COMMERCE BANCSHARES INC /MO/
Form 10-Q
August 07, 2007

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

þ **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

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from to
Commission File No. 0-2989

COMMERCE BANCSHARES, INC.

(Exact name of registrant as specified in its charter)

Missouri (State of Incorporation)	**43-0889454** (IRS Employer Identification No.)
1000 Walnut, **Kansas City, MO** (Address of principal executive offices)	**64106** (Zip Code)

(816) 234-2000
(Registrant s telephone number, including area code)

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

Yes X No __

Indicate by checkmark 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 Act. (Check one):

Large accelerated filer X 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 _X_

As of August 1, 2007, the registrant had outstanding 68,654,787 shares of its $5 par value common stock, registrant s only class of common stock.

Commerce Bancshares, Inc. and Subsidiaries

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PART I: FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

Commerce Bancshares, Inc. and Subsidiaries

CONSOLIDATED BALANCE SHEETS

	June 30 2007	December 31 2006
	(Unaudited)	
	(In thousands)	
ASSETS		
Loans, net of unearned income	**$ 10,225,921**	$ 9,681,520
Allowance for loan losses	**(132,960)**	(131,730)
Net loans	**10,092,961**	9,549,790
Loans held for sale	**258,563**	278,598
Investment securities:		
Available for sale ($526,509,000 pledged in 2007 and $526,430,000 pledged in 2006 to secure structured repurchase agreements)	**3,129,310**	3,415,440
Trading	**19,600**	6,676
Non-marketable	**92,213**	74,207
Total investment securities	**3,241,123**	3,496,323
Federal funds sold and securities purchased under agreements to resell	**566,145**	527,816
Cash and due from banks	**497,909**	626,500
Land, buildings and equipment, net	**397,108**	386,095
Goodwill	**110,705**	97,643
Other intangible assets, net	**18,052**	19,633
Other assets	**336,805**	247,951
Total assets	**$ 15,519,371**	$ 15,230,349

LIABILITIES AND STOCKHOLDERS EQUITY		
Deposits:		
Non-interest bearing demand	**$ 1,271,730**	$ 1,312,400
Savings, interest checking and money market	**6,910,086**	6,879,047
Time open and C.D. s of less than $100,000	**2,363,580**	2,302,567
Time open and C.D. s of $100,000 and over	**1,516,326**	1,250,840
Total deposits	**12,061,722**	11,744,854
Federal funds purchased and securities sold under agreements to repurchase	**1,494,604**	1,771,282
Other borrowings	**346,137**	53,934
Other liabilities	**159,221**	218,165
Total liabilities	**14,061,684**	13,788,235
Stockholders equity:		
Preferred stock, $1 par value		
Authorized and unissued 2,000,000 shares		
Common stock, $5 par value		
Authorized 100,000,000 shares; issued 70,465,922 shares	**352,330**	352,330
Capital surplus	**422,189**	427,421
Retained earnings	**756,014**	683,176
Treasury stock of 1,367,512 shares in 2007 and 422,468 shares in 2006, at cost	**(65,904)**	(20,613)
Accumulated other comprehensive loss	**(6,942)**	(200)
Total stockholders equity	**1,457,687**	1,442,114
Total liabilities and stockholders equity	**$ 15,519,371**	$ 15,230,349

See accompanying notes to consolidated financial statements.

Commerce Bancshares, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share data)	**For the Three Months Ended June 30** **2007**	2006	**For the Six Months Ended June 30** **2007**	2006
	(Unaudited)			
INTEREST INCOME				
Interest and fees on loans	**$ 183,736**	$ 155,672	**$ 360,279**	$ 300,285
Interest and fees on loans held for sale	**6,185**	5,516	**12,265**	10,777
Interest on investment securities	**36,370**	36,261	**74,789**	73,391
Interest on federal funds sold and securities purchased under agreements to resell	**6,517**	1,801	**13,742**	3,424
Total interest income	**232,808**	199,250	**461,075**	387,877
INTEREST EXPENSE				
Interest on deposits:				
Savings, interest checking and money market	**29,812**	23,002	**57,449**	42,609
Time open and C.D. s of less than $100,000	**27,671**	19,448	**54,236**	36,179
Time open and C.D. s of $100,000 and over	**19,566**	13,906	**36,479**	27,093
Interest on federal funds purchased and securities sold under agreements to repurchase	**18,621**	14,024	**43,744**	26,605
Interest on other borrowings	**3,274**	2,391	**3,824**	5,177
Total interest expense	**98,944**	72,771	**195,732**	137,663
Net interest income	**133,864**	126,479	**265,343**	250,214
Provision for loan losses	**9,054**	5,672	**17,215**	10,104
Net interest income after provision for loan losses	**124,810**	120,807	**248,128**	240,110
NON-INTEREST INCOME				
Deposit account charges and other fees	**30,081**	28,910	**56,592**	56,407
Bank card transaction fees	**25,855**	23,558	**48,938**	45,266
Trust fees	**19,972**	17,992	**38,625**	35,811
Trading account profits and commissions	**1,440**	2,010	**3,301**	4,575
Consumer brokerage services	**3,332**	2,771	**6,375**	5,160
Loan fees and sales	**2,712**	2,745	**3,997**	6,488

Other	**10,667**	10,193	**20,515**	21,517
Total non-interest income	**94,059**	88,179	**178,343**	175,224
INVESTMENT SECURITIES GAINS (LOSSES), NET	**(493)**	3,284	**3,402**	5,687
NON-INTEREST EXPENSE				
Salaries and employee benefits	**76,123**	71,239	**153,023**	142,964
Net occupancy	**10,843**	10,230	**22,633**	21,207
Equipment	**5,681**	6,071	**12,114**	12,020
Supplies and communication	**8,586**	7,872	**17,092**	16,265
Data processing and software	**12,149**	12,631	**23,380**	25,024
Marketing	**4,859**	4,657	**9,177**	8,975
Other	**18,108**	16,850	**35,349**	33,056
Total non-interest expense	**136,349**	129,550	**272,768**	259,511
Income before income taxes	**82,027**	82,720	**157,105**	161,510
Less income taxes	**26,453**	27,387	**50,035**	53,233
NET INCOME	**$ 55,574**	$ 55,333	**$ 107,070**	$ 108,277
Net income per share basic	**$ .80**	$ .79	**$ 1.54**	$ 1.54
Net income per share diluted	**$ .79**	$ .78	**$ 1.52**	$ 1.52

See accompanying notes to consolidated financial statements.

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Commerce Bancshares, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

(In thousands, except per share data)	Common Stock	Capital Surplus	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total
			(Unaudited)			
Balance January 1, 2007	**$ 352,330**	**$ 427,421**	**$ 683,176**	**$ (20,613)**	**$ (200)**	**$ 1,442,114**
Net income			**107,070**			**107,070**
Change in unrealized gain (loss) on available for sale securities, net of tax					**(6,971)**	**(6,971)**
Amortization of pension loss, net of tax					**229**	**229**
Total comprehensive income						**100,328**
Purchase of treasury stock				**(91,584)**		**(91,584)**
Issuance of stock under purchase and equity compensation plans		**(7,197)**		**16,005**		**8,808**
Net tax benefit related to equity compensation plans		**1,644**				**1,644**
Stock based compensation		**2,995**				**2,995**
Issuance of nonvested stock awards		**(2,371)**		**2,371**		
Cash dividends paid ($.500 per share)			**(34,678)**			**(34,678)**
Issuance in South Tulsa Financial Corp. acquisition		**(303)**		**27,917**		**27,614**
Adoption of FIN 48			**446**			**446**
Balance June 30, 2007	**$ 352,330**	**$ 422,189**	**$ 756,014**	**$ (65,904)**	**$ (6,942)**	**$ 1,457,687**
Balance January 1, 2006	$ 347,049	$ 388,552	$ 693,021	$ (86,901)	$ (3,883)	$ 1,337,838
Net income			108,277			108,277

Change in unrealized gain (loss) on available for sale securities, net of tax					(13,548)	(13,548)
Total comprehensive income						94,729
Purchase of treasury stock				(75,773)		(75,773)
Issuance of stock under purchase and equity compensation plans		(4,943)		9,408		4,465
Net tax benefit related to equity compensation plans		747				747
Stock based compensation		2,079				2,079
Issuance of nonvested stock awards		(1,077)		1,077		
Cash dividends paid ($.467 per share)			(32,690)			(32,690)
Balance June 30, 2006	$ 347,049	$ 385,358	$ 768,608	$ (152,189)	$ (17,431)	$ 1,331,395

See accompanying notes to consolidated financial statements.

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Commerce Bancshares, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)	For the Six Months Ended June 30 **2007**	2006
	(Unaudited)	
OPERATING ACTIVITIES:		
Net income	**$ 107,070**	$ 108,277
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	**17,215**	10,104
Provision for depreciation and amortization	**25,849**	23,219
Amortization of investment security premiums, net	**3,911**	6,209
Investment securities gains, net[(A)]	**(3,402)**	(5,687)
Net gains on sales of loans held for sale	**(2,373)**	(4,889)
Originations of loans held for sale	**(184,214)**	(166,857)
Proceeds from sales of loans held for sale	**206,446**	242,192
Net (increase) decrease in trading securities, including amounts in the course of settlement	**(55,015)**	2,156
Stock based compensation	**2,995**	2,079
(Increase) decrease in interest receivable	**1,465**	(1,574)
Increase in interest payable	**3,730**	9,897
Increase in income taxes payable	**1,918**	8,691
Net tax benefit related to equity compensation plans	**(1,644)**	(747)
Other changes, net	**(11,262)**	6,213
Net cash provided by operating activities	**112,689**	239,283
INVESTING ACTIVITIES:		
Net cash and cash equivalents received in acquisition	**10,771**	
Proceeds from sales of investment securities[(A)]	**5,541**	17,528
Proceeds from maturities/pay downs of investment securities[(A)]	**582,224**	562,754
Purchases of investment securities[(A)]	**(350,874)**	(277,268)
Net increase in loans	**(446,888)**	(561,317)
Purchases of land, buildings and equipment	**(29,170)**	(16,614)
Sales of land, buildings and equipment	**2,619**	1,690
Net cash used in investing activities	**(225,777)**	(273,227)

FINANCING ACTIVITIES:		
Net decrease in non-interest bearing demand, savings, interest checking and money market deposits	**(157,462)**	(87,709)
Net increase in time open and C.D. s	**291,226**	314,937
Net increase (decrease) in federal funds purchased and securities sold under agreements to repurchase	**(276,678)**	260,084
Additional long-term borrowings	**300,000**	
Repayment of long-term borrowings	**(18,450)**	(124,390)
Purchases of treasury stock	**(91,584)**	(75,773)
Issuance of stock under stock purchase and equity compensation plans	**8,808**	4,465
Net tax benefit related to equity compensation plans	**1,644**	747
Cash dividends paid on common stock	**(34,678)**	(32,690)
Net cash provided by financing activities	**22,826**	259,671
Increase (decrease) in cash and cash equivalents	**(90,262)**	225,727
Cash and cash equivalents at beginning of year	**1,154,316**	674,135
Cash and cash equivalents at June 30	**$ 1,064,054**	$ 899,862

(A) Available for sale and non-marketable securities

Income tax payments, net of refunds	**$ 46,942**	$ 44,460
Interest paid on deposits and borrowings	**$ 191,764**	$ 127,766

See accompanying notes to consolidated financial statements.

Commerce Bancshares, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2007 (Unaudited)

1. Principles of Consolidation and Presentation

The accompanying consolidated financial statements include the accounts of Commerce Bancshares, Inc. and all majority-owned subsidiaries (the Company). The consolidated financial statements in this report have not been audited. All significant intercompany accounts and transactions have been eliminated. Certain reclassifications were made to 2006 data to conform to current year presentation. In the opinion of management, all adjustments necessary to present fairly the financial position and the results of operations for the interim periods have been made. All such adjustments are of a normal recurring nature. The results of operations for the three and six month periods ended June 30, 2007 are not necessarily indicative of results to be attained for the full year or any other interim periods.

The significant accounting policies followed in the preparation of the quarterly financial statements are disclosed in the 2006 Annual Report on Form 10-K.

2. Acquisitions

The Company completed its previously announced acquisition of South Tulsa Financial Corporation (South Tulsa) on April 1, 2007, and South Tulsa s results of operations were included in the Company s consolidated financial results beginning on that date. In this transaction, the Company acquired the outstanding stock of South Tulsa and issued 561,951 shares of Company stock valued at $27.6 million. The valuation of Company stock was based on the average closing price of Company stock during the measurement period of March 21 through March 27. The Company s acquisition of South Tulsa added $114.7 million in loans, $103.9 million in deposits and two branch locations in Tulsa, Oklahoma. Intangible assets recognized as a result of the transaction consisted of approximately $11.4 million in goodwill and $2.7 million in core deposit premium.

On July 1, 2007, the Company completed its previously announced acquisition of Commerce Bank in Denver, Colorado. In this transaction, the Company acquired the outstanding stock of Commerce Bank for $29.5 million in cash. The acquisition added $74.5 million in loans, $72.2 million in deposits and the Company s first location in Colorado. Intangible assets recognized as a result of the transaction consisted primarily of goodwill and core deposit premium of approximately $21.3 million.

3. Loans and Allowance for Loan Losses

Major classifications within the Company s loan portfolio at June 30, 2007 and December 31, 2006 are as follows.

(In thousands)	**June 30 2007**	December 31 2006
Business	**$ 3,080,804**	$ 2,860,692
Real estate construction	**712,206**	658,148
Real estate business	**2,187,301**	2,148,195
Real estate personal	**1,533,943**	1,478,669

Consumer	**1,567,897**	1,435,038
Home equity	**442,294**	441,851
Credit card	**675,953**	648,326
Overdrafts	**25,523**	10,601
Total loans	**$ 10,225,921**	$ 9,681,520

Included in the table above are impaired loans amounting to $37,076,000 at June 30, 2007 and $18,236,000 at December 31, 2006. Impaired loans include loans on non-accrual status and other loans classified as substandard and more than 60 days past due. Loans acquired in the South Tulsa transaction with evidence of a deterioration in credit quality were not material to the consolidated financial statements of the Company. Accordingly, the provisions of AICPA Statement of Position 03-3, which require special accounting for such loans, were not applied.

In addition to its basic portfolio, the Company originates other held for sale loans which it intends to sell in secondary markets. Loans held for sale amounted to $258,563,000 at June 30, 2007 compared to $278,598,000 at December 31, 2006. These loans consist mainly of student loans, amounting to $247,353,000 at June 30, 2007, in addition to $11,210,000 of certain fixed rate residential mortgage loans.

The following is a summary of the allowance for loan losses.

	For the Three Months Ended June 30		For the Six Months Ended June 30	
(In thousands)	**2007**	2006	**2007**	2006
Balance, beginning of period	**$ 131,730**	$ 128,468	**$ 131,730**	$ 128,447
Additions:				
Allowance for loan losses of acquired bank	**1,228**		**1,228**	
Provision for loan losses	**9,054**	5,672	**17,215**	10,104
Total additions	**10,282**	5,672	**18,443**	10,104
Deductions:				
Loan losses	**13,888**	9,223	**26,281**	18,569
Less recoveries on loans	**4,836**	3,529	**9,068**	8,464
Net loan losses	**9,052**	5,694	**17,213**	10,105
Balance, June 30	**$ 132,960**	$ 128,446	**$ 132,960**	$ 128,446

4. Investment Securities

Investment securities, at fair value, consist of the following at June 30, 2007 and December 31, 2006.

	June 30	December 31
(In thousands)	**2007**	2006

Available for sale:		
U.S. government and federal agency obligations	**$ 9,754**	$ 9,651
Government-sponsored enterprise obligations	**380,430**	464,567
State and municipal obligations	**592,541**	594,824
Mortgage-backed securities	**1,732,541**	1,782,443
Other asset-backed securities	**233,727**	354,465
Other debt securities	**23,379**	36,009
Equity securities	**156,938**	173,481
Total available for sale	**3,129,310**	3,415,440
Trading	**19,600**	6,676
Non-marketable	**92,213**	74,207
Total investment securities	**$ 3,241,123**	$ 3,496,323

Available for sale equity securities included short-term investments in money market mutual funds of $40,660,000 at June 30, 2007 and $59,973,000 at December 31, 2006. Equity securities also included common and preferred stock held by the Parent with a fair value of $95,392,000 at June 30, 2007 and $107,840,000 at December 31, 2006.

Non-marketable securities included Federal Home Loan Bank stock and Federal Reserve Bank stock held for debt and regulatory purposes, which totaled $49,165,000 and $35,592,000 at June 30, 2007 and December 31, 2006, respectively. Also included were venture capital and private equity investments, which amounted to $42,968,000 and $38,548,000 at June 30, 2007 and December 31, 2006, respectively. During the first six months of 2007 and 2006, net gains of $3,328,000 and $5,003,000, respectively, were recognized on venture capital and private equity investments. The net gains consisted of both realized gains and losses and fair value adjustments.

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At June 30, 2007, securities carried at $2.0 billion were pledged to secure public fund deposits, securities sold under agreements to repurchase, trust funds, and borrowing capacity at the Federal Reserve. Securities pledged under agreements pursuant to which the collateral may be sold or re-pledged by the secured parties approximated $526.5 million, while securities pledged under agreements pursuant to which the secured parties may not sell or re-pledge the collateral approximated $1.5 billion at June 30, 2007.

5. Goodwill and Other Intangible Assets

The following table presents information about the Company s intangible assets which have estimable useful lives.

	June 30, 2007			December 31, 2006		
(In thousands)	**Gross Carrying Amount**	**Accumulated Amortization**	**Net Amount**	Gross Carrying Amount	Accumulated Amortization	Net Amount
Amortizable intangible assets:						
Core deposit premium	**$ 20,162**	**$ (2,831)**	**$ 17,331**	$ 19,920	$ (1,093)	$ 18,827
Mortgage servicing rights	**1,338**	**(617)**	**721**	1,338	(532)	806
Total	**$ 21,500**	**$ (3,448)**	**$ 18,052**	$ 21,258	$ (1,625)	$ 19,633

Aggregate amortization expense on intangible assets was $887,000 and $3,000, respectively, for the three month periods ended June 30, 2007 and 2006, and $1,823,000 and $4,000 for the six month periods ended June 30, 2007 and 2006. The following table shows the estimated future amortization expense based on existing asset balances and the interest rate environment as of June 30, 2007. The Company s actual amortization expense in any given period may be different from the estimated amounts depending upon the addition of new intangible assets, changes in mortgage interest rates, pre-payment rates and other market conditions.

(In thousands)	
2007	$ 3,611
2008	3,316
2009	2,896
2010	2,480
2011	2,067

Changes in the carrying amount of goodwill and net other intangible assets for the six month period ended June 30, 2007 are as follows. Additional intangible assets were acquired in the South Tulsa transaction, and adjustments were recorded to intangible assets acquired in prior years, mainly due to the finalization of core deposit premium valuation analyses.

(In thousands)	Goodwill	Core Deposit Premium	Mortgage Servicing Rights
Balance at December 31, 2006	$ 97,643	$ 18,827	$ 806
Current year acquisition	11,364	2,732	
Adjustments to prior year acquisitions	1,698	(2,490)	
Amortization		(1,738)	(85)
Balance at June 30, 2007	$ 110,705	$ 17,331	$ 721

6. Guarantees

The Company, as a provider of financial services, routinely issues financial guarantees in the form of financial and performance standby letters of credit. Standby letters of credit are contingent commitments issued by the Company generally to guarantee the payment or performance obligation of a customer to a third party. While these represent a potential outlay by the Company, a significant amount of the commitments may expire without being drawn upon. The Company has recourse against the customer for any amount it is required to pay to a third party under a standby letter of credit. The letters of credit are subject to the same credit policies, underwriting standards and approval process as loans made by the Company. Most of the standby letters of credit are secured and in the event of nonperformance by the customers, the Company has rights to the underlying collateral, which could include commercial real estate, physical plant and property, inventory, receivables, cash and marketable securities.

Upon issuance of standby letters of credit, the Company recognizes a liability for the fair value of the obligation undertaken, which is estimated to be equivalent to the amount of fees to be received from the customer over the life of the agreement. At June 30, 2007 that net liability was $5,522,000, which will be accreted into income over the remaining life of the respective commitments. The contractual amount of these letters of credit, which represents the maximum potential future payments guaranteed by the Company, was $466,297,000 at June 30, 2007.

The Company guarantees payments to holders of certain trust preferred securities issued by wholly owned grantor trusts. Preferred securities issued by Breckenridge Capital Trust I, amounting to $4,000,000, are due in 2030 and may be redeemed beginning in 2010. These securities have a 10.875% interest rate throughout their term. Securities issued by West Pointe Statutory Trust I, amounting to $10,000,000, are due in 2034 and may be redeemed beginning in 2009. These securities have a variable interest rate based on LIBOR, which resets on a quarterly basis. The maximum potential future payments guaranteed by the Company, which includes future interest and principal payments through maturity, was estimated to be approximately $44,793,000 at June 30, 2007. At June 30, 2007, the Company had a recorded liability of $14,179,000 in principal and accrued interest to date, representing amounts owed to the security holders.

In 2007, the Company entered into a risk participation agreement (RPA) with another financial institution which mitigates that institution s credit risk arising from an interest rate swap with a third party. The RPA stipulates that, in the event of default by the third party on the interest rate swap, the Company will reimburse a portion of the loss borne by the financial institution. The Company s exposure is based on a notional amount of $9,934,000. At inception, the Company recorded a liability which represented the fair value of the RPA, which is being accreted to income over the seven year term of the RPA, given no adverse change in the third party s creditworthiness. At June 30, 2007 the liability was $68,000. The maximum potential future payment guaranteed by the Company cannot be readily estimated, but is dependent upon the fair value of the interest rate swap at the time of default. If an event of default had occurred at June 30, 2007, the Company would not have been required to make a payment.

7. Pension

The amount of net pension cost (income) is as follows:

	For the Three Months Ended June 30		For the Six Months Ended June 30	
(In thousands)	**2007**	2006	**2007**	2006
Service cost benefits earned during the period	**$ 247**	$ 276	**$ 495**	$ 552
Interest cost on projected benefit obligation	**1,146**	1,191	**2,291**	2,382

Expected return on plan assets		**(1,705)**		(1,800)		**(3,410)**		(3,600)
Amortization of unrecognized net loss		**185**		257		**370**		515
Net periodic pension cost (income)	**$**	**(127)**	$	(76)	**$**	**(254)**	$	(151)

Substantially all benefits under the Company s defined benefit pension plan were frozen effective January 1, 2005. During the first six months of 2007, the Company made no funding contributions to its defined benefit pension plan, and made minimal funding contributions to a supplemental executive retirement plan (the CERP), which carries no segregated assets. The Company has no plans to make any further contributions, other than those related to the CERP, during the remainder of 2007. The higher income recognized for the defined benefit pension plan in the three and six month periods ended June 30, 2007 compared to the same periods in 2006 was primarily due to the greater than expected return on plan assets for the year ended September 30, 2006 (the valuation date).

Recently issued accounting pronouncements required the Company to reflect the funded status of its defined benefit pension plan on its consolidated balance sheet at December 31, 2006. Accordingly, the Company recorded a pre-tax reduction in accumulated other comprehensive income of $17,532,000, consisting of accumulated net loss, on that date. During the first six months of 2007, $370,000 of accumulated net loss was recognized as a component of net periodic benefit cost, as shown above, and as an increase in other comprehensive income.

8. Common Stock

Presented below is a summary of the components used to calculate basic and diluted earnings per share.

	For the Three Months Ended June 30		For the Six Months Ended June 30	
(In thousands, except per share data)	**2007**	2006	**2007**	2006
Basic earnings per share:				
Net income available to common shareholders	**$ 55,574**	$ 55,333	**$ 107,070**	$ 108,277
Weighted average basic common shares outstanding	**69,285**	69,879	**69,457**	70,108
Basic earnings per share	**$ .80**	$ .79	**$ 1.54**	$ 1.54
Diluted earnings per share:				
Net income available to common shareholders	**$ 55,574**	$ 55,333	**$ 107,070**	$ 108,277
Weighted average common shares outstanding	**69,285**	69,879	**69,457**	70,108
Net effect of nonvested stock and the assumed exercise of stock-based awards based on the treasury stock method using the average market price for the respective periods	**782**	954	**822**	969
Weighted average diluted common shares outstanding	**70,067**	70,833	**70,279**	71,077
Diluted earnings per share	**$ .79**	$ .78	**$ 1.52**	$ 1.52

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9. Other Comprehensive Income (Loss)

The Company s components of other comprehensive income (loss) consist of the unrealized holding gains and losses on available for sale investment securities and the amortization of accumulated pension loss which has been recognized in net periodic benefit cost.

(In thousands)	**For the Three Months Ended June 30** **2007**	2006	**For the Six Months Ended June 30** **2007**	2006
Available for sale investment securities:				
Unrealized holding gains (losses)	**$ (21,106)**	$ (5,109)	**$ (11,135)**	$ (21,851)
Reclassification adjustment for gains included in net income	**(77)**		**(75)**	
Net unrealized gains (losses) on securities	**(21,183)**	(5,109)	**(11,210)**	(21,851)
Income tax expense (benefit)	**(8,050)**	(1,941)	**(4,239)**	(8,303)
Holding gains (losses) on investment securities	**(13,133)**	(3,168)	**(6,971)**	(13,548)
Prepaid pension cost:				
Amortization of accumulated pension loss	**185**		**370**	
Income tax expense (benefit)	**(71)**		**(141)**	
Accumulated pension loss	**114**		**229**	
Other comprehensive income (loss)	**$ (13,019)**	$ (3,168)	**$ (6,742)**	$ (13,548)

10. Segments

The Company segregates financial information for use in assessing its performance and allocating resources among three operating segments. The Consumer segment includes the retail branch network, consumer finance, bankcard, student loans and discount brokerage services. The Commercial segment provides corporate lending, leasing, and international services, as well as business, government deposit and cash management services. The Money Management segment provides traditional trust and estate tax planning services, and advisory and discretionary investment management services.

The following table presents selected financial information by segment and reconciliations of combined segment totals to consolidated totals. There were no material intersegment revenues among the three segments. Management periodically makes changes to methods of assigning costs and income to its business segments to better reflect operating results. If appropriate, these changes are reflected in prior year information presented below.

(In thousands)	Consumer	Commercial	Money Management	Segment Totals	Other/ Elimination	Consolidated Totals
Three Months Ended June 30, 2007:						
Net interest income	**$ 98,450**	**$ 55,629**	**$ 2,566**	**$ 156,645**	**$ (22,781)**	**$ 133,864**
Provision for loan losses	**8,028**	**1,040**		**9,068**	**(14)**	**9,054**
Non-interest income	**48,194**	**20,908**	**22,661**	**91,763**	**2,296**	**94,059**
Investment securities losses, net					**(493)**	**(493)**
Non-interest expense	**76,636**	**39,198**	**15,401**	**131,235**	**5,114**	**136,349**
Income before income taxes	**$ 61,980**	**$ 36,299**	**$ 9,826**	**$ 108,105**	**$ (26,078)**	**$ 82,027**
Three Months Ended June 30, 2006:						
Net interest income	$ 93,255	$ 51,662	$ 2,410	$ 147,327	$ (20,848)	$ 126,479
Provision for loan losses	5,320	393		5,713	(41)	5,672
Non-interest income	45,738	19,444	21,169	86,351	1,828	88,179
Investment securities gains, net					3,284	3,284
Non-interest expense	71,934	36,397	14,938	123,269	6,281	129,550
Income before income taxes	$ 61,739	$ 34,316	$ 8,641	$ 104,696	$ (21,976)	$ 82,720
Six Months Ended June 30, 2007:						
Net interest income	**$ 195,736**	**$ 111,087**	**$ 4,768**	**$ 311,591**	**$ (46,248)**	**$ 265,343**
Provision for loan losses	**15,925**	**1,261**		**17,186**	**29**	**17,215**
Non-interest income	**88,744**	**40,976**	**44,566**	**174,286**	**4,057**	**178,343**
Investment securities gains, net					**3,402**	**3,402**
Non-interest expense	**151,135**	**78,448**	**31,557**	**261,140**	**11,628**	**272,768**
Income before income taxes	**$ 117,420**	**$ 72,354**	**$ 17,777**	**$ 207,551**	**$ (50,446)**	**$ 157,105**

Six Months Ended June 30, 2006:						
Net interest income	$ 181,664	$ 101,344	$ 5,034	$ 288,042	$ (37,828)	$ 250,214
Provision for loan losses	10,967	(854)		10,113	(9)	10,104
Non-interest income	89,219	38,613	42,855	170,687	4,537	175,224
Investment securities gains, net					5,687	5,687
Non-interest expense	143,064	71,881	30,650	245,595	13,916	259,511
Income before income taxes	$ 116,852	$ 68,930	$ 17,239	$ 203,021	$ (41,511)	$ 161,510

The information presented above was derived from the internal profitability reporting system used by management to monitor and manage the financial performance of the Company. This information is based on internal management accounting policies, which have been developed to reflect the underlying economics of the businesses. The policies address the methodologies applied in connection with funds transfer pricing and assignment of overhead costs among segments. Funds transfer pricing was used in the determination of net interest income by assigning a standard cost (credit) for funds used (provided) by assets and liabilities based on their maturity, prepayment and/or repricing characteristics.

The performance measurement of the operating segments is based on the management structure of the Company and is not necessarily comparable with similar information for any other financial institution. The information is also not necessarily indicative of the segments financial condition and results of operations if they were independent entities.

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11. Derivative Instruments

The Company s interest rate risk management strategy includes the ability to modify the re-pricing characteristics of certain assets and liabilities so that changes in interest rates do not adversely affect the net interest margin and cash flows. Interest rate swaps are used on a limited basis as part of this strategy. At June 30, 2007, the Company had entered into two interest rate swaps with a notional amount of $13,832,000, which are designated as fair value hedges of certain fixed rate loans. The Company also sells swap contracts to customers who wish to modify their interest rate sensitivity. These swaps are offset by matching contracts purchased by the Company from other financial institutions. Because of the matching terms of the offsetting contracts, the effect of these transactions on net income is minimal. The notional amount of these types of swaps at June 30, 2007 was $275,511,000. These swaps are accounted for as free-standing derivatives and changes in their fair value were recorded in other non-interest income.

Through its International Department, the Company enters into foreign exchange contracts consisting mainly of contracts to purchase or deliver foreign currencies for customers at specific future dates. Also, mortgage loan commitments and forward sales contracts result from the Company s mortgage banking operation, in which fixed rate personal real estate loans are originated and sold to other institutions.

The Company s derivative instruments are listed below.

	June 30, 2007			December 31, 2006		
(In thousands)	**Notional Amount**	**Positive Fair Value**	**Negative Fair Value**	Notional Amount	Positive Fair Value	Negative Fair Value
Interest rate contracts:						
Swap contracts	**$ 289,343**	**$ 2,495**	**$ (3,260)**	$ 181,464	$ 1,185	$ (2,003)
Option contracts	**6,970**	**4**	**(4)**	6,970	10	(10)
Credit-related contracts	**9,934**		**(68)**			
Foreign exchange contracts:						
Forward contracts	**8,862**	**273**	**(271)**	16,117	29	(20)
Option contracts	**2,820**	**4**	**(4)**	2,670	16	(16)
Mortgage loan commitments	**7,909**	**12**	**(25)**	11,529		(43)
Mortgage loan forward sale contracts	**20,018**	**205**	**(13)**	21,269	60	(14)
Total	**$ 345,856**	**$ 2,993**	**$ (3,645)**	$ 240,019	$ 1,300	$ (2,106)

12. Income Taxes

For the second quarter of 2007, income tax expense amounted to $26,453,000 compared to $27,387,000 in the second quarter of 2006. The effective income tax rate for the Company was 32.2% in the current quarter compared to 33.1% in the same quarter last year. For the six months ended June 30, 2007 and 2006, income tax expense amounted to $50,035,000 and $53,233,000, resulting in effective income tax rates of 31.8% and 33.0%, respectively.

Effective January 1, 2007, the Company adopted Financial Accounting Standards Board Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48). Upon adoption of FIN 48, the Company recognized a $446,000 decrease to the liability for unrecognized tax benefits which, as required, was accounted for as an increase to the January 1, 2007 balance of retained earnings. The resulting amount of unrecognized tax benefits at January 1, 2007 was $2,379,000, which included $444,000 of related accrued interest and penalties.

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The Company recognizes interest and penalties related to unrecognized tax benefits within income tax expense in the consolidated statements of income.

The Company s federal income tax returns for 2003 through 2006 remain subject to examination by the Internal Revenue Service. Its state tax returns for 2002 through 2006 remain subject to examination by various state jurisdictions, based on individual state statutes of limitations.

13. Stock-Based Compensation

During the first six months of 2007, stock-based compensation was issued in the form of stock appreciation rights (SARs) and nonvested stock. The stock-based compensation expense that has been charged against income was $1,477,000 and $1,280,000 in the three months ended June 30, 2007 and 2006, respectively, and $2,995,000 and $2,079,000 in the six months ended June 30, 2007 and 2006, respectively.

The Company s adoption of SFAS No. 123R, Share-Based Payment (the Statement), on January 1, 2006 resulted in a $543,000 reduction in stock-based compensation expense, which was recorded at the adoption date. This adjustment resulted from a change by the Company from its former policy of recognizing the effect of forfeitures only as they occurred to the Statement s requirement to estimate the number of outstanding instruments for which the requisite service is not expected to be rendered.

In determining compensation cost, the Black-Scholes option-pricing model is used to estimate the fair value of SARs and options on date of grant. SARs and stock options are granted with an exercise price equal to the market price of the Company s stock at the date of grant and have 10-year contractual terms. SARs, which were granted for the first time in 2006, vest on a graded basis over 4 years of continuous service. All SARs must be settled in stock under provisions of the plan. Stock options, which were granted in 2005 and previous years, vest on a graded basis over 3 years of continuous service. The table below shows the fair values of SARs granted during the first six months of 2007 and 2006, including the model assumptions for those grants.

	Six Months Ended June 30	
	2007	2006
Weighted per share average fair value at grant date	**$12.56**	$13.41
Assumptions:		
Dividend yield	**1.9%**	1.7%
Volatility	**19.9%**	21.1%
Risk-free interest rate	**4.6%**	4.6%
Expected term (in years)	**7.4 years**	7.4 years

A summary of option activity during the first six months of 2007 is presented below.

Weighted

(Dollars in thousands, except per share data)	Shares	Weighted Average Exercise Price	Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at January 1, 2007	3,225,100	$ 33.14		
Granted				
Cancelled	(2,207)	43.16		
Exercised	(343,668)	28.12		
Outstanding at June 30, 2007	2,879,225	$ 33.73	4.9 years	$ 33,302

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A summary of SAR activity during the first six months of 2007 is presented below.

(Dollars in thousands, except per share data)	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at January 1, 2007	477,009	$ 49.29		
Granted	473,950	49.50		
Cancelled	(14,822)	49.13		
Exercised				
Outstanding at June 30, 2007	936,137	$ 49.40	9.1 years	$

A summary of the status of the Company s nonvested share awards, as of June 30, 2007, and changes during the six month period then ended is presented below.

	Shares	Weighted Average Grant Date Fair Value
Nonvested at January 1, 2007	167,560	$ 41.09
Granted	51,141	48.75
Vested	(17,694)	33.38
Forfeited	(3,361)	45.15
Nonvested at June 30, 2007	197,646	$ 43.69

Item 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF CONSOLIDATED FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with the consolidated financial statements and related notes and with the statistical information and financial data appearing in this report as well as the Company s 2006 Annual Report on Form 10-K. Results of operations for the three and six month periods ended June 30, 2007 are not necessarily indicative of results to be attained for any other period.

Forward Looking Information

This report may contain forward-looking statements that are subject to risks and uncertainties and include information about possible or assumed future results of operations. Many possible events or factors could affect the future financial results and performance of the Company. This could cause results or performance to differ materially from those expressed in the forward-looking statements. Words such as expects , anticipates , believes , estimates , variatio of such words and other similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in, or implied by, such forward-looking statements. Readers should not rely solely on the forward-looking statements and should consider all uncertainties and risks discussed throughout this report. Forward-looking statements speak only as of the date they are made. The Company does not undertake to update forward-looking statements to reflect circumstances or events that occur after the date the forward-looking statements are made or to reflect the occurrence of unanticipated events. Such possible events or factors include: changes in economic conditions in the Company s market area, changes in policies by regulatory agencies, governmental legislation and regulation, fluctuations in interest rates, changes in liquidity requirements, demand for loans in the Company s market area, and competition with other entities that offer financial services.

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Critical Accounting Policies

The Company s consolidated financial statements are prepared based on the application of certain accounting policies, some of which require numerous estimates and strategic or economic assumptions that may prove inaccurate or be subject to variations which may significantly affect the Company s reported results and financial position for the current period or future periods. The use of estimates, assumptions, and judgments are necessary when financial assets and liabilities are required to be recorded at, or adjusted to reflect, fair value. Assets and liabilities carried at fair value inherently result in more financial statement volatility. Fair values and the information used to record valuation adjustments for certain assets and liabilities are based on either quoted market prices or are provided by other independent third-party sources, when available. When such information is not available, management estimates valuation adjustments primarily by using internal cash flow and other financial modeling techniques. Changes in underlying factors, assumptions, or estimates in any of these areas could have a material impact on the Company s future financial condition and results of operations.

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

The Company performs periodic and systematic detailed reviews of its loan portfolio to assess overall collectability. The level of the allowance for loan losses reflects the Company s estimate of the losses inherent in the loan portfolio at any point in time. While these estimates are based on substantive methods for determining allowance requirements, actual outcomes may differ significantly from estimated results, especially when determining allowances for business, lease, construction and business real estate loans. These loans are normally larger and more complex, and their collection rates are harder to predict. Personal loans, including personal mortgage, credit card and consumer loans, are individually smaller and perform in a more homogenous manner, making loss estimates more predictable. Further discussion of the methodologies used in establishing the allowance is provided in the Provision and Allowance for Loan Losses section of this discussion.

The Company, through its direct holdings and its Small Business Investment subsidiaries, has numerous private equity and venture capital investments, which totaled $43.0 million at June 30, 2007. These private equity and venture capital securities are reported at fair value. The values assigned to these securities where no market quotations exist are based upon available information and management s judgment. Although management believes its estimates of fair value reasonably reflect the fair value of these securities, key assumptions regarding the projected financial performance of these companies, the evaluation of the investee company s management team, and other economic and market factors may affect the amounts that will ultimately be realized from these investments.

The objectives of accounting for income taxes are to recognize the amount of taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an entity s financial statements or tax returns. Judgment is required in assessing the future tax consequences of events that have been recognized in the Company s financial statements or tax returns. Fluctuations in the actual outcome of these future tax consequences, including the effects of IRS examinations and examinations by other state agencies, could materially impact the Company s financial position and its results of operations. Further discussion of income taxes is presented in the Income Taxes section of this discussion.

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Selected Financial Data

	Three Months Ended June 30		Six Months Ended June 30	
	2007	2006	**2007**	2006
Per Share Data				
Net income basic	**$ .80**	$ .79	**$ 1.54**	$ 1.54
Net income diluted	**.79**	.78	**1.52**	1.52
Cash dividends	**.250**	.233	**.500**	.467
Book value			**21.12**	19.12
Market price			**45.30**	47.67
Selected Ratios				
(Based on average balance sheets)				
Loans to deposits*	**87.73%**	84.27%	**87.75%**	83.80%
Non-interest bearing deposits to total deposits	**5.43**	6.06	**5.39**	5.80
Equity to loans*	**14.04**	14.48	**14.14**	14.62
Equity to deposits	**12.31**	12.21	**12.41**	12.26
Equity to total assets	**9.62**	9.69	**9.59**	9.70
Return on total assets	**1.46**	1.61	**1.42**	1.59
Return on total stockholders equity	**15.12**	16.59	**14.77**	16.37
(Based on end-of-period data)				
Non-interest income to revenue**	**41.27**	41.08	**40.20**	41.19
Efficiency ratio***	**59.43**	60.35	**61.07**	61.00
Tier I capital ratio			**10.65**	11.51
Total capital ratio			**11.89**	12.85
Leverage ratio			**8.94**	9.47

* *Includes loans held for sale.*

** *Revenue includes net interest income and non-interest income.*

*** *The efficiency ratio is calculated as non-interest expense (excluding intangibles amortization) as a percent of revenue.*

Results of Operations

Summary

	Three Months Ended June 30			Six Months Ended June 30		
(Dollars in thousands)	**2007**	2006	% Change	**2007**	2006	% Change
Net interest income	**$ 133,864**	$ 126,479	5.8%	**$ 265,343**	$ 250,214	6.0%
Provision for loan losses	**(9,054)**	(5,672)	59.6	**(17,215)**	(10,104)	70.4

Non-interest income	**94,059**	88,179	6.7	**178,343**	175,224	1.8
Investment securities gains (losses), net	**(493)**	3,284	(115.0)	**3,402**	5,687	(40.2)
Non-interest expense	**(136,349)**	(129,550)	5.2	**(272,768)**	(259,511)	5.1
Income taxes	**(26,453)**	(27,387)	(3.4)	**(50,035)**	(53,233)	(6.0)
Net income	**$ 55,574**	$ 55,333	.4%	**$ 107,070**	$ 108,277	(1.1)%

For the quarter ended June 30, 2007, net income amounted to $55.6 million, an increase of $241 thousand, or .4%, over the second quarter of the previous year. For the current quarter, the annualized return on average assets was 1.46%, the annualized return on average equity was 15.12%, and the efficiency ratio was 59.43%. Compared to the second quarter of last year, net interest income increased 5.8%, mainly due to loan growth and higher yields. Non-interest income grew 6.7%, with increases in bank card, deposit account and trust fee income. Net gains reported on securities transactions and valuations declined $3.8 million. The provision for loan losses amounted to $9.1 million for the quarter, a $3.4 million increase over the second quarter of last year. Non-interest expense grew by 5.2%, with most of the increase related to salaries and employee benefits. Diluted earnings per share was $.79, an increase of 1.3% over $.78 per share in the second quarter of 2006.

Net income for the first six months of 2007 was $107.1 million, a $1.2 million, or 1.1%, decrease from the first six months of 2006. For the first six months of 2007, the annualized return on average assets was 1.42%, the annualized return on average equity was 14.77%, and the efficiency ratio was 61.07%. The decrease in net income was primarily due to a 5.1% increase in non-interest expense and a $7.1 million increase in the provision for loan losses. These effects were partly offset by a 6.0% increase in net interest income and a 1.8% increase in non-interest income. Diluted earnings per share of $1.52 for the first six months of 2007 was unchanged from the same period in the prior year.

Effective April 1, 2007, the Company completed the acquisition of South Tulsa Financial Corporation (South Tulsa). In this transaction, the Company acquired the outstanding stock of South Tulsa and issued 561,951 shares of Company stock valued at $27.6 million. The Company s acquisition of South Tulsa added $114.7 million in loans, $103.9 million in deposits and two branch locations in Tulsa, Oklahoma. Goodwill of $11.4 million and core deposit premium of $2.7 million were recorded in this transaction.

In the third quarter of 2006, the Company acquired certain assets and assumed certain liabilities of Boone National Savings and Loan Association in central Missouri through a purchase and assumption agreement. Loans and deposits of $126.4 million and $100.9 million, respectively, were acquired, and goodwill and core deposit premium of $15.6 million and $2.6 million, respectively, were recorded as a result of this transaction. During the same quarter, the Company acquired the outstanding stock of West Pointe Bancorp, Inc. in Belleville, Illinois, which added $508.8 million in assets (including $255.0 million in loans) and $381.8 million in deposits. Goodwill of $38.7 million and core deposit premium of $14.9 million were recorded in this transaction.

On July 1, 2007, the Company completed the acquisition of Commerce Bank in Denver, Colorado. In this transaction, the Company acquired the outstanding stock of Commerce Bank for $29.5 million in cash. The acquisition added $74.5 million in loans, $72.2 million in deposits and the Company s first location in Colorado.

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Net Interest Income

The following table summarizes the changes in net interest income on a fully taxable equivalent basis, by major category of interest earning assets and interest bearing liabilities, identifying changes related to volumes and rates. Changes not solely due to volume or rate changes are allocated to rate.

Analysis of Changes in Net Interest Income

	Three Months Ended June 30, 2007 vs. 2006			Six Months Ended June 30, 2007 vs. 2006		
	Change due to			Change due to		
(In thousands)	Average Volume	Average Rate	Total	Average Volume	Average Rate	Total
Interest income, fully taxable equivalent basis:						
Loans	$ 20,795	$ 7,489	$ 28,284	$ 40,387	$ 19,963	$ 60,350
Loans held for sale	1,148	(479)	669	773	715	1,488
Investment securities:						
U.S. government and federal agency securities	(2,476)	522	(1,954)	(5,323)	993	(4,330)
State and municipal obligations	2,764	287	3,051	6,494	688	7,182
Mortgage and asset-backed securities	(1,631)	2,051	420	(3,475)	4,717	1,242
Other securities	(756)	(130)	(886)	(1,550)	102	(1,448)
Total interest on investment securities	(2,099)	2,730	631	(3,854)	6,500	2,646
Federal funds sold and securities purchased under agreements to resell	4,367	349	4,716	9,049	1,269	10,318
Total interest income	24,211	10,089	34,300	46,355	28,447	74,802
Interest expense:						
Deposits:						
Savings	13	(14)	(1)	31	(9)	22
Interest checking and money market	2,294	4,517	6,811	3,305	11,513	14,818
Time open & C.D. s of less than $100,000	3,685	4,538	8,223	7,478	10,579	18,057
Time open & C.D. s of $100,000 and over	3,446	2,214	5,660	4,176	5,210	9,386
Total interest on deposits	9,438	11,255	20,693	14,990	27,293	42,283

Federal funds purchased and securities sold under agreements to repurchase	2,126	2,471	4,597	9,645	7,494	17,139
Other borrowings	959	(79)	880	(1,163)	(193)	(1,356)
Total interest expense	12,523	13,647	26,170	23,472	34,594	58,066
Net interest income, fully taxable equivalent basis	$ 11,688	$ (3,558)	$ 8,130	$ 22,883	$ (6,147)	$ 16,736

Net interest income in the second quarter of 2007 amounted to $133.9 million, which increased $7.4 million, or 5.8%, compared to the second quarter of last year. The growth in net interest income was the result of loan growth, coupled with higher average rates earned on loans. These increases were partially offset by an increase in average rates paid on interest bearing deposits and higher levels of deposits and borrowings. During the second quarter of 2007, the net yield on earning assets (tax equivalent) was 3.82%, compared with 3.98% in the same quarter last year. For the first six months of 2007, net interest income totaled $265.3 million, a $15.1 million increase over net interest income of $250.2 million in the first six months of 2006. The net yield on earning assets declined by 15 basis points during the first six months of 2007 to 3.83%, compared with 3.98% in the same period last year.

Total interest income increased $33.6 million, or 16.8%, over the second quarter of 2006. The increase was the result of higher loan interest income, which grew $28.3 million on a tax equivalent basis (excluding loans held for sale), or 18.1%. The growth in loan interest income was mainly due to an increase of $1.2 billion in average loan balances outstanding, which included increases of $440.4 million in business loans, $227.4 million in business real estate loans, $148.8 million in personal real estate loans, and $185.8 million in consumer loans. Also, overall average rates earned on the loan portfolio increased 29 basis points and contributed $7.5 million in tax equivalent interest income. The second quarter of 2007 included the effects of bank acquisitions during the third quarter of 2006 and the second quarter of 2007, which contributed average loan growth of $454.3 million and related loan income of $8.6 million in the second quarter of 2007. The second quarter of 2006 included a $1.3 million increase to loan income, resulting from the Company s decision at that time to classify its student loan portfolio as held for sale and to cease amortization of deferred costs related to those loans. Total interest income was also slightly impacted by the level and yields of the investment securities portfolio. Average yields rose 40 basis points during the second quarter of 2007 compared to the second quarter of 2006, which contributed $2.7 million in tax equivalent income. This increase was partly offset by lower average balances in the securities portfolio. While the total portfolio declined $242.2 million on average compared to the second quarter of 2006, investments in state and municipal securities rose from 9.9% of the portfolio in the second quarter of 2006 to 18.3% in the second quarter of 2007 and contributed $3.1 million on a tax equivalent basis. The average tax equivalent yield on interest earning assets was 6.60% in the second quarter of 2007 compared to 6.25% in the second quarter of 2006.

Compared to the first six months of 2006, total interest income increased $73.2 million, or 18.9%. The increase reflects similar trends as noted in the quarterly comparison above, with higher average rates earned on higher loan balances, contributing an increase of $60.4 million in tax equivalent interest income. The rate increase was the result of increases in the federal funds rate ordered earlier in 2006 by the Federal Reserve. Securities interest income in the first six months of 2007 compared to the prior period rose $2.6 million on a tax equivalent basis, due mainly to higher yields. Average yields on securities rose 45 basis points over the prior period, partly offset by a $225.9 million decline in average balances, as proceeds from maturities and pay downs were shifted to fund loan growth. Interest earned on overnight investments in federal funds sold and resale agreements rose $10.3 million over the prior period, primarily due to a $387.6 million increase in average balances. The average tax equivalent yield on total interest earning assets for the six months was 6.61% in 2007 and 6.14% in 2006.

Total interest expense increased $26.2 million, or 36.0%, compared to the second quarter of 2006. This increase was mainly the result of growth in deposit interest expense of $20.7 million, due to a 53 basis point increase in average rates paid, in addition to a $1.0 billion increase in average interest bearing deposit balances. Average rates paid on overnight borrowings increased 44 basis points, along with a $257.9 million increase in average borrowings, causing interest expense on federal funds purchased and securities sold under agreements to repurchase to increase $4.6 million. The average rate paid on all interest bearing liabilities increased to 3.04% in the second quarter of 2007 compared to 2.49% in the second quarter of 2006.

For the first six months of 2007, total interest expense increased $58.1 million, or 42.2%, compared with the previous year. Most of the growth was due to higher deposit interest expense of $42.3 million. Both higher interest bearing deposit balances, which rose $889.7 million, and higher rates paid, which rose 60 basis points, contributed to the increase. Interest expense on overnight borrowings grew $17.1 million, which was due to both higher balances and higher rates paid. The overall average cost of total interest bearing liabilities was 3.03% for the first six months of

2007 compared to 2.37% for the same period in 2006.

Summaries of average assets and liabilities and the corresponding average rates earned/paid appear on the last page of this discussion.

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Non-Interest Income