Bancorp, Inc.
Form 10-K
March 16, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2006

OR

¨ **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 51018

The Bancorp, Inc.

(exact name of registrant as specified in its charter)

Delaware	**23-3016517**
(State or other jurisdiction of	**(IRS Employer**
incorporation or organization)	**Identification No.)**
405 Silverside Road, Wilmington, DE	**19809**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code: (302) 385-5000

Securities registered pursuant to section 12(b) of the Act:

Title of each Class	Name of each Exchange on which Registered
None	**None**

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, par value $1.00 per share

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

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

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

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

The aggregate market value of the common shares of the registrant held by non-affiliates of the registrant, based upon the closing price of such shares on June 30, 2006 of $25.01, was approximately $342 million.

As of March 12, 2007, 13,772,820 shares of common stock, par value $1.00 per share, of the registrant were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the proxy statement for registrant s 2006 Annual Meeting of Shareholders are incorporated by reference in Part III of this Form 10-K.

THE BANCORP, INC.

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FORWARD LOOKING STATEMENTS

The Securities and Exchange Commission, or SEC, encourages companies to disclose forward-looking information so that investors can better understand a company s future prospects and make informed investment decisions. This report contains such forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or Exchange Act.

Words such as anticipates, estimates, expects, projects, intends, plans, believes and words and terms of similar substance used in conne any discussion of future operating a financial performance identify forward-looking statements. Unless we have indicated otherwise, or the context otherwise requires, references in this report to we, us, and our or similar terms, are to The Bancorp, Inc. and its subsidiaries.

We claim the protection of the safe harbor for forward-looking statements provided in the Private Securities Litigation Reform Act of 1995. These statements may be made directly in this report and they may also be incorporated by reference in this report to other documents filed with the SEC, and include, but are not limited to, statements about future financial and operating results and performance, statements about our plans, objectives, expectations and intentions with respect to future operations, products and services, and other statements that are not historical facts. These forward-looking statements are based upon the current beliefs and expectations of our management and are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are difficult to predict and generally beyond our control. In addition, these forward-looking statements are subject to assumptions with respect to future business strategies and decisions that are subject to change. Actual results may differ materially from the anticipated results discussed in these forward-looking statements.

The following factors, among others, could cause actual results to differ materially from the anticipated results or other expectations expressed in the forward-looking statements:

- the risk factors discussed and identified in Item 1A of this report and in other of our public filings with the SEC;
- our expected growth may not be fully realized or may take longer to realize than expected;
- operating costs may be greater than expected;
- adverse governmental or regulatory policies may be enacted;
- management and other key personnel may be lost;
- competition may increase;
- we may be unable to obtain sufficient deposits or other funds at attractive rates, or otherwise, to fund our expected loan growth;
- fluctuations in interest rates may affect our revenue and the value of our assets;
- adverse market trends may affect the value of real estate and other assets that secure our loans;
- the costs of our interest-bearing liabilities, principally deposits, may increase relative to the interest received on our interest-bearing assets, principally loans;

the geographic concentration of our loans could result in our loan portfolio being adversely affected by economic factors unique to the geographic area and not reflected in other regions of the country;

- the market value of real estate that secures our loans could diminish due to factors outside of our control such as natural disasters, changes in neighborhood values, competitive overbuilding, weather, casualty losses, occupancy rates and other similar factors; and

- general business and economic conditions could adversely affect credit quality and loan origination.

We caution you not to place undue reliance on these forward-looking statements, which speak only as of the date of this report. All subsequent written and oral forward-looking statements attributable to us or any person acting on our behalf are expressly qualified in their entirety by the cautionary statements contained or referred to in this section. Except to the extent required by applicable law or regulation, we undertake no obligation to update these forward-looking statements to reflect events or circumstances after the date of this filing or to reflect the occurrence of unanticipated events.

PART I

Item 1. Business.

General

We are a Delaware financial holding company with a wholly owned subsidiary, The Bancorp Bank, which we refer to as the Bank. Through the Bank, we provide a wide range of commercial and retail banking products and services to both regional and national markets. We were formed in 1999 and commenced operations in July 2000. From our formation until February 2004 we were the sole stockholder of the Bank. In February 2004, the Bank completed a public offering of its common stock which resulted in our holding 32.7% of the Bank s common stock. In December 2004, we completed a reorganization with the Bank which resulted in the Bank once again becoming our wholly-owned subsidiary.

Regionally, our target market is the greater Philadelphia-Wilmington metropolitan area, consisting of the 12 counties surrounding Philadelphia and Wilmington including Philadelphia, Delaware, Chester, Montgomery, Bucks and Lehigh Counties in Pennsylvania, New Castle County in Delaware and Mercer, Burlington, Camden, Ocean and Cape May Counties in New Jersey. We believe that changes in this market have created an underserved base of small and middle-market businesses and high net worth individuals that are interested in banking with a company headquartered in, and with decision-making authority based in, the Philadelphia-Wilmington area. We believe that our presence in the area provides us with insights as to the local market and, as a result, with the ability to tailor our products and services, and particularly the structure of our loans, more closely to the needs of our targeted customers. We seek to develop overall banking relationships with our targeted customers so that our lending operations serve us a generator of deposits and our deposit relationships serve a source of loan assets. We believe that our regional presence also allows us to oversee and further develop our existing customer relationships.

To serve our regional customers, we provide a full range of retail and commercial banking services, including a variety of checking, savings and other interest-bearing accounts. We feature accounts with no required minimum balance, no service fees, rebates on ATM fees, free debit Visa check card, overdraft protection plans and, on our interest-bearing accounts, competitive interest rates. Our business lending services focus on secured loans and lines of credit, construction loans and customized equipment and vehicle leasing programs. Our consumer lending services focus on home equity loans, personal and home equity lines of credit, personal installment loans and vehicle leasing.

Nationally, we provide banking services to the members and employees of organizations or businesses, which we call affinity group banking. We provide online banking under the name of and through the facilities of the affinity group, referred to as private label banking, and offer an affinity group the ability to customize the banking services offered on the website to respond to the needs and preferences of its members. Our affinity group relationships serve as a source of deposits and also as a source for loans, such as security or home equity lines of credit, where credit decisions are primarily statistically-based.

As part of our national affinity group banking operations,, we have developed a system for processing credit and debit card transactions for independent sales organizations and their merchant members that is a source of fee income for us and, because the merchant members must maintain accounts with us, a source of low-cost deposits. By using our services rather than those of other banks, independent service organizations remove potential competitors from the relationship between the independent service organization and its merchant customers, since we do not offer any products comparable to those of the independent service organization. Our infrastructure allows us to process a high volume of transactions that permit merchant customers to access the card associations and debit networks at a significantly lower cost. We offer end-to-end services, which means that we believe we have the ability to fulfill all of our customers needs with respect to merchant card services and funds transfers. We market our services through a variety of sales channels that includes affinity groups and independent sales organizations and financial institutions.

Our customers access our banking services through our website, or the website of their affinity group, from any personal computer with a web browser, and obtain cash withdrawals from automated teller machines. As a result, we do not maintain a branch bank system.

Our offices are located at 405 Silverside Road, Wilmington, Delaware 19809 and our telephone number is (302) 385-5000. We also maintain executive offices at 1818 Market Street, Philadelphia, Pennsylvania 19103. Our web address is www.thebancorp.com. We make available free of charge on our website our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports as soon as reasonably practicable after we file them with the SEC.

Our Strategy

Our principal growth strategies are to:

Build upon the network of relationships developed by our senior management. We seek to build upon our senior managers network of relationships through the regional division of the Bank that targets individuals and businesses in the greater Philadelphia-Wilmington metropolitan area with which our senior management has developed relationships. This division seeks to offer these customers products and services that meet their banking and financing needs, and to provide them with the attention of senior management which we believe is often lacking at larger financial institutions. The division offers a staff of people experienced in dealing with, and solving, the banking and financing needs of small to mid-size businesses. The website for the division is www.philadelphiaprivatebank.com.

Develop relationships with affinity groups to gain sponsored access to their membership, client or customer bases to market our banking products and services. We seek to develop relationships with organizations with established membership, client or customer bases. Through these affinity group relationships, we gain access to the affinity groups members, clients and customers through their pre-existing relationships with the groups, and under the groups sponsorship. We seek to build on these relationships by offering private label banking. We believe that by marketing targeted products and services to constituencies through their pre-existing relationships with affinity groups, we will lower our customer acquisition costs and build close customer relationships.

Develop Relationships with Small to Mid-Size Businesses and Their Principals. Our target market regionally is small to midsize businesses and their principals. We believe that satisfactory attention to this market requires a combination of the ability to provide a high level of services, including customized financing to meet a customer s needs, and the personal attention of senior management. Because of the significant consolidation of banking institutions in the Philadelphia-Wilmington metropolitan area, we believe that many of the financial institutions with which we compete may have become too large to provide those services efficiently and cost-effectively.

Use Our Existing Infrastructure as a Platform for Growth. We have made significant investments in our banking infrastructure in order to be able to support our growth. We believe that this infrastructure can accommodate significant additional growth without substantial additional expenditure. We believe that this infrastructure enables us to maximize efficiencies in both our regional market and our national affinity group market through economies of scale as we grow without adversely affecting our relationships with our customers.

Products and Services

Deposit Products and Services. We offer our depositors a wide range of products and services, including:

checking accounts, featuring no required minimum balance, no service fees, competitive interest rates, rebates on automated teller machine fees, free debit Visa check card and overdraft protection plans; premium checking accounts have free online bill paying, an enhanced debit Visa check card or an automated teller machine card;

savings accounts;

health savings accounts;

money market accounts;

individual retirement accounts, including Roth and education IRAs as well as traditional IRAs;

commercial accounts, including general commercial checking, small business checking, business savings and business money market accounts;

certificates of deposit; and

stored value and payroll cards.

Lending Activities. At December 31, 2006, we had a loan portfolio of $1.065 billion, representing 79.8% of our total assets at that date. We originate substantially all of the loans held in our portfolio, except in certain instances we have purchased individual lease and lease pools. Where a proposed loan exceeds our lending limit, we typically sell a participation in the loan to another financial institution. We generally separate our lending function into commercial term loans, commercial mortgage loans, commercial lines of credit, construction loans, direct lease financing and personal loans. We focus primarily on lending to small to mid-size businesses and their principals. As a result, commercial, construction and commercial mortgage loans have comprised a majority of our loan portfolio since we commenced operations. At December 31, 2006, commercial, construction and commercial mortgage loans made up $802.1 million, or 75.3%, of our total loan portfolio. These types of loans are generally viewed as having more risk of default than residential real estate loans or consumer loans and are typically larger than residential real estate and consumer loans.

While in making our loans we rely upon our evaluation of the creditworthiness and debt-servicing capability of a borrower, we typically require that our loans be secured by tangible collateral, usually residential or commercial real property. We do not typically engage in non-recourse lending (that is, lending as to which the lender only looks to the asset securing the loan for repayment) and will typically require the principals of any commercial borrower to personally guarantee the loan. In general, we require that the ratio of the principal amount of a loan to the value of the collateral securing it be no greater than between 65% to 85% depending on the type of property and its use. The maturity dates on our loans are generally short to mid-term. We typically seek to structure our loans with variable rates of interest based upon either a stated prime rate or the London Inter-Bank Offered Rate (Libor), although we do lend at fixed rates when appropriate for a particular customer.

Commercial Term Lending. We make loans to businesses to finance fixed assets, acquisitions and other long-term needs of our business customers. While the loans are generally secured, the loans are underwritten principally upon our evaluation of the future cash flows of the borrower. Maturities of these loans are typically five years or less and have amortization schedules that do not exceed the useful life of the asset to be acquired with the financing. As of December 31, 2006, commercial term loans were 5.9% of our total loan portfolio.

Commercial Mortgage Lending. We make loans to businesses to finance the acquisition of, or to refinance, income-producing real property. The principal repayment source for these loans is the property and the income it produces, which depends upon the operation of the property and its market value, although we also evaluate the creditworthiness of the borrower and guarantors as a second repayment source. These loans typically are secured by real estate which is either for rent or sale. Maturities on these loans generally do not exceed 10 years, although they may have an extended amortization schedule resulting in a balloon payment due at maturity. As of December 31, 2006, commercial mortgages were 20.6% of our total loan portfolio.

Commercial lines of credit. Lines of credit are typically short-term facilities intended to support seasonal cash needs. They may be secured or unsecured, depending on the purpose, anticipated repayment source and financial condition of the borrower. This form of financing is typically self-liquidating as repayment comes from the conversion of the financed assets to cash. All lines of credit are payable on demand and the availability of the

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line of credit is subject to a periodic review of the borrower s financial information. Generally, lines of credit terminate between one year and 18 months after they have been established. Lines of credit that have termination dates in excess of one year typically must be paid out at least annually. As of December 31, 2006, loans drawn from our outstanding commercial lines of credit were 23.0% of our total loan portfolio.

Construction Loans. The majority of our construction loans are made to residential developers for acquisition of land, site improvements and construction of single and multi-family residential units for sale. Terms of the loans are generally for no longer than two years. Repayment of these loans typically depends on the sale of the residential units to consumers or sale of the property to another developer. Loans to finance the construction of commercial or industrial properties require permanent financing upon completion of the construction. As of December 31, 2006, construction loans were 25.8% of our total loan portfolio.

Direct Lease Financing. Substantially all of our leases are for financing commercial automobile fleets. We expanded our traditional market of small commercial fleets through the acquisition of Mears Motor Livery in January 2005 to include government municipalities and agencies. As of December 31, 2006, direct lease financing made up 8.7% of our total loan portfolio.

Consumer Loans. We provide loans to consumers to finance personal residences, automobiles, home improvements and other personal wants. The majority of our consumer loans are secured by either the borrower s residence, typically in a first or second lien position, or the borrower s securities portfolio. The ratio of loan amount to the value of the collateral securing the loan is typically less than 85% on loans collateralized by real estate and less than 50% on loans collateralized by securities; however, based on a borrower s financial strength, we may increase the ratio. As of December 31, 2006, consumer loans were 16.0% of total loan portfolio.

Other Operations

Account Activity. Account holders may access our products and services through the websites of their affinity groups, or through our website, from any personal computer with a secure web browser, regardless of its location. This access allows account holders to apply for loans, review account activity, enter transactions into an on-line account register, pay bills electronically, receive statements by mail and print bank statement reports. To open a new account, a customer must complete a simple on-line enrollment form. Customers can make deposits into an open account via direct deposit programs, by transferring funds between existing accounts, by wire transfer, by mail, at any deposit-taking automated teller machine, at any of the more than 3,400 UPS Stores throughout the United States, or in person at our Delaware offices (although we do not maintain a teller line and do not currently intend to establish a physical branch system). Customers may also make withdrawals and have access to their accounts at automated teller machines.

Call Center. We have a call center as a customer support service as well as for outbound telemarketing efforts. The call center provides account holders or potential account holders with assistance in opening accounts, applying for loans or otherwise accessing the Bank s products and services, and in resolving any problems that may arise in the servicing of accounts, loans or other banking products. The call center operates from 8:00 a.m. to 8:00 p.m., Delaware time, on weekdays. Outside these hours, and on weekends, we outsource call center operations to a third-party service provider. We currently employ twelve persons in our call center, including one supervisor.

Third-Party Service Providers. To reduce operating costs and to capitalize on the technical capabilities of selected vendors, we arrange for the outsourcing of specific bank operations and systems to third-party service providers, principally the following:

- fulfillment functions and similar operating services, including check processing, check imaging, electronic bill payment and statement rendering;

- issuance and servicing of debit cards;

compliance and internal audit;

access to automated teller machine networks;

processing and temporarily funding residential mortgage loans where we will not hold the loans in our portfolio;

bank accounting and general ledger system; and

data warehousing services.

Because we outsource these operational functions to experienced third-party service providers that have the capacity to process a high volume of transactions, we believe it allows us to more readily and cost-effectively respond to growth than if we sought to develop these capabilities internally. Should any of our current relationships terminate, we believe we could secure the required services from an alternative source without material interruption of our operations.

The Affinity Group Relationship

We seek to create a unique banking website for each affinity group, enabling the affinity group to provide its members with the full banking services and products we offer or just those banking services and products it believes will be of interest to its members. We design each website to carry the brand of the affinity group and carry the look and feel of the affinity group s own website. Each such website, however, indicates that we provide all banking services. To facilitate the creation of these individualized banking websites, we have packaged our products and services into a series of modules, with each module providing a specific service, such as basic banking, electronic payment systems and loan and mortgage centers. Each affinity group selects from our menu of service modules those services that it wants to offer its members or customers. We and the affinity group also may create products and services, or modify products and services already on our menu, that specifically relate to the needs and interests of the affinity group s members or customers. We pay fees to the affinity group based upon deposits and loans it generates through our program with it. The fees typically range from between 25 to 100 basis points (0.25% to 1.00%) of average deposits and loans generated by the relationship and outstanding in the period, with the lower fees being charged on interest-bearing deposits and loans with lower interest rates. We include these fees as a component of expense in calculating our net interest margin. In the year ended December 31, 2006, these fees aggregated $1.3 million.

As a result of our initial investment in developing private-label banking software, we have reduced the time, personnel and expense in establishing a privately-labeled banking website providing core banking products and services to an affinity group to approximately two weeks of dedicated time of one of our technical staff members, at a cost of approximately $9,000.

We currently have 138 affinity group relationships, as follows:

Thirty affinity group relationships are with health care providers, third party administrators and benefit administrators who facilitate the enrollment of both groups and individuals in high deductible health plans and health savings accounts. Our health savings account program provides entities a turnkey, low-cost way to provide this benefit to their members. Under these programs, we open health savings accounts offered in a privately-labeled banking environment, which enables the affinity groups members to access account information, conduct transactions and process payments to health care providers.

Sixty-four affinity group relationships are with independent service organizations. These organizations provide operating and settlement accounts to their merchant members, enabling the merchants to service their client base from the point at which a credit or debit card transaction occurs through settlement of that transaction. We have created banking products that enable those organizations to more easily process electronic payments and maintain reserve accounts as protection against chargebacks and losses from the parties with which they deal. Our services also enable independent service organizations to provide their members with access to their account balances through the Internet. By using our services rather than those of other banks, independent service organizations remove potential competitors from the relationship between the independent service organization and its merchant customers, since we do not offer any products comparable to those of the independent service organization. In addition to the customary banking fees generated by these relationships (which we share with the independent service organizations), these relationships are a source of low-cost deposits for us because of the settlement and reserve checking accounts that merchants affiliated with the independent service organization must maintain with us.

Forty-four affinity group relationships are with businesses and a forty-fifth relationship is with a university. We offer these organizations, and other institutions with which we may develop relationships, privately-labeled full service retail banking or, at the organization s option, a selection of banking services and products targeted to the needs or preferences of its members. In addition, we separately market a treasury program to these organizations that provides transaction processing and maintenance services to managers of the organization.

Sales and Marketing

Private Banking Division. We have established a private banking division that targets a customer base of successful individuals and business owners in the Philadelphia area and uses a personal contact/ targeted media advertising approach. This program consists of:

direct e-mail and letter introductions to senior management s contacts;

invitation-only, private receptions with prominent business leaders in the Philadelphia community;

advertisements in local media outlets, principally newspapers and radio stations; and

charitable sponsorships.

Affinity Group Marketing. We pursue affinity group relationships through the contacts of our senior management. We seek to attract customers from an affinity group s community not only by our presence on the affinity group s website and through targeted marketing programs to the affinity group s members, but also through the quality of our products and services.

Loan Production Offices. We maintain three loan production offices in the Philadelphia metropolitan area. We established these offices to serve suburban areas south (our Exton, Pennsylvania office), west (our Media, Pennsylvania office) and north (our Warminster, Pennsylvania office) of center city Philadelphia. In addition, we maintain three offices to market and administer our automobile leasing programs, one in Maryland, one in Alabama and one in Florida in connection with our acquisition of Mears Motor Livery in 2005.

Marketing Staff. We have a marketing department, currently consisting of nine peoples that focus on developing marketing campaigns to particular affinity group communities and the targeted audience of the Philadelphia Private Bank.

Technology

Core and Internet Banking Systems. We obtain a significant portion of our core and internet banking systems and operations under non-exclusive licenses between us and Metavante (previously M&I Data Services). These systems principally include those for general ledger and deposit, loan and checks processing. In 2005 we converted our internet banking platform to a product offered by Digital Insight Corporation. The Digital Insight platform is front end system used by customers to access their account via the internet.

Software. We have internally-developed software to provide our online and traditional banking products and services. We have developed a series of financial services modules that are easy to deploy and that we can readily adopt to serve a customers needs. We developed these modules using an open architecture and object-oriented technologies. We use the modules to extend the functionality of our core and internet banking systems and to personalize financial services to the constituencies we serve.

System Architecture. We provide financial products and services through a highly-secured four-tiered architecture using the Microsoft Windows 2003 operating system, Microsoft Internet Information Server web server software, Microsoft SQL 2005, Microsoft.net, CheckPoint Systems and Cisco Systems firewalls, and our licensed and proprietary financial services software. User activity is distributed and load-balanced across multiple servers on each tier through our proprietary software and third-party equipment, which maintain replicated, local storage of underlying software and data, resulting in minimal interdependencies among servers. Each server is backed up to a Storage Area Network (SAN) that replicates across locations. The system s flexible architecture is designed to have the capacity, or to be easily expanded to add capacity, to meet future demand. In addition to built-in redundancies, we continuously operate automated internal monitoring tools and independent third parties continuously monitor our websites.

Our primary website hosting facility is in Wilmington, Delaware and connects to the Internet by Cisco routers through Internap s New York network operating center and US LEC s, Bethlehem, Pennsylvania network operating center. We also maintain a completely redundant standby hosting facility at our Philadelphia offices. Internap s New York network operating center provides Internet connectivity to the Philadelphia offices.

Intellectual Property and Other Proprietary Rights

Since a significant portion of the core and internet banking systems and operations we use come from third-party providers, our primary proprietary intellectual property is the software for creating affinity group bank websites. We rely principally upon trade secret and trademark law to protect our intellectual property. We do not typically enter into confidentiality agreements with our employees or our affinity group customers because we maintain control over the software used to create the sites and their banking functions rather than licensing them for customers to use. Moreover, we believe that factors such as the relationships we develop with our affinity group and banking customers, the quality of our banking products, the level and reliability of the service we provide, and the customization of our products and services to meet the need of our affinity group and other customers are substantially more significant to our ability to succeed.

Competition

We believe that our principal competition is mid-Atlantic regional banks such as Citizens Bank, Sovereign Bank, Commerce Bank, Royal Bank and Republic First Bank. While we also believe that we face competition from Internet-based banks or bank divisions such as ING Direct and E-Trade Bank, we compete more directly with National Interbanc and Virtual Bank, Internet-based banks that provide private labeled financial services to affinity groups and communities. We also compete more generally with numerous other banks and thrift institutions, mortgage brokers and other financial institutions such as finance companies, credit unions, insurance companies, money market funds, investment firms and private lenders, as well as on-line computerized services and other non-traditional competitors. We believe that our ability to compete successfully depends on a number of factors, including:

- our ability to build upon the customer relationships developed by our senior management;

- our ability to expand our affinity group banking program;

- competitors interest rates and service fees;

- the scope of our products and services;

- the relevance of our products and services to customer needs and demands and the rate at which we and our competitors introduce them;
- satisfaction of our customers with our customer service;
- ease of use of our banking website;
- the capacity, reliability and security of our network infrastructure; and
- industry and general economic trends.

If we experience difficulty in any of these areas, our competitive position could be materially adversely affected, which would affect our growth, our profitability and, possibly, our ability to continue operations. While the banking industry is highly competitive, we believe we can compete effectively as a result of our focus on small to mid-size businesses and their principals, a market segment we believe is under-served in our region. However, many of our competitors have larger customer bases, greater name recognition and brand awareness, greater financial and other resources and longer operating histories which may make it difficult for us to compete effectively. Our future success will depend on our ability to compete effectively in a highly competitive market and geographic area.

Regulation Under Banking Law

We are extensively regulated under both federal and state banking law. We are a Delaware corporation and a registered bank holding company that is also a registered financial holding company. We are also subject to supervision and regulation by the Federal Reserve and the Delaware Office of the State Bank Commissioner.

The Bank, as a state-chartered depository institution, is supervised by the Delaware Office of the State Bank Commissioner, as well as the Federal Deposit Insurance Company, or FDIC. The Bank is subject to requirements and restrictions under federal and state law, including requirements to maintain reserves against deposits, restrictions on the types and amount of loans that may be made and the interest that may be charged, and limitations on the types of investments that may be made and the types of services that may be offered. Various consumer laws and regulations also affect the Bank s operations.

Federal Regulation

As a bank holding company, we must file annual reports with the Federal Reserve, provide any additional information that the Federal Reserve may request, and are subject to regular examination by the Federal Reserve.

Gramm-Leach-Bliley Act. The Gramm-Leach-Bliley Act, or GLBA, made extensive changes in the rules governing the financial services industry, particularly banking. It eliminated many of the restrictions placed upon the activities of bank holding companies and established a new type of bank holding company called a financial holding company. We were registered as a financial holding company in 2004. Financial holding companies are granted the authority to engage in financial activities that are beyond those of conventional bank holding companies and to affiliate with entities engaged in financial activities. While the Federal Reserve (together with the Treasury Secretary) is authorized to determine what a financial activity is, the GLBA provides that financial activities include:

- lending, investing for others or safeguarding money or securities;
- underwriting insurance and annuities as principal, agent or broker;
- providing financial, investment or economic advisory services;

issuing or selling interests in pools of assets permissible for a bank to hold directly;

engaging in any activity that the Federal Reserve found before the act to be a proper incident to banking; and

insurance portfolio investing.

The GLBA directs the Federal Reserve to define the following activities as financial in nature and the extent to which they are financial in nature:

lending, exchanging, transferring, investing for others or safeguarding financial assets other than money or securities; and

arranging financial transactions for the account of third parties.

The banking and nonfinancial subsidiaries of a financial holding company may not cross-sell each other s products and services where the financial holding company owns the non-financial subsidiary through the financial holding company s merchant banking authority or through its insurance subsidiary under its investment portfolio authority. However, insurance products or services may be marketed by Internet websites or statement inserts with Federal Reserve approval if there is no illegal tying arrangement. A bank also may not engage in a covered transaction with a controlled affiliate of a financial holding company. A covered transaction includes loans to, investments in, purchases of assets from or guaranteeing loans of the affiliate, or accepting securities of the affiliate as collateral for a loan.

Regulatory Restrictions on Dividends. It is the policy of the Federal Reserve that bank holding companies should pay cash dividends on common stock only out of income available over the past year and only if prospective earnings retention is consistent with the organization s expected future needs and financial condition. The policy provides that bank holding companies should not maintain a level of cash dividends that undermines the bank holding company s ability to serve as a source of strength to its banking subsidiaries. See Holding Company Liability, below. Federal Reserve policies also affect the ability of a bank holding company to pay in-kind dividends.

Various federal and state statutory provisions limit the amount of dividends that subsidiary banks can pay to their holding companies without regulatory approval. The Bank is also subject to limitations under state law regarding the payment of dividends, including the requirement that dividends may be paid only out of net profits. See Delaware Regulation below. In addition to these explicit limitations, federal and state regulatory agencies are authorized to prohibit a banking subsidiary or bank holding company from engaging in an unsafe or unsound banking practices. Depending upon the circumstances, the agencies could take the position that paying a dividend would constitute an unsafe or unsound banking practice.

Because we are a legal entity separate and distinct from the Bank, our right to participate in the distribution of assets of the Bank, or any other subsidiary, upon the Bank s or the subsidiary s liquidation or reorganization will be subject to the prior claims of the Bank s or subsidiary s creditors. In the event of a liquidation or other resolution of an insured depository institution, the claims of depositors and other general or subordinated creditors have priority of payment over the claims of holders of any obligation of the institution s holding company or any of its shareholders or creditors.

Holding Company Liability. Under Federal Reserve policy, a bank holding company is expected to act as a source of financial strength to each of its banking subsidiaries and commit resources to their support. Such support may be required at times when, absent this Federal Reserve policy, a holding company may not be inclined to provide it. As discussed below under Prompt Corrective Action, a bank holding company in certain circumstances could be required to guarantee the capital plan of an undercapitalized banking subsidiary.

In the event of a bank holding company s bankruptcy under Chapter 11 of the U.S. Bankruptcy Code, the trustee will be deemed to have assumed, and is required to cure immediately, any deficit under any commitment by the debtor holding company to any of the federal banking agencies to maintain the capital of an insured depository institution, and any claim for breach of such obligation will generally have priority over most other unsecured claims.

Capital Adequacy. The Federal Reserve and FDIC have issued standards for measuring capital adequacy for bank holding companies and banks. These standards are designed to provide risk-based capital guidelines and to incorporate a consistent framework. The risk-based guidelines are used by the agencies in their examination and supervisory process, as well as in the analysis of any applications to them to obtain approvals, including our applications for approval of the reorganization and for registration as a financial holding company. As discussed under Prompt Corrective Action, a failure to meet minimum capital requirements could subject us or the Bank to a variety of enforcement remedies available to federal regulatory authorities, including, in the most severe cases, termination of deposit insurance by the FDIC and placing the Bank into conservatorship or receivership.

In general, the risk-related standards require banks and bank holding companies to maintain capital based on risk-adjusted assets so that the categories of assets with potentially higher credit risk will require more capital backing than categories with lower credit risk. In addition, banks and bank holding companies are required to maintain capital to support off-balance sheet activities such as loan commitments.

The standards classify total capital for this risk-based measure into two tiers, referred to as Tier 1 and Tier 2. Tier 1 capital consists of common stockholders equity, certain non-cumulative perpetual preferred stock, and minority interests in equity accounts of consolidated subsidiaries, less certain adjustments. Tier 2 capital consists of the allowance for loan and lease losses (within certain limits), perpetual preferred stock not included in Tier 1, hybrid capital instruments, term subordinate debt, and intermediate-term preferred stock, less certain adjustments. Together, these two categories of capital comprise a bank s or bank holding company s qualifying total capital. However, capital that qualifies as Tier 2 capital is limited in amount to 100% of Tier 1 capital in testing compliance with the total risk-based capital minimum standards. Banks and bank holding companies must have a minimum ratio of 8% of qualifying total capital to risk-weighted assets, and a minimum ratio of 4% of qualifying Tier 1 capital to risk-weighted assets. At December 31, 2006, we and the Bank had a total capital to risk-adjusted assets ratios of 14.28% and 13.22%, respectively, and Tier 1 capital to risk-adjusted assets ratios of 13.50% and 12.44%, respectively.

In addition, the Federal Reserve and the FDIC have established minimum leverage ratio guidelines. The principal objective of these guidelines is to constrain the maximum degree to which a financial institution can leverage its equity capital base. It is intended to be used as a supplement to the risk-based capital guidelines. These guidelines provide for a minimum ratio of Tier 1 capital to adjusted average total assets of 3% for bank holding companies that meet certain specified criteria, including those having the highest regulatory rating. Other financial institutions generally must maintain a leverage ratio of at least 3% plus 100 to 200 basis points. The guidelines also provide that financial institutions experiencing internal growth or making acquisitions will be expected to maintain strong capital positions substantially above minimum supervisory levels, without significant reliance on intangible assets. Furthermore, the banking agencies have indicated that they may consider other indicia of capital strength in evaluating proposals for expansion or new activities. At December 31, 2006, we and the Bank had leverage ratios of 12.28% and 11.36%, respectively.

The federal banking agencies standards provide that concentration of credit risk and certain risks arising from nontraditional activities, as well as an institution s ability to manage these risks, are important factors to be taken into account by them in assessing a financial institution s overall capital adequacy. The risk-based capital standards also provide for the consideration of interest rate risk in the agency s determination of a financial institution s capital adequacy. The standards require financial institutions to effectively measure and monitor their interest rate risk and to maintain capital adequate for that risk.

These standards can be expected to be amended from time to time.

Prompt Corrective Action. Under the Federal Deposit Insurance Corporation Improvement Act of 1991, federal banking agencies must take prompt supervisory and regulatory actions against undercapitalized depository institutions. Depository institutions are assigned one of five capital categories well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized subjected to differential regulation corresponding to the capital category within which the institution falls. Under certain circumstances, a well capitalized, adequately capitalized or undercapitalized institution may be treated as if the institution were in the next lower capital category. As we describe in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources, an institution is deemed to be well capitalized if it has a total risk-based capital ratio of at least 10%, a Tier 1 risk-based capital ratio of at least 6.0% and a leverage ratio of at least 5% . An institution is adequately capitalized if it has a total risk-based capital ratio of at least 8%, a Tier 1 risk-based capital ratio of at least 4% and a leverage ratio of at least 4%. At December 31, 2006, our total risk-based capital ratio was 14.28%, our Tier 1 risk-based capital ratio was 13.50% and our leverage ratio was 12.28%, while the Bank s ratios were 13.22%, 12.44% and 11.36%, respectively. A depository institution is generally prohibited from making capital distributions (including paying dividends) or paying management fees to a holding company if the institution would thereafter be undercapitalized. Adequately capitalized institutions cannot accept, renew or roll over brokered deposits except with a waiver from the FDIC, and are subject to restrictions on the interest rates that can be paid on such deposits. Undercapitalized institutions may not accept, renew, or roll over brokered deposits. As of December 31, 2006, both we and the Bank were well capitalized within the meaning of the regulatory categories.

Banking regulatory agencies are permitted or, in certain cases, required to take action with respect to institutions falling within one of the three undercapitalized categories. Depending on the level of an institution s capital, the agency s corrective powers include, among other things:

- prohibiting the payment of principal and interest on subordinated debt;
- prohibiting the holding company from making distributions without prior regulatory approval;
- placing limits on asset growth and restrictions on activities;
- placing additional restrictions on transactions with affiliates;
- restricting the interest rate the institution may pay on deposits;
- prohibiting the institution from accepting deposits from correspondent banks; and
- in the most severe cases, appointing a conservator or receiver for the institution.

A banking institution that is undercapitalized must submit a capital restoration plan. This plan will not be accepted unless, among other things, the banking institution s holding company guarantees the plan up to an agreed-upon amount. Any guarantee by a depository institution s holding company is entitled to a priority of payment in bankruptcy. Failure to implement a capital plan, or failure to have a capital restoration plan accepted, may result in a conservatorship or receivership.

Community Reinvestment Act. Under the Community Reinvestment Act of 1977, which we refer to as the CRA, a federally-insured institution has a continuing and affirmative obligation to help meet the credit needs of its community, including low-and moderate-income neighborhoods, consistent with the safe and sound operation of the institution. The CRA requires the board of directors of federally-insured institutions, such as the Bank, to adopt a CRA statement for its assessment area that, among other things, describes its efforts to help meet community credit needs and the specific types of credit that the institution is willing to extend. The CRA further requires that a record be kept of whether a financial institution meets its community s credit needs, which record will be taken into account when evaluating applications for, among other things, domestic branches and mergers and acquisitions. The regulations promulgated pursuant to the CRA contain three evaluation tests:

a lending test which compares the institution s market share of loans in low-and moderate-income areas to its market share of loans in its entire service area and the percentage of the institution s outstanding loans to low-and moderate-income areas or individuals;

a services test, which evaluates the provision of services that promote the availability of credit to low-and moderate-income areas; and

an investment test, which evaluates an institution s record of investments in organizations designed to foster community development, small-and minority-owned businesses and affordable housing lending, including state and local government housing or revenue bonds.

The Bank was examined for CRA compliance in 2002 and received a satisfactory rating.

Control Acquisitions. The Change in Bank Control Act, which we refer to as the CBCA, prohibits a person or group of persons from acquiring control of a bank holding company unless the Federal Reserve has been notified and has not objected to the transaction. Under a rebuttable presumption established by the Federal Reserve, the acquisition of 10% or more of any class of voting securities of a bank holding company is presumed to be an acquisition of control of the holding company if:

the bank holding company has a class of securities registered under Section 12 of the Securities Exchange Act of 1934; or

no other person will own or control a greater percentage of that class of voting securities immediately after the transaction.

An acquisition of 25% or more of the outstanding shares of any class of voting securities of a bank holding company is conclusively deemed to be the acquisition of control. In determining percentage ownership for a person, Federal Reserve policy is to count securities obtainable by that person through option or warrant exercise, even if the options or warrants have not then vested.

Insurance of Deposit Accounts. The Bank s deposits are insured to the maximum extent permitted by the Bank Insurance Fund, or BIF. As the insurer, the FDIC is authorized to conduct examinations of, and to require reporting by, FDIC-insured institutions. It also may prohibit any FDIC-insured institution from engaging in any activity the FDIC determines by regulation or order to pose a serious threat to the FDIC. The FDIC also has the authority to initiate enforcement actions against banks. The FDIC has implemented a risk-based assessment system under which FDIC-insured depository institutions pay annual premiums at rates based on their risk classification. A bank s risk classification is based on its capital levels and the level of supervisory concern the bank poses to the regulators. Institutions assigned to higher risk classifications (that is, institutions that pose a greater risk of loss to the BIF) pay assessments at higher rates than institutions that pose a lower risk. A decrease in a bank s capital ratios or the occurrence of events that have an adverse effect on a bank s asset quality, management, earnings or liquidity could result in a substantial increase in deposit insurance premiums paid by a bank, which would adversely affect earnings. In addition, the FDIC can impose special assessments in certain instances. The range of assessments in the risk-based system is a function of the reserve ratio in the BIF. The current range of BIF assessments is between 0% and 0.27% of deposits because the BIF reserve ratio was greater than 1.25% when the ratios were set. In 2002, the BIF reserve ratio fell below 1.25%, creating the possibility that the FDIC would raise assessment rates, but in 2003 the ratio was slightly above 1.25%. At December 31, 2006 and December 31, 2005, the Bank s BIF assessment rate was 0%. If the BIF reserve ratio were to fall below 1.25% again, the FDIC would consider whether to levy higher assessments. Congress has also in the past considered proposals that would increase assessments on certain types of rapidly growing institutions. New FDIC assessment rules were proposed in July 2006 that may change the manner in which FDIC insurance premiums are assessed. These changes will likely not occur until sometime in 2007.

Federal Deposit Insurance Reform. On February 8, 2006, President Bush signed the Federal Deposit Insurance Reform Act of 2005 (FDIRA). Among other things, FDIRA changes the Federal deposit insurance system by:

raising the coverage level for retirement accounts to $250,000;

indexing deposit insurance coverage levels for inflation beginning in 2012;

prohibiting undercapitlzed financial institutions from accepting employee benefit plan deposits;

merging the Bank Insurance Fund and Savings Association Insurance Fund into a new Deposit Insurance Fund, or the DIF; and

providing credits to financial institutions that capitalized the FDIC prior to 1996 to offset future assessment premiums.

FDIRA also authorizes the FDIC to revise the current risk-based assessment system, subject to notice and comments, and caps the amount of the DIF at 1.50% of domestic deposits. The FDIC must issue cash dividends, awarded on a historical basis, for the amount of the DIF over the 1.50% ratio. Additionally, if the DIF exceeds 1.35% of domestic deposits at year-end, the FDIC must issue cash dividends, awarded on a historical basis, for half of the amount of the excess.

Loans-to-One Borrower. Generally, a bank may not make a loan or extend credit to a single or related group of borrowers in excess of 15% of its unimpaired capital and surplus. An additional amount may be lent, equal to 10% of unimpaired capital and surplus, if such loan is secured by specified collateral, generally readily marketable collateral (which is defined to include certain financial instruments and bullion) and real estate. At December 31, 2005, the Bank s limit on loans-to-one borrower was $21.5 million ($35.9 million for secured loans). At December 31, 2006, the Bank s largest aggregate outstanding balance of loans-to-one borrower was $25.3 million, which was secured.

Transactions with Related Parties. The Bank s authority to engage in transactions with related parties or affiliates (that is, any company that controls or is under common control with an institution, including us and our non-bank subsidiaries) is limited by Sections 23A and 23B of the Federal Reserve Act and Regulation W promulgated thereunder. Section 23A restricts the aggregate amount of covered transactions with any individual affiliate to 10% of the Bank s capital and surplus. At December 31, 2006, we were not indebted to the Bank. The aggregate amount of covered transactions with all affiliates is limited to 20% of the Bank s capital and surplus. Certain transactions with affiliates are required to be secured by collateral in an amount and of a type described in Section 23A and the purchase of low quality assets from affiliates is generally prohibited. Section 23B generally provides that certain transactions with affiliates, including loans and asset purchases, must be on terms and under circumstances, including credit standards, that are substantially the same or at least as favorable to the institution as those prevailing at the time for comparable transactions with non-affiliated companies.

Enforcement. Under the Federal Deposit Insurance Act, the FDIC has the authority to bring actions against a bank and all affiliated parties, including stockholders, attorneys, appraisers and accountants, who knowingly or recklessly participate in wrongful action likely to have an adverse effect on the bank. Formal enforcement action may range from the issuance of a capital directive or cease and desist order to removal of officers and/or directors to institution of receivership, conservatorship or termination of deposit insurance. Civil penalties cover a wide range of violations and can amount to $25,000 per day, or even $1 million per day in especially egregious cases. Federal law also establishes criminal penalties for certain violations.

Standards for Safety and Soundness. The Federal Deposit Insurance Act requires each federal banking agency to prescribe for all insured depository institutions standards relating to, among other things, internal controls, information and audit systems, loan documentation, credit underwriting, interest rate risk exposure, asset growth, and compensation, fees, benefits and such other operational and managerial standards as the agency deems appropriate. The federal banking agencies have adopted final regulations and Interagency Guidelines Prescribing Standards for Safety and Soundness to implement these safety and soundness standards. The guidelines set forth the safety and soundness standards that the federal banking agencies use to identify and address problems at insured depository institutions before capital becomes impaired. If the appropriate federal banking agency determines that an institution fails to meet any standard prescribed by the guidelines, the agency may require the institution to submit to the agency an acceptable plan to achieve compliance with the standard.

Federal Reserve System. Federal Reserve regulations require banks to maintain non-interest bearing reserves against their transaction accounts (primarily negotiated order of withdrawal, or NOW, and regular checking accounts). Federal Reserve regulations generally required for 2006 that reserves be maintained against aggregate transaction accounts as follows: for accounts aggregating $45.4 million or less (subject to adjustment by the Federal Reserve), the reserve requirement is 3%; and, for accounts aggregating greater than $45.4 million, the reserve requirement is $1.164 million plus 10% (subject to adjustment by the Federal Reserve to between 8% and 14%) of that portion of total transaction accounts in excess of $45.4 million. The first $6.6 million of otherwise reservable balances (subject to adjustments by the Federal Reserve) are exempt from the reserve requirements. At December 31, 2006, the Bank met these requirements.

USA Patriot Act. The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act was intended to detect, and prevent, the use of the United States financial system for money laundering and terrorist financing activities. The Act requests financial institutions, such as banks, to prohibit correspondent accounts with foreign shell banks, to establish an anti-money laundering program that includes employee training and an independent audit, to follow minimum standards for identifying customers and maintaining records of the identification information, and to make regular comparisons of customers against agency lists of suspected terrorists, terrorist organizations and money launderers.

Other regulations. Interest and other charges collected or contracted for by the Bank will be subject to state usury laws and federal laws concerning interest rates. The Bank s loan operations are also subject to federal laws applicable to credit transactions, such as:

- the federal Truth-In-Lending Act, governing disclosures of credit terms to consumer borrowers;
- the Home Mortgage Disclosure Act of 1975, requiring financial institutions to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the community it serves;
- the Equal Credit Opportunity Act, prohibiting discrimination on the basis of race, creed or other prohibited factors in extending credit;
- the Fair Credit Reporting Act of 1978, governing the use and provision of information to credit reporting agencies;
- the Fair Debt Collection Act, governing the manner in which consumer debts may be collected by collection agencies; and
- the rules and regulations of the various federal agencies charged with the responsibility of implementing these federal laws.

The deposit operations of the Bank will be subject to:

- the Right to Financial Privacy Act, which imposes a duty to maintain confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records; and
- the Electronic Funds Transfer Act and Regulation E issued by the Federal Reserve to implement that act, which govern automatic deposits to and withdrawals from deposit accounts and customers rights and liabilities arising from the use of automated teller machines and other electronic banking services.

Effect of governmental monetary policies. The commercial banking business is affected not only by general economic conditions but also by both U.S. fiscal policy and the monetary policies of the Federal Reserve. Some of the instruments of fiscal and monetary policy available to the Federal Reserve include changes in the discount rate on member bank borrowings, the fluctuating availability of borrowings at the discount window, open market operations, the imposition of and changes in reserve requirements against member banks deposits and assets of foreign branches, the imposition of and changes in reserve requirements against certain borrowings by

banks and their affiliates, and the placing of limits on interest rates that member banks may pay on time and savings deposits. Such policies influence to a significant extent the overall growth of bank loans, investments, and deposits and the interest rates charged on loans or paid on time and savings deposits. We cannot predict the nature of future fiscal and monetary policies and the effect of such policies on the future business and our earnings

Delaware Regulation

General. As a Delaware bank holding company, we are subject to the supervision of and periodic examination by the Delaware Office of the State Bank Commissioner and must comply with the reporting requirements of the Delaware Office of the State Bank Commissioner. The Bank, as a banking corporation chartered under Delaware law, is subject to comprehensive regulation by the Delaware Office of the State Bank Commissioner, including regulation of the conduct of its internal affairs, the extent and exercise of its banking powers, the issuance of capital notes or debentures, any mergers, consolidations or conversions, its lending and investment practices and its revolving and closed-end credit practices. The Bank also is subject to periodic examination by the Delaware Office of the State Bank Commissioner and must comply with the reporting requirements of the Delaware Office of the State Bank Commissioner. The Delaware Office of the State Bank Commissioner has the power to issue cease and desist orders prohibiting unsafe and unsound practices in the conduct of a banking business.

Limitation on Dividends. Under Delaware banking law, the Bank s directors may declare dividends on common or preferred stock of so much of its net profits as they judge expedient, but the Bank must, before the declaration of a dividend on common stock from net profits, carry 50% of its net profits of the preceding period for which the dividend is paid to its surplus fund until its surplus fund amounts to 50% of its capital stock and thereafter must carry 25% of its net profits for the preceding period for which the dividend is paid to its surplus fund until its surplus fund amounts to 100% of its capital stock.

Employees

As of February 1, 2007, we had 181 employees and believe our relationships with our employees to be good. Our employees are not employed under a collective bargaining agreement.

Item 1A. Risk Factors.

Risks Relating to our Business and Operations

We may have difficulty managing our growth which may divert resources and limit our ability to successfully expand our operations.

We expect to continue to experience significant growth in the amount of our assets, the level of our deposits and the scale of our operations. Our future profitability will depend in part on our continued ability to grow; however, we may not be able to sustain our historical growth rate or even be able to grow at all. Our future success will depend on the ability of our officers and key employees to continue to implement and improve our operational, financial and management controls, reporting systems and procedures, and manage a growing number of customer relationships. We may not implement improvements to our management information and control systems in an efficient or timely manner and may discover deficiencies in existing systems and controls. Consequently, our continued growth may place a strain on our administrative and operational infrastructure. Any such strain could increase our costs, reduce or eliminate our profitability and reduce the price at which our common shares trade.

Changes in interest rates could reduce our income, cash flows and asset values.

Our consolidated income and cash flows and the value of our consolidated assets will depend to a great extent on the difference between the interest rates we earn on interest-earning assets, such as loans and investment securities, and the interest rates we pay on interest-bearing liabilities such as deposits and borrowings. We discuss the effects of interest rate changes on the market value of our portfolios equity and net interest income in Management s Discussion and Analysis of Financial Condition and Results of Operations Asset and Liability Management. Interest rates are highly sensitive to many factors which are beyond our control, including general economic conditions and policies of various governmental and regulatory agencies and, in particular, the Federal Reserve. Changes in monetary policy, including changes in interest rates, will influence not only the interest we receive on our loans and investment securities and the amount of interest we pay on deposits, it will also affect our ability to originate loans and obtain deposits and our costs in doing so. If the rate of interest we pay on our deposits and other borrowings increases more than the rate of interest we earn on our loans and other investments, our consolidated net interest income, and therefore our consolidated earnings, could decline or we could sustain losses. Our earnings could also decline or we could sustain losses if the rates on our loans and other investments fall more quickly than those on our deposits and other borrowings.

We are subject to lending risks.

There are risks inherent in making all loans. These risks include interest rate changes over the time period in which loans may be repaid and changes in the national economy or the economy of our regional market that impact the ability of our borrowers to repay their loans or the value of the collateral securing those loans. Our loan portfolio contains a high percentage of commercial, construction and commercial mortgage loans in relation to our total loans and total assets. At December 31, 2006, commercial loans were 18.7% of total loans, construction loans were 25.8% of total loans and commercial mortgage loans were 30.8% of total loans. These types of loans are generally viewed as having more risk of default than residential real estate loans or consumer loans. These types of loans are also typically larger than residential real estate loans and consumer loans. Because our loan portfolio contains a significant number of commercial, construction and commercial mortgage loans with relatively large balances, the deterioration of one or a few of these loans would cause a significant increase in nonperforming loans. On a consolidated basis, an increase in nonperforming loans could result in an increase in our provision for loan losses or in loan charge-offs and a consequent reduction of our earnings.

Lack of seasoning of our loan portfolio may increase the risk of credit defaults in the future.

All of the loans in our loan portfolio were originated within the past six years. In general, loans do not begin to show signs of credit deterioration or default until they have been outstanding for some period of time, a process referred to as seasoning. As a result, a portfolio of older loans will usually behave more predictably than a portfolio of recently originated loans. Because our loan portfolio is relatively unseasoned, the current level of delinquencies and defaults may be below the level that will prevail when the portfolio becomes more seasoned.

Until our portfolio becomes more seasoned, we must rely in part on the historical loan loss experience of other financial institutions and our management s past experience in determining the allowance for loan and lease losses, which may result in our having inadequate reserves.

Because most of our loans were originated relatively recently, our loan portfolio does not provide an adequate history of loan losses for management to rely upon in establishing its allowance for loan and lease losses. We therefore rely to a significant extent upon other financial institutions histories of loan losses and their allowance for loan and lease losses, as well as management s estimates based on their experience in the banking industry, when determining our loss allowance. The history of loan and lease losses, the reserving policies of other financial institutions and management s judgment may not result in reserving policies that will be adequate for our consolidated business and operations.

Our operations are concentrated in the Philadelphia-Wilmington metropolitan area.

Our loan activities are largely based in the Philadelphia-Wilmington metropolitan area. To a lesser extent, our deposit base is also generated from this area. As a result, our consolidated financial performance depends largely upon economic conditions in this area. Adverse local economic conditions could cause us to experience an increase in loan delinquencies, a reduction in deposits, an increase in the number of borrowers who default on their loans and a reduction in the value of the collateral securing their loans, all of which would adversely affect our consolidated profitability.

We depend to a significant extent upon wholesale and brokered deposits to satisfy funding needs.

We have relied to a significant extent on funds provided by wholesale and brokered deposits to support the growth of our loan portfolio. These funding sources amounted to 43.6% of our total deposits at December 31, 2006 an increase from 33.8% of total deposits at December 31, 2005. If we are not successful in obtaining wholesale funding or increasing our current deposit base to a level commensurate with our funding needs, we may be unable to continue our growth, or could experience contraction in our total assets. Moreover, to the extent that we are unable to match the maturities of the interest rates we pay for wholesale and brokered funds to the maturities of the loans we make using those funds, increases in the interest rates we pay for such funds could decrease our consolidated net interest income.

Our future success will depend on our ability to compete effectively in a highly competitive market and geographic area.

We will face substantial competition in all phases of our operations from a variety of different competitors, including commercial banks and their holding companies, savings and loan associations, mutual savings banks, credit unions, consumer finance companies, factoring companies, insurance companies and money market mutual funds. Competition for financial services in the Philadelphia-Wilmington metropolitan area, which is our principal service area, is very strong. This geographic area includes offices of many of the largest financial institutions in the nation. Most of those competing institutions have much greater financial and marketing resources than we have and, because we are a relatively newly-formed entity, far greater name recognition. Due to their size, many of our competitors can achieve economies of scale and, as a result, may offer a broader range of products and services as well as better pricing structures for those products and services. Moreover, because we are smaller and less well-established, we may have to pay higher rates on our deposits or offer more free or reduced-cost services in order to attract and retain customers. Some of the financial services organizations with which we compete are not subject to the same degree of regulation as federally-insured and regulated financial institutions such as ours. As a result, those competitors may be able to access funding and provide various services more easily or at less cost than we can.

Our affinity group marketing strategy has been adopted by other institutions with which we compete.

As a result of the high costs encountered by Internet banks in acquiring customers through traditional marketing and advertising or for other reasons, several online banking operations as well as the online banking programs of conventional banks have instituted affinity group marketing strategies similar to ours. As a consequence, we have encountered competition in this area and anticipate that we will continue to do so in the future. This competition may increase our costs, reduce our revenues or revenue growth or, because we are a relatively new banking operation without the name recognition of other, more established banking operations, make it difficult for us to compete effectively in obtaining affinity group relationships.

Our lending limit may adversely affect our competitiveness.

Our regulatory lending limit as of December 31, 2006 to any one customer or related group of customers was $21.5 million. Our lending limit is substantially smaller than those of most financial institutions with which we compete. While we believe that our lending limit is sufficient for our targeted market of small to mid-size businesses, individuals and affinity group members, it may affect our ability to attract or maintain customers or to compete with other financial institutions. Moreover, to the extent that we incur losses and do not obtain additional capital, our lending limit, which depends upon the amount of our capital, will decrease.

Environmental liability associated with lending activities could result in losses.

In the course of our business, we may foreclose on and take title to properties securing our loans. If hazardous substances were discovered on any of these properties, we may be liable to governmental entities or third parties for the costs of remediation of the hazard, as well as for personal injury and property damage. Many environmental laws can impose liability regardless of whether we knew of, or were responsible for, the contamination. In addition, if we arrange for the disposal of hazardous or toxic substances at another site, we may be liable for the costs of cleaning up and removing those substances from the site, even if we neither own nor operate the disposal site. Environmental laws may require us to incur substantial expenses and may materially limit use of properties we acquire through foreclosure, reduce their value or limit our ability to sell them in the event of a default on the loans they secure. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase our exposure to environmental liability.

As a financial institution whose principal medium for delivery of banking services is the internet, we are subject to risks particular to that medium.

We operate an independent Internet bank, as distinguished from the Internet banking service of an established conventional bank. Independent Internet banks often have found it difficult to achieve profitability and revenue growth. Several factors contribute to the unique problems that Internet banks face. These include concerns for the security of personal information, the absence of personal relationships between bankers and customers, the absence of loyalty to a conventional hometown bank, the customer s difficulty in understanding and assessing the substance and financial strength of an Internet bank, a lack of confidence in the likelihood of success and permanence of Internet banks and many individuals unwillingness to trust their personal assets to a relatively new technological medium such as the Internet. As a result, many potential customers may be unwilling to establish a relationship with us.

Conventional financial institutions, in growing numbers, are offering the option of Internet banking and financial services to their existing and prospective customers. The public may perceive conventional financial institutions as being safer, more responsive, more comfortable to deal with and more accountable as providers of their banking and financial services, including their Internet banking services. We may not be able to offer Internet banking and financial services and personal relationship characteristics that have sufficient advantages over the Internet banking and financial services and other characteristics of established conventional financial institutions to enable us to compete successfully.

Moreover, both the Internet and the financial services industry are undergoing rapid technological changes, with frequent introductions of new technology-driven products and services. In addition to improving the ability to serve customers, the effective use of technology increases efficiency and enables financial institutions to reduce costs. Our future success will depend, in part, upon our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands, as well as to create additional efficiencies in our operations. Many of our competitors have substantially greater resources to invest in technological improvements. We may not be able to implement effectively new technology-driven products and services or be successful in marketing these products and services to our customers.

Our operations may be interrupted if our network or computer systems, or those of our providers, fail.

Because we deliver our products and services over the Internet and outsource several critical functions to third parties, our operations depend on our ability, as well as that of our service providers, to protect computer systems and network infrastructure against interruptions in service due to damage from fire, power loss, telecommunications failure, physical break-ins, computer hacking or similar catastrophic events. Our operations also depend upon our ability to replace a third-party provider if it experiences difficulties that interrupt our operations or if an operationally essential third-party service terminates. Service interruptions to customers may adversely affect our ability to obtain or retain customers and could result in regulatory sanctions. Moreover, if a customer were unable to access his or her account or complete a financial transaction due to a service interruption, we could be subject to a claim by the customer for his or her loss. While our accounts and other agreements contain disclaimers of liability for these kinds of losses, we cannot predict the outcome of litigation if a customer were to make a claim against us.

Security concerns may adversely affect internet banking.

A significant barrier to on-line financial transactions is the secure transmission of confidential information over public networks. The systems we use rely on encryption and authentication technology to provide secure transmission of confidential information. Advances in computer capabilities, new discoveries in the field of cryptography or other developments could result in a compromise or breach of the algorithms used to protect customer transaction data. If we, or another provider of financial services through the Internet, were to suffer damage from a security breach, public acceptance and use of the Internet as a medium for financial transactions could suffer. Any security breach could deter potential customers or cause existing customers to leave, thereby impairing our ability to grow and maintain profitability and, possibly, our ability to continue delivering our products and services through the Internet. Although we, with the help of third-party service providers, intend to continue to implement security technology and establish operational procedures to prevent security breaches, these measures may not be successful.

We outsource many essential services to third-party providers who may terminate their agreements with us, resulting in interruptions to our banking operations.

We obtain essential technological and customer services support for the systems we use from third-party providers. We outsource our check processing, check imaging, electronic bill payment, statement rendering, internal audit and other services to third party vendors. For a description of these services, you should read Item 1, Business Other Operations Third Party Service Providers. Our agreements with each service provider are generally cancelable without cause by either party upon specified notice periods. If one of our third-party service providers terminates its agreement with us and we are unable to replace it with another service provider, our operations may be interrupted. If an interruption were to continue for a significant period of time, our earnings could decrease, we could experience losses and we could lose customers.

We may be affected by government regulation.

We are subject to extensive federal and state banking regulation and supervision. The regulations are intended primarily to protect our depositors funds, the federal deposit insurance funds and the safety and soundness of the Bank, not our shareholders. Regulatory requirements affect lending practices, capital structure, investment practices, dividend policy and growth. A failure by either the Bank or us to meet minimum capital requirements will result in the imposition of limitations on our operations and could, if capital levels drop significantly, result in our being required to cease operations. Changes in governing law, regulations or regulatory practices could impose additional costs on us or impair our ability to obtain deposits or make loans and, as a consequence, our consolidated revenues and profitability.

As a Delaware-chartered bank whose depositors and financial services customers are located in several states, the Bank may be subject to additional licensure requirements or other regulation of its activities by state regulatory authorities and laws outside of Delaware. If the Bank s compliance with licensure requirements or other regulation becomes overly burdensome, we may seek to convert its state charter to a federal charter in order to gain the benefits of federal preemption of some of those laws and regulations.

Conversion of the Bank to a federal charter will require the prior approval of the relevant federal bank regulatory authorities, which we may not be able to obtain. Moreover, even if we obtain approval, there could be a significant period of time between our application and receipt of the approval, and/or any approval we do obtain may be subject to burdensome conditions or restrictions.

Our success will depend on our ability to retain Betsy Z. Cohen, our Chief Executive Officer.

We believe that our future success will depend upon the expertise of, and customer relationships established by Betsy Z. Cohen, our chief executive officer. If Mrs. Cohen were to become unavailable for any reason, or if we are unable to hire highly qualified and experienced personnel with similar relationships to replace her, our ability to attract deposits or loan customers may be materially adversely affected. We do not have key person life insurance on Mrs. Cohen.

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties

We are the lessee of nine premises. Our banking and operations facilities occupy 20,236 square feet in Wilmington, Delaware under a lease expiring in 2010. The rent is currently $35,011 per month and escalates yearly based upon scheduled increases in base rent and actual increases in taxes and premises operating costs over specified base rates. We also hold a lease on 24,531 square feet of space in Philadelphia, Pennsylvania expiring in 2014. The rent is currently $60,076 per month and escalates yearly based upon scheduled increases in base rent and actual increases in taxes and premises operating costs over specified base rates. We provided a letter of credit, $260,424 in outstanding principal amount as of December 31, 2006, as security under the lease. The letter of credit reduces $80,000 per year. We sublease portions of our Philadelphia space to affiliated entities. We use the Philadelphia space for our executive offices. We pay aggregate rent of $12,927 per month for our three Philadelphia-area loan production offices, and an aggregate of $4,938 per month for our Maryland and Alabama automobile leasing offices. We made payments of $6,594 per month to a related party for our Florida leasing office. We also pay rent of $603 per month for a customer service space, principally an automated teller machine, or ATM, and computer interfaces. We believe these facilities are adequate for our current needs and for the reasonably foreseeable future.

Item 3. Legal Proceedings.

None.

Item 4. Submission of Matters to a Vote of Security Holders.

None.

PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Our common stock trades on the NASDAQ National Market under the symbol TBBK. The following table sets forth the range of high and low sales prices for the indicated periods for our common stock.

	Price range	
	High	Low
2005		
First Quarter	$ 15.75	$ 13.04
Second Quarter	$ 17.44	$ 13.59
Third Quarter	$ 18.05	$ 15.64
Fourth Quarter	$ 18.99	$ 15.44
2006		
First Quarter	$ 24.90	$ 16.56
Second Quarter	$ 25.50	$ 21.45
Third Quarter	$ 26.33	$ 22.84
Fourth Quarter	$ 30.49	$ 23.19
2007		
First Quarter (through March 12, 2007)	$ 30.30	$ 24.03

As of March 12, 2007 there were 13,772,820 shares of common stock outstanding held of record by 164 persons.

We have not paid cash dividends on our common stock since our inception, and do not plan to pay cash dividends on our common stock for the foreseeable future. We intend to retain earnings, if any, to fund the development and growth of our operations. Our board of directors will determine any changes in our dividend policy based upon its analysis of factors it deems relevant. We expect that these factors will include our earnings, financial condition, cash requirements and available investment opportunities.

Our payment of dividends is subject to restrictions which we disclose in Item 1 Business Regulations Under Banking Law. In addition, before we may pay a cash dividend on our common stock in any quarter, we must pay that quarter s dividend on our Series A preferred stock.

We have not repurchased any of our common stock since our inception.

Performance graph

The following graph compares the performance of The Bancorp, Inc. s common shares to the Nasdaq Composite Index and the Nasdaq Bank Stock Index. The graph shows the value of $100 invested in Bancorp common stock and both indices on December 23, 2004 (the date the Company began trading on NASDAQ) and the change in the value of Bancorp s common shares compared to the indices as of the end of each year. The graph assumes the reinvestment of all dividends. Historical stock price performance is not necessarily indicative of future stock price performance.

	Period ending			
Index	**12/23/2004**	**12/31/2004**	**12/31/2005**	**12/31/2006**
The Bancorp, Inc.	100.00	100.00	106.25	185.00
Nasdaq Bank Stock Index	100.00	99.95	95.62	106.14
Nasdaq Composite Stock Index	100.00	100.82	102.07	111.79

Item 6. Selected Financial Data.

The following table sets forth selected financial data as of and for the years ended December 31, 2006, 2005, 2004, 2003 and 2002. We derived the selected financial data for the years ended December 31, 2006, 2005, 2004, 2003 and 2002 from our financial statements for those periods, which have been audited by Grant Thornton LLP, independent registered public accounting firm. You should read the selected financial data in this table together with, and such selected financial data is qualified by reference to our financial statements, the notes to those financial statements in Item 8 of this report and Management s Discussion and Analysis of Financial Condition and Results of Operations in Item 7 of this report.

	As of and for the year ended				
	December 31, 2006	**December 31, 2005**	**December 31, 2004**	**December 31, 2003**	**December 31, 2002**
Income Statement Data:					
Interest income	$ 80,968	$ 47,134	$ 24,673	$ 14,797	$ 12,060
Interest expense	36,695	14,975	7,077	5,423	4,590
Net interest income	44,273	32,159	17,596	9,374	7,470
Provision for loan and lease losses	2,975	2,100	1,632	685	600
Net interest income after provision for loan and lease losses	41,298	30,059	15,964	8,689	6,870
Non-interest income	5,038	4,323	2,800	3,077	1,694
Non-interest expense	25,505	22,754	15,968	10,864	9,055
Net income (loss) before income tax (benefit)	20,831	11,628	2,796	902	(491)
Income tax (benefit)	8,331	4,181	(922)	(169)	(500)
Net income (loss)	12,500	7,447	3,718	1,071	9
Less preferred stock dividends and accretion	(75)	(598)	(817)	(881)	(750)
Less preferred stock conversion premium		(459)			
Income allocated to Series A preferred shareholders	(110)	(72)	(323)	(61)	
Net income (loss) available to common stock	$ 12,315	$ 6,318	$ 2,578	$ 129	$ (741)
Net income per share basic	$ 0.90	$ 0.49	$ 0.25	$ 0.06	nm
Net income per share diluted	$ 0.86	$ 0.48	$ 0.24	$ 0.06	nm
Balance Sheet Data:					
Total Assets	$ 1,334,838	$ 917,471	$ 576,279	$ 304,161	$ 23,342
Total loans, net of unearned costs (fees)	1,064,819	681,582	427,881	232,397	163,337
Allowance for loan and lease losses	8,400	5,513	3,593	1,991	1,379
Total cash and cash equivalents	137,121	117,093	19,503	42,183	30,148
Deposits	1,069,255	732,588	388,081	276,765	209,443
Federal Home Loan Bank advances	100,000	40,000	55,000		
Shareholders equity	148,908	134,947	121,402	21,673	16,969
Selected Ratios:					
Return on average assets	1.19%	1.02%	0.79%	0.41%	nm
Return on average common equity	8.90%	5.69%	3.94%	4.93%	nm
Net interest margin	4.32%	4.57%	3.86%	3.77%	4.05%
Book value per share	$ 10.76	$ 9.80	$ 9.32	nm	nm
Selected capital and Asset Quality Ratios:					
Equity/assets	11.16%	14.71%	21.07%	7.13%	7.27%
Tier I capital to average assets	12.28%	15.90%	22.88%	8.46%	9.76%
Tier 1 capital to total risk-weighted assets	13.50%	17.94%	26.29%	10.26%	11.60%
Total Capital to total risk-weighted assets	14.28%	18.69%	27.04%	11.05%	12.33%

Allowance for loan and lease losses to total loans	0.79%	0.81%	0.84%	0.86%	0.84%

nm not meaningful

Item 7. Managements s Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion provides information to assist in understanding our financial condition and results of operations. This discussion should be read in conjunction with our consolidated financial statements and related notes appearing in Item 8 of this report.

Overview

We are a registered financial holding company whose principal asset is our wholly owned subsidiary bank. Since July 2000, when the Bank began banking operations, we have grown to $1.3 billion in consolidated assets as of December 31, 2006. We focus on two markets: small to mid-size businesses and their principals and affinity groups with their established membership, client or customer bases. We concentrate our lending activities in the Philadelphia-Wilmington area, while we draw our deposits from that area and from out of area, principally through our merchant card processing operation. To a lesser extent, we obtain deposits from the open market as required to meet our loan funding needs. Our lending activities emphasize commercial, industrial and construction loans secured by real estate and commercial real estate loans.

Critical accounting policies and estimates

Our accounting and reporting policies conform with accounting principles generally accepted in the United States and general practices within the financial services industry. The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Actual results could differ from those estimates.

We believe that the determination of our allowance for loan and lease losses involves a higher degree of judgment and complexity than our other significant accounting policies. We determine our allowance for loan and lease losses with the objective of maintaining a reserve level we believe to be sufficient to absorb our estimated probable credit losses. We base our determination of the adequacy of the allowance on periodic evaluations of our loan portfolio and other relevant factors. However, this evaluation is inherently subjective as it requires material estimates, including, among others, expected default probabilities, the amount of loss we may incur on a defaulted loan, expected commitment usage, the amounts and timing of expected future cash flows on impaired loans, value of collateral, estimated losses on consumer loans and residential mortgages, and general amounts for historical loss experience. We also evaluate economic conditions and uncertainties in estimating losses and inherent risks in our loan portfolio. All of these factors may be susceptible to significant change. To the extent actual outcomes differ from our estimates, we may need additional provisions for loan losses. Any such additional provision for loan losses will be a direct charge to our earnings.

Beginning in January 2006, we adopted the provisions of SFAS 123R, which requires the expense recognition for the fair value of share based compensation awards, such as stock options, restricted stock, performance based shares and the like. This standard allows management to establish modeling assumptions as to expected stock price volatility, option terms, forfeiture rates and dividend rates which directly impact estimated fair value. All of these estimates and assumptions may be susceptible to significant change that may impact earnings in future periods.

We account for income taxes under the liability method whereby we determine deferred tax assets and liabilities based on the difference between the carrying values on our financial statements and the tax basis of assets and liabilities as measured by the enacted tax rates which will be in effect when these differences reverse. Deferred tax expense (benefit) is the result of changes in deferred tax assets and liabilities.

We account for goodwill in accordance with Statement of Financial Accounting Standards, or SFAS, No 142. Goodwill and Intangible Assets. SFAS No 142 includes requirements to test goodwill and indefinitive lived intangible assets for impairment rather than amortize them. We have tested goodwill as of December 31, 2006 and have determined that is not impaired.

Results of operations

Net Income: fiscal 2006 compared to fiscal 2005. Net income for fiscal 2006 was $12.5 million, compared to $7.4 million for fiscal 2005. Preferred stock dividends and income allocated to preferred shareholders for fiscal 2006 were $185,000, compared to $1.1 million for fiscal 2005, which resulted in net income available to common stock of $12.3 million for fiscal 2006 as compared to net income of $6.3 million for fiscal 2005. Diluted earnings per share were $0.86 for fiscal 2006 as compared to $0.48 for fiscal 2005. Return on average assets was 1.19% and return on average equity was 8.90% for fiscal 2006. The reduction in preferred stock dividends was the result of a solicitation in 2005 to have Series A preferred shareholders convert their Series A preferred stock to common stock.

Net income: fiscal 2005 compared to fiscal 2004. Net income for fiscal 2005 was $7.4 million, compared to net income of $3.7 million for fiscal 2004. Preferred stock dividends and accretion for fiscal 2005 were $1.1 million, compared to $817,000 for fiscal 2004, which resulted in a net income available to common stock of $6.3 million for fiscal 2005 as compared to net income of $2.6 million for fiscal 2004. Diluted earnings per share were $0.48 for fiscal 2005 as compared to $0.24 for fiscal 2004. Return on average assets was 1.02% and return on average equity was 5.69% for fiscal 2005.

Net Interest Income: fiscal 2006 compared to fiscal 2005. Our interest income for fiscal 2006 increased to $81.0 million from $47.1 million for fiscal 2005, while our net interest income increased to $44.3 million from $32.2 million. Our average loans increased to $849.6 for fiscal 2006 from $550.0 million for the prior year period. The primary reason for the increase in our interest income as well as our net interest income was our ability to increase of earning assets, in particular our loan portfolio, through organic growth.

Our net interest margin (calculated by dividing net interest income by average interest-earning assets) for fiscal 2006 decreased to 4.32% from 4.57% for 2005, a decrease of 25 basis points (.25%). For fiscal 2006 the average yield on our interest-earning assets increased to 7.90% from 6.70% for fiscal 2005, an increase of 120 basis points (1.20%). The increase in yield was the result of increases in the overall interest rate environment. The cost of interest-bearing deposits increased to 4.47% for fiscal 2006 from 2.93% for fiscal 2005, an increase of 154 basis points (1.54%), while the cost of interest bearing liabilities increased to 4.49% for fiscal 2006 from 2.97% for fiscal 2005, an increase of 152 basis points (1.52%). The decrease in the net interest margin is due to a flattening of the yield curve in 2006 as well as deposit rates increasing disproportionately higher than loan rates during the year. Average interest-bearing deposits increased to $773.9 million from $460.1 million, an increase of $313.9 million or 68.2%

Net Interest Income: fiscal 2005 compared to fiscal 2004. Our interest income for fiscal 2005 increased to $47.1 million from $24.7 million for fiscal 2004, while our net interest income increased to $32.2 million from $17.6 million. Our average loans increased to $550.0 million for fiscal 2005 from $315.1 million for the prior year period. The primary reason for the increases in our interest income and net interest income was our ability to increase our earning assets through continued organic growth of our loan portfolio as well as the acquisition of Mears Motor Livery Corp. in January 2005 which increased our portfolio of direct financing leases.

Our net interest margin (calculated by dividing net interest income by average interest-earning assets) for fiscal 2005 increased to 4.57% from 3.86% for 2004, an increase of 71 basis points (.71%). For fiscal 2005 the average yield on our interest-earning assets increased to 6.70% from 5.42% for fiscal 2004, an increase of 128 basis points (1.28%). The increase in yield was the result of increases in the overall interest rate environment, an increase in direct lease financing from the acquisition of Mears Motor Livery and an increase in our demand (non-interest bearing) account balances. Cost of interest-bearing deposits increased to 2.93% for fiscal 2005 from 2.14% for fiscal 2004, an increase of 79 basis points (.79%) due to increases in the overall interest rate environment. Average interest-bearing deposits increased to $460.1 million from $279.3 million, an increase of $180.8 million or 64.7%.

Average Daily Balances. The following table presents the average daily balances of assets, liabilities and shareholders equity and the respective interest earned or paid on interest-earning assets and interest-bearing liabilities, as well as average rates for the periods indicated:

	Year ended December 31, 2006			Year ended December 31, 2005		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
	(dollars in thousands)					
Assets:						
Interest-earning assets:						
Loans net of unearned discount	$ 849,640	$ 71,270	8.39%	$ 549,993	$ 40,534	7.37%
Investment securities	112,843	6,542	5.80%	106,371	5,018	4.72%
Interest bearing deposits	1,668	71	4.26%	1,029	3	0.29%
Federal funds sold	60,939	3,085	5.06%	45,698	1,579	3.46%
Net interest-earning assets	1,025,090	80,968	7.90%	703,091	47,134	6.70%
Allowance for loan and lease losses	(6,774)			(4,510)		
Other assets	34,151			34,332		
	$ 1,052,467			$ 732,913		
Liabilities and Shareholders Equity:						
Deposits:						
Demand (non-interest bearing)	$ 90,144			$ 94,385		
Interest bearing deposits						
Interest checking	60,990	$ 1,459	2.39%	28,624	$ 343	1.20%
Savings and money market	321,220	14,126	4.40%	205,146	5,825	2.84%
Time	391,716	19,005	4.85%	226,290	7,302	3.23%
Total interest bearing deposits	773,926	34,590	4.47%	460,060	13,470	2.93%
FHLB advances	38,862	2,043	5.26%	39,356	1,292	3.28%
Other borrowed funds	4,140	62	1.50%	4,168	75	1.80%
Subordinated debt				1,314	138	10.50%
Net interest bearing liabilities	816,928	36,695	4.49%	504,898	14,975	2.97%
Other liabilities	5,005			2,710		
Total liabilities	912,077			601,993		
Shareholders equity	140,390			130,920		
	$ 1,052,467			$ 732,913		
Net yield on average interest earning assets		$ 44,273	4.32%		$ 32,159	4.57%

	Year ended December 31, 2004		
	Average Balance	Interest	Average Rate
	(dollars in thousands)		
Assets:			
Interest-earning assets:			
Loans net of unearned discount	$ 315,088	$ 19,472	6.18%
Investment securities	102,967	4,710	4.57%
Interest bearing deposits	827	11	1.33%
Federal funds sold	36,532	480	1.31%
Net interest-earning assets	455,414	24,673	5.42%
Allowance for loan and lease losses	(2,530)		
Other assets	16,747		
	$ 469,631		
Liabilities and Shareholders Equity:			
Deposits:			
Demand (non-interest bearing)	$ 57,669		
Interest bearing deposits			
Interest checking	22,070	$ 262	1.19%
Savings and money market	126,166	2,576	2.04%
Time	131,023	3,145	2.40%
Total interest bearing deposits	279,259	5,983	2.14%
FHLB advances	29,057	516	1.78%
Other borrowed funds	1,507	27	1.79%
Subordinated debt	5,250	551	10.50%
Net interest bearing liabilities	315,073	7,077	2.25%
Other liabilities	2,415		
Total liabilities	375,157		
Shareholders equity	94,474		
	$ 469,631		
Net yield on average interest earning assets		$ 17,596	3.86%

In fiscal 2006, average interest-earning assets increased to $1.03 billion, an increase of $322.0 million, or 45.8%, from fiscal 2005. During the same period, average loan balances increased $299.6 million, or 54.5%. In fiscal 2005, average interest-earning assets increased to $703.1 million, an increase of $247.7 million, or 54.4%, from fiscal 2004. During the same period, average loan balances increased $234.9 million, or 74.6%.

Volume and Rate Analysis. The following table sets forth the changes in net interest income attributable to either changes in volume (average balances) or to changes in average rates from 2004 through 2006. The changes attributable to the combined impact of volume and rate have been allocated proportionately to the changes due to volume and the changes due to rate.

	2006 versus 2005			2005 versus 2004		
	Due to change in:			Due to change in:		
	Volume	Rate	Total	Volume	Rate	Total
Interest income:						
Loans net of unearned discount	$ 24,518	$ 6,218	$ 30,736	$ 16,738	$ 4,324	$ 21,062
Investment Securities	320	1,204	1,524	158	150	308
Interest bearing deposits	3	65	68	4	(12)	(8)
Federal funds sold	629	877	1,506	147	952	1,099
Total interest earning assets	25,470	8,364	33,834	17,047	5,414	22,461
Interest expense:						
Interest checking	$ 593	$ 523	$ 1,116	$ 79	$ 2	$ 81
Savings and money market	4,214	4,087	8,301	2,000	1,249	3,249
Time	6,929	4,774	11,703	2,821	1,336	4,157
Total deposit interest expense	11,736	9,384	21,120	4,900	2,587	7,487
Subordinated debt	(69)	(69)	(138)	(413)		(413)
FHLB advances	(16)	767	751	229	547	776
Other borrowed funds	(1)	(12)	(13)	48		48
Total interest expense	11,650	10,070	21,720	4,764	3,134	7,898
Net interest income:	$ 13,820	$ (1,706)	$ 12,114	$ 12,283	$ 2,280	$ 14,563

Provision for Loan and Lease Losses. Our provision for loan and lease losses was $3.0 million for fiscal 2006, $2.1 million for fiscal 2005 and $1.6 million for 2004. The increase in the provision is based on our review of the adequacy of our allowance for loan and lease losses. At December 31, 2006, our allowance for loan and lease losses amounted to $8.4 million or 0.79% of total loans. We believe that our allowance is adequate to cover expected losses. For more information about our provision and allowance for loan and lease losses and our loss experience see Allowance for Loan and Lease Losses and Summary of Loan and Lease Loss Experience, below.

Non-Interest Income. Non-interest income was $5.0 million for fiscal 2006 as compared to $4.3 million for fiscal 2005, an increase of $715,000 or 16.5%. There were no gains on sales of investment securities in fiscal 2006 as compared to a $56,000 gain on sale investment securities for fiscal 2005. Gains (or losses) on sales of investment securities vary from transaction to transaction, and the timing of these transactions also may vary. As a result, there may be significant variation in the amount of our gains (or losses) from period to period. The principal reasons for the increase of non-interest income, exclusive of gains on sales of investment securities, were an increase in Automated Clearing House, or ACH, processing fees, service fees on deposit accounts and other income. Service fees on deposit accounts increased to $849,000 in fiscal 2006 from $710,000 in fiscal 2005, an increase of $139,000. The primary reason for the increase was the growth in our health savings accounts, or HSA, deposit accounts. Other income increased to $1.0 million in fiscal 2006 from $730,000 in fiscal 2005, a