as well as certain mortgage loans sold to investors with recourse. The Company's policy is to record such instruments when funded and the funded status.

COMPREHENSIVE INCOME

At the Company, comprehensive income represents net income plus other comprehensive income, which consists primarily of the net change in unrealized gains or losses on securities available for sale for the period. Accumulated other comprehensive (loss) income represents the net unrealized gains or losses on securities available for sale and the previously unrecognized portion of the funded status of employee benefit plans, net of income taxes, as of the consolidated balance sheet dates.

PENSION COSTS

The Company maintains a noncontributory, defined benefit pension plan covering substantially all employees, as well as supplemental employee retirement plans covering certain executives and a defined benefit postretirement healthcare plan that covers certain employees. Costs associated with these plans, based on actuarial computations of current and future benefits for employees, are charged to current operating expenses.

Effective December 31, 2006, the Company adopted SFAS No. 158, *Employers' Accounting For Defined Benefit Pension and Other Postretirement Plans - An Amendment of FASB Statements No. 87, 88, 106, and 132(R),* which requires the Company to recognize the overfunded or underfunded status of a single employer defined benefit

postretirement plan as an asset or liability on its balance sheet and to recognize changes in the funded status in comprehensive income in the year in which the change occurred. However, gains or losses, prior service costs or credits, and transition assets or obligations that have not been included in net periodic benefit cost as of the end of 2006, the fiscal year in which SFAS No. 158 is initially applied, are to be recognized as components of the ending balance of accumulated other comprehensive income, net of tax. The adjustment to accumulated other comprehensive loss for the adoption of SFAS No. 158 was $7.6 million.

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TRUST

Assets held by the Company in a fiduciary or agency capacity for its customers are not included in the accompanying consolidated balance sheets, since such assets are not assets of the Company. Such assets totaled $2.5 billion and $2.2 billion at December 31, 2006 and 2005, respectively. Trust income is recognized on the accrual method based on contractual rates applied to the balances of trust accounts.

Recent Accounting Pronouncements

In February 2006, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standard 155 - Accounting for Certain Hybrid Financial Instruments ("SFAS 155"), which eliminates the exemption from applying SFAS 133 to interests in securitized financial assets so that similar instruments are accounted for similarly regardless of the form of the instruments. SFAS 155 also allows the election of fair value measurement at acquisition, at issuance, or when a previously recognized financial instrument is subject to a remeasurement event. Adoption is effective for all financial instruments acquired or issued after the beginning of the first fiscal year that begins after September 15, 2006. Early adoption is permitted. We are evaluating whether the adoption of SFAS 155 is expected to have a material effect on our consolidated financial position, results of operations or cash flows.

In March 2006, the FASB issued Statement of Financial Accounting Standard 156 - Accounting for Servicing of Financial Assets ("SFAS 156"), which requires all separately recognized servicing assets and servicing liabilities be initially measured at fair value. SFAS 156 permits, but does not require, the subsequent measurement of servicing assets and servicing liabilities at fair value. Adoption is required as of the beginning of the first fiscal year that begins after September 15, 2006. Early adoption is permitted. The adoption of SFAS 156 is not expected to have a material effect on our consolidated financial position, results of operations or cash flows.

In July 2006, the FASB posted the final Interpretation No. 48 - Accounting for Uncertainty in Income Taxes ("FIN 48"), which prescribes a minimum recognition threshold a tax position must meet before being recognized in the financial statements. FIN 48 concludes that recognition of a tax position, based solely on its technical merits, occurs when the tax position is more-likely-than-not to be sustained upon examination. The tax benefit is measured as the largest amount of benefit that is more-likely-than-not to be realized upon ultimate settlement. In addition, FIN 48 expands disclosure requirements to include a tabular roll-forward of the beginning and ending aggregate unrecognized tax benefits as well as detail regarding tax uncertainties for which it is reasonably possible the amount of unrecognized tax benefit will increase or decrease within 1 year. The adoption of FIN 48 did not have a material effect on our consolidated financial position, results of operations or cash flows.

In September 2006, the FASB issued Statement of Financial Accounting Standard 157 - Fair Value Measurements ("SFAS 157"), which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. This Statement does not require any new fair value measurements, but the application of this Statement may change current practice. Adoption is required as of the beginning of the first fiscal year that begins after November 15, 2007. Early application of this Standard is encouraged. The Company is assessing the effect that SFAS 157 will have on our consolidated financial position, results of operations or cash flows.

In September 2006, the SEC published Staff Accounting Bulletin No. 108 - Considering the Effects of Prior Year Misstatements in Current Year Financial Statements ("SAB 108") to provide guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of a materiality assessment. SAB 108 addresses the effects that unadjusted assets and liabilities of prior year errors have on current year financial statements. Registrants must quantify the impact of correcting all misstatements, including both the carryover and reversing effects of prior year misstatements, on the current year financial statements. A registrant's

financial statements would require adjustment when a misstatement is quantified as material, after considering all relevant quantitative and qualitative factors. Restating prior periods is not mandatory, but financial statements covering the first fiscal year ending after November 15, 2006 should reflect the effects of prior year misstatements. The adoption of SAB 108 as of January 1, 2006 did not have a material effect on the Company's consolidated financial statements.

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(2) MERGER AND ACQUISITION ACTIVITY

A) EPIC Advisors, Inc.
In January 2005, the Company acquired EPIC Advisors, Inc., a 401(k) record keeping firm located in Rochester, NY. In that transaction, the Company recorded customer relationship intangible assets of $2.1 million and non-compete provision intangible assets of $0.2 million, which have amortization periods of 13 years and 5 years, respectively. Also in connection with the acquisition, the Company recorded $3.0 million in goodwill.

B) M. Griffith Inc.
In March 2005, the Company sold its broker/dealer subsidiary, M. Griffith Inc. In connection with the sale of M. Griffith Inc., goodwill was reduced by $1.1 million and was allocated against the sales price. In the fourth quarter of 2004, the Company recorded a $2.0 million goodwill impairment charge in connection with the above mentioned sale. A definitive agreement was signed by the Company and the acquirer in the fourth quarter of 2004. The negotiation and resolution of sale terms for M. Griffith Inc. during the fourth quarter of 2004 resulted in the goodwill impairment charge.

C) CNB Bancorp, Inc.
On February 10, 2006, the Company acquired CNB Bancorp, Inc. ("CNB"), a bank holding company headquartered in Gloversville, New York. The acquisition was accomplished by merging CNB with and into the Company (the "Merger"). By virtue of this acquisition, CNB's banking subsidiary, City National Bank and Trust Company was merged with and into NBT Bank, N.A. City National Bank and Trust Company operated 9 full-service community banking offices - located in Fulton, Hamilton, Montgomery and Saratoga counties, with approximately $400 million in assets. The Merger increases the Company's assets to approximately $4.9 billion.

In connection with the Merger, the Company issued an aggregate of 2.1 million shares of Company common stock and $39 million in cash to the former holders of CNB common stock. In connection with acquisition of CNB, the Company formed NBT Statutory Trust II in February 2006 to fund the cash portion of the acquisition as well as to provide regulatory capital. The Company raised $51.5 million through NBT Statutory Trust II in February 2006.

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

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

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(3) EARNINGS PER SHARE

The following is a reconciliation of basic and diluted earnings per share for the years presented in the consolidated statements of income:

	Years ended December 31,								
	2006			2005			2004		
(In thousands, except per share data)	**Net income**	**Weighted average shares**	**Per share amount**	Net income	Weigthed average shares	Per share amount	Net income	Weighted average shares	Per share amount
Basic earnings per share	**$ 55,947**	**33,886**	**$ 1.65**	$ 52,438	32,437	$ 1.62	$ 50,047	32,739	$ 1.53
Effect of dilutive securities									
Stock based compensation		**302**			265			336	
Contingent shares		**18**			8			12	
Diluted earnings per share	**$ 55,947**	**34,206**	**$ 1.64**	$ 52,438	32,710	$ 1.60	$ 50,047	33,087	$ 1.51

There were approximately 356,000, 386,000, and 5,000 weighted average stock options for the years ended December 31, 2006, 2005, and 2004, respectively, that were not considered in the calculation of diluted earnings per share since the stock options' exercise prices were greater than the average market price during these periods.

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(4) FEDERAL RESERVE BANK REQUIREMENT

The Company is required to maintain reserve balances with the Federal Reserve Bank. The required average total reserve for NBT Bank for the 14-day maintenance period ending December 20, 2006 was $62.9 million.

(5) SECURITIES

The amortized cost, estimated fair value, and unrealized gains and losses of securities available for sale are as follows:

(In thousands)		Amortized cost		Unrealized gains		Unrealized losses		Estimated fair value
December 31, 2006								
U.S. Treasury	**$**	**10,516**	**$**	**-**	**$**	**29**	**$**	**10,487**
Federal Agency		**343,529**		**550**		**2,366**		**341,713**
State & municipal		**99,724**		**2,099**		**122**		**101,701**
Mortgage-backed		**400,549**		**628**		**11,136**		**390,041**
Collateralized mortgage obligations		**241,984**		**198**		**3,412**		**238,770**
Corporate		**1,285**		**106**		**-**		**1,391**
Other securities		**18,861**		**3,428**		**70**		**22,219**
Total securities available for sale	**$**	**1,116,448**	**$**	**7,009**	**$**	**17,135**	**$**	**1,106,322**
December 31, 2005								
U.S. Treasury	$	10,005	$	-	$	-	$	10,005
Federal Agency		236,410		41		3,015		233,436
State & municipal		76,574		2,861		30		79,405
Mortgage-backed		448,496		1,186		10,517		439,165
Collateralized mortgage obligations		178,263		-		4,284		173,979
Corporate		1,184		137		-		1,321
Other securities		13,806		3,394		37		17,163
Total securities available for sale	$	964,738	$	7,619	$	17,883	$	954,474

In the available for sale category at December 31, 2006, federal agency securities were comprised of Government-Sponsored Enterprise (“GSE”) securities; Mortgaged-backed securities were comprised of GSEs with an amortized cost of $352.0 million and a fair value of $341.8 million and US Government Agency securities with an amortized cost of $48.5 million and a fair value of $48.2 million; Collateralized mortgage obligations were comprised of GSEs with an amortized cost of $164.8 million and a fair value of $163.0 million and US Government Agency securities with an amortized cost of $77.1 million and a fair value of $75.8 million. At December 31, 2006, all of the mortgaged-backed securities held to maturity were comprised of US Government Agency securities.

In the available for sale category at December 31, 2005, federal agency securities were comprised of Government-Sponsored Enterprise (“GSE”) securities; Mortgaged-backed securities were comprised of GSEs with an amortized cost of $395.5 million and a fair value of $386.0 million and US Government Agency securities with an amortized cost of $53.0 million and a fair value of $53.2 million; Collateralized mortgage obligations were comprised of GSEs with an amortized cost of $102.6 million and a fair value of $100.2 million and US Government Agency securities with an amortized cost of $75.7 million and a fair value of $73.8 million.

Other securities include nonmarketable equity securities, including certain securities acquired by NBT Bank’s small business investment company (SBIC) subsidiary, and trust preferred securities.

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The following table sets forth information with regard to sales transactions of securities available for sale:

	Years ended December 31		
(In thousands)	**2006**	2005	2004
Proceeds from sales	**$ 42,292**	$ 53,044	$ 12,950
Gross realized gains	**$ 618**	$ 816	$ 457
Gross realized losses	**(1,493)**	(2,052)	(241)
Net securities (losses) gains	**$ (875)**	$ (1,236)	$ 216

At December 31, 2006 and 2005, securities available for sale with amortized costs totaling $951.4 million and $887.4 million, respectively, were pledged to secure public deposits and for other purposes required or permitted by law. Additionally, at December 31, 2006, securities available for sale with an amortized cost of $143.9 million were pledged as collateral for securities sold under the repurchase agreements.

The amortized cost, estimated fair value, and unrealized gains and losses of securities held to maturity are as follows:

(In thousands)	**Amortized cost**	**Unrealized gains**	**Unrealized losses**	**Estimated fair value**
December 31, 2006				
Mortgage-backed	**$ 3,434**	**$ 63**	**$ -**	**$ 3,497**
State & municipal	**132,213**	**345**	**435**	**132,123**
Other securities	**667**	**-**	**-**	**667**
Total securities held to maturity	**$ 136,314**	**$ 408**	**$ 435**	**$ 136,287**
December 31, 2005				