

PEOPLES BANCORP INC
Form 10-Q
August 02, 2007

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

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2007

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ____ to ____

Commission file number 0-16772

PEOPLES BANCORP INC.

(Exact name of Registrant as specified in its charter)

Ohio

(State or other jurisdiction of incorporation or organization)

31-0987416

(I.R.S. Employer Identification No.)

**138 Putnam Street, P. O. Box 738, Marietta,
Ohio**

(Address of principal executive offices)

45750

(Zip Code)

Registrant's telephone number, including area code:

(740) 373-3155

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

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

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Large accelerated filer

Accelerated filer

Non-accelerated filer

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

Yes

No

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date: 10,475,110 common shares, without par value, at July 31, 2007.

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CONSOLIDATED BALANCE SHEETS (Unaudited)**

<i>(Dollars in thousands)</i>	June 30,	December
	2007	31, 2006
Assets		
Cash and cash equivalents:		
Cash and due from banks	\$ 35,925	\$ 35,405
Interest-bearing deposits in other banks	1,379	1,101
Federal funds sold	500	3,300
Total cash and cash equivalents	37,804	39,806
Available-for-sale investment securities, at estimated fair value (amortized cost of \$558,081 at June 30, 2007 and \$550,239 at December 31, 2006)	553,930	548,733
Loans, net of deferred fees and costs	1,108,409	1,132,394
Allowance for loan losses	(14,692)	(14,509)
Net loans	1,093,717	1,117,885
Loans held for sale	1,755	1,041
Bank premises and equipment, net	23,008	23,455
Business owned life insurance	49,449	48,630
Goodwill	62,520	61,373
Other intangible assets	6,473	7,479
Other assets	28,041	26,853
Total assets	\$ 1,856,697	\$ 1,875,255
Liabilities		
Deposits:		
Non-interest-bearing	\$ 173,675	\$ 170,921
Interest-bearing	1,029,423	1,062,608
Total deposits	1,203,098	1,233,529
Short-term borrowings	235,005	194,883
Long-term borrowings	181,760	200,793
Junior subordinated notes held by subsidiary trusts	22,443	29,412
Accrued expenses and other liabilities	17,840	19,469
Total liabilities	1,660,146	1,678,086
Stockholders' Equity		
Common stock, no par value, 24,000,000 shares authorized, 10,903,116 shares issued at June 30, 2007 and 10,889,242 shares issued		

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at December 31, 2006, including shares in treasury	163,044	162,654
Retained earnings	49,784	43,439
Accumulated comprehensive loss, net of deferred income taxes	(4,663)	(2,997)
Treasury stock, at cost, 438,375 shares at June 30, 2007 and 237,257 shares at December 31, 2006	(11,614)	(5,927)
Total stockholders' equity	196,551	197,169
Total liabilities and stockholders' equity	\$ 1,856,697	\$ 1,875,255

See Notes to the Consolidated Unaudited Financial Statements

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PEOPLES BANCORP INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME (Unaudited)

<i>(Dollars in thousands, except per share data)</i>	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2007	2006	2007	2006
Interest Income:				
Interest and fees on loans	\$ 21,509	\$ 19,977	\$ 42,850	\$ 38,938
Interest on taxable investment securities	5,984	6,267	12,386	12,284
Interest on tax-exempt investment securities	543	724	1,114	1,454
Other interest income	44	38	90	78
Total interest income	28,080	27,006	56,440	52,754
Interest Expense:				
Interest on deposits	9,347	7,435	18,474	14,077
Interest on short-term borrowings	2,841	2,756	6,056	4,523
Interest on long-term borrowings	2,028	2,861	3,874	6,062
Interest on junior subordinated notes held by subsidiary trusts	531	649	1,182	1,284
Total interest expense	14,747	13,701	29,586	25,946
Net interest income	13,333	13,305	26,854	26,808
Provision for loan losses	847	573	1,470	841
Net interest income after provision for loan losses	12,486	12,732	25,384	25,967
Other Income:				
Service charges on deposit accounts	2,445	2,604	4,813	5,065
Insurance commissions	2,409	2,274	5,359	5,426
Trust and investment income	1,286	1,120	2,429	2,120
Electronic banking income	900	799	1,728	1,496
Business owned life insurance	408	399	819	805
Mortgage banking income	264	243	471	413
Gain on securities transactions	21	4	38	4
Other	242	166	449	394
Total other income	7,975	7,609	16,106	15,723
Other Expenses:				
Salaries and employee benefits	6,870	6,432	14,167	13,344
Net occupancy and equipment	1,352	1,210	2,684	2,452
Professional fees	631	663	1,245	1,275
Data processing and software	551	476	1,064	944
Amortization of intangible assets	489	567	989	1,149
Franchise tax	448	446	887	891
Bankcard Costs	394	318	754	607

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Marketing	379	413	728	888
Other	2,036	2,032	3,974	4,073
Total other expenses	13,150	12,557	26,492	25,623
Income before income taxes	7,311	7,784	14,998	16,067
Income taxes	1,962	2,248	4,003	4,600
Net income	\$ 5,349	\$ 5,536	\$ 10,995	\$ 11,467

Earnings per share:

Basic	\$ 0.51	\$ 0.52	\$ 1.04	\$ 1.09
Diluted	\$ 0.51	\$ 0.52	\$ 1.04	\$ 1.07

Weighted-average number of shares outstanding:

Basic	10,503,952	10,591,926	10,544,199	10,561,355
Diluted	10,574,250	10,714,030	10,619,815	10,689,465

Cash dividends declared	\$ 2,322	\$ 2,239	\$ 4,650	\$ 4,359
Cash dividends declared per share	\$ 0.22	\$ 0.21	\$ 0.44	\$ 0.41

See Notes to the Consolidated Unaudited Financial Statements

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PEOPLES BANCORP INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY (Unaudited)

<i>(Dollars in thousands, except per share data)</i>	Common Stock		Retained Earnings	Accumulated Comprehensive Loss	Treasury Stock	Total
	Shares	Amount				
Balance, December 31, 2006	10,889,242	\$ 162,654	\$ 43,439	\$ (2,997)	\$ (5,927)	\$ 197,169
Net income			10,995			10,995
Other comprehensive loss, net of tax				(1,666)		(1,666)
Cash dividends declared of \$0.44 per share			(4,650)			(4,650)
Stock-based compensation expense		239				239
Purchase of treasury stock, 243,842 shares					(6,861)	(6,861)
Exercise of common stock options (reissued 38,062 treasury shares)		(395)			1,045	650
Tax benefit from exercise of stock options		165				165
Issuance of common stock under dividend reinvestment plan	13,874	386				386
Issuance of common stock related to the acquisition of the Putnam Agency (reissued 4,662 treasury shares)		(5)			129	124
Balance, June 30, 2007	\$ 10,903,116	\$ 163,044	\$ 49,784	\$ (4,663)	\$ (11,614)	\$ 196,551

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)

<i>(Dollars in thousands)</i>	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2007	2006	2007	2006
Net income	\$ 5,349	\$ 5,536	\$ 10,995	\$ 11,467
Other comprehensive loss:				
Unrealized loss on available-for-sale securities arising in the period	(5,214)	(4,316)	(2,606)	(8,694)
Less: reclassification adjustment for net securities gains included in net income	21	4	38	4
Net unrecognized loss and service cost on pension plan	41	—	81	—
Total other comprehensive loss	(5,194)	(4,320)	(2,563)	(8,698)
Income tax benefit	1,818	1,512	897	3,044
Total other comprehensive loss, net of tax	(3,376)	(2,808)	(1,666)	(5,654)
Total comprehensive income	\$ 1,973	\$ 2,728	\$ 9,329	\$ 5,813

See Notes to the Consolidated Unaudited Financial Statements

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PEOPLES BANCORP INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

	For the Six Months Ended June 30,	
<i>(Dollars in thousands)</i>	2007	2006
Net cash provided by operating activities	\$ 11,722	\$ 15,508
Cash flows from investing activities:		
Purchases of available-for-sale securities	(76,912)	(20,289)
Proceeds from maturities, calls and prepayments of available-for-sale securities	68,951	31,921
Net decrease (increase) in loans	22,762	(42,363)
Expenditures for premises and equipment	(987)	(850)
Net proceeds from sales of other real estate owned	59	515
Business acquisitions, net of cash received	(637)	(1,059)
Investment in limited partnership and tax credit funds	(277)	(899)
Net cash provided by (used in) investing activities	12,959	(33,024)
Cash flows from financing activities:		
Net increase in non-interest-bearing deposits	2,754	7,174
Net (decrease) increase in interest-bearing deposits	(33,285)	55,656
Net increase in short-term borrowings	40,122	54,872
Proceeds from long-term borrowings	45,000	-
Payments on long-term borrowings	(64,033)	(99,494)
Cash dividends paid	(4,212)	(3,961)
Purchase of treasury stock	(6,861)	(452)
Repurchase of trust preferred securities	-	(25)
Repayment of trust preferred securities	(7,000)	-
Proceeds from issuance of common stock	665	1,678
Excess tax benefit for share-based payments	167	-
Net cash (used in) provided by financing activities	(26,683)	15,448
Net decrease in cash and cash equivalents	(2,002)	(2,068)
Cash and cash equivalents at beginning of period	39,806	39,648
Cash and cash equivalents at end of period	\$ 37,804	\$ 37,580

See Notes to the Consolidated Unaudited Financial Statements

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NOTES TO THE CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS

1. Basis of Presentation

The accounting and reporting policies of Peoples Bancorp Inc. (“Peoples Bancorp”) and its subsidiaries (collectively, “Peoples”) conform to accounting principles generally accepted in the United States (“US GAAP”) and to general practices within the financial services industry. Peoples considers all of its principal activities to be financial services related. The accompanying unaudited consolidated financial statements of Peoples reflect all adjustments (which include normal recurring adjustments) necessary to present fairly such information for the periods and dates indicated. The preparation of the financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. To conform to the 2007 presentation, brokerage income was reclassified to trust and investment income from insurance and investment commissions, which had no impact on net income, comprehensive income, net cash provided by operating activities or stockholders’ equity. Results of operations for the six months ended June 30, 2007, are not necessarily indicative of the results that may be expected for the year ending December 31, 2007.

Certain information and footnotes typically included in the annual financial statements prepared in conformity with US GAAP have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. The balance sheet at December 31, 2006 contained herein has been derived from the audited balance sheet included in Peoples Bancorp’s Annual Report on Form 10-K for the fiscal year ended December 31, 2006 (“2006 Form 10-K”). These unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the 2006 Form 10-K.

The consolidated financial statements include the accounts of Peoples Bancorp and its consolidated subsidiaries, Peoples Bank, National Association (“Peoples Bank”) and Peoples Investment Company, along with their respective wholly-owned subsidiaries. Peoples Bancorp previously formed two statutory business trusts that are variable interest entities for which Peoples Bancorp is not the primary beneficiary. As a result, the accounts of these trusts are not included in Peoples’ consolidated financial statements. All significant intercompany accounts and transactions have been eliminated.

2. New Accounting Pronouncements:

On February 15, 2007, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities—Including an amendment of FASB Statement No. 115,” (“SFAS 159”), which permits companies to choose to measure many financial instruments and certain other items at fair value. The objective of SFAS 159 is to improve financial reporting by providing companies with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS 159 is effective for fiscal years beginning after November 15, 2007, but permitted companies an option for earlier adoption. Peoples will adopt SFAS 159 effective January 1, 2008, as required, although management has not yet completed its evaluation of SFAS 159 to determine the impact adoption may have on Peoples’ financial statements taken as a whole.

On September 15, 2006, the FASB issued Statement of Financial Accounting Standards No. 157, “Fair Value Measurements” (“SFAS 157”), which replaces various definitions of fair value in existing accounting literature with a single definition, establishes a framework for measuring fair value and requires additional disclosures about fair value measurements upon adoption. SFAS 157 clarifies that fair value is the price that would be received to sell an asset or the price paid to transfer a liability in the most advantageous market available to the entity and emphasizes that fair value is a market-based measurement and should be based on the assumptions market participants would use. SFAS 157 also creates a three-level hierarchy under which individual fair value estimates are to be ranked based on the relative reliability of the inputs used in the valuation. This hierarchy is the basis for the disclosure requirements, with

fair value estimates based on the least reliable inputs requiring more extensive disclosures about the valuation method used and the gains and losses associated with those estimates. SFAS 157 is required to be applied whenever another financial accounting standard requires or permits an asset or liability to be measured at fair value. The statement does not expand the use of fair value to any new circumstances. Peoples will be required to apply the new guidance beginning January 1, 2008. Management has not completed its analysis to determine what impact adoption will have a material impact on Peoples' financial statements.

On July 13, 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes –an interpretation of FASB Statement No. 109" ("FIN 48"), which prescribes a comprehensive model for how companies should recognize, measure, present and disclose in their financial statements uncertain tax positions taken or expected to be taken on a tax return. Under FIN 48, a tax position is initially recognized in the financial statements when it is more

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likely than not the position will be sustained upon examination by the tax authorities. Such tax positions are initially and subsequently measured as the largest amount of tax benefit that is greater than 50% likely of being realized upon ultimate settlement with the tax authority assuming full knowledge of the position and all relevant facts. FIN 48 permits companies the option to classify penalties and interest incurred under the applicable tax law as either income tax expense or a component of other expenses. Effective January 1, 2007, Peoples adopted the provisions of FIN 48, as required. In connection with the adoption, Peoples elected to continue its existing accounting policy of classifying penalties and interest as income tax expense.

The adoption of FIN 48 had no material impact on Peoples' financial statements taken as a whole and no cumulative effect adjustments relating to the adoption were required. The amount of Peoples' uncertain income tax positions, unrecognized benefits and accrued interest were immaterial at both June 30, 2007 and January 1, 2007. Peoples is currently open to audit under the applicable statutes of limitations by the Internal Revenue Service for the years ended December 31, 2004 through 2006. Peoples' state income tax returns are currently open to audit under the applicable statutes of limitations for the years ended December 31, 2004 through 2006.

3. Stock-Based Compensation:

Under the Peoples Bancorp Inc. 2006 Equity Plan (the "2006 Equity Plan") approved by shareholders, Peoples Bancorp may grant, among other awards, nonqualified stock options, incentive stock options, restricted stock awards, stock appreciation rights or any combination thereof to certain employees and non-employee directors of Peoples Bancorp and its subsidiaries covering up to 500,000 common shares. Common shares issued in connection with stock-based awards are issued from treasury shares to the extent available. If no treasury shares are available, common shares are issued from authorized but unissued common shares.

The Compensation Committee of Peoples Bancorp's Board of Directors has the authority to select the employees and non-employee directors of Peoples Bancorp's subsidiaries to be granted awards, establish the awards to be granted, and approve the terms and conditions of each award contract. The full Board of Directors of Peoples Bancorp has sole authority to select thenon-employee directors of Peoples Bancorp to be granted awards, establish the awards to be granted, and approve the terms and conditions of each award contract. Through December 31, 2006, nonqualified and incentive stock options were the only stock-based awards made to employees and directors by Peoples Bancorp. Beginning in February 2007, Peoples Bancorp has granted a combination of restricted common shares and stock appreciation rights ("SARs") to certain employees and restricted common shares to non-employee directors subject to the terms and conditions prescribed by the 2006 Equity Plan.

Stock Options

Under the provisions of the 2006 Equity Plan and predecessor stock option plans, the price per share of any stock option granted may not be less than the fair market value of the underlying common shares on the date of grant of the stock option. Recent stock options granted to employees vest three years from the grant date. Stock options granted to non-employee directors of Peoples Bancorp and Peoples Bank in recent periods vest six months from the grant date. All stock options granted to both employees and non-employee directors expire ten years from the date of grant.

The following summarizes the changes to Peoples' stock options for the six months ended June 30, 2007:

	Weighted- Average Remaining	Aggregate
Number of	Weighted-Average	Contractual
Shares	Exercise Price	Life
		Intrinsic
		Value
397,766	\$ 21.88	

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Outstanding at January 1					
Granted		–		–	
Exercised	38,407		17.17		
Forfeited	3,163		17.03		
Outstanding at June 30	356,196	\$	22.43	5.1 years	\$2,038,000
Exercisable at June 30	310,690	\$	21.55	4.6 years	\$2,038,000

For the six months ended June 30, 2007, total intrinsic value of stock options exercised was \$395,000. At June 30, 2007, unrecognized stock-based compensation expense related to unvested stock options totaled \$101,000.

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The following summarizes information concerning Peoples' stock options outstanding at June 30, 2007:

Options Outstanding				Options Exercisable	
Range of Exercise Prices	Number of Shares	Weighted-Average		Number of Shares	Weighted-Average Exercise Price
		Contractual Life	Exercise Price		
\$13.48 to \$18.21	90,055	2.4 years	\$ 14.41	90,055	\$ 14.41
\$18.70 to \$22.32	86,132	4.0 years	21.26	86,132	21.26
\$22.33 to \$27.51	93,244	6.1 years	25.50	93,244	25.50
\$27.51 to \$30.00	86,765	8.1 years	28.61	41,259	28.80
	356,196	5.1 years	\$ 22.43	310,690	\$ 21.55

Stock Appreciation Rights

SARs granted to employees have an exercise price equal to the fair market value of Peoples Bancorp's common shares on the date of grant and will be settled using common shares of Peoples Bancorp. Additionally, the SARs granted will vest three years from the grant date and expire ten years from the date of grant. The following summarizes the changes to Peoples' SARs for the six months ended June 30, 2007:

	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Contractual Life
Outstanding at January 1	–	\$ –	
Granted	22,047	29.25	
Exercised	–	–	
Forfeited	673	29.25	
Outstanding at June 30	21,374	\$ 29.25	9.6 years

The weighted-average estimated fair value of the SARs granted was \$8.13. At June 30, 2007, unrecognized stock-based compensation expense related to unvested SARs totaled \$82,000.

The estimated fair value of SARs granted was calculated at grant date using the Black-Scholes option pricing model with the following weighted-average assumptions:

Risk-free interest rate	4.89%
Dividend yield	2.85%
Volatility factor of the market price of parent stock	25.3%

Weighted-average	10
expected life	years

The Black-Scholes option valuation model was originally developed for use in estimating the fair value of traded options, which have different characteristics than stock-based awards granted by Peoples, such as no vesting or transfer restrictions. The model requires the input of highly subjective assumptions, including the expected stock price volatility, which can materially affect the fair value estimate. The expected volatility and expected life assumptions were based solely on historical data. The expected dividend yield is computed based on the current dividend rate and the risk-free interest rate is based on U.S. Treasury zero-coupon issues with a remaining term approximating the expected life of the awards.

Restricted Shares

Under the 2006 Equity Plan, Peoples Bancorp may award restricted common shares to officers, key employees and non-employee directors. In general, the restrictions on common shares awarded to non-employee directors expire after six months, while those awarded to key employees and officers expire after three years. Peoples recognizes compensation expense over the restricted period.

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The following summarizes the changes to Peoples' restricted common shares for the six months ended June 30, 2007:

	Number of Shares	Weighted-Average Grant Date Fair Value
Outstanding at January 1	–	\$ –
Awarded	12,443	28.84
Released	–	–
Forfeited	192	29.25
Outstanding at June 30	12,251	\$ 28.84

Unrecognized stock-based compensation expense related to restricted common shares totaled \$150,000 at June 30, 2007.

4. Employee Benefit Plans:

Peoples Bancorp sponsors a noncontributory defined benefit pension plan that covers substantially all employees hired before January 1, 2003, and a noncontributory defined contribution plan that covers substantially all employees hired on or after January 1, 2003. Peoples Bancorp also sponsors a contributory postretirement benefit plan for former employees who were retired as of December 31, 1992.

The following table details the components of the net periodic benefit cost for the plans:

Pension Benefits

<i>(Dollars in thousands)</i>	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Service cost	\$ 211	\$ 217	\$ 423	\$ 434
Interest cost	190	190	379	378
Expected return on plan assets	(386)	(291)	(596)	(582)
Amortization of prior service cost	–	–	1	1
Amortization of net loss	40	64	80	128
Net periodic benefit cost	\$ 55	\$ 180	\$ 287	\$ 359

Postretirement Benefits

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006

(Dollars in thousands)

Interest cost	\$	6	\$	7	\$	13	\$	13
Amortization of net loss		1		–		2		–
Net periodic benefit cost	\$	7	\$	7	\$	15	\$	13

5. Junior Subordinated Notes Held by Subsidiary Trusts:

Peoples Bancorp previously formed two statutory business trusts (the “Trusts”) for the purpose of issuing or participating in pools of corporation-obligated mandatorily redeemable capital securities (the “Capital Securities” or “Trust Preferred Securities”), with 100% of the common equity in the Trusts owned by Peoples Bancorp. The proceeds from the Capital Securities and common equity were invested in junior subordinated debt securities of Peoples Bancorp (the “Debentures”).

The Debentures held by the trusts are the sole assets of those trusts. Distributions on the Capital Securities are payable semiannually at a rate per annum equal to the interest rate being earned by the Trusts on the Debentures and are recorded as interest expense by Peoples. Since the Trusts are variable interest entities and Peoples Bancorp is not deemed to be the primary beneficiary, the Trusts are not included in Peoples’ consolidated financial statements. As a result, Peoples includes the Debentures as a separate category of long-term debt on the Consolidated Balance Sheets

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entitled “Junior Subordinated Notes Held by Subsidiary Trusts” and the related expense as interest expense on the Consolidated Statements of Income.

Under the provisions of the Debentures, Peoples Bancorp has the right to defer payment of interest on the Debentures at any time, or from time to time, for periods not exceeding five years. If interest payments on the Debentures are deferred, the dividends on the Capital Securities are also deferred. Interest on the Debentures is cumulative. Peoples Bancorp has entered into agreements which, taken collectively, fully and unconditionally guarantee the Capital Securities subject to the terms of each of the guarantees.

The Capital Securities are subject to mandatory redemption, in whole or in part, upon repayment of the Debentures. The Debentures held by PEBO Capital Trust I are first redeemable, in whole or in part, by Peoples Bancorp on May 1, 2009. On April 23, 2007, Peoples Bancorp repaid the entire \$7.2 million of the Debentures held by PEBO Capital Trust II, which had a then current rate of 9.10%. As a result of this repayment, PEBO Capital Trust II redeemed all of the outstanding Capital Securities and common equity and was dissolved in accordance with the terms of the Amended and Restated Declaration of Trust of PEBO Capital Trust II.

Under the risk-based capital standards for bank holding companies adopted by the Board of Governors of the Federal Reserve System, the Trust Preferred Securities qualify as Tier 1 capital for regulatory capital purposes, subject to certain quantitative limits and qualitative standards. Specifically, the aggregate amount of trust preferred securities and certain other capital elements that qualify as Tier 1 capital is limited to 25% of core capital elements, net of goodwill, with the excess amount not qualifying for Tier 1 capital being included in Tier 2 capital. Additionally, trust preferred securities no longer qualify for Tier 1 capital within five years of their maturity. The redemption of the Capital Securities issued by PEBO Capital Trust II had a minimal impact on Peoples’ regulatory capital ratios.

The Capital Securities issued by the Trusts are summarized as follows:

<i>(Dollars in thousands)</i>	June 30, 2007	December 31, 2006
Capital securities of PEBO Capital Trust I, 8.62%, due May 1, 2029, net of unamortized issuance costs	\$ 22,443	\$ 22,425
Capital securities of PEBO Capital Trust II, 6-month LIBOR + 3.70%, due April 22, 2032, net of unamortized issuance costs	–	6,987
Total capital securities	\$ 22,443	\$ 29,412
Total capital securities qualifying for Tier 1 capital	\$ 22,443	\$ 29,412

6. Comprehensive Loss

The following details the balances in accumulated other comprehensive loss for the periods indicated:

<i>(Dollars in thousands)</i>	At June 30, 2007		
	Gross Amount	Tax Benefit	Net of Tax Amount
	(4,152)	(1,454)	(2,698)

Unrealized net losses on available-for-sale securities			
Unrecognized net pension and postretirement costs	(3,023)	(1,058)	(1,965)
Total accumulated comprehensive loss	(7,175)	(2,512)	(4,663)

At December 31, 2006			
	Gross Amount	Tax Benefit	Net of Tax Amount
Unrealized net losses on available-for-sale securities	(1,506)	(527)	(979)
Unrecognized net pension and postretirement costs	(3,105)	(1,087)	(2,018)
Total accumulated comprehensive loss	(4,611)	(1,614)	(2,997)

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7. Contingent Liabilities

In the normal course of business, Peoples Bancorp and its subsidiaries are routinely subject to examinations and challenges from federal and state tax authorities regarding positions taken in their tax returns. Any challenge or examination by a tax authority may result in adjustments to the timing or amount of taxable net worth or taxable income or deductions or the allocation of income among tax jurisdictions. Such adjustments, if not resolved in Peoples' favor, could have a material adverse effect on Peoples' financial condition and results of operation.

Peoples Bank has been undergoing an examination by the Ohio Department of Taxation (the "Department") of its 2002 Ohio Corporation Franchise Tax Report related to the fiscal year ended December 31, 2001 (the "2002 Tax Year"). As a result of this examination, the Department issued a Notice of Assessment in the amount of approximately \$1.4 million in regard to Peoples Bank's corporate franchise tax liability for the 2002 Tax Year. The Department has also proposed adjustments to Peoples Bank's 2003 Ohio Corporation Franchise Tax Report (the "2003 Ohio Report") related to the fiscal year ended December 31, 2002 (the "2003 Tax Year") on the basis of the 2002 Tax Year assessment that would materially increase the amount of corporate franchise tax due. Management disagrees with the assessment and the proposed adjustments in their entirety and has filed a Petition for Reassessment with the Department objecting to the assessment.

On June 25, 2007, the Department commenced an examination of Peoples Bank's Ohio Corporation Franchise Tax Reports related to the fiscal years ended December 31, 2002 through 2005, and an examination of other related companies for the same periods. The Department has not proposed any adjustments with respect to these examinations, although the administrative process is ongoing.

While management believes it has taken appropriate positions on the tax returns under examination and does not expect the examinations will have a material impact on Peoples' future financial statements, Peoples is unable to assess whether an unfavorable outcome is probable, nor to estimate the amount of liability, if any, that might result from an unfavorable outcome. However, no assurance can be given that Peoples' corporate franchise tax liability for any tax year under examination will not be different than what is reflected in Peoples' current and historical consolidated financial statements since the outcome of the examinations by the Department and ultimate resolution of the assessment with regard to the 2002 Tax Year are inherently difficult to predict. To the extent additional taxes may be due, Peoples recognizes liabilities for such tax exposures when management judges the losses associated with the claims to be probable and the amount of loss can be reasonably estimated.

Table of Contents**ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATION AND FINANCIAL CONDITION****SELECTED FINANCIAL DATA**

The following data should be read in conjunction with the unaudited consolidated financial statements and management's discussion and analysis that follows:

SIGNIFICANT RATIOS	At or For the Three Months Ended June 30,		At or For the Six Months Ended June 30,	
	2007	2006	2007	2006
Return on average equity	10.81%	11.88%	11.19%	12.45%
Return on average assets	1.16%	1.18%	1.19%	1.24%
Net interest margin (a)	3.31%	3.29%	3.32%	3.34%
Efficiency ratio (b)	58.68%	56.25%	58.57%	56.47%
Average stockholders' equity to average assets	10.69%	9.96%	10.62%	9.98%
Average loans to average deposits	93.35%	96.90%	93.52%	96.32%
Cash dividends to net income	43.41%	40.44%	42.29%	38.01%
Nonperforming loans as a percent of total loans (c)	0.67%	0.93%	0.67%	0.93%
Nonperforming assets as a percent of total assets (d)	0.41%	0.56%	0.41%	0.56%
Allowance for loan losses to loans net of unearned interest	1.33%	1.38%	1.33%	1.38%
Allowance for loan losses to nonperforming loans (c)	198.32%	148.04%	198.32%	148.04%
Provision for loan losses to average loans	0.07%	0.05%	0.13%	0.08%
Net charge-offs as a percentage of average loans (annualized)	0.24%	- 0.03%	0.23%	0.04%
CAPITAL RATIOS (end of period)				
Tier I capital ratio	11.74%	11.95%	11.74%	11.95%
Total risk-based capital ratio	12.97%	13.26%	12.97%	13.26%
Leverage ratio	8.67%	8.46%	8.67%	8.46%
PER SHARE DATA				
Earnings per share – basic	\$ 0.51	\$ 0.52	\$ 1.04	\$ 1.09
Earnings per share – diluted	0.51	0.52	1.04	1.07
Cash dividends declared per share	0.22	0.21	0.44	0.41
Book value per share (end of period)	18.78	17.60	18.78	17.60
Tangible book value per share (end of period) (e)	\$ 12.19	\$ 11.03	\$ 12.19	\$ 11.03
	10,503,952	10,591,926	10,544,199	10,561,355

Weighted average shares outstanding –

Basic

Weighted average shares outstanding –	10,574,250	10,714,030	10,619,815	10,689,465
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Diluted

Common shares outstanding at end of period	10,464,741	10,600,413	10,464,741	10,600,413
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- (a) Fully-tax equivalent net interest income as a percentage of average earning assets.
- (b) Non-interest expense (less intangible amortization) as a percentage of fully-tax equivalent net interest income plus non-interest income.
- (c) Nonperforming loans include loans 90 days past due and accruing, renegotiated loans and nonaccrual loans.
- (d) Nonperforming assets include nonperforming loans and other real estate owned.
- (e) Tangible book value per share reflects capital calculated for banking regulatory requirements and excludes balance sheet impact of intangible assets acquired through acquisitions.

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Forward-Looking Statements

Certain statements in this Form 10-Q which are not historical fact are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, Section 21E of the Securities Exchange Act of 1934, as amended, and the Private Securities Litigation Reform Act of 1995. Words such as “feels”, “expects,” “believes”, “plans”, “will”, “would”, “should”, “could” and similar expressions are intended to identify these forward-looking statements but are not the exclusive means of identifying such statements. Forward-looking statements are subject to risks and uncertain-ties that may cause actual results to differ materially. Factors that might cause such a difference include, but are not limited to:

- (1) competitive pressures among financial institutions or from non-financial institutions, which may increase significantly;
 - (2) changes in the interest rate environment, which may adversely impact interest margins;
- (3) prepayment speeds, loan originations and sale volumes, charge-offs and loan loss provisions, which may be less favorable than expected;
- (4) general economic conditions, either national or in the states in which Peoples Bancorp and its subsidiaries do business, which may be less favorable than expected;
- (5) political developments, wars or other hostilities, which may disrupt or increase volatility in securities markets or other economic conditions;
- (6) legislative or regulatory changes or actions, which may adversely affect the business of Peoples Bancorp and its subsidiaries;
 - (7) changes in the conditions and trends in the securities markets;
 - (8) a delayed or incomplete resolution of regulatory issues that could arise;
- (9) the impact of reputation risk created by the developments discussed above on such matters as business generation and retention, funding and liquidity;
- (10) the costs and effects of regulatory and legal developments, including the outcome of regulatory or other governmental inquiries and legal proceedings and results of regulatory examinations; and
- (11) other risk factors relating to the banking industry or Peoples as detailed from time to time in Peoples Bancorp’s reports filed with the Securities and Exchange Commission (“SEC”), including those risk factors included in the disclosure under the heading “ITEM 1A. RISK FACTORS” of Part I of Peoples Bancorp’s 2006 Form 10-K and in the disclosure in “ITEM 1A: RISK FACTORS” of Part II of this Quarterly Report on Form 10-Q.

All forward-looking statements speak only as of the execution date of this Form 10-Q and are expressly qualified in their entirety by the cautionary statements. Although management believes the expectations in these forward-looking statements are based on reasonable assumptions within the bounds of management’s knowledge of Peoples’ business and operations, it is possible that actual results may differ materially from these projections. Additionally, Peoples undertakes no obligation to update these forward-looking statements to reflect events or circumstances after the date of this Form 10-Q or to reflect the occurrence of unanticipated events except as may be required by applicable legal requirements. Copies of documents filed with the SEC are available free of charge at the SEC’s website at <http://www.sec.gov> and/or from Peoples Bancorp’s website.

Business Overview

The following discussion and analysis of the unaudited consolidated financial statements of Peoples is presented to provide insight into management’s assessment of the financial condition and results of operations. Peoples Bancorp’s subsidiaries are Peoples Bank, National Association (“Peoples Bank”), Peoples Investment Company and PEBO Capital Trust I. Peoples Bank also owns Peoples Insurance Agency, Inc. (“Peoples Insurance”), PBNA L.L.C. and Peoples Loan Services, Inc. Peoples Investment Company also owns Peoples Capital Corporation.

Peoples offers diversified financial products and services through 50 financial service locations and 37 ATMs in southeastern Ohio, northwestern West Virginia and northeastern Kentucky through its financial service units – Peoples

Bank, Peoples Financial Advisors (a division of Peoples Bank) and Peoples Insurance. Peoples Bank is a member of the Federal Reserve System and subject to regulation, supervision and examination by the Office of the Comptroller of the Currency. Peoples Bank makes available an array of financial products and services to customers that include traditional banking products such as deposit accounts, lending products, credit and debit cards, corporate and personal trust services, and safe deposit rental facilities. Peoples Bank provides services through traditional walk-in offices and automobile drive-in facilities, automated teller machines, banking by phone, and its internet-banking service, Peoples OnLine Connection, at www.peoplesbancorp.com (this uniform resource locator (URL) is an inactive, textual reference only).

Peoples Bank also makes available other financial services through Peoples Financial Advisors, which provides customer-tailored services for fiduciary needs, investment alternatives, financial planning, retirement plans and other asset management needs. Brokerage services are offered exclusively through an unaffiliated registered broker-dealer located at Peoples Bank's offices. Peoples Insurance is a full-service insurance agency offering a complete array of life, health, property and casualty insurance products.

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Peoples Investment Company and its subsidiary, Peoples Capital Corporation, were formed to optimize Peoples' consolidated capital position and improve profitability by providing new investment opportunities that are either limited or restricted at the bank level. These investments include, but are not limited to, low-income housing tax credit funds or projects, venture capital, and other higher risk investments. Presently, the operations of both companies do not represent a significant part of Peoples' overall business activities.

This discussion and analysis should be read in conjunction with the audited consolidated financial statements, and notes thereto, contained in Peoples Bancorp's 2006 Form 10-K, as well as the consolidated financial statements, ratios, statistics and discussions contained elsewhere in this Form 10-Q.

Critical Accounting Policies

The accounting and reporting policies of Peoples conform to US GAAP and to general practices within the financial services industry. The preparation of the financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could materially differ from those estimates. Management has identified the accounting policies that, due to the judgments, estimates and assumptions inherent in those policies, are critical to an understanding of Peoples' consolidated financial statements and management's discussion and analysis at June 30, 2007, which were unchanged from the policies disclosed in Peoples Bancorp's 2006 Form 10-K.

Summary of Recent Transactions and Events

The following is a summary of recent transactions that have impacted or are expected to impact Peoples' results of operations or financial condition:

- o On January 12, 2007, Peoples Bancorp announced the authorization to repurchase up to 425,000, or approximately 4%, of Peoples Bancorp's then outstanding common shares in 2007 in open market transactions (the "2007 Stock Repurchase Program"). Any repurchased common shares will be held as treasury shares and are anticipated to be used for future exercises of equity awards granted from Peoples Bancorp's equity plans, future issuances of common shares in connection with Peoples Bancorp's deferred compensation plans, and other general corporate purposes. Through July 31, 2007, Peoples Bancorp had repurchased 295,500 common shares (or 70% of the total authorized), at an average price of \$27.32, under the 2007 Stock Repurchase Program. The 2007 Stock Repurchase Program expires on December 31, 2007.
- o On April 5, 2007, Peoples announced plans to construct a new financial services office in Huntington, West Virginia. The new office will include drive-through banking facilities and an ATM and is expected to be completed during the fourth quarter of 2007.
- o On April 23, 2007, Peoples Bancorp repaid the entire \$7.2 million of variable rate junior subordinated notes issued to and held by its subsidiary, PEBO Capital Trust II, which had a then current rate of 9.10%. As a result of this repayment, PEBO Capital Trust II was required to redeem all of its outstanding capital securities and common shares. Management expects this redemption will have minimal impact on Peoples' regulatory capital ratios and produce a modest improvement in future net interest income and margin, as the junior subordinated notes will be replaced by lower cost borrowings. PEBO Capital Trust II was dissolved in accordance with the terms of the Amended and Restated Declaration of Trust as a result of the redemption of all of the outstanding common securities and all of the capital securities.
- o On June 4, 2007, Peoples announced plans to open a full-service banking location in Zanesville, Ohio. Management originally anticipated the office to be opened during the third quarter; however, it is now

probable that the entry into the Zanesville market will be delayed as management strategically explores all possibilities to entering that market, including office location, personnel, products and services to be offered, the approach to customers and any other element of this expansion.

The impact of these transactions, where material, is discussed in the applicable sections of this management's discussion and analysis.

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As previously disclosed in “ITEM 1A. RISK FACTORS” and Note 18 of the Notes to the Consolidated Financial Statements included in Item 8 of Peoples Bancorp’s 2006 Form 10-K, Peoples Bank has been undergoing an examination by the Ohio Department of Taxation (the “Department”) of its 2002 Ohio Corporation Franchise Tax Report related to the fiscal year ended December 31, 2001 (the “2002 Tax Year”). On June 25, 2007, the Department commenced an examination of Peoples Bank’s Ohio Corporation Franchise Tax Reports related to fiscal years ended December 31, 2002 through 2005, and an examination of other related companies for the same periods. Additional information regarding the examinations by the Department can be found in “ITEM 1: LEGAL PROCEEDINGS” of Part II of this Quarterly Report on Form 10-Q.

Executive Summary

For the three months ended June 30, 2006, net income totaled \$5.3 million, or \$0.51 per diluted share, compared to \$5.5 million and \$0.52 per diluted share earned in the second quarter of 2006. On a year-to-date basis, net income totaled \$11.0 million and diluted earnings per share were \$1.04, versus \$11.5 million and \$1.07, respectively, a year ago. Peoples’ lower earnings for both the second quarter and first half of 2007 were the result of higher non-interest expense, primarily salaries and benefit costs, coupled with flat net interest income due mostly to the challenging interest rate environment. Compared to the first quarter of 2007, net income declined as a result of the non-recurrence of seasonal insurance income earned annually during the first quarter.

Second quarter 2007 return on equity (“ROE”) was 10.81% versus 11.88% a year ago, while return on assets (“ROA”) was 1.16% and 1.18%, respectively. For the six months ended June 30, 2007, ROE was 11.19% and ROA was 1.19%, compared to 12.45% and 1.24%, respectively, for the first half of 2006.

For the three months ended June 30, 2007, net interest income was \$13.3 million, unchanged from a year ago and down slightly compared to the first quarter of 2007. Net interest margin was 3.31% for the second quarter of 2007 versus 3.32% last quarter and 3.29% for 2006’s second quarter. On a year-to-date basis compared to the first half of 2006, net interest income was flat, and net interest margin compressed two basis points to 3.32%. Peoples’ ability to grow both net interest income and margin in the first half of 2007 has been challenged by the interest rate environment, plus sizable commercial loan payoffs and prepayments of investment securities that lowered average earning assets and interest income, although stable funding costs in the second quarter tempered the overall decline. Net interest income for the three and six months ended June 30, 2007, also include an adjustment to write off \$211,000 of interest receivable related to certain investment securities.

Other income totaled \$8.0 million in the second quarter of 2007, up 5% from a year ago, while on a year-to-date basis, other income was \$16.1 million versus \$15.7 million. These increases were due mostly to a combination of higher trust and investment income and electronic banking revenues. Also contributing to the second quarter growth was higher insurance sales commission income. Total other expense was \$13.2 million and \$26.5 million for the three and six months ended June 30, 2007, versus \$12.6 million and \$25.6 million for the same periods a year ago. These increases were due mostly to higher salary and benefit costs and additional occupancy and equipment expenses, offset by lower intangible amortization expense, marketing costs and professional fees.

Total assets were \$1.86 billion at June 30, 2007, down \$18.6 million since year-end 2006 as a result of the decline in loan balances. At June 30, 2007, gross portfolio loan balances were \$1.11 billion compared to \$1.13 billion, a \$24.0 million decrease due to the anticipated commercial loan payoffs that exceeded new originations. Investment securities totaled \$553.9 million at quarter-end versus \$548.7 million at year-end 2006.

At June 30, 2007, total liabilities were \$1.66 billion compared to \$1.68 billion at December 31, 2006. Total deposit balances decreased \$30.4 million during the first half of 2007, the result of Peoples’ reducing brokered deposits by \$62.5 million due to retail deposit growth and utilization of other, lower cost wholesale funds. Retail deposits, which

exclude brokered deposits, grew \$32.1 million, or 3%, from a \$29.3 million increase in interest-bearing retail deposits and additional non-interest-bearing balances of \$2.8 million.

Total stockholders' equity was \$196.6 million at June 30, 2007, down from \$197.2 million at December 31, 2006, due to treasury stock purchases totaling \$6.9 million that were largely offset by the \$6.3 million increase in Peoples' retained earnings.

Table of Contents**RESULTS OF OPERATIONS****Interest Income and Expense**

Peoples earns interest income from loans, investment securities and short-term investments and incurs interest expense on interest-bearing deposits and borrowed funds. Net interest income, the amount by which interest income exceeds interest expense, remains Peoples' largest source of revenue. For the three and six months ended June 30, 2007, net interest income totaled \$13.3 million and \$26.9 million, respectively, and was equal to the prior year.

Peoples derives a portion of its interest income from loans to and investment securities issued by states and political subdivisions. Since these revenues generally are not subject to income taxes, management believes it is more meaningful to analyze net interest income on a fully-tax equivalent ("FTE") basis, which adjusts interest income by converting tax-exempt income to the pre-tax equivalent of taxable income using a 35% tax rate. The following table details the calculation of FTE net interest income:

<i>(Dollars in thousands)</i>	Three Months Ended			Six Months Ended	
	June 30, 2007	March 31, 2007	June 30, 2006	June 30, 2007	2006
Net interest income, as reported	\$ 13,333	\$ 13,521	\$ 13,305	\$ 26,854	\$ 26,808
Taxable equivalent adjustments	324	334	426	659	855
Fully-tax equivalent net interest income	\$ 13,657	\$ 13,855	\$ 13,731	\$ 27,513	\$ 27,663

Net interest margin, calculated by dividing FTE net interest income by average interest-earning assets, serves as an important measurement of the net revenue stream generated by the volume, mix and pricing of Peoples' earning assets and interest-bearing liabilities. The following tables detail Peoples' average balance sheet and analysis of net interest income for the periods presented:

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<i>(Dollars in thousands)</i>	For the Three Months Ended June 30,					
	2007			2006		
	Average Balance	Income/ Expense	Yield/ Rate	Average Balance	Income/ Expense	Yield/ Rate
ASSETS						
Short-term investments:						
Interest-bearing deposits with banks	\$ 2,462	\$ 30	4.85%	\$ 2,553	\$ 23	3.61%
Federal funds sold	1,043	14	5.27%	1,194	15	5.01%
Total short-term investments	3,505	44	4.98%	3,747	38	4.06%
Securities (1):						
Taxable	487,381	5,984	4.91%	514,108	6,267	4.88%
Tax-exempt (2)	53,233	836	6.28%	67,816	1,114	6.57%
Total securities	540,614	6,820	5.05%	581,924	7,381	5.07%
Loans (3):						
Commercial (2)	760,062	14,686	7.75%	722,684	13,209	7.33%
Real estate (4)	293,204	5,247	7.16%	313,307	5,381	6.87%
Consumer	77,289	1,607	8.34%	68,848	1,422	8.28%
Total loans	1,130,555	21,540	7.64%	1,104,839	20,012	7.26%
Less: Allowance for loan loss	(14,656)			(15,008)		
Net loans	1,115,899	21,540	7.74%	1,089,831	20,012	7.36%
Total earning assets	1,660,018	28,404	6.86%	1,675,502	27,431	6.56%
Intangible assets						