NBT BANCORP INC
Form 10-Q
May 10, 2007

# SECURITIES AND EXCHANGE COMMISSION 

Washington, D. C. 20549
FORM 10-Q
(Mark One)
xQUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2007.

## OR

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

For the transition period from $\qquad$ to $\qquad$ .

## COMMISSION FILE NUMBER 0-14703

NBT BANCORP INC.
(Exact Name of Registrant as Specified in its Charter)

DELAWARE<br>(State of Incorporation)<br>16-1268674<br>(I.R.S. Employer Identification No.)<br>\section*{52 SOUTH BROAD STREET, NORWICH, NEW YORK 13815<br><br>(Address of Principal Executive Offices) (Zip Code)}<br>Registrant's Telephone Number, Including Area Code: (607) 337-2265

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 shorter periods 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 whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer.

Large Accelerated Filer x $\quad$ Accelerated Filer " Non-Accelerated Filer
Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2). Yes * No x

As of April 30, 2007, there were 34,011,906 shares outstanding of the Registrant's common stock, $\$ 0.01$ par value.

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FORM 10-Q--Quarter Ended March 31, 2007
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NBT Bancorp Inc. and Subsidiaries
Consolidated Balance Sheets (unaudited)


## Stockholders' equity

Preferred stock, $\$ 0.01$ par value. Authorized 2,500,000 shares at March
31, 2007, December 31, 2006 and March 31,2006
Common stock, $\$ 0.01$ par value. Authorized 50,000,000 shares at March
31, 2007, December 31, 2006 and March 31, 2006; issued 36,459,481,
36,459,491, and 36,459,560 at March 31, 2007, December 31, 2006, and

| March 31, 2006, respectively | $\mathbf{3 6 5}$ | $\mathbf{3 6 5}$ | $\mathbf{3 6 5}$ |
| :--- | ---: | ---: | ---: |
| Additional paid-in-capital | $\mathbf{2 7 2 , 0 2 6}$ | $\mathbf{2 7 1 , 5 2 8}$ | $\mathbf{2 7 0 , 4 6 2}$ |
| Retained earnings | $\mathbf{1 9 8 , 9 4 8}$ | $\mathbf{1 9 1 , 7 7 0}$ | $\mathbf{1 7 0 , 3 3 0}$ |
| Accumulated other comprehensive loss | $\mathbf{( 1 1 , 7 2 4 )}$ | $\mathbf{( 1 4 , 0 1 4 )}$ | $\mathbf{( 1 2 , 2 1 0 )}$ |
| Common stock in treasury, at cost, $2,463,124,2,203,549$ and $2,126,450$ |  |  |  |
| shares at March 31,2007 , December 31,2006 , and March 31,2006, |  | $\mathbf{( 5 2 , 0 3 5 )}$ | $\mathbf{( 4 5 , 8 3 2 )}$ |
| respectively | $\mathbf{4 0 7 , 5 8 0}$ | $\mathbf{4 0 3 , 8 1 7}$ | $\mathbf{3 8 5 , 1 9 3 )}$ |
| Total stockholders' equity | $\mathbf{\$ ~ 5 , 1 0 0 , 7 8 1}$ | $\mathbf{\$ 5 , 0 8 7 , 5 7 2}$ | $\mathbf{\$ 4 , 8 8 5 , 8 5 1}$ |
| Total liabilities and stockholders' equity |  |  |  |

See accompanying notes to unaudited interim consolidated financial statements.

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| NBT Bancorp Inc. and Subsidiaries | 31, |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
| Consolidated Statements of Income (unaudited) | 2007 |  |  | 2006 |
| (In thousands, except per share data) |  |  |  |  |
| Interest, fee, and dividend income |  |  |  |  |
| Interest and fees on loans and leases | \$ | 59,808 | \$ | 52,833 |
| Securities available for sale |  | 13,467 |  | 11,877 |
| Securities held to maturity |  | 1,444 |  | 985 |
| Other |  | 740 |  | 611 |
| Total interest, fee, and dividend income |  | 75,459 |  | 66,306 |
| Interest expense |  |  |  |  |
| Deposits |  | 25,984 |  | 17,225 |
| Short-term borrowings |  | 3,092 |  | 3,937 |
| Long-term debt |  | 4,486 |  | 4,142 |
| Trust preferred debentures |  | 1,268 |  | 883 |
| Total interest expense |  | 34,830 |  | 26,187 |
| Net interest income |  | 40,629 |  | 40,119 |
| Provision for loan and lease losses |  | 2,096 |  | 1,728 |
| Net interest income after provision for loan and lease losses |  | 38,533 |  | 38,391 |
| Noninterest income |  |  |  |  |
| Service charges on deposit accounts |  | 4,469 |  | 4,219 |
| Broker/ dealer and insurance revenue |  | 1,083 |  | 908 |
| Trust |  | 1,437 |  | 1,358 |
| Net securities losses |  | (5) |  | (934) |
| Bank owned life insurance |  | 434 |  | 381 |
| ATM fees |  | 1,896 |  | 1,645 |
| Retirement plan administration fees |  | 1,592 |  | 1,231 |
| Other |  | 1,784 |  | 2,416 |
| Total noninterest income |  | 12,690 |  | 11,224 |
| Noninterest expense |  |  |  |  |
| Salaries and employee benefits |  | 15,964 |  | 15,748 |
| Occupancy |  | 3,169 |  | 2,988 |
| Equipment |  | 1,933 |  | 2,156 |
| Data processing and communications |  | 2,877 |  | 2,702 |
| Professional fees and outside services |  | 1,658 |  | 1,832 |
| Office supplies and postage |  | 1,296 |  | 1,181 |
| Amortization of intangible assets |  | 409 |  | 323 |
| Loan collection and other real estate owned |  | 377 |  | 211 |
| Other |  | 3,189 |  | 3,331 |
| Total noninterest expense |  | 30,872 |  | 30,472 |
| Income before income tax expense |  | 20,351 |  | 19,143 |
| Income tax expense |  | 6,219 |  | 5,555 |
| Net income | \$ | 14,132 | \$ | 13,588 |
| Earnings per share |  |  |  |  |
| Basic | \$ | 0.41 | \$ | 0.41 |
| Diluted | \$ | 0.41 | \$ | 0.40 |

See accompanying notes to unaudited interim consolidated financial statements.

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NBT Bancorp Inc. and Subsidiaries
Consolidated Statements of Stockholders' Equity (unaudited)



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| NBT Bancorp Inc. and Subsidiaries | March 31, |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
| Consolidated Statements of Cash Flows (unaudited) | 2007 |  | 2006 |  |
| (In thousands, except per share data) |  |  |  |  |
| Operating activities |  |  |  |  |
| Net income | \$ | 14,132 | \$ | 13,588 |
| Adjustments to reconcile net income to net cash provided by operating activities |  |  |  |  |
| Provision for loan and lease losses |  | 2,096 |  | 1,728 |
| Depreciation and amortization of premises and equipment |  | 1,344 |  | 1,590 |
| Net accretion on securities |  | 19 |  | 135 |
| Amortization of intangible assets |  | 409 |  | 323 |
| Stock-based compensation |  | 839 |  | 711 |
| Bank owned life insurance income |  | (434) |  | (381) |
| Proceeds from sale of loans held for sale |  | 5,389 |  | 8,837 |
| Originations and purchases of loans held for sale |  | $(7,948)$ |  | $(6,957)$ |
| Net gains on sales of loans held for sale |  | (43) |  | (60) |
| Net security losses |  | 5 |  | 934 |
| Net gain on sales of other real estate owned |  | (36) |  | (60) |
| Net gain on sale of branch |  | - |  | (470) |
| Net (increase) decrease in other assets |  | $(2,135)$ |  | 6,025 |
| Net increase (decrease) in other liabilities |  | 3,590 |  | $(2,199)$ |
| Net cash provided by operating activities |  | 17,227 |  | 23,744 |
| Investing activities |  |  |  |  |
| Net cash paid for sale of branch |  | - |  | $(2,307)$ |
| Net cash used in CNB Bancorp, Inc. merger |  | - |  | $(20,770)$ |
| Securities available for sale: |  |  |  |  |
| Proceeds from maturities, calls, and principal paydowns |  | 56,182 |  | 45,451 |
| Proceeds from sales |  | 10,553 |  | 42,292 |
| Purchases |  | $(72,795)$ |  | $(108,488)$ |
| Securities held to maturity: |  |  |  |  |
| Proceeds from maturities, calls, and principal paydowns |  | 8,094 |  | 11,013 |
| Purchases |  | $(17,581)$ |  | $(11,837)$ |
| Net decrease (increase) in loans |  | 17,313 |  | $(38,054)$ |
| Net decrease in Federal Reserve and FHLB stock |  | 8,325 |  | 2,297 |
| Purchases of premises and equipment, net |  | (146) |  | (599) |
| Proceeds from sales of other real estate owned |  | 131 |  | 210 |
| Net cash provided by (used in) investing activities |  | 10,076 |  | $(80,792)$ |
| Financing activities |  |  |  |  |
| Net increase in deposits |  | 170,417 |  | 130,856 |
| Net decrease in short-term borrowings |  | $(140,987)$ |  | $(115,275)$ |
| Repayments of long-term debt |  | $(24,936)$ |  | $(12,020)$ |
| Proceeds from the issuance of trust preferred debentures |  | - |  | 51,547 |
| Tax benefit from exercise of stock options |  | 249 |  | 313 |
| Proceeds from the issuance of shares to employee benefit plans and other stock plans |  | 1,346 |  | 3,012 |
| Purchase of treasury stock |  | $(8,562)$ |  | $(4,055)$ |
| Cash dividends and payment for fractional shares |  | $(6,531)$ |  | $(6,550)$ |
| Net cash (used in) provided by financing activities |  | $(9,004)$ |  | 47,828 |
| Net increase (decrease) in cash and cash equivalents |  | 18,299 |  | $(9,220)$ |
| Cash and cash equivalents at beginning of year |  | 138,793 |  | 142,488 |

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| Supplemental disclosure of cash flow information Cash paid during the period for: | March 31, |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
|  | 2007 |  | 2006 |  |
| Interest | \$ | 33,783 | \$ | 24,820 |
| Income taxes |  | 96 |  | 449 |
| Noncash investing activities: |  |  |  |  |
| Loans transferred to OREO | \$ | 338 | \$ | 164 |
| Dispositions: |  |  |  |  |
| Fair value of assets sold | \$ | - | \$ | 3,453 |
| Fair value of liabilities transferred |  | - |  | 5,760 |
| Acquisitions: |  |  |  |  |
| Fair value of assets acquired | \$ | - | \$ | 431,943 |
| Goodwill and identifiable intangible assets recognized in purchase combination |  | - |  | 65,572 |
| Fair value of liabilities assumed |  | - |  | 360,648 |
| Fair value of equity issued in purchase combination |  | - |  | 50,525 |

See accompanying notes to unaudited interim consolidated financial statements.

| Consolidated Statements of Comprehensive Income (unaudited) (In thousands) | Three months ended March 31, |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
|  | 2007 |  | 2006 |  |
| Net income | \$ | 14,132 | \$ | 13,588 |
| Other comprehensive income (loss), net of tax |  |  |  |  |
| Unrealized net holding gains (losses) arising during the year (pre-tax amounts of \$3,806 and (\$10,089)) |  | 2,233 |  | $(6,065)$ |
| Less reclassification adjustment for net losses related to securities available for sale included in net income (pre-tax amounts of $\$ 5$ and \$934) |  | 3 |  | 561 |
| Minimum pension liability adjustment |  |  |  | (229) |
| Changes in pension amounts previously recognized (pre-tax amounts of \$90 and \$0) |  | 54 |  | - |
| Total other comprehensive income (loss) |  | 2,290 |  | $(5,733)$ |
| Comprehensive income | \$ | 16,422 | \$ | 7,855 |

See accompanying notes to unaudited interim consolidated financial statements
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# NBT BANCORP INC. and Subsidiary <br> NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS 

## March 31, 2007

## Note 1.

## Description of Business

NBT Bancorp Inc. (the Company or the Registrant) is a registered financial holding company incorporated in the state of Delaware in 1986, with its principal headquarters located in Norwich, New York. The Company is the parent holding company of NBT Bank, N.A. (the Bank), NBT Financial Services, Inc. (NBT Financial), Hathaway Agency, Inc., CNBF Capital Trust I, NBT Statutory Trust I and NBT Statutory Trust II. Through these subsidiaries, the Company operates as one segment focused on community banking operations. The Company's primary business consists of providing commercial banking and financial services to its customers in its market area. The principal assets of the Company are all of the outstanding shares of common stock of its direct subsidiaries, and its principal sources of revenue are the management fees and dividends it receives from the Bank and NBT Financial.

The Bank is a full service commercial bank formed in 1856, which provides a broad range of financial products to individuals, corporations and municipalities throughout the central and upstate New York and northeastern Pennsylvania market area.

## Note 2.

## Basis of Presentation

The accompanying unaudited interim consolidated financial statements include the accounts of NBT Bancorp Inc. and its wholly owned subsidiaries, NBT Bank, N.A., NBT Financial Services, Inc., Hathaway Agency, Inc., CNBF Capital Trust I, NBT Statutory Trust I and NBT Statutory Trust II. Collectively, the Registrant and its subsidiaries are referred to herein as "the Company". All intercompany transactions have been eliminated in consolidation. Amounts in the prior period financial statements are reclassified whenever necessary to conform to current period presentation.

## Note 3.

## New Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 157 - Fair Value Measurements ("SFAS 157"), which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. This Statement does not require any new fair value measurements, but the application of this Statement may change current practice. Adoption is required as of the beginning of the first fiscal year that begins after November 15, 2007. Early application of this Standard is encouraged. The Company is assessing the effect that SFAS 157 will have on our consolidated financial position, results of operations and cash flows.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, The Fair Value Option for Finanical Assets and Financial Liabilities ("SFAS 159"). SFAS 159 allows entities to voluntarily choose, at election dates, to measure many financial assets and financial liabilities (as well as certain nonfinancial instruments that are similar to financial instruments) at fair value (the "fair value option"). The election is made on an instrument-by-instrument basis and is irrevocable. If the fair value option is elected for an instrument, the Statement specifies that all subsequent changes in fair value for that instrument shall be reported in earnings. The Statement is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. Earlier adoption of the Statement is permitted as of the beginning of an entity's fiscal year, provided the choice to early adopt is made within 120 days of the beginning of the fiscal year of adoption and the entity has not yet issued financial statements for any interim period of that fiscal year. In addition, in order to early adopt SFAS 159, an entity must also adopt all of the requirements of SFAS 157 (see above). The Company is not adopting SFAS 159 early.

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## Note 4.

## Business Combination

On February 10, 2006, the Company completed the acquisition through merger of CNB Bancorp, Inc. ("CNB"). CNB was a bank holding company for City National Bank and Trust Company ("CNB Bank") and Hathaway Agency, Inc. ("Hathaway"), headquartered in Gloversville, NY. CNB Bank conducted business from nine community bank offices in four upstate New York counties-Fulton, Hamilton, Montgomery and Saratoga. The stockholders of CNB received approximately $\$ 39$ million in cash and 2,058,661 shares of NBT common stock. The aggregate transaction value was approximately $\$ 89.0$ million. The transaction was accounted for under the purchase method of accounting. CNB had total assets of $\$ 399.0$ million, loans of $\$ 197.6$ million, deposits of $\$ 335.0$ million and shareholders equity of $\$ 40.1$ million. As part of the merger, the Company acquired approximately $\$ 65.6$ million in goodwill and identifiable intangibles. CNB was merged with and into the Company, CNB Bank was merged with and into NBT Bank and Hathaway became a direct subsidiary of the Company. The results of operations are included in the consolidated financial statements from the date of acquisition, February 10, 2006.

## Note 5.

## Use of Estimates

Preparing financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period, as well as the disclosures provided. Actual results could differ from those estimates. Estimates associated with the allowance for loan losses, pension expense, fair values of financial instruments and status of contingencies are particularly susceptible to material change in the near term.

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

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

Management believes that the allowance for loan and lease losses is adequate. While management uses available information to recognize loan and lease losses, future additions to the allowance for loan and lease losses may be necessary based on changes in economic conditions or changes in the values of properties securing loans in the process of foreclosure. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan and lease losses. Such agencies may require the Company to recognize additions to the allowance for loan and lease losses based on their judgments about information available to them at the time of their examination which may not be currently available to management.

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

Income taxes are accounted for under the asset and liability method. The Company files consolidated tax returns on the accrual basis. Deferred income taxes are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Realization of deferred tax assets is dependent upon the generation of future taxable income or the existence of sufficient taxable income within the available carryback period. A valuation allowance is provided when it is more likely than not that some portion of the deferred tax asset will not be realized. Based on available evidence, gross deferred tax assets will ultimately be realized and a valuation allowance was not deemed necessary at March 31, 2007 and 2006, or December 31, 2006. The effect on deferred taxes of a change in tax rates is recognized in income in the period that includes the enactment date.

## Note 6.

## Commitments and Contingencies

The Company is a party to financial instruments in the normal course of business to meet financing needs of its customers and to reduce its own exposure to fluctuating interest rates. These financial instruments include commitments to extend credit, unused lines of credit, and standby letters of credit. Exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to make loans and standby letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policy to make such commitments as it uses for on-balance-sheet items. Commitments to extend credit and unused lines of credit totaled $\$ 534.5$ million at March 31, 2007 and $\$ 536.3$ million at December 31, 2006. Since commitments to extend credit and unused lines of credit may expire without being fully drawn upon, this amount does not necessarily represent future cash commitments. Collateral obtained upon exercise of the commitment is determined using management's credit evaluation of the borrower and may include accounts receivable, inventory, property, land and other items.

The Company guarantees the obligations or performance of customers by issuing stand-by letters of credit to third parties. These stand-by letters of credit are frequently issued in support of third party debt, such as corporate debt issuances, industrial revenue bonds, and municipal securities. The risk involved in issuing stand-by letters of credit is essentially the same as the credit risk involved in extending loan facilities to customers, and they are subject to the same credit origination, portfolio maintenance and management procedures in effect to monitor other credit and off-balance sheet products. Typically, these instruments have terms of five years or less and expire unused; therefore, the total amounts do not necessarily represent future cash requirements. Standby letters of credit totaled $\$ 27.9$ million at March 31, 2007 and $\$ 30.8$ million at December 31, 2006. As of March 31, 2007, the fair value of standby letters of credit was not material to the Company's consolidated financial statements.

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Note 7.

## Earnings per share

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

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

| Three months ended March 31, | $\mathbf{2 0 0 7}$ | 2006 |  |
| :--- | ---: | ---: | ---: |
| (in thousands, except per share data) <br> Basic EPS: <br> Weighted average common shares outstanding |  |  |  |
| Net income available to common shareholders | $\mathbf{\$ 4 , 1 7 6}$ | 33,422 |  |
| Basic EPS | $\mathbf{1 4 , 1 3 2}$ | $\$$ | 13,588 |
|  | $\mathbf{0 . 4 1}$ | $\$$ | 0.41 |
| Diluted EPS: |  |  |  |
| Weighted average common shares outstanding | $\mathbf{3 4 , 1 7 6}$ | 33,422 |  |
| Dilutive effect of common stock options and restricted stock | $\mathbf{2 8 1}$ | 324 |  |
| Weighted average common shares and common share equivalents | $\mathbf{3 4 , 4 5 7}$ | 33,746 |  |
| Net income available to common shareholders | $\mathbf{1 4 , 1 3 2}$ | $\$$ | 13,588 |
| Diluted EPS | $\mathbf{0 . 4 1}$ | $\$$ | 0.40 |

There were 272,565 stock options for the quarter ended March 31, 2007 and 375,211 stock options for the quarter ended March 31, 2006 that were not considered in the calculation of diluted earnings per share since the stock options' exercise price was greater than the average market price during these periods.

## Note 8.

## Defined Benefit Postretirement Plans

The Company has a qualified, noncontributory, defined benefit pension plan covering substantially all of its employees at December 31, 2006. Benefits paid from the plan are based on age, years of service, compensation, social security benefits, and are determined in accordance with defined formulas. The Company's policy is to fund the pension plan in accordance with ERISA standards. Assets of the plan are invested in publicly traded stocks and bonds. Prior to January 1, 2000, the Company's plan was a traditional defined benefit plan based on final average compensation. On January 1, 2000, the plan was converted to a cash balance plan with grandfathering provisions for existing participants.

In addition to the pension plan, the Company also provides supplemental employee retirement plans to certain current and former executives. These supplemental employee retirement plans and the defined benefit pension plan are collectively referred to herein as "Pension Benefits".

Also, the Company provides certain health care benefits for retired employees. Benefits are accrued over the employees' active service period. Only employees that were employed by NBT Bank on or before January 1, 2000 are eligible to receive postretirement health care benefits. The plan is contributory for participating retirees, requiring participants to absorb certain deductibles and coinsurance amounts with contributions adjusted annually to reflect cost sharing provisions and benefit limitations called for in the plan. Employees become eligible for these benefits if they reach normal retirement age while working for the Company. The Company funds the cost of postretirement health
care as benefits are paid. The Company elected to recognize the transition obligation on a delayed basis over twenty years. These postretirement benefits are referred to herein as "Other Benefits".

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The Components of pension expense and postretirement expense are set forth below (in thousands):

| Components of net periodic benefit cost: | Pension Benefits <br> Three months ended March 31, |  |  |  | Other Benefits <br> Three months ended March 31, |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2007 |  | 2006 |  | 2007 |  | 2006 |  |
| Service Cost | \$ | 526 | \$ | 517 | \$ | 6 | \$ | 1 |
| Interest Cost |  | 740 |  | 555 |  | 54 |  | 51 |
| Expected return on plan assets |  | $(1,343)$ |  | (905) |  | - |  | - |
| Net amortization |  | 105 |  | 182 |  | (15) |  | (24) |
| Total | \$ | 28 | \$ | 349 | \$ | 45 | \$ | 28 |

The Company is not required to make contributions to the Plan in the remainder of 2007. The Company recorded approximately $\$ 54,000$, net of tax, as amortization of previously recognized pension amounts in Accumulated Other Comprehensive Income.

## Note 9.

## Trust Preferred Debentures

CNBF Capital Trust I is a Delaware statutory business trust formed in 1999 , for the purpose of issuing $\$ 18$ million in trust preferred securities and lending the proceeds to the Company. NBT Statutory Trust I is a Delaware statutory business trust formed in 2005, for the purpose of issuing $\$ 5$ million in trust preferred securities and lending the proceeds to the Company. NBT Statutory Trust II is a Delaware statutory business trust formed in 2006, for the purpose of issuing $\$ 50$ million in trust preferred securities and lending the proceeds to the Company to provide funding for the acquisition of CNB Bancorp, Inc. These three statutory business trusts are collectively referred herein as "the Trusts". The Company guarantees, on a limited basis, payments of distributions on the trust preferred securities and payments on redemption of the trust preferred securities. The Trusts are variable interest entities (VIEs) for which the Company is not the primary beneficiary, as defined in Financial Accounting Standards Board Interpretation ("FIN") No. 46 "Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin No. 51 (Revised December 2003) (FIN 46R)." In accordance with FIN 46R, which was implemented in the first quarter of 2004, the accounts of the Trusts are not included in the Company's consolidated financial statements.

As of March 31, 2007, the Trusts had the following issues of trust preferred debentures, all held by the Trusts, outstanding (dollars in thousands):

| Description | Issuance Date | Trust Preferred Securities Outstanding | Interest <br> Rate | Trust Preferred Debt Owed To Trust | Final Maturity date |
| :---: | :---: | :---: | :---: | :---: | :---: |
| CNBF Capital Trust I | August-99 | 18,000 | 3-month LIBOR plus 2.75\% | 18,720 | August-29 |
|  |  |  |  |  |  |
| NBT Statutory Trust I | November-05 | 5,000 | 6.30\% Fixed | 5,155 | December-35 |
|  |  |  |  |  |  |
|  |  |  | 6.195\% |  |  |
| NBT Statutory Trust II | February-06 | 50,000 | Fixed | 51,547 | March-36 |

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The Company owns all of the common stock of the three business trusts, which have issued trust preferred securities in conjunction with the Company issuing trust preferred debentures to the Trusts. The terms of the trust preferred debentures are substantially the same as the terms of the trust preferred securities. In February 2005, the Federal Reserve Board issued a final rule that allows the continued inclusion of trust preferred securities in the Tier 1 capital of bank holding companies. The Board's final rule limits the aggregate amount of restricted core capital elements (which includes trust preferred securities, among other things) that may be included in the Tier 1 capital of most bank holding companies to $25 \%$ of all core capital elements, including restricted core capital elements, net of goodwill less any associated deferred tax liability. Large, internationally active bank holding companies (as defined) are subject to a $15 \%$ limitation. Amounts of restricted core capital elements in excess of these limits generally may be included in Tier 2 capital. The final rule provides a five-year transition period, ending March 31, 2009, for application of the quantitative limits. The Company does not expect that the quantitative limits will preclude it from including the trust preferred securities in Tier 1 capital. However, the trust preferred securities could be redeemed without penalty if they were no longer permitted to be included in Tier 1 capital.

## Note 10.

## Income Taxes

The Company adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes ("FIN 48"), on January 1, 2007. As a result of the implementation of FIN 48, the Company was not required to recognize any change in the liability for unrecognized tax benefits. The total unrecognized tax benefits upon adoption were approximately $\$ 2.6$ million. Included in this amount is $\$ 1.2$ million which would impact the effective rate if recognized or reversed and $\$ 0.4$ million which would impact goodwill.

The Company and its subsidiaries file income tax returns in the U.S. federal jurisdiction, New York State, Pennsylvania and certain other states. The Company is currently under examination by the Internal Revenue Service for tax years 2003 and 2004. All prior year federal returns are closed under the statute of limitations. The Company is also currently under examination by New York State for tax years 2000 through 2004. It is likely that the examination phase of some of these audits will conclude in 2007, and it is reasonably possible that a reduction in the unrecognized tax benefits may occur; however, quantification of an estimated range cannot be made at this time.

The Company's policy is to accrue interest and penalties as part of income tax expense. As of the date of adoption of FIN 48, the Company had accrued $\$ 0.5$ million of interest. Interest accrued as of March 31, 2007 is $\$ 0.6$ million.

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## NBT BANCORP INC. and Subsidiaries <br> Item 2 --MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The purpose of this discussion and analysis is to provide the reader with a concise description of the financial condition and results of operations of NBT Bancorp Inc. (Bancorp) and its wholly owned subsidiaries, NBT Bank, N.A. (the Bank), NBT Financial Services, Inc. (NBT Financial), Hathaway Agency, Inc., CNBF Capital Trust I, NBT Statutory Trust I and NBT Statutory Trust II. (collectively referred to herein as the Company). This discussion will focus on Results of Operations, Financial Position, Capital Resources and Asset/Liability Management. Reference should be made to the Company's consolidated financial statements and footnotes thereto included in this Form 10-Q as well as to the Company's 2006 Form 10-K for an understanding of the following discussion and analysis.

## FORWARD LOOKING STATEMENTS

Certain statements in this filing and future filings by the Company with the Securities and Exchange Commission, in the Company's press releases or other public or shareholder communications, contain forward-looking statements, as defined in the Private Securities Litigation Reform Act. These statements may be identified by the use of phrases such as "anticipate," "believe," "expect," "forecasts," "projects," or other similar terms. There are a number of factors, many which are beyond the Company's control that could cause actual results to differ materially from those contemplated by the forward looking statements. Factors that may cause actual results to differ materially from those contemplated by such forward-looking statements include, among others, the following possibilities: (1) competitive pressures among depository and other financial institutions may increase significantly; (2) revenues may be lower than expected; (3) changes in the interest rate environment may effect interest margins; (4) general economic conditions, either nationally or regionally, may be less favorable than expected, resulting in, among other things, a deterioration in credit quality and/or a reduced demand for credit; (5) legislative or regulatory changes, including changes in accounting standards or tax laws, may adversely affect the businesses in which the Company is engaged; (6) competitors may have greater financial resources and develop products that enable such competitors to compete more successfully than the Company; (7) adverse changes may occur in the securities markets or with respect to inflation; (8) acts of war or terrorism; (9) the costs and effects of litigation and of unexpected or adverse outcomes in such litigation; (10) internal control failures; and (11) the Company's success in managing the risks involved in the foregoing.

The Company wishes to caution readers not to place undue reliance on any forward-looking statements, which speak only as of the date made, and to advise readers that various factors, including those described above and other factors discussed in the Company's annual and quarterly reports previously filed with the Securities and Exchange Commission, could affect the Company's financial performance and could cause the Company's actual results or circumstances for future periods to differ materially from those anticipated or projected.

Unless required by law, the Company does not undertake, and specifically disclaims any obligations to publicly release the result of any revisions that may be made to any forward-looking statements to reflect statements to the occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

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## Critical Accounting Policies

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

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

## Overview

The Company earned net income of $\$ 14.1$ million ( $\$ 0.41$ diluted earnings per share) for the three months ended March 31, 2007 compared to net income of $\$ 13.6$ million ( $\$ 0.40$ diluted earnings per share) for the three months ended March 31, 2006. The increase in net income from 2006 to 2007 was primarily the result of increases in net interest income of $\$ 0.5$ million and noninterest income of $\$ 1.5$ million. These increases were partially offset by increases in total noninterest expense of $\$ 0.4$ million, income tax expense of $\$ 0.7$ million, and provision for loan and lease losses of $\$ 0.4$ million. The increase in net interest income resulted primarily from $8 \%$ growth in average loans during the three months ended March 31, 2007 compared to the same period in 2006. Included in noninterest income for the three months ended March 31, 2006 were $\$ 0.9$ million in net losses from investment securities sales. Excluding the effect of these securities transactions in 2006, noninterest income increased $\$ 0.5$ million or $4.4 \%$ compared to the same period in 2006. The increase in noninterest income resulted from increases in service charges on deposit accounts, ATM and debit card fees, retirement plan administration fees, trust administration fees, broker/dealer and insurance revenue, and bank owned life insurance income. The increase in total noninterest expense was due primarily to increases in salaries and employee benefits, office supplies and postage, occupancy expense, amortization of intangible assets, data processing and communications, and loan collection and other real estate owned expenses.

Table 1 depicts several annualized measurements of performance using GAAP net income. Returns on average assets and equity measure how effectively an entity utilizes its total resources and capital, respectively. Net interest margin, which is the net federal taxable equivalent (FTE) interest income divided by average earning assets, is a measure of an entity's ability to utilize its earning assets in relation to the cost of funding. Interest income for tax-exempt securities and loans is adjusted to a taxable equivalent basis using the statutory Federal income tax rate of $35 \%$.

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Table 1 - Performance Measures

| 2007 | First <br> Quarter |
| :--- | ---: |
| Return on average assets (ROAA) | $1.13 \%$ |
| Return on average equity (ROAE) | $14.06 \%$ |
| Net Interest Margin | $3.63 \%$ |
| 2006 | $1.18 \%$ |
| Return on average assets (ROAA) | $15.11 \%$ |
| Return on average equity (ROAE) | $3.86 \%$ |

## Net Interest Income

Net interest income is the difference between interest income on earning assets, primarily loans and securities, and interest expense on interest-bearing liabilities, primarily deposits and borrowings. Net interest income is affected by the interest rate spread, the difference between the yield on earning assets and cost of interest-bearing liabilities, as well as the volumes of such assets and liabilities. Net interest income is one of the major determining factors in a financial institution's performance as it is the principal source of earnings. Table 2 represents an analysis of net interest income on a federal taxable equivalent basis.

Federal taxable equivalent (FTE) net interest income increased $\$ 0.8$ million during the three months ended March 31, 2007, compared to the same period of 2006. The increase in FTE net interest income resulted primarily from $8.3 \%$ growth in average earning assets. The Company's interest rate spread declined 31 bp during the three months ended March 31, 2007 compared to the same period in 2006. The yield on earning assets for the period increased 32 bp , to $6.63 \%$ for the three months ended March 31, 2007 from $6.31 \%$ for the same period in 2006. Meanwhile, the rate paid on interest-bearing liabilities increased 63 bp , to $3.54 \%$ for the three months ended March 31, 2007 from $2.91 \%$ for the same period in 2006.

For the quarter ended March 31, 2007, total interest expense increased $\$ 8.6$ million, primarily the result of the 50 bp increase in the Federal Funds target rate since March 31, 2006, which impacts the Company's short-term borrowing, money market account and time deposit rates. Additionally, average interest-bearing liabilities increased \$335.4 million for the three months ended March 31, 2007 when compared to the same period in 2006, principally from strong organic deposit growth as well as deposits assumed from the CNB transaction. Total average interest-bearing deposits increased $\$ 435.5$ million for the three months ended March 31, 2007 when compared to the same period in 2006. The rate paid on average interest-bearing deposits increased 76 bp from $2.49 \%$ for the three months ended March 31, 2006 to $3.25 \%$ for the same period in 2007. The increase in average interest-bearing deposits resulted from organic deposit growth as well as the previously mentioned deposits assumed from the CNB transaction, which increased average interest bearing deposits approximately $\$ 127.6$ million for the three months ended March 31, 2007 as compared to March 31, 2006. For the quarter ended March 31, 2007, the Company experienced a shift in its deposit mix from savings and NOW accounts to money market and time deposit accounts, as interest sensitive customers shifted funds into higher paying interest bearing accounts. Savings and NOW accounts collectively decreased approximately $\$ 44.0$ million and money market and time deposit accounts collectively increased approximately $\$ 479.4$ million (time deposits was the primary driver of the increase). If short-term rates continue to rise, the Company anticipates that this trend will continue placing greater pressure on the net interest margin.

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Total average borrowings, including trust preferred debentures, decreased $\$ 100.0$ million for the three months ended March 31, 2007 compared with the same period in 2006. Average short-term borrowings decreased by $\$ 106.3$ million, from $\$ 371.6$ million for the three months ended March 31,2006 to $\$ 265.3$ million for the three months ended March 31, 2007. Despite this $28.6 \%$ decrease, interest expense from short-term borrowings only decreased $\$ 0.8$ million, or $21.5 \%$. The rate paid on short-term borrowings increased from $4.30 \%$ for the three months ended March 31,2006 to $4.73 \%$ for the same period in 2007. Average trust preferred debentures increased $\$ 21.8$ million for the three months ended March 31, 2007, compared with the same period in 2006, primarily from the issuance of $\$ 51.5$ million in trust preferred debentures in February 2006 to fund the cash portion of the CNB transaction and to provide regulatory capital. The rate paid on trust preferred debentures increased to $6.82 \%$ for the three months ended March 31,2007 , compared with $6.68 \%$ for the same period in 2006 , driven primarily by $\$ 51.5$ million in trust preferred debentures issued in February 2006 with a fixed rate of $6.195 \%$ and $\$ 18.7$ million in trust preferred debentures that reprice quarterly at 3-month LIBOR plus 275 bp .

Another important performance measurement of net interest income is the net interest margin. Despite a 31 bp decrease in the Company's net interest spread, the net interest margin only declined by 23 bp to $3.63 \%$ for the three months ended March 31, 2007, compared with $3.86 \%$ for the same period in 2006. The Company thus far has mitigated some of the margin pressure by growing noninterest bearing demand deposit accounts. Average demand deposits increased $\$ 25.9$ million or $8.9 \%$ for the three months ended March 31, 2007, compared to the same period in 2006.

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## Table 2

## Average Balances and Net Interest Income

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

Three months ended March

| 3 | Average Balance |  | 2007 |  | Yield/ <br> Rates | Average Balance |  | 2006 |  | Yield/ <br> Rates |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| (dollars in thousands) ASSETS |  |  |  | nterest |  |  |  |  | Interest |  |
| Short-term interest bearing accounts | \$ | 9,255 | \$ | 110 | 4.83\% | \$ | 7,742 | \$ | 78 | 4.09\% |
| Securities available for sale (2) |  | 1,123,414 |  | 14,057 | 5.07\% |  | 1,054,370 |  | 12,437 | 4.79\% |
| Securities held to maturity (2) |  | 140,856 |  | 2,173 | 6.26\% |  | 97,347 |  | 1,464 | 6.11\% |
| Investment in FRB and FHLB |  |  |  |  |  |  |  |  |  |  |
| Banks |  | 34,804 |  | 630 | 7.34\% |  | 40,549 |  | 533 | 5.34\% |
| Loans and leases (1) |  | 3,398,590 |  | 60,001 | 7.16\% |  | 3,147,115 |  | 53,016 | 6.84\% |
| Total interest earning assets |  | 4,706,919 |  | 76,971 | 6.63\% |  | 4,347,123 |  | 67,528 | 6.31\% |
| Other assets |  | 361,572 |  |  |  |  | 319,040 |  |  |  |
| Total assets | \$ | 5,068,491 |  |  |  | \$ | 4,666,163 |  |  |  |

LIABILITIES AND
STOCKHOLDERS' EQUITY

| Money market deposit accounts | \$ | 642,907 |  | 5,466 | 3.45\% | \$ | 451,822 |  | 3,239 | 2.91\% |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| NOW deposit accounts |  | 441,230 |  | 945 | 0.87\% |  | 431,503 |  | 646 | 0.61\% |
| Savings deposits |  | 492,044 |  | 1,120 | 0.92\% |  | 545,754 |  | 1,076 | 0.80\% |
| Time deposits |  | 1,668,971 |  | 18,453 | 4.48\% |  | 1,380,617 |  | 12,264 | 3.61\% |
| Total interest bearing deposits |  | 3,245,152 |  | 25,984 | 3.25\% |  | 2,809,696 |  | 17,225 | 2.49\% |
| Short-term borrowings |  | 265,347 |  | 3,092 | 4.73\% |  | 371,632 |  | 3,937 | 4.30\% |
| Trust preferred debentures |  | 75,422 |  | 1,268 | 6.82\% |  | 53,658 |  | 883 | 6.68\% |
| Long-term debt |  | 406,603 |  | 4,486 | 4.47\% |  | 422,097 |  | 4,142 | 3.98\% |
| Total interest bearing |  |  |  |  |  |  |  |  |  |  |
| liabilities |  | 3,992,524 |  | 34,830 | 3.54\% |  | 3,657,083 |  | 26,187 | 2.91\% |
| Demand deposits |  | 616,938 |  |  |  |  | 591,087 |  |  |  |
| Other liabilities |  | 51,510 |  |  |  |  | 52,978 |  |  |  |
| Stockholders' equity |  | 407,519 |  |  |  |  | 365,015 |  |  |  |
| Total liabilities and stockholders' equity | \$ | 5,068,491 |  |  |  | \$ | 4,666,163 |  |  |  |
| Net interest income (FTE basis) |  |  | \$ | 42,141 |  |  |  | \$ | 41,341 |  |
| Interest rate spread |  |  |  |  | 3.09\% |  |  |  |  | 3.40\% |
| Net interest margin |  |  |  |  | 3.63\% |  |  |  |  | 3.86\% |
| Taxable equivalent adjustment |  |  | \$ | 1,512 |  |  |  | \$ | 1,222 |  |
| Net interest income |  |  | \$ | 40,629 |  |  |  | \$ | 40,119 |  |

(1) For purposes of these computations, nonaccrual loans are included in the average loan balances outstanding.

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The following table presents changes in interest income and interest expense attributable to changes in volume (change in average balance multiplied by prior year rate), changes in rate (change in rate multiplied by prior year volume), and the net change in net interest income. The net change attributable to the combined impact of volume and rate has been allocated to each in proportion to the absolute dollar amounts of change.

## Analysis of Changes in Taxable Equivalent Net Interest Income

Three months ended March 31,

| (in thousands) | Increase (Decrease) 2007 over 2006 |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Volume |  | Rate |  | Total |  |
| Short-term interest bearing accounts | \$ | 17 | \$ | 15 | \$ | 32 |
| Securities available for sale |  | 840 |  | 780 |  | 1,620 |
| Securities held to maturity |  | 670 |  | 39 |  | 709 |
| Investment in FRB and FHLB Banks |  | (83) |  | 180 |  | 97 |
| Loans and leases |  | 4,363 |  | 2,622 |  | 6,985 |
| Total interest income |  | 5,769 |  | 3,674 |  | 9,443 |
| Money market deposit accounts |  | 1,547 |  | 680 |  | 2,227 |
| NOW deposit accounts |  | 15 |  | 284 |  | 299 |
| Savings deposits |  | (112) |  | 156 |  | 44 |
| Time deposits |  | 2,850 |  | 3,339 |  | 6,189 |
| Short-term borrowings |  | $(1,209)$ |  | 364 |  | (845) |
| Trust preferred debentures |  | 366 |  | 19 |  | 385 |
| Long-term debt |  | (156) |  | 500 |  | 344 |
| Total interest expense |  | 2,557 |  | 6,086 |  | 8,643 |
| Change in FTE net interest income | \$ | 3,212 | \$ | $(2,412)$ | \$ | 800 |

## Noninterest Income

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

|  | Three months ended March 31, |  |  |  |
| :--- | ---: | ---: | ---: | ---: |
| 2007 | 2006 |  |  |  |
| (in thousands) | $\$$ | $\mathbf{1 , 4 3 7}$ | $\$$ | 1,358 |
| Trust | $\mathbf{4 , 4 6 9}$ | 4,219 |  |  |
| Service charges on deposit accounts | $\mathbf{1 , 8 9 6}$ | 1,645 |  |  |
| ATM fees | $\mathbf{1 , 0 8 3}$ | 908 |  |  |
| Broker/dealer and insurance fees | $\mathbf{( 5 )}$ | $(934)$ |  |  |
| Net securities losses | $\mathbf{4 3 4}$ | 381 |  |  |
| Bank owned life insurance income | $\mathbf{1 , 5 9}$ | 1,231 |  |  |
| Retirement plan administration fees | $\mathbf{1 , 7 8 4}$ | 2,416 |  |  |
| Other | $\mathbf{1 2 , 6 9 0}$ | $\$$ | 11,224 |  |

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Noninterest income for the three months ended March 31, 2007, was $\$ 12.7$ million, up $\$ 1.5$ million or $13.1 \%$ from $\$ 11.2$ million for the same period in 2006. Fees from service charges on deposit accounts and ATM and debit cards collectively increased $\$ 0.5$ million from growth in our debit card base as well as growth in our demand deposit accounts. Retirement plan administration fees for the three months ended March 31, 2007, increased $\$ 0.4$ million, compared with the same period in 2006, as a result of our growing client base. Broker/dealer and insurance revenue for the three months ended March 31, 2007, increased $\$ 0.2$ million in large part due to the growth in brokerage income from retail financial services as well as the addition of Hathaway Insurance Agency as part of the acquisition of CNB. Bank-owned life insurance income for the three months ended March 31, 2007, increased $\$ 0.1$ million, compared with the same period in 2006. This increase was due in large part to the acquisition of CNB. Trust administration income increased $\$ 0.1$ million for the three months ended March 31, 2007, compared with the same period in 2006. This increase stems from the increased market value of accounts, an increase in customer accounts as a result of the acquisition of CNB and successful business development. Other noninterest income for the three months ended March 31, 2007, decreased $\$ 0.6$ million, compared with the same period in 2006, primarily as a result of a gain on the sale of a branch in 2006. Net securities losses for the three months ended March 31, 2007, were nominal, compared with net securities losses of $\$ 0.9$ million for the three months ended March 31, 2006. Excluding the effect of these securities transactions, noninterest income increased $\$ 0.5$ million, or $4.4 \%$, for the three months ended March 31, 2007, compared with the same period in 2006.

## Noninterest Expense

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

|  | Three months ended March 31, |  |  |
| :--- | ---: | ---: | ---: | ---: |
| 2007 | 2006 |  |  |
| (in thousands) |  |  |  |
| Salaries and employee benefits | $\mathbf{1 5 , 9 6 4}$ | $\$$ | 15,748 |
| Occupancy | $\mathbf{3 , 1 6 9}$ | 2,988 |  |
| Equipment | $\mathbf{1 , 9 3 3}$ | 2,156 |  |
| Data processing and communications | $\mathbf{2 , 8 7 7}$ | 2,702 |  |
| Professional fees and outside services | $\mathbf{1 , 6 5 8}$ | 1,832 |  |
| Office supplies and postage | $\mathbf{1 , 2 9 6}$ | 1,181 |  |
| Amortization of intangible assets | $\mathbf{4 0 9}$ | 323 |  |
| Loan collection and other real estate owned | $\mathbf{3 7 7}$ | 211 |  |
| Other | $\mathbf{3 , 1 8 9}$ | 3,331 |  |
| Total noninterest expense | $\mathbf{3 0 , 8 7 2}$ | $\$$ | 30,472 |

Noninterest expense for the three months ended March 31, 2007, was $\$ 30.9$ million, up from $\$ 30.5$ million for the same period in 2006. Office expenses, such as supplies and postage, occupancy, equipment and data processing and communications charges, increased collectively by $\$ 0.2$ million, or $2.7 \%$, for the three months ended March 31, 2007, compared with the same period in 2006. Salaries and employee benefits increased $\$ 0.2$ million, or $1.4 \%$, for the three months ended March 31, 2007, over the same period in 2006. Professional fees and services decreased $\$ 0.2$ million, or $9.5 \%$, for the three months ended March 31, 2007, compared with the same period in 2006 in large part due to a decrease in information technology and other consulting services. Amortization expense increased $\$ 0.1$ million for the three months ended March 31, 2007, over the same period in 2006. This increase was due primarily to the acquisition of CNB in February 2006. Loan collection and other real estate owned expenses increased $\$ 0.2$ million for the three months ended March 31, 2007, over the same period in 2006. This increase was due primarily to an increase in the amount of real estate taxes paid on foreclosures in 2007 compared with 2006. Other operating expense for the three months ended March 31, 2007, decreased $\$ 0.1$ million, or $4.3 \%$, compared with the same period in 2006.

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## Income Taxes

Income tax expense for the three months ended March 31, 2007, was $\$ 6.2$ million, up from $\$ 5.6$ million for the same period in 2006. The effective rate for the three months ended March 31, 2007, was $30.6 \%$, up from $29.0 \%$ for the same period in 2006. The increase in the effective tax rate for the three months ended March 31, 2007, versus the same period in 2006 resulted primarily from a tax refund received in the first quarter of 2006.

## ANALYSIS OF FINANCIAL CONDITION

## Loans and Leases

A summary of loans and leases, net of deferred fees and origination costs, by category for the periods indicated follows:

|  | March 31, | December | March 31, |  |
| :--- | ---: | ---: | ---: | ---: |
| (In thousands) | $\mathbf{2 0 0 7}$ | 31,2006 | 2006 |  |
| Residential real estate mortgages | $\$ 738,336$ | $\$$ | 739,607 | $\$$ |
| 747,912 |  |  |  |  |
| Commercial | 637,828 | 658,647 | 661,302 |  |
| Commercial real estate mortgages | 592,605 | 581,736 | 564,708 |  |
| Real estate construction and development | 82,040 | 94,494 | 77,682 |  |
| Agricultural and agricultural real estate mortgages | 119,399 | 118,278 | 114,008 |  |
| Consumer | 598,758 | 586,922 | 523,381 |  |
| Home equity | 541,352 | 546,719 | 477,173 |  |
| Lease financing | 85,158 | 86,251 | 81,675 |  |
| Total loans and leases | $\$ 3,395,476$ | $\$ 3,412,654$ | $\$ 3,247,841$ |  |

Real estate construction and development loans presented in March 2006 have been reclassified to conform with current year presentation which represents the conversion of construction loans to permanent financing

Total loans and leases were $\$ 3.4$ billion, or $66.6 \%$ of assets, at March 31, 2007, $\$ 3.4$ billion, or $67.1 \%$ of assets, at December 31, 2006, and $\$ 3.2$ billion, or $66.5 \%$, at March 31, 2006. Total loans and leases decreased slightly by $\$ 17.2$ million or $0.5 \%$ from December 31, 2006 to March 31, 2007. This decrease was due primarily to a $0.8 \%$ decrease in commercial and commercial real estate loans. Home equity loans decreased $\$ 5.4$ million, or $1.0 \%$. Consumer loans, most notably indirect installment loans, increased $\$ 11.8$ million or $2.0 \%$. Real estate construction and development loans decreased $\$ 12.5$ million, or $13.2 \%$, at March 31, 2007, as compared to December 31, 2006.

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## Securities

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

Average total earning securities increased $\$ 112.6$ million for the three months ended March 31, 2007 when compared to the same period in 2006. The average balance of securities available for sale increased $\$ 69.0$ million for the three months ended March 31, 2007 when compared to the same period in 2006. The average balance of securities held to maturity increased $\$ 43.5$ million for the three months ended March 31, 2007, compared to the same period in 2006. The average total securities portfolio represents $26.9 \%$ of total average earning assets for the three months ended March 31, 2007, up from $26.5 \%$ for the same period in 2006.

The following details the composition of securities available for sale, securities held to maturity and regulatory investments for the periods indicated:

|  | At March 31, |  |
| :--- | :---: | ---: |
|  | 2007 | 2006 |
| Mortgage-backed securities: | $26 \%$ | $33 \%$ |
| With maturities 15 years or less | $4 \%$ | $4 \%$ |
| With maturities greater than 15 years | $19 \%$ | $17 \%$ |
| Collateral mortgage obligations | $19 \%$ | $16 \%$ |
| Municipal securities | $28 \%$ | $26 \%$ |
| US agency notes | $4 \%$ | $4 \%$ |
| Other | $100 \%$ | $100 \%$ |
| Total |  |  |

## Allowance for Loan and Lease Losses, Provision for Loan and Lease Losses, and Nonperforming Assets

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

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

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For purposes of evaluating the adequacy of the allowance, the Company considers a number of significant factors that affect the collectibility of the portfolio. For individually analyzed loans, these include estimates of loss exposure, which reflect the facts and circumstances that affect the likelihood of repayment of such loans as of the evaluation date. For homogeneous pools of loans and leases, estimates of the Company's exposure to credit loss reflect a thorough current assessment of a number of factors, which could affect collectibility. These factors include: past loss experience; the size, trend, composition, and nature of the loans and leases; changes in lending policies and procedures, including underwriting standards and collection, charge-off and recovery practices; trends experienced in nonperforming and delinquent loans and leases; current economic conditions in the Company's market; portfolio concentrations that may affect loss experienced across one or more components of the portfolio; the effect of external factors such as competition, legal and regulatory requirements; and the experience, ability, and depth of lending management and staff. In addition, various regulatory agencies, as an integral component of their examination process, periodically review the Company's allowance for loan and lease losses. Such agencies may require the Company to recognize additions to the allowance based on their judgment about information available to them at the time of their examination, which may not be currently available to management.

After a thorough consideration and validation of the factors discussed above, required additions to the allowance for loan and lease losses are made periodically by charges to the provision for loan and lease losses. These charges are necessary to maintain the allowance at a level which management believes is reasonably reflective of overall inherent risk of probable loss in the portfolio. While management uses available information to recognize losses on loans and leases, additions to the allowance may fluctuate from one reporting period to another. These fluctuations are reflective of changes in risk associated with portfolio content and/or changes in management's assessment of any or all of the determining factors discussed above. The allowance for loan and lease losses to outstanding loans and leases at March 31, 2007 was $1.49 \%$ compared with $1.48 \%$ at December 31, 2006, and $1.53 \%$ at March 31, 2006. Management considers the allowance for loan losses to be adequate based on evaluation and analysis of the loan portfolio.

Table 4 reflects changes to the allowance for loan and lease losses for the periods presented. The allowance is increased by provisions for losses charged to operations and is reduced by net charge-offs. Charge-offs are made when the collectability of loan principal within a reasonable time is unlikely. Any recoveries of previously charged-off loans are credited directly to the allowance for loan and lease losses.

Table 4
Allowance For Loan and Lease Losses

| (dollars in thousands) | 2007 |  | 2006 |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Balance, beginning of period | \$ | 50,587 |  | \$ | 47,455 |  |
| Recoveries |  | 1,444 |  |  | 1,175 |  |
| Chargeoffs |  | $(3,573)$ |  |  | $(2,950)$ |  |
| Net chargeoffs |  | $(2,129)$ |  |  | $(1,775)$ |  |
| Allowance related to purchase acquisition |  | - |  |  | 2,410 |  |
| Provision for loan losses |  | 2,096 |  |  | 1,728 |  |
| Balance, end of period | \$ | 50,554 |  | \$ | 49,818 |  |
| Composition of Net Chargeoffs |  |  |  |  |  |  |
| Commercial and agricultural | \$ | (701) | 33\% | \$ | (858) | 48\% |
| Real estate mortgage |  | (307) | 14\% |  | (71) | 4\% |
| Consumer |  | $(1,121)$ | 53\% |  | (846) | 48\% |
| Net chargeoffs | \$ | $(2,129)$ | 100\% | \$ | $(1,775)$ | 100\% |
| Annualized net chargeoff's to average loans and leases |  | 0.25\% |  |  | 0.23\% |  |

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Nonperforming assets consist of nonaccrual loans, loans 90 days or more past due and still accruing, restructured loans, other real estate owned (OREO), and nonperforming securities. Loans are generally placed on nonaccrual when principal or interest payments become ninety days past due, unless the loan is well secured and in the process of collection. Loans may also be placed on nonaccrual when circumstances indicate that the borrower may be unable to meet the contractual principal or interest payments. OREO represents property acquired through foreclosure and is valued at the lower of the carrying amount or fair market value, less any estimated disposal costs. Nonperforming securities include securities which management believes are other-than-temporarily impaired, carried at their estimated fair value and are not accruing interest.

Total nonperforming assets were $\$ 18.0$ million at March 31, 2007, $\$ 15.7$ million at December 31, 2006, and $\$ 13.6$ million at March 31, 2006. Nonaccrual loans were $\$ 16.3$ million at March 31, 2007, as compared to $\$ 13.7$ million at December 31, 2006 and $\$ 12.6$ million at March 31, 2006. The increase in nonperforming assets from March 31, 2006 to March 31, 2007 was mainly attributable to increases in nonperforming small business and agricultural loans, primarily due to regional flooding as well as falling milk prices. OREO increased from $\$ 0.3$ million at March 31, 2006 to $\$ 0.6$ million at March 31, 2007.

In addition to the nonperforming loans discussed above, the Company has also identified approximately $\$ 70.9$ million in potential problem loans at March 31, 2007 as compared to $\$ 69.8$ million at December 31, 2006. Potential problem loans are loans that are currently performing, but where known information about possible credit problems of the borrowers causes management to have serious doubts as to the ability of such borrowers to comply with the present loan repayment terms and which may result in disclosure of such loans as nonperforming at some time in the future. At the Company, potential problem loans are typically loans that are performing but are classified by the Company's loan rating system as "substandard." At March 31, 2007, potential problem loans primarily consisted of commercial real estate and commercial and agricultural loans. Management cannot predict the extent to which economic conditions may worsen or other factors which may impact borrowers and the potential problem loans. Accordingly, there can be no assurance that other loans will not become 90 days or more past due, be placed on nonaccrual, become restructured, or require increased allowance coverage and provision for loan losses.

Subsequent to March 31, 2007, the Company has identified $\$ 4.9$ million of loans that has migrated to nonaccrual status as of the date of filing this $10-\mathrm{Q}$, of which $\$ 1.7$ million was included in the potential problem loan balance at March 31, 2007. The $\$ 4.9$ million of new non-accrual loans consists of two commercial real estate relationships aggregating $\$ 3.0$ million, with the remainder of the balance consisting of agricultural loans. Also, subsequent to March 31, 2007, the Company has identified an additional $\$ 4.7$ million in potential problem loans as of the date of filing this $10-\mathrm{Q}$.

Net chargeoffs totaled $\$ 2.1$ million for the three months ended March 31, 2007, up $\$ 0.3$ million from the $\$ 1.8$ million charged off during the same period in 2006. The provision for loan and lease losses totaled $\$ 2.1$ million for the three months ended March 31, 2007, compared with the $\$ 1.7$ million provided during the same period in 2006.

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Table 5
Nonperforming Assets


## Deposits

Total deposits were $\$ 4.0$ billion at March 31, 2007, up $\$ 170.4$ million from year-end 2006, and up $\$ 346.6$ million, or $9.6 \%$, from the same period in the prior year. The increase in deposits compared with March 31, 2006, was driven by organic deposit growth (driven primarily by time deposit growth). Total average deposits for the three months ended March 31, 2007 increased $\$ 461.3$ million, or $13.6 \%$, from the same period in 2006. The Company experienced an increase in average time deposits of $\$ 288.4$ million or $20.9 \%$, for the three months ended March 31,2007 compared to the same period in 2006. This increase in average time deposits was due to organic growth of approximately $\$ 230.9$ million, as well as approximately $\$ 57.5$ million resulting from the CNB transaction. The Company experienced a shift in its deposit mix from interest sensitive customers into higher paying time accounts. Average savings and NOW accounts experienced a decrease of $\$ 44.0$ million for the three month period ending March 31, 2007 as compared to the same period in 2006. This decrease was the result of the previously mentioned shift in deposit mix from lower cost deposit accounts to higher cost deposit accounts with more attractive interest rates (which have increased due to the rising rate environment). Average money market accounts increased $\$ 191.1$ million for the three months ended March 31, 2007 from the same period in 2006, as organic money market account growth totaled approximately $\$ 167.9$ million and approximately $\$ 23.2$ million was attributed to the acquisition of CNB. Average demand deposit accounts increased $\$ 25.9$ million for the three months ended March 31, 2007 as compared to the same period in 2006. This was due primarily to the CNB transaction, which accounted for approximately $\$ 21.3$ million of the increase.

## Borrowed Funds

The Company's borrowed funds consist of short-term borrowings and long-term debt. Short-term borrowings totaled $\$ 204.4$ million at March 31, 2007 compared to $\$ 345.4$ million and $\$ 329.7$ million at December 31, and March 31, 2006, respectively. Long-term debt was $\$ 392.8$ million at March 31, 2007, and was $\$ 417.7$ and $\$ 424.9$ million at December 31, and March 31, 2006, respectively. For more information about the Company's borrowing capacity and liquidity position, see the section with the title caption of "Liquidity Risk" on page 32 in this discussion.

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## Capital Resources

Stockholders' equity of $\$ 407.6$ million represents $8.0 \%$ of total assets at March 31, 2007, compared with $\$ 385.8$ million, or $7.9 \%$ as of March 31, 2006, and $\$ 403.8$ million, or $7.9 \%$ at December 31, 2006. On April 23, 2007, the NBT Board of Directors authorized a new repurchase program whereby NBT intends to repurchase up to an additional $1,000,000$ shares (approximately $3 \%$ ) of its outstanding common stock, as market conditions warrant in open market and privately negotiated transactions. When this repurchase was authorized, there were 363,180 shares remaining under previous authorizations. These remaining shares were combined with this new authorization, increasing the total shares available for repurchase to $1,363,180$. Under the authorized programs for the period, the Company purchased 373,967 shares of its common stock during the three months ended March 31, 2007, for a total of $\$ 8.6$ million at an average price of $\$ 22.90$ per share.

The Board of Directors considers the Company's earnings position and earnings potential when making dividend decisions. The Company does not have a target dividend pay out ratio.

As the capital ratios in Table 6 indicate, the Company remains "well capitalized". Capital measurements are significantly in excess of regulatory minimum guidelines and meet the requirements to be considered well capitalized for all periods presented. Tier 1 leverage, Tier 1 capital and Risk-based capital ratios have regulatory minimum guidelines of $3 \%, 4 \%$ and $8 \%$ respectively, with requirements to be considered well capitalized of $5 \%, 6 \%$ and $10 \%$, respectively.

## Table 6

## Capital Measurements

| 2007 | March 31, |  |
| :--- | :---: | :---: |
| Tier 1 leverage ratio | $7.60 \%$ |  |
| Tier 1 capital ratio | $10.53 \%$ |  |
| Total risk-based capital ratio | $11.78 \%$ |  |
| Cash dividends as a percentage of net income | $46.21 \%$ |  |
| Per common share: | $\$$ | 11.99 |
| Book value | $\$ .61$ |  |
| Tangible book value | March 31, |  |
| 2006 | $7.77 \%$ |  |
| Tier 1 leverage ratio | $10.30 \%$ |  |
| Tier 1 capital ratio | $11.56 \%$ |  |
| Total risk-based capital ratio | $48.20 \%$ |  |
| Cash dividends as a percentage of net income | $\$$ | 11.22 |
| Per common share: | $\$$ | 7.84 |
| Book value |  |  |

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The accompanying Table 7 presents the high, low and closing sales price for the common stock as reported on the NASDAQ Stock Market, and cash dividends declared per share of common stock. The Company's price to book value ratio was 1.95 at March 31, 2007 and 2.07 in the comparable period of the prior year. The Company's price was 14.3 times trailing twelve months earnings at March 31, 2007, compared to 14.2 times for the same period last year.

Table 7
Quarterly Common Stock and Dividend Information

| Quarter Endings | High |  | Low |  | Close |  | Cash Dividends Declared |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| 2006 |  |  |  |  |  |  |  |  |
| March 31 | \$ | 23.90 | \$ | 21.02 | \$ | 23.25 | \$ | 0.190 |
| June 30 |  | 23.24 |  | 21.03 |  | 23.23 |  | 0.190 |
| September 30 |  | 24.57 |  | 21.44 |  | 23.26 |  | 0.190 |
| December 31 |  | 26.47 |  | 22.36 |  | 25.51 |  | 0.190 |
| 2007 |  |  |  |  |  |  |  |  |
| March 31 | \$ | 25.81 | \$ | 21.73 | \$ | 23.43 | \$ | 0.200 |

## Liquidity and Interest Rate Sensitivity Management

## Market Risk

Interest rate risk is among the most significant market risk affecting the Company. Other types of market risk, such as foreign currency exchange rate risk and commodity price risk, do not arise in the normal course of the Company's business activities. Interest rate risk is defined as an exposure to a movement in interest rates that could have an adverse effect on the Company's net interest income. Net interest income is susceptible to interest rate risk to the degree that interest-bearing liabilities mature or reprice on a different basis than earning assets. When interest-bearing liabilities mature or reprice more quickly than earning assets in a given period, a significant increase in market rates of interest could adversely affect net interest income. Similarly, when earning assets mature or reprice more quickly than interest-bearing liabilities, falling interest rates could result in a decrease in net interest income.

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

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

The primary tool utilized by ALCO to manage interest rate risk is a balance sheet/income statement simulation model (interest rate sensitivity analysis). Information such as principal balance, interest rate, maturity date, cash flows, next repricing date (if needed), and current rates is uploaded into the model to create an ending balance sheet. In addition,

ALCO makes certain assumptions regarding prepayment speeds for loans and leases and mortgage related investment securities along with any optionality within the deposits and borrowings.

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The model is first run under an assumption of a flat rate scenario (i.e. no change in current interest rates) with a static balance sheet over a 12 -month period. Two additional models are run with static balance sheets: (1) a gradual increase of 200 bp , (2) and a gradual decrease of 200 bp takes place over a 12 month period with a static balance sheet. Under these scenarios, assets subject to prepayments are adjusted to account for faster or slower prepayment assumptions. Any investment securities or borrowings that have callable options embedded into them are handled accordingly based on the interest rate scenario. The resultant changes in net interest income are then measured against the flat rate scenario.

In the declining rate scenario, net interest income is projected to decrease when compared to the forecasted net interest income in the flat rate scenario through the simulation period. The decrease in net interest income is a result of earning assets repricing downward at a faster rate than interest bearing liabilities. The inability to effectively lower deposit rates will likely reduce or eliminate the benefit of lower interest rates. In the rising rate scenarios, net interest income is projected to experience a decline from the flat rate scenario. Net interest income is projected to remain at lower levels than in a flat rate scenario through the simulation period primarily due to a lag in assets repricing while funding costs increase. The potential impact on earnings is dependent on the ability to lag deposit repricing. If short-term rates continue to increase, the Company expects competitive pressures will likely lead to core deposit pricing increases, which will likely continue compression of the net interest margin.

Net interest income for the next 12 months in the $+200 /-200 \mathrm{bp}$ scenarios, as described above, is within the internal policy risk limits of not more than a $7.5 \%$ change in net interest income. The following table summarizes the percentage change in net interest income in the rising and declining rate scenarios over a 12 -month period from the forecasted net interest income in the flat rate scenario using the March 31, 2007 balance sheet position:

## Table 8

Interest Rate Sensitivity Analysis

| Change in interest rates | Percent change in <br> (in basis points) |
| :--- | :---: |
| $\mathbf{+ 2 0 0}$ | $\mathbf{( 3 . 0 0 \% )}$ |
| $-\mathbf{2 0 0}$ | $\mathbf{( 0 . 1 2 \% )}$ |

The Company has taken several measures to mitigate net interest margin compression. The Company began originating 20 -year and 30 -year residential real estate mortgages with the intent to sell beginning with the second quarter of 2005. Over time, the Company has shortened the average life of its investment securities portfolio by limiting purchases of mortgage-backed securities and redirecting proceeds into short-duration CMOs and US Agency notes and bonds. Lastly, the Company will continue to focus on growing noninterest bearing demand deposits and prudently managing deposit costs.

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## Liquidity Risk

Liquidity involves the ability to meet the cash flow requirements of customers who may be depositors wanting to withdraw funds or borrowers needing assurance that sufficient funds will be available to meet their credit needs. The ALCO is responsible for liquidity management and has developed guidelines which cover all assets and liabilities, as well as off balance sheet items that are potential sources or uses of liquidity. Liquidity policies must also provide the flexibility to implement appropriate strategies and tactical actions. Requirements change as loans and leases grow, deposits and securities mature, and payments on borrowings are made. Liquidity management includes a focus on interest rate sensitivity management with a goal of avoiding widely fluctuating net interest margins through periods of changing economic conditions.

The primary liquidity measurement the Company utilizes is called the Basic Surplus which captures the adequacy of its access to reliable sources of cash relative to the stability of its funding mix of average liabilities. This approach recognizes the importance of balancing levels of cash flow liquidity from short- and long-term securities with the availability of dependable borrowing sources which can be accessed when necessary. At March 31, 2007, the Company's Basic Surplus measurement was $8.92 \%$ of total assets or $\$ 453$ million, which was above the Company's minimum of $5 \%$ or $\$ 255$ million set forth in its liquidity policies.

This Basic Surplus approach enables the Company to adequately manage liquidity from both operational and contingency perspectives. By tempering the need for cash flow liquidity with reliable borrowing facilities, the Company is able to operate with a more fully invested and, therefore, higher interest income generating, securities portfolio. The makeup and term structure of the securities portfolio is, in part, impacted by the overall interest rate sensitivity of the balance sheet. Investment decisions and deposit pricing strategies are impacted by the liquidity position. At March 31, 2007, the Company Basic Surplus improved compared to December 31, 2006, Basic Surplus of $7.9 \%$, driven primarily by the CNB transaction.

The Company's primary source of funds is from its subsidiary, NBT Bank. Certain restrictions exist regarding the ability of the Company's subsidiary bank to transfer funds to the Company in the form of cash dividends. The approval of the Office of Comptroller of the Currency (OCC) is required to pay dividends when a bank fails to meet certain minimum regulatory capital standards or when such dividends are in excess of a subsidiary bank's earnings retained in the current year plus retained net profits for the preceding two years (as defined in the regulations). At March 31, 2007, approximately $\$ 55.1$ million of the total stockholders' equity of NBT Bank was available for payment of dividends to the Company without approval by the OCC. NBT Bank's ability to pay dividends also is subject to the Bank being in compliance with regulatory capital requirements. NBT Bank is currently in compliance with these requirements. Under the State of Delaware Business Corporation Law, the Company may declare and pay dividends either out of accumulated net retained earnings or capital surplus.

## Item 3. Quantitative and Qualitative Disclosure About Market Risk

Information called for by Item 3 is contained in the Liquidity and Interest Rate Sensitivity Management section of the Management Discussion and Analysis.

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## Item 4. Controls and Procedures

The Company's management, including the Company's Chief Executive Officer and Chief Financial Officer evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) and 15(d)-15(e) under the Securities Exchange Act of 1934, as amended) as of March 31, 2007. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of the Evaluation Date, the Company's disclosure controls and procedures were effective in timely alerting them to any material information relating to the Company and its subsidiaries required to be included in the Company's periodic SEC filings.

There were no changes made in the Company's internal controls over financial reporting that occurred during the Company's most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect the Company's internal controls over financial reporting.

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## PART II. OTHER INFORMATION

Item 1 -- Legal Proceedings
There are no material legal proceedings, other than ordinary routine litigation incidental to business to which the Company is a party or of which any of its property is subject.

Item 1A - Risk Factors
Management of the Company does not believe there have been any material changes in the risk factors that were disclosed in the Form 10-K filed with the Securities and Exchange Commission on March 1, 2007.

Item 2 - Unregistered Sales of Equity Securities and Use of Proceeds
(a)
Not applicable
(b)
Not applicable
(c)The table below sets forth the information with respect to purchases made by the Company (as defined in Rule 10b-18(a)(3) under the Securities Exchange Act of 1934), of our common stock during the quarter ended March 31, 2007:

| Period | Total Number of Shares Purchased | Average Price Paid Per Share |  | Total Number of Shares Purchased as Part of Publicly Announced Plans | Maximum Number of Shares That May Yet be Purchased Under The Plans (1) |
| :---: | :---: | :---: | :---: | :---: | :---: |
| 1/1/07-1/31/07 | - | \$ |  | - | 737,147 |
| 2/1/07-2/28/07 | - |  |  | - | 737,147 |
| 3/1/07-3/31/07 | 373,967 |  | 22.90 | 373,967 | 363,180 |
| Total | 373,967 | \$ | 22.90 | 373,967 | 363,180 |

(1) On April 23, 2007, the NBT Board of Directors authorized a new repurchase program whereby NBT intends to repurchase up to an additional $1,000,000$ shares (approximately $3 \%$ ) of its outstanding common stock, as market conditions warrant in open market and privately negotiated transactions. When this repurchase was authorized, there were 363,180 shares remaining under previous authorizations. These remaining shares were combined with this new authorization, increasing the total shares available for repurchase to $1,363,180$. Under the authorized programs for the period, the Company purchased 373,967 shares of its common stock during the three months ended March 31, 2007, for a total of $\$ 8.6$ million at an average price of $\$ 22.90$ per share.

Item 3 -- Defaults Upon Senior Securities
None
Item 4 -- Submission of Matters to a Vote of Security Holders
None
Item 5 -- Other Information

On April 23, 2007, NBT Bancorp Inc. announced the declaration of a regular quarterly cash dividend of $\$ 0.20$ per share. The cash dividend will be paid on June 15, 2007 to stockholders of record as of June 1, 2007.

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Item 6 -- Exhibits
3.1 Certificate of Incorporation of NBT Bancorp Inc. as amended through July 23, 2001 (filed as Exhibit 3.1 to Registrant's Form 10-K for the year ended December 31, 2001, filed on March 29, 2002 and incorporated herein by reference).
3.2 By-laws of NBT Bancorp Inc. as amended and restated through July 23, 2001 (filed as Exhibit 3.2 to Registrant's Form 10-K for the year ended December 31, 2001, filed on March 29, 2002 and incorporated herein by reference).
3.3 Rights Agreement, dated as of November 15, 2004, between NBT Bancorp Inc. and Registrar and Transfer Company, as Rights Agent (filed as Exhibit 4.1 to Registrant's Form 8-K, file number 0-14703, filed on November 18, 2004, and incorporated by reference herein).
3.4 Certificate of Designation of the Series A Junior Participating Preferred Stock (filed as Exhibit A to Exhibit 4.1 of the Registration's Form 8-K, file Number 0-14703, filed on November 18, 2004, and incorporated herein by reference).
4.1 Specimen common stock certificate for NBT's common stock (filed as exhibit 4.1 to the Registrant's Amendment No. 1 to Registration Statement on Form S-4 filed on December 27, 2005 and incorporated herein by reference).
10.1 Form of Employment Agreement between NBT Bancorp, Inc. and Jeffrey M. Levy made as of April 23, 2007.
10.2 Change in control agreement with Jeffrey M. Levy made as of April 23, 2007.
31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1 Written Statement of the Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2 Written Statement of the Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized, this 10th day of May 2007.

## NBT BANCORP INC.

## By: /s/ MICHAEL J. CHEWENS

Michael J. Chewens, CPA
Senior Executive Vice President Chief Financial Officer and Corporate Secretary

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