FULTON FINANCIAL CORP
Form 10-Q
May 10, 2006

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20459
FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2006, or

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

For the transition period from __________ to __________

Commission File No. 0-10587

FULTON FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

PENNSYLVANIA	23-2195389
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

One Penn Square, P.O. Box 4887 Lancaster, Pennsylvania	17604
(Address of principal executive offices)	(Zip Code)

(717) 291-2411

(Registrant s telephone number, including area code)

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

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

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date:

Common Stock, $2.50 Par Value 165,313,000 shares outstanding as of April 30, 2006.

FULTON FINANCIAL CORPORATION
FORM 10-Q FOR THE QUARTER ENDED MARCH 31, 2006
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Item 1. Financial Statements

FULTON FINANCIAL CORPORATION
CONSOLIDATED BALANCE SHEETS

(dollars in thousands, except per-share data)

	Mar. 31, 2006 (unaudited)	December 31 2005
ASSETS		
Cash and due from banks	$ 398,111	$ 368,043
Interest-bearing deposits with other banks	24,623	31,404
Federal funds sold	11,034	528
Loans held for sale	202,751	243,378
Investment securities:		
Held to maturity (estimated fair value of $13,960 in 2006 and $18,317 in 2005)	13,900	18,258
Available for sale	2,776,722	2,543,887
Loans, net of unearned income	9,718,710	8,424,728
Less: Allowance for loan losses	(106,195)	(92,847)
Net Loans	9,612,515	8,331,881
Premises and equipment	182,115	170,254
Accrued interest receivable	60,145	53,261
Goodwill	620,734	418,735
Intangible assets	46,653	29,687
Other assets	225,182	192,239
Total Assets	$ 14,174,485	$ 12,401,555
LIABILITIES		
Deposits:		
Noninterest-bearing	$ 1,958,958	$ 1,672,637
Interest-bearing	7,994,888	7,132,202
Total Deposits	9,953,846	8,804,839
Short-term borrowings:		
Federal funds purchased	1,001,366	939,096
Other short-term borrowings	529,015	359,866
Total Short-Term Borrowings	1,530,381	1,298,962

Accrued interest payable	**46,092**	38,604
Other liabilities	**137,027**	115,834
Federal Home Loan Bank advances and long-term debt	**1,058,800**	860,345
Total Liabilities	**12,726,146**	11,118,584
SHAREHOLDERS EQUITY		
Common stock, $2.50 par value, 600 million shares authorized, 181.1 million shares issued in 2006 and 172.3 million shares issued in 2005	**452,774**	430,827
Additional paid-in capital	**1,133,967**	996,708
Retained earnings	**158,368**	138,529
Accumulated other comprehensive loss	**(51,709)**	(42,285)
Treasury stock, 15.4 million shares in 2006 and 15.3 million shares in 2005, at cost	**(245,061)**	(240,808)
Total Shareholders Equity	**1,448,339**	1,282,971
Total Liabilities and Shareholders Equity	**$ 14,174,485**	$ 12,401,555

See Notes to Consolidated Financial Statements

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FULTON FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)
(dollars in thousands, except per-share data)

	Three months ended March 31	
	2006	**2005**
INTEREST INCOME		
Loans, including fees	**$ 161,114**	$ 115,938
Investment securities:		
Taxable	**22,539**	18,261
Tax-exempt	**3,533**	2,849
Dividends	**1,345**	1,084
Loans held for sale	**3,458**	2,502
Other interest income	**663**	176
Total Interest Income	**192,652**	140,810
INTEREST EXPENSE		
Deposits	**50,190**	27,808
Short-term borrowings	**15,306**	6,824
Long-term debt	**12,113**	7,930
Total Interest Expense	**77,609**	42,562
Net Interest Income	**115,043**	98,248
PROVISION FOR LOAN LOSSES	**1,000**	800
Net Interest Income After Provision for Loan Losses	**114,043**	97,448
OTHER INCOME		
Investment management and trust services	**10,032**	9,019
Service charges on deposit accounts	**10,247**	9,332
Other service charges and fees	**6,654**	5,556
Gains on sales of mortgage loans	**4,772**	6,049
Investment securities gains	**2,665**	3,315
Other	**2,237**	2,582
Total Other Income	**36,607**	35,853
OTHER EXPENSES		
Salaries and employee benefits	**49,929**	44,297
Net occupancy expense	**8,589**	7,498

Equipment expense	**3,593**	3,070
Data processing	**2,909**	3,169
Advertising	**2,253**	1,973
Intangible amortization	**1,852**	1,179
Other	**18,891**	12,642
Total Other Expenses	**88,016**	73,828
Income Before Income Taxes	**62,634**	59,473
INCOME TAXES	**18,755**	18,037
Net Income	**$ 43,879**	$ 41,436
PER-SHARE DATA:		
Net income (basic)	**$ 0.27**	$ 0.26
Net income (diluted)	**0.27**	0.26
Cash dividends	**0.145**	0.132

See Notes to Consolidated Financial Statements

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FULTON FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY AND COMPREHENSIVE INCOME (UNAUDITED)
THREE MONTHS ENDED MARCH 31, 2006 AND 2005

	Number of Shares Outstanding	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Com-prehensive (Loss) Income	Treasury Stock	Total
			(dollars in thousands)				
Balance at December 31, 2005	157,017,000	$ 430,827	$ 996,708	$ 138,529	$ (42,285)	$ (240,808)	$ 1,282,971
Comprehensive income:							
Net income				43,879			43,879
Unrealized loss on securities (net of $3.4 million tax effect)					(6,297)		(6,297)
Unrealized loss on derivative financial instrument (net of $751,000 tax effect)					(1,394)		(1,394)
Less reclassification adjustment for gains included in net income (net of $933,000 tax expense)					(1,733)		(1,733)
Total comprehensive income							34,455
Stock issued, including related tax benefits	569,000	1,424	3,307				4,731
Stock-based compensation awards			344				344
Stock issued for acquisition of	8,209,000	20,523	133,608				154,131

Columbia Bancorp Acquisition of treasury stock	**(49,000)**					**(830)**	**(830)**
Accelerated share repurchase settlement						**(3,423)**	**(3,423)**
Cash dividends $0.145 per share				**(24,040)**			**(24,040)**
Balance at March 31, 2006	**165,746,000**	**$ 452,774**	**$ 1,133,967**	**$ 158,368**	**$ (51,709)**	**$ (245,061)**	**$ 1,448,339**
Balance at December 31, 2004	157,150,000	$ 335,604	$ 1,018,403	$ 60,924	$ (10,133)	$ (160,711)	$ 1,244,087
Comprehensive income:							
Net income				41,436			41,436
Unrealized loss on securities (net of $10.9 million tax effect)					(20,170)		(20,170)
Less reclassification adjustment for gains included in net income (net of $1.2 million tax expense)					(2,155)		(2,155)
Total comprehensive income							19,111
Stock issued, including related tax benefits	590,000	418	(950)			5,469	4,937
Stock-based compensation awards			96				96
Acquisition of treasury stock	(400,000)					(6,923)	(6,923)
Cash dividends $0.132 per share				(20,797)			(20,797)
Balance at March 31, 2005	157,340,000	$ 336,022	$ 1,017,549	$ 81,563	$ (32,458)	$ (162,165)	$ 1,240,511

See Notes to Consolidated Financial Statements

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FULTON FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(in thousands)

	Three months ended March 31	
	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Income	**$ 43,879**	$ 41,436
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	**1,000**	800
Depreciation and amortization of premises and equipment	**4,009**	3,263
Net amortization of investment security premiums	**1,015**	1,256
Investment securities gains	**(2,665)**	(3,315)
Net decrease (increase) in loans held for sale	**40,627**	(18,114)
Amortization of intangible assets	**1,852**	1,179
Stock-based compensation expense	**344**	96
Increase in accrued interest receivable	**(228)**	(1,581)
Increase in other assets	**(24,109)**	(5,064)
Increase in accrued interest payable	**6,441**	2,267
Increase in other liabilities	**16,596**	8,645
Total adjustments	**44,882**	(10,568)
Net cash provided by operating activities	**88,761**	30,868
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sales of securities available for sale	**64,225**	56,380
Proceeds from maturities of securities held to maturity	**4,355**	1,525
Proceeds from maturities of securities available for sale	**197,541**	153,488
Purchase of securities held to maturity		(4,383)
Purchase of securities available for sale	**(319,199)**	(196,144)
Decrease (increase) in short-term investments	**13,129**	(47,435)
Net increase in loans	**(228,950)**	(149,072)
Net cash paid for acquisitions	**(105,266)**	
Net purchase of premises and equipment	**(7,966)**	(5,844)
Net cash used in investing activities	**(382,131)**	(191,485)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in demand and savings deposits	**45,118**	48,989
Net increase in time deposits	**134,953**	31,649
Addition to long-term debt	**172,642**	99,350
Repayment of long-term debt	**(54,323)**	(10,457)

Increase in short-term borrowings	**47,336**	70,836
Dividends paid	**(22,766)**	(19,790)
Net proceeds from issuance of common stock	**4,731**	4,937
Acquisition of treasury stock	**(4,253)**	(6,923)
Net cash provided by financing activities	**323,438**	218,591
Net Increase in Cash and Due From Banks	**30,068**	57,974
Cash and Due From Banks at Beginning of Period	**368,043**	278,065
Cash and Due From Banks at End of Period	**$ 398,111**	$ 336,039
Supplemental Disclosures of Cash Flow Information		
Cash paid during the period for:		
Interest	**$ 71,168**	$ 40,295
Income taxes	**2,500**	799

See Notes to Consolidated Financial Statements

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FULTON FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE A Basis of Presentation

The accompanying unaudited consolidated financial statements of Fulton Financial Corporation (the Corporation) have been prepared in accordance with United States (U.S.) generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and notes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three-month period ended March 31, 2006 are not necessarily indicative of the results that may be expected for the year ending December 31, 2006.

NOTE B Net Income Per Share and Comprehensive Income

The Corporation s basic net income per share is calculated as net income divided by the weighted average number of shares outstanding. For diluted net income per share, net income is divided by the weighted average number of shares outstanding plus the incremental number of shares added as a result of converting common stock equivalents, calculated using the treasury stock method. The Corporation s common stock equivalents consist solely of outstanding stock options. Excluded from the calculation were 1.3 million anti-dilutive options for the three months ended March 31, 2006.

A reconciliation of the weighted average shares outstanding used to calculate basic net income per share and diluted net income per share follows:

	Three months ended March 31	
	2006	2005
	(in thousands)	
Weighted average shares outstanding (basic)	**162,732**	157,351
Impact of common stock equivalents	**2,188**	2,037
Weighted average shares outstanding (diluted)	**164,920**	159,388

Total comprehensive income was $34.5 and $19.1 million for the three months ended March 31, 2006 and 2005, respectively.

NOTE C Disclosures about Segments of an Enterprise and Related Information

The Corporation does not have any operating segments, which require disclosure of additional information. While the Corporation owned fifteen separate banks as of March 31, 2006, each engaged in similar activities and provided similar products and services. The Corporation s non-banking activities are immaterial and, therefore, separate information has not been disclosed.

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NOTE D Stock Dividend

The Corporation declared a 5% stock dividend on April 18, 2006, which will be paid on June 8, 2006 to shareholders of record on May 19, 2006. Since the market price of the Corporation s stock will not adjust as a result of the stock dividend until subsequent to the filing of these financial statements, the stock dividend has not been recorded in shareholders equity, and share and per-share information has not been restated. The following table provides share and per-share amounts reflecting the impact of the stock dividend:

	Three months ended March 31	
	2006	2005
	(shares in thousands)	
As Reported:		
Net income per share (basic)	**$ 0.27**	$ 0.26
Net income per share (diluted)	**0.27**	0.26
Weighted average shares outstanding (basic)	**162,732**	157,351
Weighted average shares outstanding (diluted)	**164,920**	159,388
Ending shares outstanding (at March 31)	**165,746**	157,340
Pro-forma:		
Net income per share (basic)	**$ 0.26**	$ 0.25
Net income per share (diluted)	**0.25**	0.25
Weighted average shares outstanding (basic)	**170,869**	165,219
Weighted average shares outstanding (diluted)	**173,166**	167,357
Ending shares outstanding (at March 31)	**174,033**	165,207

NOTE E Stock-Based Compensation

Statement of Financial Accounting Standards No.123R, Share-Based Payment (Statement 123R), requires that the fair value of equity awards to employees be recognized as compensation expense over the period during which an employee is required to provide service in exchange for such award. During the third quarter of 2005, the Corporation adopted Statement 123R using modified retrospective application , electing to restate all prior periods including all per-share amounts. The Corporation s equity awards consist of stock options and restricted stock granted under its Stock Option and Compensation Plans (Option Plans) and shares purchased by employees under its Employee Stock Purchase Plan.

The following table presents compensation expense and related tax benefits for equity awards recognized in the consolidated income statements:

	Three months ended March 31	
	2006	2005
	(in thousands)	
Compensation expense	**$ 344**	$ 96
Tax benefit	**(133)**	(2)
Net income effect	**$ 211**	$ 94

Under the Option Plans, options are granted to key personnel for terms of up to ten years at option prices equal to the fair market value of the Corporation s stock on the date of grant. Options are typically granted annually on July 1st and, prior to the July 1, 2005 grant, had been 100% vested immediately upon grant. For

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the July 1, 2005 grant, a three-year cliff-vesting feature was added. Certain events, as specified in the Option Plans, would result in the acceleration of the vesting period. As of March 31, 2006, the Option Plans had 14.9 million shares reserved for the future grants through 2013.

NOTE F Employee Benefit Plans

The Corporation maintains a defined benefit pension plan (Pension Plan) for certain employees. Contributions to the Pension Plan are actuarially determined and funded annually. Pension Plan assets are invested in money markets, fixed income securities, including corporate bonds, U.S. Treasury securities and common trust funds, and equity securities, including common stocks and common stock mutual funds. The Pension Plan has been closed to new participants, but existing participants continue to accrue benefits according to the terms of the plan. The Corporation expects to contribute approximately $4.1 million to the Pension Plan in 2006.

The Corporation currently provides medical and life insurance benefits under a post-retirement benefits plan (Post-Retirement Plan) to certain retired full-time employees who were employees of the Corporation prior to January 1, 1998. Certain other full-time employees may become eligible for these discretionary benefits if they reach retirement age while working for the Corporation. Benefits are based on a graduated scale for years of service after attaining the age of 40.

The net periodic benefit cost for the Corporation s Pension Plan and Post-Retirement Plan, as determined by consulting actuaries, consisted of the following components for the quarters ended March 31:

	Pension Plan		**Post-Retirement Plan**	
	2006	2005	**2006**	2005
	(in thousands)			
Service cost	**$ 609**	$ 622	**$ 143**	$ 89
Interest cost	**864**	843	**185**	117
Expected return on plan assets	**(1,057)**	(818)	**(1)**	
Net amortization and deferral	**202**	222	**(80)**	(57)
Net periodic benefit cost	**$ 618**	$ 869	**$ 247**	$ 149

NOTE G Acquisitions

On February 1, 2006, the Corporation completed its acquisition of Columbia Bancorp (Columbia), of Columbia, Maryland. Columbia was a $1.3 billion bank holding company whose primary subsidiary was The Columbia Bank, which operates 20 full-service community banking offices and five retirement community offices in Howard, Montgomery, Prince George s and Baltimore Counties and Baltimore City.

Under the terms of the merger agreement, each of the approximately 6.9 million shares of Columbia s common stock was acquired by the Corporation based on a cash election merger structure. Each Columbia shareholder elected to receive 100% of the merger consideration in stock, 100% in cash, or a combination of stock and cash.

As a result of Columbia shareholder elections, approximately 3.5 million of the Columbia shares outstanding on the acquisition date were converted into shares of the Corporation s common stock, based upon a fixed exchange ratio of 2.325 shares of Corporation stock for each share of Columbia stock. The remaining 3.4 million shares of Columbia stock were purchased for $42.48 per share. In addition, each of the options to acquire Columbia s stock was converted into options to purchase the Corporation s stock or was settled in cash, based on the election of each option holder and the terms of the merger agreement. The total purchase price was approximately $305.8 million, including $154.2 million in stock issued and stock options

assumed, $149.4 million of Columbia stock purchased and options settled for cash and $2.2 million for other direct acquisition costs. The purchase price for shares issued was determined based on the value of the Corporation s stock on the date when the number of shares was fixed and determinable.

As a result of the acquisition, Columbia was merged into the Corporation, and The Columbia Bank became a wholly owned subsidiary. The acquisition is being accounted for using purchase accounting, which requires the Corporation to allocate the total purchase price of the acquisition to the assets acquired and liabilities assumed, based on their respective fair values at the acquisition date, with any remaining purchase price being recorded as goodwill. Resulting goodwill balances are then subject to an impairment review on at least an annual basis. The results of Columbia s operations are included in the Corporation s financial statements prospectively from the February 1, 2006 acquisition date.

The following is a summary of the purchase price allocation based on estimated fair values on the acquisition date (in thousands):

Cash and due from banks	$ 46,407
Other earning assets	16,854
Investment securities available for sale	113,771
Loans, net of allowance	1,052,684
Premises and equipment	7,904
Core deposit intangible asset	17,953
Trade name intangible asset	865
Goodwill	200,110
Other assets	91,608
Total assets acquired	1,548,156
Deposits	968,936
Short-term borrowings	184,083
Long-term debt	80,136
Other liabilities	9,223
Total liabilities assumed	1,242,378
Net assets acquired	$ 305,778

On July 1, 2005, the Corporation completed its acquisition of SVB Financial Services, Inc. (SVB). SVB was a $530 million bank holding company whose primary subsidiary was Somerset Valley Bank, which operates thirteen community-banking offices in Somerset, Hunterton and Middlesex Counties in New Jersey. The total purchase price was $90.4 million, including $66.6 million in stock issued and options assumed and $22.4 million in SVB stock purchased and options settled for cash and $1.4 million in other direct acquisition costs.

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The following table summarizes unaudited pro-forma information assuming the acquisitions of Columbia and SVB had occurred on January 1, 2005. This pro-forma information includes certain adjustments, including amortization related to fair value adjustments recorded in purchase accounting (in thousands, except per-share information):

	Three months ended March 31	
	2006	2005
Net interest income	**$120,541**	$115,625
Other income	**35,874**	37,688
Net income	**44,686**	45,955
Per Share:		
Net income (basic)	**$ 0.27**	$ 0.27
Net income (diluted)	**0.27**	0.27

Note H Derivative Financial Instruments

As of March 31, 2006, interest rate swaps with a notional amount of $280 million were used to hedge certain long-term fixed rate certificates of deposit. The terms of the certificates of deposit and the interest rate swaps mirror each other and were committed to simultaneously. Under the terms of the swap agreements, the Corporation is the fixed rate receiver and the floating rate payer (generally tied to the three month London Interbank Offering Rate, or LIBOR, a common index used for setting rates between financial institutions). The interest rate swaps are classified as fair value hedges and both the interest rate swaps and the certificates of deposit are recorded at fair value, with changes in the fair values during the period recorded as income or expense. For interest rate swaps accounted for as a fair value hedge, ineffectiveness is the difference between the changes in the fair value of the interest rate swap and the hedged item, in this case the certificates of deposit.

The Corporation s analysis of hedge effectiveness indicated they were highly effective as of March 31, 2006. For the quarter ended March 31, 2006, a $61,000 net charge to expense was recorded representing the net impact of the change in fair values of the interest rate swaps and the certificates of deposit.

The Corporation entered into a forward-starting interest rate swap with a notional amount of $150 million in October 2005 in anticipation of the issuance of $150 million of trust preferred securities in January 2006. This was accounted for as a cash flow hedge as it hedged the variability of interest payments attributable to changes in interest rates on the forecasted issuance of fixed-rate debt. As of December 31, 2005, $2.2 million had been recorded as an other comprehensive loss representing the estimated fair value of the swap on that date, net of a $1.2 million tax effect. The Corporation settled this derivative on its contractual maturity date in January 2006 with a total payment of $5.5 million to the counterparty that resulted in an additional $1.4 million charge to other comprehensive loss (net of $751,000 tax effect) during the quarter. The total amount recorded in other comprehensive loss is being amortized to interest expense over the life of the related securities using the effective interest method. The total amount of net losses in accumulated other comprehensive income that will be reclassified into earnings during the next twelve months is expected to be approximately $185,000.

NOTE I Commitments and Contingencies

The Corporation is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. Those financial instruments include commitments to extend credit and letters of credit, which involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the Corporation s Consolidated Balance Sheets. Exposure to credit

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loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and letters of credit is represented by the outstanding amount of those instruments.

The outstanding amounts of commitments to extend credit and letters of credit were as follows:

	March 31	
	2006	2005
	(in thousands)	
Commitments to extend credit	**$4,268,227**	$3,492,011
Standby letters of credit	**689,842**	532,287
Commercial letters of credit	**26,334**	24,654

From time to time, the Corporation and its subsidiary banks may be defendants in legal proceedings relating to the conduct of their banking business. Most of such legal proceedings are a normal part of the banking business and, in management s opinion, the financial position and results of operations and cash flows of the Corporation would not be affected materially by the outcome of such legal proceedings.

During the first quarter of 2006, a tentative legal settlement was reached in a lawsuit against Resource Bank, a wholly owned subsidiary of Fulton Financial. The suit alleged Resource Bank violated the Telephone Consumer Protection Act (TCPA), prior to being acquired by the Corporation in April 2004.

An accrual of $4.7 million, based upon the costs and probable claims associated with the lawsuit, and a corresponding receivable of $2.5 million, based primarily upon an expected recovery of costs from the Corporation s insurance carrier were recorded, resulting in a net charge of $2.2 million to other expense for the year ended December 31, 2005. The Corporation reduced its receivable due to the insurance carrier reserving its rights with respect to coverage for the lawsuit under exclusions in the applicable policy, resulting in an additional $1.6 million charge to other expense for the quarter ended March 31, 2006.

NOTE J Stock Repurchases

In 2005, the Corporation purchased 4.3 million shares of its common stock from an investment bank at a total cost of $73.6 million under an Accelerated Share Repurchase program (ASR), which allowed the shares to be purchased immediately rather than over time. The investment bank, in turn, repurchased shares on the open market over a period that was determined by the average daily trading volume of the Corporation s shares, among other factors. The Corporation completed the ASR in February 2006 and settled its position with the investment bank by paying $3.4 million, representing the difference between the initial payment and the actual total price of the shares repurchased.

In March 2006, the Corporation s Board of Directors approved a stock repurchase plan for 2.0 million shares through December 31, 2006. Repurchases under this plan will occur through open market acquisitions. During the first quarter of 2006, 49,000 shares were repurchased under this plan.

NOTE K Long-Term Debt

In January 2006, the Corporation purchased all of the common stock of a subsidiary trust, Fulton Capital Trust I, which was formed for the purpose of issuing $150.0 million of trust preferred securities at a fixed rate of 6.29% and an effective rate of approximately 6.50% as a result of issuance costs and the settlement cost of the forward-starting interest rate swap. In connection with this transaction, $154.6 million of junior subordinated deferrable interest debentures were issued to the trust. These debentures carry the same rate and mature on February 1, 2036.

In March 2005, the Corporation issued $100.0 million of ten-year subordinated notes at a fixed rate of 5.35%, with semi-annual interest payments commencing in October 2005. The notes mature on April 1, 2015.

NOTE L New Accounting Standards

In March 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 156, Accounting for Servicing of Financial Assets an amendment of FASB Statement No. 140 (Statement 156). Statement 156 requires recognition of a servicing asset or liability at fair value each time an obligation is undertaken to service a financial asset by entering into a servicing contract. Statement 156 also provides guidance on subsequent measurement methods for each class of separately recognized servicing assets and liabilities and specifies financial statement presentation and disclosure requirements. This statement is effective for fiscal years beginning after September 15, 2006, or January 1, 2007 for the Corporation. The Corporation is currently evaluating the impact of Statement 156 on the consolidated financial statements.

In April 2006, the FASB issued Staff Position FIN 46(R)-6, Determining the Variability to Be Considered in Applying FASB Interpretation No. 46(R) (Staff Position FIN 46(R)-6). This staff position addresses how an entity should determine the variability to be considered in applying FASB Interpretation No. FIN 46(R) (FIN 46). The variability that is to be considered in applying FIN 46 affects the determination of (a) whether the entity is a variable interest entity (VIE), (b) which interests are variable interests in the entity and (c) which party, if any, is the primary beneficiary of the VIE. The requirements prescribed by this staff position are to be applied prospectively for all new arrangements at the commencement of the first reporting period that begins after June 15, 2006, or July 1, 2006 for the Corporation. The new requirements need not be applied to entities that have previously been analyzed under FIN 46 unless a reconsideration event occurs. The Corporation is currently evaluating the impact of Staff Position FIN 46(R)-6 on the consolidated financial statements.

NOTE M Reclassifications

Certain amounts in the 2005 consolidated financial statements and notes have been reclassified to conform to the 2006 presentation.

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

Management s Discussion and Analysis of Financial Condition and Results of Operations (Management s Discussion) concerns Fulton Financial Corporation (the Corporation), a financial holding company incorporated under the laws of the Commonwealth of Pennsylvania in 1982, and its wholly owned subsidiaries. This discussion and analysis should be read in conjunction with the consolidated financial statements and notes presented in this report.

FORWARD-LOOKING STATEMENTS

The Corporation has made, and may continue to make, certain forward-looking statements with respect to its acquisition and growth strategies, management of net interest income and margin, the ability to realize gains on equity investments, allowance and provision for loan losses, expected levels of certain non-interest expenses and the liquidity position of the Corporation and Parent Company. The Corporation cautions that these forward-looking statements are subject to various assumptions, risks and uncertainties. Because of the possibility of changes in these assumptions, risks and uncertainties, actual results could differ materially from forward-looking statements.

In addition to the factors identified herein, the following risk factors could cause actual results to differ materially from such forward-looking statements:

- Changes in interest rates may have an adverse effect on the Corporation s profitability.
- Changes in economic conditions and the composition of the Corporation s loan portfolios could lead to higher loan charge-offs or an increase in Fulton s allowance for loan losses and may reduce the Corporation s income.
- Fluctuations in the value of the Corporation s equity portfolio, or assets under management by the Corporation s trust and investment management services, could have a material impact on the Corporation s results of operations.
- If the Corporation is unable to acquire additional banks on favorable terms or if it fails to successfully integrate or improve the operations of acquired banks, the Corporation may be unable to execute its growth strategies.
- If the goodwill that the Corporation has recorded in connection with its acquisitions becomes impaired, it could have a negative impact on the Corporation s profitability.
- The competition the Corporation faces is increasing and may reduce the Corporation s customer base and negatively impact the Corporation s results of operations.
- The supervision and regulation by various regulatory authorities to which the Corporation is subject can be a competitive disadvantage.

The Corporation s forward-looking statements are relevant only as of the date on which such statements are made. By making any forward-looking statements, the Corporation assumes no duty to update them to reflect new, changing or unanticipated events or circumstances.

RESULTS OF OPERATIONS

Overview

The Corporation currently derives the majority of its earnings from traditional banking activities, with net interest income, or the difference between interest income earned on loans and investments and interest paid on deposits and borrowings, accounting for approximately 75% of revenues. Growth in net interest income is

dependent upon balance sheet growth or increasing the net interest margin, which is net interest income as a percentage of average interest-earning assets. The Corporation also generates revenue through fees earned on the various services and products offered to its customers and through sales of assets, such as loans, investments, or properties. Offsetting these revenue sources are provisions for credit losses on loans, other operating expenses and income taxes.

The Corporation s net income for the first quarter of 2006 increased $2.4 million, or 5.9%, from $41.4 million in 2005 to $43.9 million in 2006. Diluted net income per share increased $0.01, or 3.8%, from $0.26 in 2005 to $0.27 in 2006. The Corporation realized annualized returns on average assets of 1.32% and average equity of 12.83% during the first quarter of 2006. The annualized return on average tangible equity, which is net income, as adjusted for intangible amortization (net of tax), divided by average shareholders equity, excluding goodwill and intangible assets, was 23.01% for the quarter.

The increase in net income compared to the first quarter of 2005 resulted from a $16.8 million, or 17.1%, increase in net interest income due primarily to external growth through acquisitions and partially due to internal growth, offset by a decline in net interest margin. Also contributing to the increase in earnings was a $1.4 million increase in other income (excluding security gains), offset by a $650,000 decrease in security gains, a $14.2 million increase in other expenses and a $718,000 increase in income taxes.

The following summarizes some of the more significant factors that influenced the Corporation s results for the first quarter of 2006.

Interest Rates Changes in the interest rate environment generally impact both the Corporation s net interest income and certain components of its non-interest income. The interest rate environment reflects both the level of short-term rates and the slope of the U. S. Treasury yield curve, which plots the yields on treasury issues over various maturity periods. During the first three months of 2006, the flat to negatively sloping yield curve, resulting from short-term rates increasing at a faster pace than longer-term rates, negatively impacted the Corporation s earnings.

Floating rate loans, short-term borrowings and savings and time deposit rates are generally influenced by short-term rates. The Federal Reserve Board (FRB) raised the Federal funds rate eight times since March 31, 2005, for a total increase of 200 basis points (from 2.75% to 4.75%). The Corporation s prime lending rate had a corresponding increase, from 5.75% to 7.75%, resulting in an increase in the rates on floating rate loans as well as the rates on new fixed-rate loans. However, the increase in short-term rates also resulted in increased funding costs, with short-term borrowings immediately repricing to higher rates and deposit rates although more discretionary increasing due to competitive pressures. The increase in rates on deposits was more pronounced than loans and other earning assets and, as a result, the Corporation realized a decrease in net interest margin in the first quarter of 2006 compared to 2005. Customers have begun to shift funds from floating rate core demand and savings accounts to fixed rate certificates of deposit in order to lock into higher rates.

With respect to longer-term rates, the 10-year treasury yield, which is a common benchmark for evaluating residential mortgage rates, increased to 4.86% at March 31, 2006, as compared to 4.50% at March 31, 2005. Higher mortgage rates have resulted in slower refinance activity and lower margins and, therefore, lower net gains for the Corporation on fixed-rate residential mortgages which are generally sold in the secondary market.

The Corporation manages its risk associated with changes in interest rates through the techniques described in the Market Risk section of Management s Discussion. Increases in long-term rates may also have a continued detrimental impact on mortgage loan origination volumes and related gains on sales of mortgage loans.

Acquisitions In February 2006, the Corporation acquired Columbia Bancorp (Columbia), of Columbia, Maryland, a $1.3 billion bank holding company whose primary subsidiary was The Columbia Bank. In July 2005, the Corporation acquired SVB Financial Services, Inc. (SVB) of Somerville, New Jersey, a $530 million bank holding company whose primary subsidiary was Somerset Valley Bank. Results for 2006 in comparison to 2005 were impacted by these acquisitions, as documented in the appropriate sections of Management s Discussion.

Acquisitions have long been a supplement to the Corporation s internal growth. These recent acquisitions provide the opportunity for additional growth, as they will allow the Corporation s existing products and services to be sold in new markets. The Corporation s acquisition strategy focuses on high growth areas with strong market demographics and targets organizations that have a comparable corporate culture, strong performance and good asset quality, among other factors. Under the Corporation s super-community banking philosophy, acquired organizations generally retain their status as separate legal entities, unless consolidation with an existing affiliate bank is practical. Back office functions are generally consolidated to maximize efficiencies.

Merger and acquisition activity in the financial services industry has been very competitive in recent years, as evidenced by the prices paid for certain acquisitions. While the Corporation has been an active acquirer, management is committed to basing its pricing on rational economic models. Management will continue to focus on generating growth in the most cost-effective manner.

Merger and acquisition activity has also impacted the Corporation s capital and liquidity. In order to complete acquisitions, the Corporation implemented strategies to maintain appropriate levels of capital and to provide necessary cash resources. In January 2006, the Corporation issued $154.6 million of junior subordinated deferrable interest debentures in order to fund the Columbia acquisition. In March 2005, the Corporation issued $100 million of subordinated debt, primarily to fund treasury stock repurchases related to acquisitions. See additional information in the Liquidity section of Management s Discussion.

Earning Assets The Corporation s interest-earning assets increased from 2005 to 2006 as a result of acquisitions, as well as internal loan growth.

From 2005 to 2006, the Corporation experienced a slight shift in its composition of interest-earning assets from investments (22.6% of total average interest-earning assets in 2006, compared to 23.8% in 2005) to loans (75.3% in 2006, compared to 74.1% in 2005). This change resulted from moderate loan demand being funded with the proceeds from maturing investment securities, primarily mortgage-backed securities. The movement to higher-yielding loans has mitigated some of the factors that have had a negative effect on the Corporation s net interest income and net interest margin. Slower growth in loans could result in a future shift in the composition of interest-earning assets from loans to investments as cash flows are reinvested into investments.

Asset Quality Asset quality refers to the underlying credit characteristics of borrowers and the likelihood that defaults on contractual payments will result in charge-offs of account balances. Asset quality is generally a function of economic conditions, but can be managed through conservative underwriting and sound collection policies and procedures.

The Corporation continued to maintain excellent asset quality, attributable to its credit culture and underwriting policies as well as general economic conditions. Annualized net charge-offs to average loans increased to 0.03% in the first quarter of 2006, compared to 0.02% in 2005, although the total level of net charge-offs in both periods remained low in absolute terms. While overall asset quality has remained strong, deterioration in quality of one or several significant accounts could have a detrimental impact and result in losses that may not be foreseeable based on current information. In addition, rising interest rates could

increase the total payments of borrowers and could have a negative impact on the ability of some to pay according to the terms of their loans.

Equity Markets As noted in the Market Risk section of Management s Discussion, equity valuations can have an impact on the Corporation s financial performance. In particular, bank stocks account for a significant portion of the Corporation s equity investment portfolio. Historically, gains on sales of these equities have been a recurring component of the Corporation s earnings, although realized gains have decreased in recent periods. Declines in bank stock portfolio values could have a detrimental impact on the Corporation s ability to recognize gains in the future.

Quarter Ended March 31, 2006 versus Quarter Ended March 31, 2005

Results for the first quarter of 2006 compared to the results of the first quarter of 2005 were impacted by the February 2006 acquisition of Columbia and the July 2005 acquisition of SVB, whose results are included in 2006 amounts, but not in 2005.

Net Interest Income

Net interest income increased $16.8 million, or 17.1%, to $115.0 million in 2006 from $98.2 million in 2005. The increase was due to average balance growth, with total interest-earning assets increasing 19.5%, offset by a lower net interest margin. The average fully taxable-equivalent (FTE) yield on interest-earning assets increased 81 basis points (a 14.4% increase) over 2005 while the cost of interest-bearing liabilities increased 102 basis points (a 49.3% increase). Due to the sharper increase in costs of interest-bearing liabilities, the net interest margin decreased eight basis points. The Corporation continues to manage its asset/liability position and interest rate risk through the methods discussed in the Market Risk section of Management s Discussion.

The following table provides a comparative average balance sheet and net interest income analysis for the first quarter of 2006 as compared to the same period in 2005. Interest income and yields are presented on an FTE basis, using a 35% Federal tax rate. The discussion following this table is based on these FTE amounts. All dollar amounts are in thousands.

	Quarter Ended March 31					
	2006			2005		
	Average Balance	**Interest**	**Yield/ Rate**	Average Balance	Interest	Yield/ Rate
ASSETS						
Interest-earning assets:						
Loans and leases (1)	**$ 9,227,642**	**$ 161,883**	**7.11%**	$ 7,605,523	$ 116,691	6.21%
Taxable investment securities (2)	**2,186,073**	**22,539**	**4.13**	1,984,864	18,261	3.67
Tax-exempt investment securities (2)	**435,959**	**5,185**	**4.76**	335,355	4,254	5.07
Equity securities (2)	**145,011**	**1,559**	**4.33**	124,822	1,270	4.22
Total investment securities	**2,767,043**	**29,283**	**4.24**	2,445,041	23,785	3.89
Loans held for sale	**199,441**	**3,458**	**6.94**	182,130	2,502	5.49
Other interest-earning assets	**63,388**	**663**	**4.23**	28,699	176	2.49
Total interest-earning assets	**12,257,514**	**195,287**	**6.45%**	10,261,393	143,154	5.64%
Non-interest-earning assets:						
Cash and due from banks	**358,481**			322,793		
Premises and equipment	**177,761**			149,017		
Other assets (2)	**786,918**			571,335		
Less: Allowance for loan losses	**(101,999)**			(90,489)		
Total Assets	**$ 13,478,675**			$ 11,214,049		
LIABILITIES AND EQUITY						
Interest-bearing liabilities:						
Demand deposits	**$ 1,666,506**	**$ 5,738**	**1.40%**	$ 1,494,984	$ 2,970	0.81%
Savings deposits	**2,272,788**	**10,398**	**1.85**	1,911,820	4,466	0.95
Time deposits	**3,744,503**	**34,054**	**3.69**	2,996,321	20,372	2.76
Total interest-bearing deposits	**7,683,797**	**50,190**	**2.65**	6,403,125	27,808	1.76
Short-term borrowings	**1,487,295**	**15,306**	**4.13**	1,239,454	6,824	2.21
Long-term debt	**995,478**	**12,113**	**4.93**	683,472	7,930	4.71
Total interest-bearing liabilities	**10,166,570**	**77,609**	**3.09%**	8,326,051	42,562	2.07%

Non-interest-bearing liabilities:						
Demand deposits	**1,765,880**			1,509,118		
Other	**159,401**			127,187		
Total Liabilities	**12,091,851**			9,962,356		
Shareholders equity	**1,386,824**			1,251,693		
Total Liabilities and Shareholders Equity	**$ 13,478,675**			$ 11,214,049		
Net interest income/net interest margin (FTE)		**117,678**	**3.88%**		100,592	3.96%
Tax equivalent adjustment		**(2,635)**			(2,344)	
Net interest income		**$ 115,043**			$ 98,248	

(1) Includes non-performing loans.

(2) Balances include amortized historical cost for available for sale securities. The related unrealized holding gains (losses) are included in other assets.

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The following table summarizes the changes in FTE interest income and expense due to changes in average balances (volume) and changes in rates:

	2006 vs. 2005 Increase (decrease) due To change in		
	Volume	Rate	Net
		(in thousands)	
Interest income on:			
Loans and leases	**$ 26,884**	**$ 18,308**	**$ 45,192**
Taxable investment securities	**1,913**	**2,365**	**4,278**
Tax-exempt investment securities	**1,200**	**(269)**	**931**
Equity securities	**248**	**41**	**289**
Loans held for sale	**253**	**703**	**956**
Other interest-earning assets	**309**	**178**	**487**
Total interest income	**$ 30,807**	**$ 21,326**	**$ 52,133**
Interest expense on:			
Demand deposits	**$ 375**	**$ 2,393**	**$ 2,768**
Savings deposits	**985**	**4,947**	**5,932**
Time deposits	**5,817**	**7,865**	**13,682**
Short-term borrowings	**1,588**	**6,894**	**8,482**
Long-term debt	**3,779**	**404**	**4,183**
Total interest expense	**$ 12,544**	**$ 22,503**	**$ 35,047**

Interest income increased $52.1 million, or 36.4%, as a result of both increases in average balances and increases in rates. Interest income increased $30.8 million as a result of the $2.0 billion, or 19.5%, increase in average balances, while an increase of $21.3 million was realized from the 81 basis point increase in rates.

The increase in average interest-earning assets was primarily due to loan growth. Average loans increased $1.6 billion, or 21.3%. The following summarizes the growth in average loans by type:

	Three months ended March 31		Increase	
	2006	2005	$	%
		(dollars in thousands)		
Commercial industrial and financial	**$ 2,278,597**	$ 2,004,879	$ 273,718	13.7%
Commercial agricultural	**327,929**	326,699	1,230	0.4
Real estate commercial mortgage	**2,944,676**	2,439,800	504,876	20.7
Real estate residential mortgage and home equity	**1,925,542**	1,654,281	271,261	16.4
Real estate construction	**1,163,368**	638,281	525,087	82.3
Consumer	**516,350**	478,615	37,735	7.9
Leasing and other	**71,180**	62,968	8,212	13.0
Total	**$ 9,227,642**	$ 7,605,523	$ 1,622,119	21.3%

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The acquisitions of Columbia and SVB contributed approximately $995.5 million to the increase in average balances. The following table presents the average balance impact of acquisitions, by type:

	Three months ended March 31	
	2006	2005
	(in thousands)	
Commercial industrial and financial	**$ 245,522**	$
Commercial agricultural		
Real estate commercial mortgage	**234,549**	
Real estate residential mortgage and home equity	**196,864**	
Real estate construction	**314,152**	
Consumer	**3,798**	
Leasing and other	**588**	
Total	**$ 995,473**	$

The following table presents the growth in average loans, by type, excluding the average balances contributed by the acquisitions of Columbia and SVB:

	Three months ended March 31		Increase (decrease)	
	2006	2005	**$**	**%**
	(dollars in thousands)			
Commercial industrial and financial	**$ 2,033,075**	$ 2,004,879	$ 28,196	1.4%
Commercial agricultural	**327,929**	326,699	1,230	0.4
Real estate commercial mortgage	**2,710,127**	2,439,800	270,327	11.1
Real estate residential mortgage and home equity	**1,728,678**	1,654,281	74,397	