

BRYN MAWR BANK CORP

Form 10-Q

August 04, 2006

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**Form 10-Q**

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**Quarterly Report Under Section 13 or 15 (d)**  
**of the Securities and Exchange Act of 1934.**

**For Quarter ended June 30, 2006**

**Commission File Number 0-15261**

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**Bryn Mawr Bank Corporation**

(Exact name of registrant as specified in its charter)

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<b>Pennsylvania</b> (State or other jurisdiction of  incorporation or organization)	<b>23-2434506</b> (I.R.S. Employer  identification No.)
<b>801 Lancaster Avenue, Bryn Mawr, Pennsylvania</b> (Address of principal executive offices)	<b>19010</b> (Zip Code)
<b>Registrant's telephone number, including area code (610) 525-1700</b>	

**Not Applicable**

**Former name, former address and fiscal year, if changed since last report.**

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Indicate by check whether the registrant (1) has filed all reports 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 ☒ No ☐

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

Large accelerated filer ☐ Accelerated filer ☒ Non-accelerated filer ☐

Indicate by check whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act) Yes ☐ No ☒

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

Class	Outstanding at August 1, 2006
Common Stock, par value \$1	8,575,398

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**BRYN MAWR BANK CORPORATION AND SUBSIDIARIES**

**FORM 10-Q**

**QUARTER ENDED June 30, 2006**

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**Table of Contents****PART I. FINANCIAL INFORMATION****ITEM 1. Financial Statements****BRYN MAWR BANK CORPORATION AND SUBSIDIARIES****Consolidated Statements of Income****Unaudited**

	<b>Three Months Ended June 30</b>		<b>Six Months Ended June 30</b>	
(dollars in thousands, except per share data)	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
<b>Net interest income:</b>				
<b>Interest income:</b>				
Interest and fees on loans	\$ 10,616	\$ 8,849	\$ 20,543	\$ 17,197
Interest on federal funds sold	18	36	84	61
Interest on interest bearing deposits with banks	8	3	13	21
Interest and dividends on investment securities	456	277	803	543
Total interest and dividend income	11,098	9,165	21,443	17,822
<b>Interest expense:</b>				
Savings, NOW, and market rate accounts	934	647	1,755	1,209
Time deposits	1,646	870	2,947	1,602
Borrowings	215	27	257	36
Total interest expense	2,795	1,544	4,959	2,847
Net interest income	8,303	7,621	16,484	14,975
Provision for loan losses	209	193	363	380
Net interest income after provision for loan losses	8,094	7,428	16,121	14,595
<b>Non-interest income:</b>				
Fees for wealth management services	3,048	2,967	6,168	5,621
Service charges on deposits	397	398	776	793
Loan servicing and late fees	282	339	572	678
Net gain on sale of loans	254	464	504	922
Other operating income	594	573	1,154	1,155
Total non-interest income	4,575	4,741	9,174	9,169
<b>Non-interest expenses:</b>				
Salaries and wages	3,834	3,758	7,663	7,265
Employee benefits	1,131	936	2,449	2,077
Occupancy and bank premises	642	581	1,266	1,137
Furniture, fixtures, and equipment	476	498	958	958
Advertising	273	312	473	488
Amortization of mortgage servicing rights	84	210	170	399
Professional fees	209	295	506	598
Other operating expenses	1,253	1,274	2,262	2,326

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Total non-interest expenses	7,902	7,864	15,747	15,248
Income before income taxes	4,767	4,305	9,548	8,516
Income taxes	1,630	1,517	3,275	2,926
Net income	\$ 3,137	\$ 2,788	\$ 6,273	\$ 5,590
Basic earnings per common share	\$ 0.37	\$ 0.33	\$ 0.73	\$ 0.65
Diluted earnings per common share*	\$ 0.36	\$ 0.32	\$ 0.72	\$ 0.64
Dividends declared per share	\$ 0.11	\$ 0.10	\$ 0.22	\$ 0.20
Weighted-average basic shares outstanding	8,577,365	8,549,675	8,574,038	8,570,533
Dilutive potential common shares	113,690	80,772	110,676	97,743
Adjusted weighted-average dilutive shares	8,691,055	8,630,447	8,684,714	8,668,276

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

**Table of Contents****BRYN MAWR BANK CORPORATION AND SUBSIDIARIES****Consolidated Balance Sheets****Unaudited**

	June 30,	December 31,
(dollars in thousands, except per share data)	2006	2005
<b>Assets</b>		
Cash and due from banks	\$ 27,529	\$ 33,896
Interest bearing deposits with banks	642	405
Federal funds sold		32,341
Investment securities available for sale, at fair value (amortized cost of \$46,787 and \$34,090 as of June 30, 2006 and December 31, 2005, respectively)	45,697	33,397
Loans held for sale	6,369	2,765
Portfolio loans	639,632	595,165
Less: Allowance for loan losses	(7,779)	(7,402)
<b>Net portfolio loans</b>	<b>631,853</b>	<b>587,763</b>
Premises and equipment, net	14,572	14,622
Accrued interest receivable	3,523	3,265
Deferred income taxes	1,720	709
Mortgage servicing rights	2,941	2,982
Other assets	16,636	15,081
<b>Total assets</b>	<b>\$ 751,482</b>	<b>\$ 727,226</b>
<b>Liabilities</b>		
Deposits:		
Noninterest-bearing demand	\$ 152,092	\$ 168,042
Savings, NOW and market rate accounts	284,458	312,896
Time deposits	197,980	155,322
<b>Total deposits</b>	<b>634,530</b>	<b>636,260</b>
Borrowed funds	22,700	
Accrued interest payable	2,936	2,143
Other liabilities	9,661	11,310
<b>Total liabilities</b>	<b>669,827</b>	<b>649,713</b>
<b>Shareholders' equity</b>		
Common stock, par value \$1; authorized 25,000,000 shares; issued 11,303,149 and 11,221,899 shares as of June 30, 2006 and December 31, 2005 respectively and outstanding of 8,575,398 and 8,556,255 shares as of June 30, 2006 and December 31, 2005, respectively	11,303	11,222
Paid-in capital in excess of par value	9,268	7,888
Accumulated other comprehensive income, net of taxes	(943)	(643)
Retained earnings	87,316	82,930
	106,944	101,397
	(25,289)	(23,884)

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Less: Common stock in treasury at cost 2,727,751 and 2,665,644 shares as of June 30, 2006 and December 31, 2005 respectively

Total shareholders' equity	81,655	77,513
Total liabilities and shareholders' equity	\$ 751,482	\$ 727,226
Book value per share	\$ 9.52	\$ 9.06

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

**Table of Contents****BRYN MAWR BANK CORPORATION AND SUBSIDIARIES****Consolidated Statements of Cash Flows****Unaudited**

	<b>Six Months Ended</b>	
	<b>June 30</b>	
<b>(dollars in thousands)</b>	<b>2006</b>	<b>2005</b>
<b>Operating activities:</b>		
Net income	\$ 6,273	\$ 5,590
Adjustments to reconcile net income to net cash (used) provided by operating activities:		
Provision for loan losses	363	380
Provision for depreciation and amortization	732	746
Loans originated for resale	(34,532)	(61,223)
Proceeds from loans sold	31,432	61,307
Gain on sale of loans	(504)	(922)
Provision for deferred income taxes (benefit)	(849)	(504)
Change in tax receivable		(354)
Change in accrued interest receivable	(258)	(319)
Change in accrued interest payable	793	(1,121)
Change in mortgage servicing rights, net	41	182
Other	(3,319)	3,530
Net cash provided by operating activities	172	7,292
<b>Investing activities:</b>		
Purchases of investment securities available for sale	(16,306)	(2,258)
Proceeds from maturity of investment securities		
Proceeds from sale of investment securities available for sale		
Proceeds from calls of investment securities	3,586	2,000
Net portfolio loan (originations) repayments	(44,453)	(28,600)
Purchases of premises and equipment	(634)	(909)
Sale of other real estate owned ( OREO )	25	172
OREO Charge-off		(25)
Net cash used by investing activities	(57,782)	(29,620)
<b>Financing activities:</b>		
Net (decrease) increase demand and savings deposits	(44,387)	(11,663)
Net increase (decrease) in time deposits	42,658	16,068
Dividends paid	(1,887)	(1,716)
Purchases of treasury stock	(1,448)	(1,780)
Retirement of treasury stock	43	40
Change in borrowed funds	22,700	
Proceeds from issuance of common stock	1,460	430
Net cash provided by financing activities	19,139	1,379
Decrease in cash and cash equivalents	(38,471)	(20,949)
Cash and cash equivalents at beginning of period	66,642	55,242
Cash and cash equivalents at end of period	\$ 28,171	\$ 34,293



**Supplemental cash flow information:**

Income taxes paid	\$ 3,810	\$ 1,148
Interest paid	\$ 4,166	\$ 3,968

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

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**BRYN MAWR BANK CORPORATION AND SUBSIDIARIES**

**Consolidated Statements of Comprehensive Income**

**Unaudited**

(dollars in thousands)	Three Months Ended June 30		Six Months Ended June 30	
	2006	2005	2006	2005
Net income	\$ 3,137	\$ 2,788	\$ 6,273	\$ 5,590
Other comprehensive income:				
Unrealized holding gain (loss) on available-for-sale securities	(229)	297	(461)	(56)
Deferred income tax (expense) benefit on unrealized holding gain (loss) on available for sale securities	80	(104)	161	20
Total comprehensive income	\$ 2,988	\$ 2,981	\$ 5,973	\$ 5,554

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

**Table of Contents****BRYN MAWR BANK CORPORATION AND SUBSIDIARIES****Notes to Consolidated Financial Statements****June 30, 2006 and 2005****(Unaudited)****1. Basis of Presentation:**

The unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information. In the opinion of Bryn Mawr Bank Corporation's (the Corporation) Management, all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of the consolidated financial position and the results of operations for the interim period presented have been included. **These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto in the Corporation's 2005 Annual Report on Form 10-K.** The Corporation's consolidated financial condition and results of operations consist almost entirely of The Bryn Mawr Trust Company's (the Bank) financial condition and results of operations.

Certain prior period amounts have been reclassified to conform to current period presentation.

The results of operations for the three and six month periods ended June 30, 2006 are not necessarily indicative of the results to be expected for the full year.

**2. Earnings Per Common Share:**

The Corporation follows the provisions of SFAS No. 128, Earnings Per Share. Basic earnings per common share excludes dilution and is computed by dividing income available to common shareholders by the weighted-average common shares outstanding during the period. Diluted earnings per common share takes into account the potential dilution, computed pursuant to the treasury stock method. The effects of stock options are excluded from the computation of diluted earnings per share in periods in which the effect would be antidilutive. For the quarter ended June 30, 2006 the weighted average antidilutive shares were 2,250 and for the quarter ended June 30, 2005 the antidilutive shares were 136,083. For the six month period ended June 30, 2006 the weighted average antidilutive shares were 2,587 and for the six month period ended June 30, 2005 the antidilutive shares were 3,250. All weighted average shares, actual shares and per share information in the financial statements have been adjusted retroactively for the effect of stock dividends and splits.

		Three Months Ended		Six Months Ended	
		June 30		June 30	
(dollars in thousands, except per share data)		2006	2005	2006	2005
<b>Numerator:</b>					
Net income available to common shareholders		\$ 3,137	\$ 2,788	\$ 6,273	\$ 5,590
<b>Denominator for basic earnings per share</b> weighted average shares					
outstanding		8,577,365	8,549,675	8,574,038	8,570,533
Effect of dilutive potential common shares		113,690	80,772	110,676	97,743
<b>Denominator for diluted earnings per share</b> adjusted weighted average					
shares outstanding		8,691,055	8,630,447	8,684,714	8,668,276
Basic earnings per share		\$ 0.37	\$ 0.33	\$ 0.73	\$ 0.65
Diluted earnings per share		\$ 0.36	\$ 0.32	\$ 0.72	\$ 0.64

**3. Allowance for Loan Losses:**

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The allowance for loan losses is established through a provision for loan losses charged as an expense. Loans are charged against the allowance for loan losses when Management believes that the principal is uncollectible. The allowance for loan losses is maintained at a level that Management believes is sufficient to absorb estimated probable credit losses. Note 1, Summary of Significant Accounting Policies Allowance for Loan Losses, included in the Corporation's 2005 Annual Report on Form 10-K contains additional information about Management's determination of the adequacy of the allowance for loan losses.

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### 4. Stock Based Compensation:

The Corporation adopted SFAS No. 123R effective January 1, 2006. SFAS 123R establishes accounting for stock-based awards exchanged for employee services. Accordingly, stock based compensation cost is measured at the grant date, based on the fair value of the award and is recognized as an expense over the vesting period. The Corporation previously applied Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations and provided the required pro forma disclosures of SFAS No. 123, Accounting for Stock-Based Compensation (SFAS 123).

Generally, the approach in SFAS 123R to stock-based payment accounting is similar to SFAS 123. However, SFAS 123R requires all share-based payments, including grants of stock options, be recognized as compensation cost in the statement of income at their fair value. The fair value of stock option grants is determined using the Black-Scholes pricing model. The assumptions necessary for the calculation of the fair value are expected life of options, annual volatility of stock price, risk free interest rate and annual dividend yield. Pro forma disclosure for periods beginning after January 1, 2006 is not an alternative under SFAS 123R.

The Corporation elected to adopt SFAS 123R using the modified prospective application method in which compensation cost is recognized beginning with the effective date (a) based upon the requirements of SFAS 123R for all share-based payments granted after the effective date, and (b) based on the requirements of SFAS 123 for all awards granted prior to the effective date of SFAS 123R that remain unvested on the effective date.

The Corporation recorded stock-based compensation expense for the three and the six month periods ended June 30, 2006 as follows:

(dollars in thousands, except per share data)	Three Months Ended			Six Months Ended		
	June 30, 2006			June 30, 2006		
	Using Previous Accounting	SFAS 123R Effects	As Reported	Using Previous Accounting	SFAS 123R Effects	As Reported
Income before taxes	\$ 4,783	\$ (16)	\$ 4,767	\$ 9,603	\$ (55)	\$ 9,548
Income taxes	1,635	5	1,630	3,294	19	3,275
Net income	\$ 3,148	\$ (11)	\$ 3,137	\$ 6,309	\$ (36)	\$ 6,273
Basic earnings per share	\$ 0.37		\$ 0.37	\$ 0.73		\$ 0.73
Diluted earnings per share	\$ 0.36		\$ 0.36	\$ 0.72		\$ 0.72

The proforma net income that would have resulted if the Corporation applied the fair value method of accounting for stock based compensation under SFAS No. 123 for the three and six month periods ended June 30, 2005 is as follows:

(dollars in thousands, except per share data)	Three Months Ended			Six Months Ended		
	June 30, 2005			June 30, 2005		
	As Reported	Pro Forma Adjustment	Pro Forma If Under SFAS 123	As Reported	Pro Forma Adjustment	Pro Forma If Under SFAS 123
Income before taxes	\$ 4,305	\$ (1,193)	\$ 3,112	\$ 8,516	\$ (1,334)	\$ 7,182
Income taxes	1,517	417	1,100	2,926	467	2,459
Net income	\$ 2,788	\$ (776)	\$ 2,012	\$ 5,590	\$ (867)	\$ 4,723
Basic earnings per share	\$ 0.33	(0.09)	\$ 0.24	\$ 0.65	(0.10)	\$ 0.55
Diluted earnings per share	\$ 0.32	(0.09)	\$ 0.23	\$ 0.64	(0.10)	\$ 0.54

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The Corporation's Stock Option Plan (SOP) permits the issuance of options to key employees and Directors to purchase shares of the Corporation's common stock. A total of 431,143 shares were authorized in 2004 by the Board of Directors. As of June 30, 2006 there are 17,439 shares available for future grant. The option price is set at the closing price for the stock on the day preceding issuance of grants as determined by the Corporation's Board of Directors. Options granted may either be incentive stock options within the meaning of the Internal Revenue Service Code, or non-qualified options. The stock options are exercisable over a period determined by the Board of Directors; however, the option period will not be longer than ten years from the date of the grant. The vesting period of option grants issued is also determined by the Corporation's Board of Directors.

During 2005 all grants were issued with immediate vesting. Also, during 2005 the vesting period on 83,916 out of money options outstanding was accelerated to avoid stock based compensation expense in future years. The historical vesting period for options issued had been three years. The pre-tax charge which the Corporation expects to avoid in 2006 and 2007 amounts to approximately \$253,000 (\$193,000 in 2006 and \$60,000 in 2007) based on the original vesting periods. During 2006 all grants were issued with a three year vesting period. The SOP provides that the option price at the date of the grant will not be less than the fair market value of the Corporation's common stock. The Corporation's practice is to generally issue option related shares from authorized but unissued shares.

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The following table provides information about options outstanding for the three months ended June 30, 2006:

	Three Months Ended		
	June 30, 2006		Weighted
	Weighted		Average Grant
	Average		
	Shares	Exercise Price	Date Fair Value
Options outstanding March 31, 2006	874,008	\$ 17.68	\$ 3.80
Granted	3,625	21.83	5.90
Forfeited			
Expired			
Exercised	(20,950)	\$ 17.70	\$ 3.73
Options outstanding June 30, 2006	856,683	\$ 17.70	\$ 3.81

The following table provides information about options outstanding for the six months ended June 30, 2006:

	Six Months Ended		
	June 30, 2006		Weighted
	Weighted		Average Grant
	Average		
	Shares	Exercise Price	Date Fair Value
Options outstanding December 31, 2005	934,308	\$ 17.44	\$ 3.74
Granted	3,625	21.83	5.90
Forfeited			
Expired			
Exercised	(81,250)	\$ 14.96	\$ 3.12
Options outstanding June 30, 2006	856,683	\$ 17.70	\$ 3.81

The following table provides information about unvested options for the three months ended June 30, 2006:

	Three Months Ended	
	June 30, 2006	
	Weighted	
	Average Grant	
	Shares	Date Fair Value
Unvested options March 31, 2006	33,001	\$ 3.99
Granted	3,625	\$ 5.90
Vested	(33,001)	\$ 3.99

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Forfeited

Unvested options June 30, 2006	3,625	\$	5.90
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The following table provides information about unvested options for the six months ended June 30, 2006:

	Six Months Ended		
	June 30, 2006		
	Weighted		
	Average Grant		
	Shares	Date	Fair Value
Unvested options December 31, 2005	33,334	\$	3.98
Granted	3,625	\$	5.90
Vested	(33,334)	\$	3.98
Forfeited			
Unvested options June 30, 2006	3,625	\$	5.90



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The total compensation cost on unvested stock options is estimated to be \$21 thousand and to be recognized over the 36 month vesting period.

Proceeds, related tax benefits realized from options exercised, and intrinsic value of options exercised during the six month periods ended June 30, 2006 and 2005 were as follows:

(Dollars in thousands)	2006	2005
Proceeds from strike price of value of options exercised	\$ 1,216	\$ 294
Related tax benefit recognized	191	94
Proceeds of options exercised	\$ 1,407	\$ 388

The intrinsic value of the options exercised during the six months ended June 30, 2006 and 2005 was \$546,000 and \$268,000, respectively.

The following table provides information about options outstanding and exercisable options at June 30, 2006:

	Outstanding	Exercisable
Number	856,683	853,058
Weighted average exercise price	\$ 17.70	\$ 17.68
Aggregate intrinsic value (dollars in thousands)	\$ 3,664	\$ 3,663
Weighted average contractual term	6.9	6.9

The weighted average remaining contractual life for options outstanding and weighted average exercise price per share for exercisable options at June 30, 2006 were as follows:

Outstanding Weighted Average			Exercisable		
Remaining			Weighted		
Contractual Life			Average		
Exercise Price	Shares	(in years)	Exercise Price	Shares	Exercise Price
\$ 8.45 10.75	51,200	3.10	\$ 10.07	51,200	\$ 10.07
\$12.25 15.15	171,400	3.53	13.32	171,400	13.32
\$16.25 18.91	351,033	7.54	18.35	351,033	18.35
\$19.11 22.68	283,050	8.65	20.91	279,425	20.90
	856,683	6.90	\$ 17.70	853,058	\$ 17.68

For the stock options granted during the three months ended June 30, 2006 and June 30, 2005, the fair value was determined at the date of the grants using a Black-Scholes option-pricing model and the following assumptions:

	2006 Grant dated 5/01/06	2005 Grant dated 6/29/06	2005 Grant dated 5/12/05
Expected average risk free interest rate	5.00%	5.00%	3.90%
Expected average life (in years)	6	6	6
Expected volatility	23.56%	24.04%	20.41%

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Expected dividend yield

1.94%

1.98%

2.12%

### **5. Pension and Other Post-Retirement Benefit Plans:**

The Corporation sponsors two pension plans, the qualified defined benefit pension plan ( QDBP ) and the non-qualified defined benefit pension plan ( SERP ), and a post-retirement benefit plan ( PRBP ).

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The following table provides a reconciliation of the components of the net periodic benefits cost for the three months and six months ended June 30, 2006 and 2005:

	For the Three Months				For the Six Months			
	Ended June 30				Ended June 30			
	Pension Benefits 2006	Pension Benefits 2005	Post Retirement Benefits 2006	Post Retirement Benefits 2005	Pension Benefits 2006	Pension Benefits 2005	Post Retirement Benefits 2006	Post Retirement Benefits 2005
Service cost	\$ 323	\$ 256	\$ 3		\$ 646	\$ 584	\$ 6	\$ 6
Interest cost	434	409	35	22	868	825	70	72
Expected return on plan assets	(557)	(533)			(1,114)	(1,077)		
Amortization of transition obligation			6	7			12	13
Amortization of prior service costs	32	33	(34)	(69)	64	65	(68)	(69)
Amortization of net (gain) loss	141	75	51	51	282	186	102	101
Net periodic benefit cost	\$ 373	\$ 240	\$ 61	\$ 11	\$ 746	\$ 583	\$ 122	\$ 123

As stated in the Corporation's 2005 Annual Report, the Corporation does not have any minimum funding requirement for its QDBP for 2006. Additionally, the Corporation is expected to contribute approximately \$131 thousand to the SERP plan for 2006. As of June 30, 2006 no contributions have been made to either of the pension plans for 2006. Changes were made to the PRBP in 2005 limiting future increases in plan costs to 120% of the then current benefit.

**6. Segment Information:**

SFAS No. 131, Segment Reporting, identifies operating segments as components of an enterprise which are evaluated regularly by the Corporation's Chief Executive Officer in deciding how to allocate resources and assess performance. The Corporation has applied the aggregation criterion set forth in SFAS No. 131 to the results of its operations.

The Corporation has identified four segments as defined by SFAS No. 131 as follows: Banking, Wealth Management, Mortgage Banking and All Other. Footnote 24 Segment Information, in the Notes to the Consolidated Financial Statements in the Corporation's 2005 Annual Report on Form 10-K provides additional descriptions of the identified segments.

Segment information for the three and six months ended June 30, 2006 and 2005 is as follows:

(Dollars in thousands)	Three Months Ended June 30, 2006				Consolidated
	Banking	Wealth Management	Mortgage Banking	All Other	
Net interest income	\$ 8,301	\$	\$	\$ 2	\$ 8,303
Less: Provision for loan losses	209				209
Net interest income after provision for loan losses	8,092			2	8,094
Other income:					
Fees for wealth management services		3,048			3,048
Other income	852		601	74	1,527
Total other income	852	3,048	601	74	4,575
Other expenses:					
Salaries and benefits	3,457	1,242	192	74	4,965
Occupancy	958	149	41	(30)	1,118
Amortization of mortgage servicing rights			84		84

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Other operating expense	1,456	255	74	(50)	1,735
Total other expense	5,871	1,646	391	(6)	7,902
Segment profit (loss) before income taxes	3,073	1,402	210	82	4,767
Intersegment pretax revenues (expenses)*	382	45	0	(427)	
Segment pretax profit (loss) after eliminations	\$ 3,455	\$ 1,447	\$ 210	(\$ 345)	\$ 4,767
% of segment pretax profit (loss)	72.5%	30.4%	4.4%	(7.3)%	100%

(Dollars in thousands)

	Three Months Ended June 30, 2005				
	Banking	Wealth Management	Mortgage Banking	All Other	Consolidated
Net interest income	\$ 7,600	\$	\$	\$ 21	\$ 7,621
Less: Provision for loan losses	193				193
Net interest income after provision for loan losses	7,407			21	7,428
Other income:					
Fees for wealth management services		2,967			2,967
Other income	780	1	919	74	1,774
Total other income	780	2,968	919	74	4,741
Other expenses:					
Salaries and benefits	3,190	1,223	217	64	4,694
Occupancy	891	161	58	(31)	1,079
Amortization of mortgage servicing rights			210		210
Other operating expense	1,327	271	149	134	1,881
Total other expense	5,408	1,655	634	167	7,864
Segment profit (loss) before income taxes	2,779	1,313	285	(72)	4,305
Intersegment pretax revenues (expenses)*	29	45		(74)	
Segment pretax profit (loss) after eliminations	\$ 2,808	\$ 1,358	\$ 285	(\$ 146)	\$ 4,305
% of segment pretax profit (loss)	65.2%	31.6%	6.6%	(3.4)%	100%

	Six Months Ended June 30, 2006				
	Banking	Wealth Management	Mortgage Banking	All Other	Consolidated
Net interest income	\$ 16,472	\$	\$	\$ 12	\$ 16,484
Less: Provision for loan losses	363				363
Net interest income after provision for loan losses	16,109			12	16,121
Other income:					
Fees for wealth management services		6,168			6,168
Other income	1,702		1,165	139	3,006
Total other income	1,702	6,168	1,165	139	9,174

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Other expenses:

Salaries and benefits	7,048	2,519	368	177	10,112
Occupancy	1,887	308	90	(61)	2,224
Amortization of mortgage servicing rights			170		170
Other operating expense	2,751	513	141	(164)	3,241
Total other expense	11,686	3,340	769	(48)	15,747
Segment profit (loss) before income taxes	6,125	2,828	396	199	9,548
Intersegment pretax revenues (expenses) *	362	90		(452)	
Segment pretax profit (loss) after eliminations	\$ 6,487	\$ 2,918	\$ 396	\$ (253)	\$ 9,548
% of segment pretax profit (loss)	67.9%	30.6%	4.1%	(2.6)%	100%

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	Six Months Ended June 30, 2005				
		Wealth	Mortgage	All	
	Banking	Management	Banking	Other	Consolidated
Net interest income	\$ 14,934	\$	\$	\$ 41	\$ 14,975
Less: Provision for loan losses	380				380
Net interest income after provision for loan losses	14,554			41	14,595
Other income:					
Fees for wealth management services		5,621			5,621
Other income	1,641	3	1,764	140	3,548
Total other income	1,641	5,624	1,764	140	9,169
Other expenses:					
Salaries and benefits	6,398	2,350	465	129	9,342
Occupancy	1,726	315	116	(62)	2,095
Amortization of mortgage servicing rights			399		399
Other operating expense	2,435	528	278	171	3,412
Total other expense	10,559	3,193	1,258	238	15,248
Segment profit (loss) before income taxes	5,636	2,431	506	(57)	8,516
Intersegment pretax revenues (expenses) *	114	90		(204)	
Segment pretax profit (loss) after eliminations	\$ 5,750	\$ 2,521	\$ 506	\$ (261)	\$ 8,516
% of segment pretax profit (loss)	67.5%	29.6%	6.0%	(3.1)%	100.0%

\* Intersegment revenues consist of rental payments, insurance commissions and a management fee.

**7. Mortgage Servicing Rights:**

The following summarizes the Corporation's activity related to mortgage servicing rights (MSRs) for the six months ended June 30, 2006 and 2005:

(dollars in thousands)	2006	2005
Balance, January 1	\$ 2,982	\$ 3,172
Additions	129	217
Amortization	(170)	(357)
Impairment		(42)
Sales		
Balance, June 30	\$ 2,941	\$ 2,990
Fair Value	\$ 4,796	\$ 3,823

There was no impairment of MSRs for the six months ended June 30, 2006. For the six months ended June 30, 2005 there was \$42,000 of temporary impairment concentrated in higher rate mortgages. This impairment was reversed in the second half of 2005.

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At June 30, 2006, key economic assumptions and the sensitivity of the current fair value of MSRs to immediate 10 and 20 percent adverse changes in those assumptions are as follows:

	June 30,
(dollars in thousands)	2006
Fair value amount of MSRs	4,796
Weighted average life (in years)	7.5
Prepayment speeds (constant prepayment rate)*:	10.4
Impact on fair value:	
10% adverse change	\$ (162)
20% adverse change	\$ (232)
Discount rate:	
Impact on fair value:	
10% adverse change	\$ (128)
20% adverse change	\$ (258)

\* Represents the weighted average prepayment rate for the life of the MSR asset.

These assumptions and sensitivities are hypothetical and should be used with caution. As the table also indicates, changes in fair value based on a 10% variation in assumptions generally cannot be extrapolated because the relationship of the change in assumptions to the change in fair value may not be linear. Also, the effect of a variation in a particular assumption on the fair value of the MSRs is calculated without changing any other assumption. In reality, changes in one factor may result in changes in another, which could magnify or counteract the sensitivities.

## 8. Impaired Loans:

The following summarizes the Corporation's impaired loans as of the applicable dates as follows:

	June 30,	December 31,	June 30,
(dollars in thousands)	2006	2005	2005
Period end balance	\$ 866	\$ 261	\$ 678
Average period to date balance	803	825	1,286
Loans with specific loss allowances			
Charge offs and recoveries			
Provision for impaired loans			
Year to date income recognized	\$ 22	\$ 22	\$ 17

## 9. Capital:

The Corporation declared and paid a regular dividend of \$0.11 per share, during the second quarter of 2006. This payment totaled \$944,000. The dividend was increased 9.1% or \$0.01 per share to \$0.12 per share effective for the dividend declared to shareholders of record on August 7, 2006, payable September 1, 2006.

During the first six months of 2006 the Corporation repurchased 66,500 shares of its common stock for \$1.448 million at an average purchase price of \$21.78.

On April 28, 2006 the Corporation paid its non-management directors their annual retainer of \$12,500 in the form of the Corporation's common stock. Each of the 7 non-management directors received 566 shares for a total of 3,962 shares. The price per share was \$22.07, the market value on April 27, 2006. On June 29, 2006, the Corporation issued 431 shares of the Corporation's common stock to its new non-management director who joined the Board on June 29, 2006 in payment of his prorated annual retainer. The purchase price of the stock was \$21.74, the market value of the stock on June 28, 2006. The foregoing transactions were made in reliance upon the exemptions from the registration provisions of the Securities Act of 1933, as amended, provided for by Section 4(2) thereof for transactions not involving a public offering.

**10. Collection of Notes Receivable:**

Notes receivable held by the Corporation relating to the sale of assets of JWR & Co. were paid in full in the first quarter of 2006. The notes receivable had a balance of \$954,000 at December 31, 2005. The notes receivable were classified as commercial and industrial loans in the consolidated balance sheet.



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**11. New Accounting Pronouncements:**

**SFAS 123R**

Stock Based Compensation - In April of 2005, the FASB issued SFAS No. 123R Share Based Payment an Amendment of FASB No. 123 and APB No. 95 . See Note 4, Stock Based Compensation, above for additional information.

**SFAS 155**

In February 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments. This Statement amends FASB Statements No. 133 and No. 140. This Statement resolves issues addressed in Statement 133 Implementation Issue No. D1, Application of Statement 133 to Beneficial Interests in Securitized Financial Assets. This Statement:

- a) permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation;
- b) clarifies which interest-only strips and principal-only strips are not subject to the requirements of Statement 133;
- c) establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation;
- d) clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives; and
- e) amends Statement 140 to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument.

This Statement is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. The fair value election provided for in paragraph 4(c) of this Statement may also be applied upon adoption of this Statement for hybrid financial instruments that had been bifurcated under paragraph 12 of Statement 133 prior to the adoption of this Statement. Earlier adoption is permitted as of the beginning of an entity's fiscal year, provided the entity has not yet issued financial statements, including financial statements for any interim period for that fiscal year. Provisions of this Statement may be applied to instruments that an entity holds at the date of adoption on an instrument-by-instrument basis. The Corporation did not early adopt SFAS 155. The Corporation has not yet determined whether this Statement will have a material impact on its consolidated financial statements upon adoption.

**SFAS 156**

In March 2006, the FASB issued SFAS No. 156, Accounting for Servicing of Financial Assets. This Statement amends FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, with respect to the accounting for separately recognized servicing assets and servicing liabilities. This Statement:

1) requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in any of the following situations:

- a) a transfer of the servicer's financial assets that meets the requirements for sale accounting;
- b) a transfer of the servicer's financial assets to a qualifying special-purpose entity in a guaranteed mortgage securitization in which the transferor retains all of the resulting securities and classifies them as either available-for-sale securities or trading securities in accordance with FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities;

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- c) an acquisition or assumption of an obligation to service a financial asset that does not relate to financial assets of the servicer or its consolidated affiliates.
- 2) requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable;
- 3) permits an entity to choose either of the following subsequent measurement methods for each class of separately recognized servicing assets and servicing liabilities:
- a) amortization method Amortize servicing assets or servicing liabilities in proportion to and over the period of estimated net servicing income or net servicing loss and assess servicing assets or servicing liabilities for impairment or increased obligation based on fair value at each reporting date;
  - b) fair value measurement method Measure servicing assets or servicing liabilities at fair value at each reporting date and report changes in fair value in earnings in the period in which the changes occur;

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4) at its initial adoption, permits a one-time reclassification of available-for-sale securities to trading securities by entities with recognized servicing rights, without calling into question the treatment of other available-for-sale securities under Statement 115, provided that the available-for-sale securities are identified in some manner as offsetting the entity's exposure to changes in fair value of servicing assets or servicing liabilities that a service elects to subsequently measure at fair value;

5) requires separate presentation of servicing assets and servicing liabilities subsequently measured at fair value in the statement of financial position and additional disclosures for all separately recognized servicing assets and servicing liabilities.

An entity should adopt this Statement as of the beginning of its first fiscal year that begins after September 15, 2006. Earlier adoption is permitted as of the beginning of an entity's fiscal year, provided the entity has not yet issued financial statements, including interim financial statements, for any period of that fiscal year. The effective date of this Statement is the date an entity adopts the requirements of this Statement. The Corporation did not early adopt SFAS 156. The Corporation has not yet determined whether this Statement will have a material impact on its consolidated financial statements upon adoption.

## **FIN 48**

In June 2006, FASB issued Financial Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes- an interpretation of FASB Statement No. 109 (FIN 48). FIN 48 provides guidance on financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. According to the Interpretation, a tax position is recognized if it is more likely than not that the tax position will be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. If the tax position meets the more-likely-than-not recognition threshold, the position is measured to determine the amount of benefit to recognize and should be measured at the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Corporation is not required to adopt FIN 48 until fiscal year 2007, and has not yet determined whether this statement will have a material impact on its consolidated financial statements upon adoption.

## **ITEM 2 Management's Discussion and Analysis of Results of Operation and Financial Condition**

**Special Cautionary Notice Regarding Forward Looking Statements** Certain of the statements contained in this Report and the documents incorporated by reference herein, may constitute forward-looking statements for the purposes of the Securities Act of 1933, as amended and the Securities Exchange Act of 1934, as amended, and may involve known and unknown risks, uncertainties and other factors which may cause actual results, performance or achievements of the Corporation to be materially different from future results, performance or achievements expressed or implied by such forward-looking statements. These forward-looking statements include statements with respect to the Corporation's financial goals, business plans, business prospects, credit quality, credit risk, reserve adequacy, liquidity, origination and sale of residential mortgage loans, impairment of goodwill, the effect of changes in accounting standards, and market and pricing trends. The words expect, anticipate, intended, plan, believe, seek, estimate, and similar expressions are intended to identify such forward-looking statements. The Corporation's actual results may differ materially from the results anticipated by the forward-looking statement due to a variety of factors, including without limitation:

the effect of future economic conditions on the Corporation and its customers, including economic factors which affect consumer confidence in the securities markets, wealth creation, investment and savings patterns, and the Corporation's interest rate risk exposure and credit risk;

changes in the securities markets with respect to the market values of financial assets and the stability of particular securities markets;

governmental monetary and fiscal policies, as well as legislation and regulatory changes;

changes in accounting requirements or interpretations;

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changes in interest rates on the level and composition of deposits, loan demand, and the value of loan collateral and securities, as well as interest rate risk;

the effects of competition from other commercial banks, thrifts, mortgage companies, finance companies, credit unions, securities brokerage firms, insurance companies, money-market and mutual funds and other institutions operating in the Corporation's trade market area and elsewhere including institutions operating locally, regionally, nationally and internationally together with such competitors offering banking products and services by mail, telephone, computer and the internet;

any extraordinary event (such as the September 11, 2001 events, the war on terrorism and the U.S. Government's response to those events including the war in Iraq);

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the Corporation's success in continuing to generate new business in its existing markets, as well as its success in identifying and penetrating targeted markets and generating a profit in those markets in a reasonable time;

the Corporation's ability to continue to generate investment results for customers and the ability to continue to develop investment products in a manner that meets customers needs;

the Corporation's timely development of competitive new products and services in a changing environment and the acceptance of such products and services by customers;

the Corporation's ability to originate and sell residential mortgage loans;

the accuracy of assumptions underlying the establishment of reserves for loan losses and estimates in the value of collateral, and various financial assets and liabilities and technological changes being more difficult or expensive than anticipated;

technological changes being more difficult or expensive than anticipated; and

the Corporation's success in managing the risks involved in the foregoing.

All written or oral forward-looking statements attributed to the Corporation are expressly qualified in their entirety by use of the foregoing cautionary statements. All forward-looking statements included in this Report are based upon information presently available, and the Corporation assumes no obligation to update any forward-looking statement.

## **Brief History of the Bank and Corporation**

The Bryn Mawr Trust Company (the "Bank") received its Pennsylvania banking charter in 1889 and is a member of the Federal Reserve System. In 1986, Bryn Mawr Bank Corporation (the "Corporation") was formed and on January 2, 1987, the Bank became a wholly-owned subsidiary of the Corporation. The Bank and Corporation are headquartered in Bryn Mawr, PA, a western suburb of Philadelphia, PA. The Corporation and its subsidiaries provide wealth management, community banking, commercial and consumer lending, residential mortgage lending, insurance and business banking services to its customers through eight full service branches and seven retirement community offices throughout Montgomery, Delaware and Chester counties. The Corporation trades on the NASDAQ Global Market under the symbol BMTC.

The goal of the Corporation is to become a preeminent community bank and wealth management organization.

The Corporation competes in a highly competitive market area that includes local, national and regional banks as competitors along with savings banks, credit unions, insurance companies, trust companies, registered investment advisors and mutual fund families. The Corporation and its subsidiaries are regulated by many regulatory agencies including the Securities and Exchange Committee ("SEC"), NASDAQ, Federal Deposit Insurance Corporation ("FDIC"), the Federal Reserve Bank of Philadelphia and the Pennsylvania Department of Banking.

## **Results of Operations**

The following is Management's discussion and analysis of the significant changes in the results of operations, capital resources and liquidity presented in its accompanying consolidated financial statements for the Corporation. The Corporation's consolidated financial condition and results of operations consist almost entirely of the Bank's financial condition and results of operations. Current performance does not guarantee, and may not be indicative of similar performance in the future. These interim financial statements are unaudited.

## **Critical Accounting Policies, Judgments and Estimates**

The accounting and reporting policies of the Corporation and its subsidiaries conform with accounting principles generally accepted in the United States of America (US GAAP) applicable to the financial services industry. All significant inter-company transactions are eliminated in

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consolidation and certain reclassifications are made when necessary to conform the previous year's financial statements to the current year's presentation. In preparing the consolidated financial statements, Management is required to make estimates and assumptions that affect the reported amount of assets and liabilities as of the dates of the balance sheets and revenues and expenditures for the periods presented. Therefore, actual results could differ from these estimates.

**The allowance for loan losses** involves a higher degree of judgment and complexity than other significant accounting policies. The allowance for loan losses is calculated with the objective of maintaining a reserve level believed by Management to be sufficient to absorb estimated probable credit losses. Management's determination of the adequacy of the allowance is based on periodic evaluations of the loan portfolio and other relevant factors. However, this evaluation is inherently subjective as it requires material estimates, including, among others, expected default probabilities, expected loan commitment usage, the amounts and timing of expected future cash flows on impaired loans, value of collateral, estimated losses on consumer loans and residential mortgages and general amounts for historical loss experience. The process also

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considers economic conditions, international events, and inherent risks in the loan portfolio. All of these factors may be susceptible to significant change. To the extent actual outcomes differ from Management estimates, additional provisions for loan losses may be required that would adversely impact earnings in future periods.

**The Corporation recognizes deferred tax assets** and liabilities for the future tax effects of temporary differences, net of operating loss carry forwards and tax credits. Deferred tax assets are subject to Management's judgment based upon available evidence that future realization is more likely than not. If Management determines that the Corporation may be unable to realize all or part of net deferred tax assets in the future, a direct charge to income tax expense may be required to reduce the recorded value of the net deferred tax asset to the expected realizable amount.

**The valuation of mortgage servicing rights (MSRs)** is a critical accounting policy due to the complexity of the quarterly valuation process which is performed by an outside consultant based on data provided by Management. Changes in market interest rates, consumer behavior, demographic trends and other factors influence the value of MSRs.

## **Executive Overview**

The Corporation reported second quarter 2006 diluted earnings per share of \$0.36, an increase of \$0.04 or 12.5% compared to \$0.32 in the same period last year. Net income for the second quarter of 2006 was \$3.1 million, an increase of 12.5% or \$349 thousand, compared to \$2.8 million in last year's second quarter. This performance was led by healthy loan growth during the first six months of the year as portfolio loans increased \$44.5 million or 7.5% since the end of 2005. At the same time, the Corporation continues to see pressure on deposit gathering activities and the deposit pricing functions as competition is intense.

The major factor contributing to the increase in earnings for the second quarter of 2006 compared to the same period last year was a \$703 thousand or 9.1% increase in net interest income (on a tax equivalent basis) to \$8.4 million from \$7.7 million. The increase in net interest income (on a tax equivalent basis) in the second quarter of 2006 compared to the same period last year was the result of a \$48.6 million increase or 7.9% increase in average interest earning assets and a 6 basis point increase in the Corporation's net interest margin to 5.04% from 4.98%.

Non-interest income for the second quarter of 2006 decreased \$166 thousand or 3.5% compared to the same period in 2005. This is due to a continued decline in residential mortgage related revenues partially offset by an increase of fees for Wealth Management Services. Wealth Management revenue increased 2.7% to \$3.048 million from \$2.967 million for the same period in 2005. Wealth Management assets under management and administration were \$2.195 billion at June 30, 2006, compared with \$2.248 billion at December 31, 2005 and \$1.901 billion June 30, 2005.

Non-interest expense for the second quarter of 2006 increased \$38 thousand or 0.5% when compared to the same period last year as a result of increases in salaries and employee benefits which were partially offset by declines in mortgage servicing rights amortization and a decrease in professional fees.

Diluted earnings per share for the six months ended June 30, 2006, was \$0.72, an increase of \$0.08 or 12.5%, compared with \$0.64 in 2005. Net income for the six months ended June 30, 2006 was \$6.3 million, an increase of \$683 thousand or 12.2%, compared to \$5.6 million in the same period last year.

The major factor contributing to the increase in earnings for the six month period ending June 30, 2006 compared to the same period last year was a \$1.6 million or 10.4% increase in net interest income (on a tax equivalent basis), partially offset by a \$499 thousand or 3.3% increase in non-interest expenses. The increase in net interest income (on a tax equivalent basis) in the first six months of 2006 compared to the same period last year was the result of a \$40.8 million or 6.6% increase in average interest earning assets, and an 18 basis point increase in the Corporation's net interest margin to 5.13% from 4.95%.

Non-interest income for the six months ended June 30, 2006, increased nominally when compared to the same period last year as fees for Wealth Management Services increased \$547 thousand or 9.7% while other non-interest income categories in the aggregate declined \$542 thousand, primarily due to lower residential mortgage related revenue.

The increase in non-interest expense for the six months ended June 30, 2006, was primarily due to increased employment related costs and occupancy expenses, partially offset by reduced mortgage servicing rights amortization and reduced professional fees. The reduction in mortgage servicing rights amortization is expected to continue as new mortgage origination volume is lower than in prior periods. The increase in occupancy expenses is related to rent expense on the new Ardmore branch site.





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Asset quality remains strong despite an increase in non-performing assets to \$1.7 million at June 30, 2006 from \$415 thousand at December 31, 2005. The \$1.7 million of non-performing loans which excludes other real estate owned consists almost entirely of two first lien residential mortgage loans. Non-performing loans as a percentage of portfolio loans was 0.26% at June 30, 2006. The allowance for loan losses increased to \$7.8 million at June 30, 2006 from \$7.4 million at December 31, 2005, however the allowance as a percentage of portfolio loans decreased to 1.22% from 1.24% over the same time period. Net loan charge-offs (recoveries) for the six months ended June 30, 2006 and 2005 were (\$14 thousand) and \$55 thousand, respectively.

Portfolio loans increased \$44.5 million or 7.5% to \$639.6 million at June 30, 2006 from \$595.2 million at December 31, 2005, reflecting a significant increase in commercial mortgage and construction loan closings in the second quarter of 2006. Portfolio loans also increased from Management's decision to portfolio certain residential mortgage loans for asset liability management purposes.

The Corporation's interest bearing liabilities at June 30, 2006 included approximately \$58 million in wholesale funding compared with \$5 million at December 31, 2005. In addition to the wholesale funding, the Corporation has seen a shift in the mix of its core deposits as lower cost interest bearing checking, money market accounts and savings accounts move into higher yielding certificates of deposit. The deposit mix changes and the addition of wholesale funding has resulted in an increase in the cost of interest bearing deposits of 81 basis points for the six months ended June 30, 2006 compared to the six months ended June 30, 2005, and 88 basis points for the three months ended June 30, 2006 compared to the three months ended June 30, 2005. This change in the core deposit mix appears to be a national trend as competition for deposit balances is very intense, high rate advertisements are commonplace and the continued increase in interest rates has resulted in noticeable customer account movement. It is expected that deposit pricing pressure and the flat yield curve will put downward pressure on the net interest margin over the near term.

The Corporation will continue with the expansion of its retail banking footprint with controlled *de novo* expansion in the suburban Philadelphia market. Construction has started on the Corporation's new Ardmore branch and its opening is anticipated in the fourth quarter of 2006. We also expect our new West Chester branch to open in the fourth quarter of 2007. This full service branch will also house the Corporation's Chester County loan production center and a regional office for Wealth Management clients. Management is excited about the opportunity to expand our business into the heart of West Chester, the county seat of Chester County, the fastest growing county in Pennsylvania.

The Corporation's Board of Directors increased the quarterly dividend \$0.01 per share or 9.1% from \$0.11 to \$0.12 per share, payable September 1, 2006, to shareholders of record as of August 7, 2006.

## Key Performance Ratios

Key financial performance ratios for the three months and six months ended June 30, 2006 and 2005 are shown in the table below:

	Three Months Ended June 30		Six Months Ended June 30	
	2006	2005	2006	2005
Return on Average Equity ROE)	15.70%	15.47%	15.98%	15.70%
Return on Average Assets (ROA)	1.74%	1.65%	1.79%	1.67%
Efficiency Ratio	61.36%	63.6%	61.37%	63.2%
Net Interest Margin (TE)	5.04%	4.98%	5.13%	4.95%
Diluted Earnings Per share	\$ 0.36	\$ 0.32	\$ 0.72	\$ 0.64
Dividend Per Share	\$ 0.11	\$ 0.10	\$ 0.22	\$ 0.20

	June 30	December 31	June 30
	2006	2005	2005
Book Value Per Share	\$ 9.52	\$ 9.06	\$ 8.63
Allowance for Loan Losses as a Percentage of Loans	1.22%	1.24%	1.22%

**Table of Contents****Components of Net Income**

Net income is affected by five major elements: **Net Interest Income**, or the difference between interest income earned on loans and investments and interest expense paid on deposit and borrowed funds; the **Provision for Loan Losses**, or the amount added to the allowance for loan losses to provide reserves for inherent losses on loans; **Non-Interest Income** which is made up primarily of certain fees, trust income, residential mortgage activities and gains and losses from the sale of securities; **Non-Interest Expenses**, which consist primarily of salaries, employee benefits and other operating expenses; and **Income Taxes**. Each of these major elements will be reviewed in more detail in the following discussion.

**NET INTEREST INCOME**

The rate volume analysis in the table below analyzes changes in the tax equivalent net interest income for the quarter ended June 30, 2006 compared to June 30, 2005 and for the six months period ended June 30, 2006 compared to June 30, 2005 by its rate and volume components.

**Rate /Volume Analysis (Tax Equivalent Basis)**

(in thousands)	Three Months Ended		
	June 30,		
	2006 Compared to 2005		
Increase/(Decrease)	Volume	Rate	Total
Interest Income:			
Interest-bearing deposits with banks	\$ 1	\$ 4	\$ 5
Federal funds sold	(26)	8	(18)
Investment securities available for sale	80	99	179
Loans	658	1,130	1,788
Total interest income	713	1,241	1,954
Interest expense:			
Savings, NOW and market rate accounts	(50)	337	287
Time deposits	253	523	776
Short term borrowings	104	84	188
Total interest expense	307	944	1,251
Interest differential	\$ 406	\$ 297	\$ 703

(in thousands)	Six Months Ended		
	June 30,		
	2006 Compared to 2005		
Increase/(Decrease)	Volume	Rate	Total
Interest-bearing deposits with banks	\$ (15)	\$ 7	\$ (8)
Federal funds sold	(12)	35	23
Investment securities available for sale	101	157	258
Loans	1,118	2,284	3,402
Total interest income	1,192	2,483	3,675

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## Interest expense:

Savings, NOW and market rate accounts	(86)	632	546
Time deposits	443	902	1,345
Short term borrowings	116	105	221
Total interest expense	473	1,639	2,112
Interest differential	\$ 719	\$ 844	\$ 1,563

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The tables below present the major asset and liability categories on an average daily basis for the periods presented, along with tax equivalent interest income and expense and tax equivalent key rates and yields.

**Average Balance and Tax Equivalent Income and Expense and Tax Equivalent Yields**

	For the Three Months ended June 30,					
	2006			2005		
	Average			Average		
	Interest	Rates		Interest	Rates	
	Average	Income/	Earned/	Average	Income/	Earned/
(dollars in thousands)	Balance	Expense	Paid	Balance	Expense	Paid
<b>Assets:</b>						
Interest-bearing deposits with other banks	\$ 687	\$ 8	4.67%	\$ 536	\$ 3	2.99%
Federal funds sold	1,467	18	4.92%	5,119	36	2.82%
Investment securities available for sale	44,197	475	4.31%	34,828	296	3.41%
Loans <sup>(1) (2)</sup>	620,931	10,683	6.90%	578,173	8,895	6.17%
Total interest earning assets	667,282	11,184	6.72%	618,656	9,230	5.98%
Cash and due from banks	24,666			33,259		
Allowance for loan losses	(7,686)			(7,251)		
Other assets	37,803			34,975		
Total assets	\$ 722,065			\$ 679,639		
<b>Liabilities:</b>						
Savings, NOW and market rate accounts	\$ 294,848	\$ 934	1.27%	\$ 319,101	\$ 647	0.81%
Time deposits	166,228	1,645	3.97%	128,777	869	2.71%
Total interest-bearing deposits	461,076	2,579	2.24%	447,878	1,516	1.36%
Short term borrowings	16,738	216	5.18%	3,540	28	3.17%
Total interest-bearing liabilities	477,814	2,795	2.35%	451,418	1,544	1.37%
Noninterest-bearing demand deposits	150,586			146,140		
Other liabilities	13,487			9,803		
Total noninterest-bearing liabilities	164,073			155,943		
Total liabilities	641,887			607,361		
Shareholders' equity	80,178			72,278		
Total liabilities and shareholders' equity	\$ 722,065			\$ 679,639		
<b>Net interest spread</b>			4.37%			4.61%
Effect of noninterest-bearing sources			.67%			0.37%
<b>Net interest income/ margin on earning assets</b>		\$ 8,389	5.04%		\$ 7,686	4.98%

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Tax equivalent adjustment	\$	86	.05%	\$	65	.04%
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The tax equivalent net interest income for the three months ended June, 2006 of \$8.389 million was \$703 thousand or 9.1% higher than the net interest income for the same period in 2005 of \$7.686 million. The analysis above indicates that increased loan volume and an increase in rates were the primary drivers of the increase in net interest income. Average earning assets increased \$48.6 million or 7.9% in the second quarter of 2006 compared to the same period in 2005. Average loans grew \$42.8 million or 7.4% while investments increased to \$9.4 million or 26.9% from the second quarter of 2005.

The tax equivalent average earning asset yield during the second quarter of 2006 of 6.72% was 74 basis points higher than the 5.98% for the same period in 2005. The floating rate loans in portfolio increased as the Fed increased rates and new fixed rate loans were priced in accordance with the current rate environment. The rate paid on average interest bearing liabilities of 2.35% was 98 basis points higher than the 1.37% rate paid during the same period in 2005. This increase is due to an increase in funds borrowed, the need to pay higher rates on interest bearing deposits to remain competitive and an increase in wholesale funding during the first six months of 2006. Average non-interest bearing demand deposits increased by \$4.446 million or a 3.0% increase from the second quarter of 2005.

**Table of Contents****Average Balance and Tax Equivalent Income and Expense and Tax Equivalent Yields**

	For the Six Months ended June 30,					
	2006			2005		
	Average			Average		
	Interest	Rates		Interest	Rates	
	Average	Income/	Earned/	Average	Income/	Earned/
(dollars in thousands)	Balance	Expense	Paid	Balance	Expense	Paid
<b>Assets:</b>						
Interest-bearing deposits with other banks	\$ 564	\$ 13	4.65%	\$ 1,834	\$ 21	2.31%
Federal funds sold	3,801	84	4.46%	4,769	61	2.58%
Investment securities available for sale	40,653	841	4.17%	34,429	583	3.41%
Loans <sup>(1) (2)</sup>	609,860	20,670	6.83%	573,036	17,268	6.08%
Total interest earning assets	654,878	21,608	6.65%	614,068	17,933	5.89%
Cash and due from banks	24,500			33,308		
Allowance for loan losses	(7,606)			(7,155)		
Other assets	36,809			34,465		
Total assets	\$ 708,581			\$ 674,686		
<b>Liabilities:</b>						
Savings, NOW and market rate accounts	\$ 299,867	\$ 1,755	1.18%	\$ 322,893	\$ 1,209	0.76%
Time deposits	156,970	2,947	3.79%	123,018	1,602	2.63%
Total interest-bearing deposits	456,837	4,702	2.08%	445,911	2,811	1.27%
Short term borrowings	10,177	257	5.09%	2,401	36	3.02%
Total interest-bearing liabilities	467,014	4,959	2.14%	448,312	2,847	1.28%
Noninterest-bearing demand deposits	148,941			144,792		
Other liabilities	13,451			9,796		
Total noninterest-bearing liabilities	162,392			154,588		
Total liabilities	629,406			602,900		
Shareholders' equity	79,175			71,786		
Total liabilities and shareholders' equity	\$ 708,581			\$ 674,686		
<b>Net interest spread</b>			4.51%			4.61%
Effect of noninterest-bearing sources			.62%			0.34%
<b>Net interest income/ margin on earning assets</b>		\$ 16,649	5.13%		\$ 15,086	4.95%
Tax equivalent adjustment		\$ 165	.05%		\$ 111	0.04%

(1)

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Non-accrual loans have been included in average loan balances, but interest on nonaccrual loans has not been included for purposes of determining interest income.

(2) Loans include portfolio loans and loans held for sale.

Net interest income for the six months ended June 30, 2006 of \$16.649 million was \$1.563 million or 10.4% higher than the net interest income for the same period in 2005 of \$15.086 million. The analysis above indicates that increased loan volume along with the increase in rates were the primary drivers of the increase in net interest income. Average earning assets increased \$40.8 million or 6.6% during the first six months of 2006 compared to the same period in 2005. Average loans grew \$36.8 million or 6.4% while investments increased \$6.2 million or 18.1% over 2005.

The average earning asset yield during the first six months of 2006 of 6.65% was 76 basis points higher than the 5.89% during the same period in 2005 as floating rate loans in the portfolio responded to the Fed's rate increases. The rate paid on average interest bearing liabilities of 2.14% in 2006 was 86 basis points higher than the 1.28% in 2005 due to the need to pay higher rates on interest bearing deposits to remain competitive and an increase in the Corporation's short term borrowings. Average non-interest bearing demand deposits grew 2.8%, while savings, NOW and market rate accounts decreased 7.1% and time deposits increased 27.6% in the first six months of 2006 compared to the same period in 2005. The growth in time deposits includes an increase in wholesale funding previously mentioned.

**Table of Contents****Net Interest Margin**

The Corporation's tax equivalent net interest margin increased 6 basis points to 5.04% in the second quarter of 2006 from 4.98% in the same period last year. As rates continue to rise, the yield on earning assets has increased due to the asset sensitivity of the balance sheet. Conversely, the cost of interest bearing deposits has also increased. This is a result of the increasing rate environment and the need to remain competitive with pricing in order to be successful in deposit retention and gathering. The impact of the increasing cost of deposits resulted in a decrease in the net interest margin from 5.19% in the fourth quarter of 2005 and 5.22% in the first quarter of 2006 to 5.04% for the second quarter of 2006. The tax equivalent net interest margin and related components for the past five linked quarters are as follows:

		TE	Interest	TE	Effect of	TE
		Earning	Bearing	Net	Non-Interest	Net
		Asset	Liability	Interest	Bearing	Interest
Year	Quarter	Yield	Cost	Spread	Sources	Margin
2006	2 <sup>nd</sup>	6.72%	2.35%	4.37%	0.67%	5.04%
2006	1 <sup>st</sup>	6.58%	1.92%	4.66%	0.56%	5.22%
2005	4 <sup>th</sup>	6.41%	1.73%	4.68%	0.51%	5.19%
2005	3 <sup>rd</sup>	6.18%	1.57%	4.61%	0.46%	5.07%
2005	2 <sup>nd</sup>	5.98%	1.37%	4.61%	0.37%	4.98%

**Interest Rate Sensitivity**

The Corporation actively manages its interest rate sensitivity position. The objectives of interest rate risk management are to control exposure of net interest income to risks associated with interest rate movements and to achieve sustainable growth in net interest income. Management's Asset Liability Committee (ALCO), using policies and procedures approved by the Corporation's Board of Directors, is responsible for managing the rate interest sensitivity position. The Corporation manages interest rate sensitivity by changing the mix, pricing and repricing characteristics of its assets and liabilities, through the management of its investment portfolio, its offering of loan and deposit terms and through borrowings from the Federal Home Loan Bank of Pittsburgh (FHLB).

The Corporation uses several tools to manage its interest rate risk including interest rate sensitivity analysis (aka Gap Analysis), market value of portfolio equity analysis, interest rate simulations under various rate scenarios and net interest margin reports. The results of these reports are compared to limits established by the Corporation's Asset Liability Management Policies and appropriate adjustments are made if the results are outside of established limits.

The following table demonstrates the annualized result of an interest rate simulation and the expected effect that a parallel interest rate shift in the yield curve and subjective adjustments in deposit pricing might have on the Corporation's projected net interest income over the next 12 months. The changes to net interest income shown below are in compliance with the Corporation's policy guidelines. Actual results may differ significantly from the interest rate simulation due to numerous factors including assumptions, the competitive environment, market reactions and customer behavior.

**Summary of Interest Rate Simulation**

	June 30, 2006	
	Change In Net Interest Income Over	
(dollars in thousands)	Next 12 Months	
<b>Change in Interest Rates</b>		
+200 basis points	\$	1,631 4.77%
+100 basis points	\$	872 2.55%
-100 basis points	\$	(823) (2.41)%
-200 basis points	\$	(1,754) (5.13)%



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The interest rate simulation above indicates that the Corporation's balance sheet as of June 30, 2006 is asset sensitive meaning that an increase in interest rates should increase net interest income and a decline in interest rates will cause a decline in net interest income over the next 12 months. The asset sensitivity position has been reduced during the second quarter of 2006 when compared to December 31, 2005 with the addition of fixed rate commercial loans, residential mortgages and mortgage-backed securities to the asset mix. Additionally, the Corporation purchased a \$25 million notional, prime rate based, three-year interest rate floor in April, 2006 for a total cost of \$155,000 to mitigate the impact on earnings of anticipated declining rates over the next three years. The expense of this interest rate floor during the second quarter of 2006 was \$53 thousand.

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The following table presents the Corporation's interest rate sensitivity position or Gap Analysis as of June 30, 2006

	0 to 90	90 to 365	1-5	Over	Non-Rate	
(dollars in thousands)	Days	Days	Years	5 Years	Sensitive	Total
<b>Assets:</b>						
Interest-bearing deposits with banks	\$ 642					\$ 642
Federal funds sold						
Investment securities	2,556	8,548	23,724	10,869		45,697
Loans <sup>(1)</sup>	271,859	45,285	237,256	91,601		646,001
Allowance for loan losses					(7,779)	(7,779)
Cash and due from banks					27,529	27,529
Other assets			136	303	38,953	39,392
<b>Total assets</b>	<b>\$ 275,057</b>	<b>\$ 53,833</b>	<b>\$ 261,116</b>	<b>\$ 102,773</b>	<b>\$ 58,703</b>	<b>\$ 751,482</b>
<b>Liabilities and shareholder's equity:</b>						
Non-interest-bearing demand	\$ 32,733	\$ 18,846	\$ 100,513			\$ 152,092
Savings, NOW and market rate	47,026	39,780	151,866	45,786		284,458
Time deposits	87,190	92,626	18,006	158		197,980
Fed funds purchased	12,700					12,700
Borrowed funds	10,000					10,000
Other liabilities					12,597	12,597
Shareholders' equity	2,916	8,749	46,660	23,330		81,655
<b>Total liabilities and shareholders' equity</b>	<b>\$ 192,565</b>	<b>\$ 160,001</b>	<b>\$ 317,045</b>	<b>\$ 69,274</b>	<b>\$ 12,597</b>	<b>\$ 751,482</b>
<b>Interest earning assets</b>	<b>\$ 275,057</b>	<b>\$ 53,833</b>	<b>\$ 260,980</b>	<b>\$ 102,470</b>	<b>\$</b>	<b>\$ 692,340</b>
<b>Interest bearing liabilities</b>	<b>156,916</b>	<b>132,406</b>	<b>169,872</b>	<b>45,944</b>	<b>\$</b>	<b>505,138</b>
<b>Difference between interest earning assets and interest bearing liabilities</b>	<b>\$ 118,141</b>	<b>\$ (78,573)</b>	<b>\$ 91,108</b>	<b>\$ 56,526</b>	<b>\$</b>	<b>\$ 187,202</b>
<b>Cumulative difference between interest earning assets and interest bearing liabilities</b>	<b>\$ 118,141</b>	<b>\$ 39,568</b>	<b>\$ 130,676</b>	<b>\$ 187,202</b>	<b>\$</b>	<b>\$ 187,202</b>
<b>Cumulative earning assets as a % of cumulative interest bearing liabilities</b>	<b>175%</b>	<b>114%</b>	<b>128%</b>	<b>137%</b>		

<sup>(1)</sup> Loans include portfolio loans and loans held for sale.

The table above indicates that the Corporation is asset sensitive in the immediate to 90 day time frame and should experience an increase in net interest income in the near term if interest rates rise. The converse is also true.

## PROVISION FOR LOAN LOSSES

### General Discussion of the Allowance for Loan Losses

The Corporation uses the allowance method of accounting for credit losses. The balance in the allowance for loan losses is determined based on Management's review and evaluation of the loan portfolio in relation to past loss experience, the size and composition of the portfolio, current economic events and conditions, and other pertinent factors, including Management's assumptions as to future delinquencies, recoveries and losses.



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Increases to the allowance for loan losses are implemented through a corresponding provision (expense) in the Corporation's statement of income. Credit exposures deemed to be uncollectible are charged against the allowance for loan losses. Recoveries of previously charged-off amounts are credited to the allowance for loan losses.

While Management considers the allowance for loan losses to be adequate based on information currently available, future additions to the allowance may be necessary due to changes in economic conditions or Management's assumptions as to future delinquencies, recoveries and losses and Management's intent with regard to the disposition of loans. In addition, the Pennsylvania Department of Banking and the Federal Reserve Bank of Philadelphia, as an integral part of their examination process, periodically review the Corporation's allowance for loan losses.

The Corporation's allowance for loan losses is the accumulation of four components that are calculated based on various independent methodologies. All components of the allowance for loan losses are estimations. Management discusses these estimates earlier in this document under the heading of Critical Accounting Policies, Judgments and Estimates. The four components are as follows:

Specific Loan Evaluation Component Includes the specific evaluation of larger classified loans

Historical Charge-Off Component Applies a five year historical charge-off rate to pools of non-classified loans

Additional Factors Component The loan portfolio is broken down into multiple homogenous subclassifications upon which multiple factors (such as delinquency trends, industry concentration, economic conditions, loan terms, and regulatory environment) are evaluated resulting in an allowance amount for each of the subclassifications. The sum of these amounts equals the Additional Factors Component.

Unallocated Component This amount represents a reserve against all loans for factors not included in the components above.

**Asset Quality and Analysis of Credit risk**

Asset quality remains strong at June 30, 2006 despite an increase in non-performing assets to \$1.7 million from \$415 thousand at December 31, 2005. The \$1.7 million of non-performing loans, which excludes other real estate owned, consist almost entirely of two first lien residential mortgage loans. Nonperforming loans as a percentage of total loans were 26 basis points at June 30, 2006 compared with 7 basis points at December 31, 2005 and 11 basis points at June 30, 2005. The allowance for loan losses as a percentage of total loans was 1.22% at June 30, 2006 compared with 1.24% at December 31, 2005 and 1.22% at June 30, 2005.

**Non Performing Assets and Related Ratios**

	June 30, 2006	December 31, 2005	June 30, 2005
(dollars in thousands)			
Non-accrual loans	\$ 866	\$ 261	\$ 678
Loans 90 days or more past due	794	129	
Total non performing loans	1,660	390	678
Other real estate owned ( OREO )		25	210
Total non performing assets	\$ 1,660	\$ 415	\$ 888
Allowance for loan losses to non performing assets	468.6%	1,783.60%	816.70%
Allowance for loan losses to non performing loans	468.6%	1,897.90%	1,069.60%
Non performing loans to total loans	.26%	.07%	.11%

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Allowance for loan losses to portfolio loans	1.22%	1.24%	1.22%
Non performing assets to portfolio assets	.22%	0.06%	0.13%
Period end portfolio loans	\$ 639,632	\$ 595,165	\$ 585,833
Average portfolio loans (quarterly average)	\$ 617,627	\$ 591,294	\$ 569,127
Allowance for loan losses	\$ 7,779	\$ 7,402	\$ 7,252

**Table of Contents****Summary of Changes in the Allowance For Loan Losses**

	Three Months Ended June 30,		Six Months Ended June 30,		Year Ended December 31,
(dollars in thousands)	2006	2005	2006	2005	2005
Balance, beginning of period	\$ 7,571	\$ 7,125	\$ 7,402	\$ 6,927	\$ 6,927
<b>Charge-offs:</b>					
Consumer	(5)	(7)	(14)	(9)	(158)
Commercial and industrial					
Real estate		(65)		(65)	(156)
Total charge-offs	(5)	(72)	(14)	(74)	(314)
<b>Recoveries:</b>					
Consumer	3	3	26	8	11
Commercial and industrial	1	2	2	10	12
Real estate		1		1	4
Total recoveries	4	6	28	19	27
Net (charge-offs) / recoveries	(1)	(66)	14	(55)	(287)
<b>Provision for loan losses</b>	<b>209</b>	<b>193</b>	<b>363</b>	<b>380</b>	<b>762</b>
Balance, end of period	\$ 7,779	\$ 7,252	\$ 7,779	\$ 7,252	\$ 7,402

**NON-INTEREST INCOME****Three months ended June 30, 2006 compared to June 30, 2005**

Non-interest income for the second quarter of 2006 was \$4.575 million, a decrease of \$166 thousand or 3.5% compared with \$4.741 million in the same period last year. Fees for Wealth Management services grew \$81 thousand or 2.7% to \$3.048 million in the second quarter of 2006 from \$2.967 million in same period last year. New business development efforts, an April 2005 fee schedule increase, increased estate settlements and growth in wealth assets contributed to these results, partially offset by equity market conditions in the second quarter of 2006. Wealth Management assets under management and administration were \$2.195 billion at June 30, 2006 compared to \$1.901 billion at June 30, 2005. This asset growth is mainly the result of an acquisition made by a significant client in the third quarter of 2005.

Partially offsetting this higher Wealth Management services revenue were reduced fees from residential mortgage-related activities. Loan servicing and late fees were \$282 thousand for the three months ended June 30, 2006, a decrease of \$57 thousand or 16.8% from \$339 thousand for three months ended June 30, 2005. The volume of loans sold servicing retained declined as more loans were sold servicing released to obtain a higher gain at the time of sale and a decision by Management to hold certain residential mortgage loans in portfolio to help reduce the Corporation's asset sensitivity position. Net gain on sale of loans was \$254 thousand for the second quarter, a decrease of \$210 thousand or 45.3% compared to \$464 thousand for the same period last year as a result of the slowdown in mortgage refinance activity compounded by very competitive pricing pressures and Management's decision to portfolio more loans. See the supplemental residential mortgage volume statistics later in this document for additional information.

**Six months ended June 30, 2006 compared to June 30, 2005**

Non-interest income for the six months ended June 30, 2006 was \$9.174 million, an increase of \$5 thousand or 0.1% compared with \$9.169 million in the same period last year. Fees for Wealth Management services grew \$547 thousand or 9.7% to \$6.168 million in the second quarter of 2006 from \$5.621 million in same period last year. New business development efforts, an April 2005 fee schedule increase, increased estate settlements, asset growth and market performance contributed to these results.

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Partially offsetting this higher Wealth Management services revenue were reduced fees from residential mortgage-related activities and lower services charges on deposit accounts. Loan servicing and late fees were \$572 thousand for the first six months of 2006, a \$106 thousand or 15.6% decrease from \$678 thousand for the same period last year. The volume of loans sold servicing retained declined due to more loans being sold servicing released to obtain a higher gain at the time of sale, and a decision by Management to hold certain residential mortgage loans in portfolio to help reduce the Corporation's asset sensitivity position. Net gain on sale of loans was \$504 thousand for the first six months of 2006, a decrease of \$418 thousand or 45.3% compared to \$922 thousand for the same period last year as a result of the slowdown in mortgage refinance activity compounded by very competitive pricing pressures and Management's decision to portfolio more loans.

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### **NON-INTEREST EXPENSE**

#### **Three months ended June 30, 2006 compared to June 30, 2005**

Non-interest expense for the second quarter of 2006 was \$7.902 million, an increase of \$38 thousand or 0.5% compared to \$7.864 million in the same period last year. Salaries and wages were \$3.834 million for the second quarter of 2006 compared to \$3.758 million for the same period last year, a \$76 thousand or 2.0% increase which was primarily the result of merit increases and additions to staff. Employee benefits were \$1.131 million for the quarter, up \$195 thousand or 20.8% compared to \$936 thousand for the same period last year. The primary reasons for this increase were related to higher payroll taxes, medical expense, pension expense and post-retirement benefit expenses. Expenses related to the opening of the Exton branch in March 2005 and the rent expense for the Ardmore Branch contributed to the increase in occupancy expense. Other operating expenses include \$53 thousand of expense related to the interest rate floor purchased in April 2006.

Partially offsetting these increases in non-interest expense were reductions in the amortization of mortgage servicing rights and professional fees. Amortization of mortgage servicing rights decreased \$126 thousand or 60.0% to \$84 thousand for the second quarter of 2006 compared to \$210 thousand for the same period last year as a result of the lower volume of loans sold serviced for others and slower prepayment speeds of mortgage loans due to the increase in mortgage rates from year to year. Other operating expenses decreased \$21 thousand or 1.6% to \$1.253 million for the second quarter of 2006 compared to \$1.274 million for the second quarter of 2005.

#### **Six months ended June 30, 2006 compared to June 30, 2005**

Non-interest expense for the first six months of 2006 was \$15.747 million, an increase of \$499 thousand or 3.3% compared to \$15.248 million in the same period last year. Salaries and wages were \$7.663 million for the first six months of 2006 compared to \$7.265 million for the same period last year, a \$398 thousand or 5.5% increase which was primarily the result of merit increases and additions to staff. Employee benefits were \$2.449 million for the first six months of 2006, up \$372 thousand or 17.9% compared to \$2.077 million for the same period last year. The primary reasons for this increase were related to higher payroll taxes, medical expenses and pension expenses. Expenses related to the opening of the Exton branch in March 2005 and rent expense on the Ardmore Branch contributed to increases in occupancy and furniture, fixtures and equipment expense.

Partially offsetting these increases in non-interest expense were reductions in the amortization of mortgage servicing rights and professional fees. Amortization of mortgage servicing rights decreased \$229 thousand or 57.4% to \$170 thousand for the first six months of 2006 compared to \$399 thousand for the same period last year as a result of the lower volume of loans sold serviced for others as well as slower prepayment speeds of mortgage loans due to the increased mortgage rate environment from year to year. Other operating expenses decreased \$64 thousand or 2.8% to \$2.262 million for the first six months of 2006 compared to \$2.326 million for the first six months of 2005.

### **INCOME TAXES**

Income taxes from operations for the three months ended June 30, 2006 were \$1.630 million, an effective tax rate of 34.2% compared to \$1.517 million, an effective tax rate of 35.2%, for the same period in 2005. The decrease in the effective tax rate is due to a higher percentage of tax-exempt income to pretax book income for the three months ended June 30, 2006, as compared to the same period in 2005.

Income taxes for the six months ended June 30, 2006 were \$3.275 million compared to \$2.926 million for the same period in 2005. This represents an effective tax rate for the six months ended June 30, 2006 of 34.3% and an effective tax rate of 34.4% for the same period in 2005.

### **BALANCE SHEET ANALYSIS**

Total assets increased \$24.3million or 3.3% from \$727.2 million as of December 31, 2005 to \$751.5 million as of June 30, 2006. This increase is related to the growth in loans outstanding, specifically in commercial mortgages, construction loans and residential mortgage loans and an increase in investment securities. Offsetting this increase was a decline in fed funds sold that increased at December 31, 2005 due to certain short term deposits. The increase in portfolio loans was \$44.5 million or 7.5 % from \$595.2 million as of December 31, 2005 to \$639.6 million as of June 30, 2006. Average portfolio loans for the second quarter of 2006 increased \$26.3 million or 4.5% to \$617.6 million compared to \$591.3 million in the fourth quarter of 2005.

The table below compares total portfolio loans outstanding at June 30, 2006 and December 31, 2005. Commercial and industrial loans declined \$3.8 million from \$170.3 million at December 31, 2005 to \$166.5 million at June 30, 2006 as interest-sensitive customers used excess cash to pay down floating rate lines as interest rates increased. This decline was more than offset by an increase in commercial mortgage loans of \$15.6 million or 9.6% from \$162.6 million as of December 31, 2005 to \$178.2 million as of June 30, 2006, an increase in construction loans of \$19.6



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million or 43% from \$45.5 million as of December 31, 2006 to \$65.1 million as of June 30, 2006 and an increase in residential mortgage loans of \$9.2 million or 9.3% from \$99.6 million as of December 31, 2005 to \$108.8 million as of

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June 30, 2006. The increase in construction loans is related to the increased usage of lines available to the borrowers and the increase in residential mortgage loans is due to Management's decision to portfolio certain residential mortgage loans as part of the Corporation's interest rate risk management process. The Corporation continues to focus its business development efforts on building banking relationships with privately held businesses, non-profits, high quality residential builders and owners of commercial real estate.

Total portfolio loans outstanding at June 30, 2006 and December 31, 2005 are as follows:

	June 30,	December 31,
(dollars in thousands)	2006	2005
Real estate loans:		
Commercial mortgage loans	\$ 178,253	\$ 162,621
Home equity lines and loans	112,157	107,699
Residential mortgage loans	108,820	99,602
Construction loans	65,097	45,523
Commercial and industrial loans	166,442	170,283
Consumer loans	8,863	9,437
Total portfolio loans	\$ 639,632	\$ 595,165
Quarterly average portfolio loans	\$ 617,627	\$ 591,294

Total deposits and borrowings increased \$20.9 million from \$636.3 million at December 31, 2005 to \$657.2 million at June 30, 2006. This increase is driven by an increase in borrowed funds of \$22.7 million, which is comprised of \$10 million from the FHLB and \$12.7 million in overnight fed funds. The increase in borrowed funds supported the 7.5% increase in portfolio loans during the first six month of 2006. The decrease in total deposits of \$1.7 million or 0.3% from \$636.3 million at December 31, 2005 to \$634.5 million at June 30, 2006 is concentrated in savings, NOW and market rate accounts, partially offset by the increase in the time deposits categories detailed below.

Average deposits for the second quarter of 2006 increased \$11.1 million or 1.8% to \$611.7 million compared to \$600.6 million in the fourth quarter of 2005. Due to the highly competitive nature of the financial services business, the Corporation is paying higher rates on certificates of deposit and is utilizing higher rate wholesale CD's. The change in the mix of the Corporation's deposits translates into higher interest expenses. It is probable that the higher rate certificates of deposits will make up a greater share of total deposits than they have historically, for the foreseeable future. It is anticipated the funding of asset growth in the future will be aided by continued expansion of the retail banking footprint, with controlled *de novo* expansion in the suburban Philadelphia market. Construction has started on the Corporation's new Ardmore branch, which is anticipated to open in the fourth quarter of 2006. It is also expected that the new West Chester branch will open in the fourth quarter of 2007.

Deposits and borrowings at June 30, 2006 and December 31, 2005 are as follows:

	June 30,	December 31,
(dollars in thousands)	2006	2005
Non-interest bearing demand	\$ 152,092	\$ 168,042
Savings, NOW and market rate accounts	284,458	312,896
Non-wholesale time deposits	162,980	150,322
Time deposits from brokers	20,000	
Time deposits from public fund sources	15,000	5,000
Total deposits	634,530	636,260
Fed funds purchased	12,700	
FHLB advances	10,000	

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Total borrowings	22,700	
Total deposits and total borrowings	\$ 657,230	\$ 636,260
Quarterly average deposits	\$ 611,662	\$ 600,559
Quarterly average borrowings	16,738	1,505
Quarterly average deposits and borrowings	\$ 628,400	\$ 602,064

**Table of Contents****Supplemental Residential Mortgage Volume Statistics**

(dollars in thousands)	Quarter Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Residential loans held in portfolio *	\$ 108,820	\$ 84,176	\$ 108,820	\$ 84,176
Mortgage originations	31,996	46,010	66,417	84,559
Mortgage loans sold:				
Servicing retained	3,615	9,972	10,625	23,759
Servicing released	13,127	16,817	20,563	37,026
Servicing retained %	21.6%	37.2%	34.1%	39.1%
Servicing released %	78.4%	62.8%	65.9%	60.9%
Loans serviced for others *	395,091	465,780	395,091	465,780
Mortgage servicing rights (MSRS)*	2,941	2,990	2,941	2,990
Net gain on sale of loans	254	464	504	922
Loan servicing and late fees	282	339	572	678
Amortization of MSRs	\$ 84	\$ 210	\$ 170	\$ 399

\* *period end balance*

**Table of Contents****Capital**

Consolidated shareholder's equity of the Corporation was \$81.7 million or 10.9% of total assets, as of June 30, 2006, compared to \$77.5 million or 10.7% of total assets, as of December 31, 2005. The following table presents the Corporation's and Bank's capital ratios and the minimum capital requirements to be considered "Well Capitalized" by regulators as of June 30, 2006, and December 31, 2005:

	Ratio	Minimum Ratio to be Well Capitalized
<b>June 30, 2006:</b>		
Total (Tier II) Capital to Risk Weighted Assets		
Consolidated	12.51%	10%
Bank	11.54%	10%
Tier I Capital to Risk Weighted Assets		
Consolidated	11.43%	6%
Bank	10.45%	6%
Tier I Leverage Ratio (Tier I Capital to Total Quarterly Average Assets)		
Consolidated	11.39%	5%
Bank	10.41%	5%
<b>December 31, 2005:</b>		
Total (Tier II) Capital to Risk Weighted Assets		
Consolidated	12.46%	10%
Bank	11.47%	10%
Tier I Capital to Risk Weighted Assets		
Consolidated	11.38%	6%
Bank	10.38%	6%
Tier I Leverage Ratio (Tier I Capital to Total Quarterly Average Assets)		
Consolidated	11.25%	5%
Bank	10.26%	5%

Both the Corporation and the Bank exceed the required capital levels to be considered "Well Capitalized" by their respective regulators at the end of each period presented.

Neither the Corporation nor the Bank are under any agreement with regulatory authorities, nor is Management aware of any current recommendations by the regulatory authorities, which, if such recommendations were implemented, would have a material effect on liquidity, capital resources or operations of the Corporation.

**Liquidity**

The Corporation manages its liquidity position on a daily basis as part of the daily settlement function and continuously as part of the formal asset liability management process. The Corporation's liquidity is maintained by managing its core deposits as the primary source, and purchasing federal funds, selling loans in the secondary market, borrowing from the FHLB and selling securities as its secondary sources. Availability with the FHLB was approximately \$230 million as of June 30, 2006. Overnight Fed Funds lines consist of lines from six banks totaling \$48 million. Quarterly, ALCO reviews the Corporation's liquidity needs and reports its findings to the Risk Management Committee of the Corporation's Board of Directors.

The deposit gathering process has become very competitive as most financial institutions are struggling to retain and attract deposits. Additionally, the Corporation is seeing a shift from lower rate NOW and savings accounts into higher rate certificates of deposit. These factors have put upward pressure on funding costs and have led Management to tap into wholesale funding sources to support asset growth.

As of June 30, 2006, the Corporation had \$22.7 million in overnight and short term borrowings. Additionally during the first six months of 2006 the corporation obtained \$20 million wholesale CD's and \$15 million of public deposits for the Corporation's liquidity needs. Additional alternative funding sources are being evaluated.

**Off Balance Sheet Risk**

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The Corporation is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit.

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Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the loan agreement. Total commitments to extend credit at June 30, 2006 were \$347 million.

Standby letters of credit are conditional commitments issued by the Bank to a customer for a third party. Such standby letters of credit are issued to support private borrowing arrangements. The credit risk involved in issuing standby letters of credit is similar to that involved in granting loan facilities to customers. The Corporation's obligation under standby letters of credit at June 30, 2006 amounted to \$11.888 million.

Estimated fair values of the Corporation's off-balance sheet instruments are based on fees and rates currently charged to enter into similar loan agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. Since fees and rates charged for off-balance sheet items are at market levels when set, there is no material difference between the stated amount and the estimated fair value of off-balance sheet instruments.

**Contractual Cash Obligations of the Corporation as of June 30, 2006:**

		Within 1	2 - 3	4 - 5	After 5
(In thousands)	Total	Year	Years	Years	Years
Deposits without a stated maturity	\$ 436,550	\$ 436,550			
Consumer certificates of deposit	197,980	179,816	17,770	236	158
Operating leases	19,883	914	1,596	1,495	15,878
Purchase obligations	1,697	990	572	135	
Non-discretionary pension contributions					
Total	\$ 656,110	\$ 618,270	\$ 19,938	\$ 1,866	\$ 16,036

**Section 404 of Sarbanes Oxley Act of 2002**

The Corporation and its Management completed compliance procedures relating to Section 404 of the Sarbanes Oxley Act of 2002 ( SOX 404 ) for the fiscal year ended December 31, 2005 as documented in the Corporation's Form 10-K. Management continues to devote considerable effort in 2006 to assure continued compliance with all aspects of SOX 404 during 2006.

**Other Information****Opening of New Full Service Branch Offices in Newtown Square and Exton**

During the first quarter of 2004, the Bank established a new full service branch office in Newtown Square, Pennsylvania, thereby enabling the Bank to both broaden and strengthen its footprint in Delaware County, Pennsylvania. This new branch had deposits of \$23.1 million as of June 30, 2006. In March of 2005, the Bank established a new full service branch in Exton, Pennsylvania. The Exton branch had deposits of \$10.6 million as of June 30, 2006. The Bank anticipates measured expansion as previously stated.

**Branches Under Construction**

The Corporation will continue with the expansion of its retail banking footprint with controlled *de novo* expansion in the suburban Philadelphia market. Construction has started on the Corporation's new Ardmore branch and its opening is anticipated in the fourth quarter of 2006. We also expect our new West Chester branch to open in the fourth quarter of 2007. This full service branch will also house the Corporation's Chester County loan production center and a regional office for Wealth Management clients. Management is excited about the opportunity to expand our business into the heart of West Chester, the county seat of Chester County, the fastest growing county in Pennsylvania.

#### Effects of Inflation

Inflation has some impact on the Corporation's operating costs. Unlike many industrial companies, however, substantially all of the Corporation's assets and liabilities are monetary in nature. As a result, interest rates have a more significant impact on the Corporation's performance than the general level of inflation. Over short periods of time, interest rates may not necessarily move in the same direction or in the same magnitude as prices of goods and services.

#### Effect of Government Monetary Policies

The earnings of the Corporation are and will be affected by domestic economic conditions and the monetary and fiscal policies of the United States government and its agencies. An important function of the Federal Reserve Board is to regulate



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the money supply and interest rates. Among the instruments used to implement those objectives are open market operations in United States government securities and changes in reserve requirements against member bank deposits. These instruments are used in varying combinations to influence overall growth and distribution of bank loans, investments, and deposits, and their use may also affect rates charged on loans or paid for deposits.

The Corporation is a member of the Federal Reserve System and, therefore, the policies and regulations of the Federal Reserve Board have a significant effect on its deposits, loans and investment growth, as well as the rate of interest earned and paid, and are expected to affect the Corporation's operations in the future. The effect of such policies and regulations upon the future business and earnings of the Corporation cannot be predicted.

### **Regulatory Matters and Pending Legislation**

Management is not aware of any current specific recommendations by regulatory authorities or proposed legislation which, if they were implemented, would have a material adverse effect upon the liquidity, capital resources, or results of operations, although the general cost of compliance with numerous and multiple federal and state laws and regulations does have, and in the future may have, an impact on the Corporation's results of operations.

In February, 2006, Congress passed the Federal Deposit Insurance Reform Act of 2005. This legislation will merge the Bank Insurance Fund and the Savings Association Insurance Fund into one fund, increase insurance coverage for retirement accounts to \$250,000, adjust the maximum deposit insurance for inflation after March 31, 2010 and give the FDIC greater flexibility in setting insurance assessments.

## **ITEM 3. Quantitative and Qualitative Disclosures About Market Risk**

There has been no material change in the Corporation's assessment of its sensitivity to market risks since its presentation in the 2005 Annual Report on Form 10-K filed with the SEC.

## **ITEM 4. Controls and Procedures**

As of the end of the period covered by the report, the Corporation carried out an evaluation, under the supervision and with the participation of the Corporation's management, including the Corporation's Chief Executive Officer, Frederick C. Peters II, and Chief Financial Officer, J. Duncan Smith, of the effectiveness of the design and operation of the Corporation's disclosure controls and procedures as defined in the Exchange Act Rules 13a-15(e) and 15d-15(e). Based upon the evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Corporation's disclosure controls and procedures are effective in timely alerting them to material information relating to the Corporation (including its consolidated subsidiaries) required to be included in the Corporation's periodic SEC filings.

There have not been any changes in the Corporation's internal controls over financial reporting during the quarter ended June 30, 2006 that have materially affected, or are reasonably likely to materially affect, its internal control over financial reporting.

## **PART II OTHER INFORMATION.**

### **ITEM 1. Legal Proceedings.**

None.

### **ITEM 1A. Risk Factors.**

There have been no material changes to the risk factors disclosed in the Corporation's 2005 Annual Report on Form 10-K.

**Table of Contents****ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds**

The following tables present the shares repurchased by the Corporation during the second quarter of 2006 <sup>(1) (2)</sup> :

				Maximum Number of Shares that May Yet Be Purchased Under the Plan	
		Total Number of	Average Price Paid	Announced Plans or	Under the Plan
Period		shares Purchased	per Share	Programs	or Programs
April 1, 2006	April 30, 2006	242	\$ 21.61		419,000
May 1, 2006	May 31, 2006	25,500	\$ 21.94	25,500	393,500
June 1, 2006	June 30, 2006	673	\$ 23.90		393,500
Total		26,415	\$ 21.98	25,500	393,500

Notes to this table:

- (1) On February 24, 2006, the Board of Directors of the Corporation adopted a new stock repurchase program (the "2006 Program") under which the Corporation may repurchase up to 450,000 shares of the Corporation's common stock, not to exceed \$10 million. The 2006 Program was publicly announced in a Press Release dated February 24, 2006. There is no expiration date on the 2006 Program and the Corporation has no plans for an early termination of the 2006 Program. All shares purchased through the 2006 Program were accomplished in open market transactions.
- (2) From April, 2006 to June, 2006, 915 shares were purchased by the Corporation's Thrift Plan and deferred compensation plan through open market transactions by the Corporation's Wealth Management Division investment personnel.

On April 28, 2006 the Corporation paid its non-management directors their annual retainer of \$12,500 in the form of the Corporation's common stock. Each of the 7 non-management directors received 566 shares for a total of 3,962 shares. The price per share was \$22.07, the market value on April 27, 2006. On June 29, 2006, the Corporation issued 431 shares of the Corporation's common stock to its new non-management director who joined the Board on June 29, 2006 in payment of his prorated annual retainer. The purchase price of the stock was \$21.74, the market value of the stock on June 28, 2006. the foregoing transactions were made in reliance upon the exemptions from the registration provisions of the Securities Act of 1933, as amended, provided for by Section 4(2) thereof for transactions not involving a public offering.

**ITEM 3. Defaults Upon Senior Securities**

None

**ITEM 4. Submission of Matters to Vote of Security Holders**

The Corporation held its Annual Meeting of Shareholders on April 25, 2006.

1. The shareholders elected David E. Lees as a Class III director to serve the remaining term of a Class III director to expire in 2009 and Francis J. Leto as a Class IV director for a four year term:

Director	For	Withheld
David E. Lees	7,476,353	88,765
Francis J. Leto	7,361,504	203,614

The following directors continued in office after the Annual Meeting: Andrea F. Gilbert, Wendell F. Holland, Frederick C. Peters II, B. Loyall Taylor, Nancy J. Vickers and Thomas A. Williams.

**ITEM 5. Other Information**

None

**ITEM 6. Exhibits**

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Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

Bryn Mawr Bank Corporation

Date: August 4, 2006

By: **/s/ FREDERICK C. PETERS II**  
**Frederick C. Peters II**  
**President & Chief Executive Officer**

Date: August 4, 2006

By: **/s/ J. DUNCAN SMITH**  
**J. Duncan Smith**  
**Treasurer & Chief Financial Officer**

**Form 10-Q**

**Index to Exhibits**

**a) Exhibits**

- Exhibit 31.1 -Certification of the Chief Executive Officer Pursuant to Exchange Act Rule 13a-14(a) or Rule 15d-14(a).**
- Exhibit 31.2 -Certification of the Chief Financial Officer Pursuant to Exchange Act Rule 13a-14(a) or Rule 15d-14(a).**
- Exhibit 32.1 -Certification of the Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.**
- Exhibit 32.2 -Certification of the Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.**

Form 10-Q