

FULTON FINANCIAL CORP

Form 10-Q

May 10, 2007

**Table of Contents**

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

(Mark One)

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

For the quarterly period ended March 31, 2007, or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

**Commission File 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 ☒ No ☐

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

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☐

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

**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 173,172,000 shares outstanding as of April 30, 2007.

**FULTON FINANCIAL CORPORATION**  
**FORM 10-Q FOR THE QUARTER ENDED MARCH 31, 2007**  
**INDEX**

| Description   | Page |
|---|------|
| <b>PART I. FINANCIAL INFORMATION</b>  |      |
| <u>Item 1. Financial Statements (Unaudited):</u>  |      |
| <u>(a) Consolidated Balance Sheets March 31, 2007 and December 31, 2006</u>   | 3    |
| <u>(b) Consolidated Statements of Income Three months ended March 31, 2007 and 2006</u>                                       | 4    |
| <u>(c) Consolidated Statements of Shareholders Equity and Comprehensive Income Three months ended March 31, 2007 and 2006</u> | 5    |
| <u>(d) Consolidated Statements of Cash Flows Three months ended March 31, 2007 and 2006</u>                                   | 6    |
| <u>(e) Notes to Consolidated Financial Statements</u>   | 7    |
| <u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                          | 13   |
| <u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u>   | 27   |
| <u>Item 4. Controls and Procedures</u>  | 30   |
| <b>PART II. OTHER INFORMATION</b>   |      |
| <u>Item 1. Legal Proceedings</u>  | 31   |
| <u>Item 1A. Risk Factors</u>  | 31   |
| <u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>  | 32   |
| <u>Item 3. Defaults Upon Senior Securities</u>  | 32   |
| <u>Item 4. Submission of Matters to a Vote of Security Holders</u>  | 32   |
| <u>Item 5. Other Information</u>  | 32   |
| <u>Item 6. Exhibits</u>   | 32   |
| <u>Signatures</u>   | 33   |
| <u>Exhibit Index</u>  | 34   |
| <u>Certifications</u>   | 35   |
| <u>CERTIFICATION OF CHIEF EXECUTIVE OFFICER</u>   |      |
| <u>CERTIFICATION OF CHIEF FINANCIAL OFFICER</u>   |      |

CERTIFICATION OF CEO PURSUANT TO 18 U.S.C. SECTION 1350

CERTIFICATION OF CFO PURSUANT TO 18 U.S.C. SECTION 1350

2

---

**Table of Contents****Item 1. Financial Statements****FULTON FINANCIAL CORPORATION****CONSOLIDATED BALANCE SHEETS****(dollars in thousands, except per-share data)**

|  | <b>March 31<br/>2007<br/>(unaudited)</b> | December 31<br>2006 |
|--|--|---------------------|
| <b>ASSETS</b>  |  |                     |
| Cash and due from banks  | \$ 344,969                               | \$ 355,018          |
| Interest-bearing deposits with other banks                                       | 12,961                                   | 27,529              |
| Federal funds sold   | 4,716                                    | 659                 |
| Loans held for sale  | 206,422                                  | 239,042             |
| Investment securities:   |  |                     |
| Held to maturity (estimated fair value of \$12,357 in 2007 and \$12,534 in 2006) | 12,424                                   | 12,524              |
| Available for sale   | 2,609,184                                | 2,865,714           |
| Loans, net of unearned income  | 10,448,175                               | 10,374,323          |
| Less: Allowance for loan losses  | (107,899)                                | (106,884)           |
| <i>Net Loans</i>   | <b>10,340,276</b>                        | 10,267,439          |
| Premises and equipment   | 190,442                                  | 191,401             |
| Accrued interest receivable  | 67,580                                   | 71,825              |
| Goodwill   | 626,335                                  | 626,042             |
| Intangible assets  | 35,750                                   | 37,733              |
| Other assets   | 219,277                                  | 224,038             |
| <i>Total Assets</i>  | <b>\$ 14,670,336</b>                     | \$ 14,918,964       |
| <b>LIABILITIES</b>   |  |                     |
| Deposits:  |  |                     |
| Noninterest-bearing  | \$ 1,795,265                             | \$ 1,831,419        |
| Interest-bearing   | 8,440,315                                | 8,401,050           |
| <i>Total Deposits</i>  | <b>10,235,580</b>                        | 10,232,469          |
| Short-term borrowings:   |  |                     |
| Federal funds purchased  | 442,362                                  | 1,022,351           |
| Other short-term borrowings  | 696,081                                  | 658,489             |
| <i>Total Short-Term Borrowings</i>   | <b>1,138,443</b>                         | 1,680,840           |

|  |                   |            |
|--|-------------------|------------|
| Accrued interest payable                           | <b>63,484</b>     | 61,392     |
| Other liabilities                                  | <b>134,615</b>    | 123,805    |
| Federal Home Loan Bank advances and long-term debt | <b>1,576,283</b>  | 1,304,148  |
| <i>Total Liabilities</i>                           | <b>13,148,405</b> | 13,402,654 |

## SHAREHOLDERS' EQUITY

|  |                  |           |
|--|------------------|-----------|
| Common stock, \$2.50 par value, 600 million shares authorized, 191.3 million shares issued in 2007 and 190.8 million shares issued in 2006 | <b>478,163</b>   | 476,987   |
| Additional paid-in capital   | <b>1,249,549</b> | 1,246,823 |
| Retained earnings  | <b>108,423</b>   | 92,592    |
| Accumulated other comprehensive loss   | <b>(36,826)</b>  | (39,091)  |
| Treasury stock, 18.2 million shares in 2007 and 17.1 million shares in 2006, at cost   | <b>(277,378)</b> | (261,001) |
| <i>Total Shareholders' Equity</i>  | <b>1,521,931</b> | 1,516,310 |

|   |                      |               |
|---|----------------------|---------------|
| <i>Total Liabilities and Shareholders' Equity</i> | <b>\$ 14,670,336</b> | \$ 14,918,964 |
|---|----------------------|---------------|

*See Notes to Consolidated Financial Statements*

**Table of Contents**

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

|  | <b>Three Months Ended<br/>March 31</b> |             |
|--|--|-------------|
|  | <b>2007</b>                            | <b>2006</b> |
| <b>INTEREST INCOME</b>                                     |  |             |
| Loans, including fees                                      | <b>\$ 195,557</b>                      | \$ 161,114  |
| Investment securities:                                     |  |             |
| Taxable  | <b>24,619</b>                          | 22,539      |
| Tax-exempt   | <b>4,281</b>                           | 3,533       |
| Dividends  | <b>1,919</b>                           | 1,345       |
| Loans held for sale  | <b>3,684</b>                           | 3,458       |
| Other interest income                                      | <b>596</b>                             | 663         |
| <i>Total Interest Income</i>                               | <b>230,656</b>                         | 192,652     |
| <b>INTEREST EXPENSE</b>                                    |  |             |
| Deposits   | <b>71,208</b>                          | 50,190      |
| Short-term borrowings                                      | <b>19,054</b>                          | 15,306      |
| Long-term debt   | <b>18,619</b>                          | 12,113      |
| <i>Total Interest Expense</i>                              | <b>108,881</b>                         | 77,609      |
| <i>Net Interest Income</i>                                 | <b>121,775</b>                         | 115,043     |
| <b>PROVISION FOR LOAN LOSSES</b>                           | <b>957</b>                             | 1,000       |
| <i>Net Interest Income After Provision for Loan Losses</i> | <b>120,818</b>                         | 114,043     |
| <b>OTHER INCOME</b>  |  |             |
| Investment management and trust services                   | <b>9,810</b>                           | 10,032      |
| Service charges on deposit accounts                        | <b>10,627</b>                          | 10,247      |
| Other service charges and fees                             | <b>7,375</b>                           | 6,654       |
| Gains on sales of mortgage loans                           | <b>5,393</b>                           | 4,772       |
| Investment securities gains                                | <b>1,782</b>                           | 2,665       |
| Other  | <b>4,078</b>                           | 2,237       |
| <i>Total Other Income</i>                                  | <b>39,065</b>                          | 36,607      |
| <b>OTHER EXPENSES</b>                                      |  |             |

|   |                      |               |
|---|----------------------|---------------|
| Salaries and employee benefits                        | <b>56,293</b>        | 49,929        |
| Net occupancy expense                                 | <b>10,196</b>        | 8,589         |
| Equipment expense                                     | <b>3,715</b>         | 3,593         |
| Data processing                                       | <b>3,202</b>         | 2,909         |
| Advertising   | <b>2,409</b>         | 2,253         |
| Intangible amortization                               | <b>1,983</b>         | 1,852         |
| Other   | <b>23,107</b>        | 18,891        |
| <i>Total Other Expenses</i>                           | <b>100,905</b>       | 88,016        |
| <br><i>Income Before Income Taxes</i>                 | <br><b>58,978</b>    | <br>62,634    |
| <b>INCOME TAXES</b>                                   | <b>17,850</b>        | 18,755        |
| <br><i>Net Income</i>                                 | <br><b>\$ 41,128</b> | <br>\$ 43,879 |
| <br><b>PER-SHARE DATA:</b>                            |                      |               |
| Net income (basic)                                    | <b>\$ 0.24</b>       | \$ 0.26       |
| Net income (diluted)                                  | <b>0.24</b>          | 0.25          |
| Cash dividends  | <b>0.1475</b>        | 0.138         |
| <i>See Notes to Consolidated Financial Statements</i> |                      |               |



**Table of Contents**

**FULTON FINANCIAL CORPORATION**  
**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY AND COMPREHENSIVE INCOME**  
**(UNAUDITED)**  
**THREE MONTHS ENDED MARCH 31, 2007 AND 2006**

|  | Number of<br>Shares<br><br>Outstanding | Common<br>Stock | Additional<br>Paid-in<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) | Treasury<br>Stock | Total        |
|--|--|-----------------|----------------------------------|----------------------|---|-------------------|--------------|
|  | (dollars in thousands)                 |                 |                                  |                      |   |                   |              |
| Balance at<br>December 31,<br>2006   | 173,648,000                            | \$ 476,987      | \$ 1,246,823                     | \$ 92,592            | \$ (39,091)   | \$ (261,001)      | \$ 1,516,310 |
| Comprehensive<br>income:   |  |                 |                                  |                      |   |                   |              |
| Net income   |  |                 |                                  | 41,128               |   |                   | 41,128       |
| Unrealized gain on<br>securities (net of<br>\$1.9 million tax<br>effect)   |  |                 |                                  |                      | 3,537   |                   | 3,537        |
| Unrealized loss on<br>derivative<br>financial<br>instruments (net of<br>\$103,000 tax<br>effect)                   |  |                 |                                  |                      | (191)   |                   | (191)        |
| Less<br>reclassification<br>adjustment for<br>gains included in<br>net income (net of<br>\$624,000 tax<br>expense) |  |                 |                                  |                      | (1,158)   |                   | (1,158)      |
| Amortization of<br>unrecognized<br>pension costs (net<br>of \$41,000 tax<br>effect)                                |  |                 |                                  |                      | 77  |                   | 77           |
| <i>Total<br/>comprehensive<br/>income</i>  |  |                 |                                  |                      |   |                   | 43,393       |
| Stock issued,<br>including related<br>tax benefits   | 474,000                                | 1,176           | 2,218                            |                      |   |                   | 3,394        |
| Stock-based<br>compensation  |  |                 | 508                              |                      |   |                   | 508          |

|  |             |            |              |            |             |              |              |
|--|-------------|------------|--------------|------------|-------------|--------------|--------------|
| awards   |             |            |              |            |             |              |              |
| Cumulative effect of FIN 48 adoption   |             |            |              | 220        |             |              | 220          |
| Acquisition of treasury stock  | (1,039,000) |            |              |            |             | (16,377)     | (16,377)     |
| Cash dividends \$0.1475 per share  |             |            |              | (25,517)   |             |              | (25,517)     |
| Balance at March 31, 2007  | 173,083,000 | \$ 478,163 | \$ 1,249,549 | \$ 108,423 | \$ (36,826) | \$ (277,378) | \$ 1,521,931 |
| Balance at December 31, 2005   | 164,868,000 | \$ 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 instruments (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)      |
| <i>Total comprehensive income</i>  |             |            |              |            |             |              | 34,455       |
| Stock issued, including related tax benefits   | 597,000     | 1,424      | 3,307        |            |             |              | 4,731        |
| Stock-based compensation awards  |             |            | 344          |            |             |              | 344          |
| Stock issued for acquisition of Columbia   | 8,619,000   | 20,523     | 133,608      |            |             |              | 154,131      |

|   |          |  |  |          |  |         |          |
|---|----------|--|--|----------|--|---------|----------|
| Acquisition of treasury stock           | (51,000) |  |  |          |  | (830)   | (830)    |
| Accelerated share repurchase settlement |          |  |  |          |  | (3,423) | (3,423)  |
| Cash dividends \$0.138 per share        |          |  |  | (24,040) |  |         | (24,040) |

|                           |             |            |              |            |             |              |              |
|---------------------------|-------------|------------|--------------|------------|-------------|--------------|--------------|
| Balance at March 31, 2006 | 174,033,000 | \$ 452,774 | \$ 1,133,967 | \$ 158,368 | \$ (51,709) | \$ (245,061) | \$ 1,448,339 |
|---------------------------|-------------|------------|--------------|------------|-------------|--------------|--------------|

*See Notes to Consolidated Financial Statements*

**Table of Contents**

**FULTON FINANCIAL CORPORATION**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**  
**(in thousands)**

|   | <b>Three Months Ended<br/>March 31</b> |             |
|---|--|-------------|
|   | <b>2007</b>                            | <b>2006</b> |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                                      |  |             |
| Net Income  | \$ 41,128                              | \$ 43,879   |
| Adjustments to reconcile net income to net cash provided by operating activities: |  |             |
| Provision for loan losses   | 957                                    | 1,000       |
| Depreciation and amortization of premises and equipment                           | 4,336                                  | 4,009       |
| Net amortization of investment security premiums                                  | 563                                    | 1,015       |
| Investment securities gains   | (1,782)                                | (2,665)     |
| Net decrease in loans held for sale   | 32,620                                 | 40,627      |
| Amortization of intangible assets   | 1,983                                  | 1,852       |
| Stock-based compensation  | 508                                    | 344         |
| Excess tax benefits from stock-based compensation                                 | (114)                                  | (584)       |
| Decrease (increase) in accrued interest receivable                                | 4,245                                  | (228)       |
| Decrease (increase) in other assets   | 2,026                                  | (24,109)    |
| Increase in accrued interest payable  | 2,092                                  | 6,441       |
| Increase in other liabilities   | 8,594                                  | 17,180      |
| Total adjustments   | 56,028                                 | 44,882      |
| <i>Net cash provided by operating activities</i>                                  | <b>97,156</b>                          | 88,761      |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                                      |  |             |
| Proceeds from sales of securities available for sale                              | 271,483                                | 64,225      |
| Proceeds from maturities of securities held to maturity                           | 220                                    | 4,355       |
| Proceeds from maturities of securities available for sale                         | 103,032                                | 197,541     |
| Purchase of securities held to maturity   | (122)                                  |             |
| Purchase of securities available for sale   | (109,428)                              | (319,199)   |
| Decrease in short-term investments  | 10,511                                 | 13,129      |
| Net increase in loans   | (73,794)                               | (228,950)   |
| Net cash paid for acquisition   |  | (105,266)   |
| Net purchase of premises and equipment  | (3,377)                                | (7,966)     |
| <i>Net cash provided by (used in) investing activities</i>                        | <b>198,525</b>                         | (382,131)   |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                                      |  |             |
| Net (decrease) increase in demand and savings deposits                            | (48,777)                               | 45,118      |
| Net increase in time deposits   | 51,888                                 | 134,953     |
| Additions to long-term debt   | 290,000                                | 172,642     |
| Repayments of long-term debt  | (17,865)                               | (54,323)    |
| (Decrease) increase in short-term borrowings                                      | (542,397)                              | 47,336      |

|  |                   |            |
|--|-------------------|------------|
| Dividends paid   | (25,596)          | (22,766)   |
| Net proceeds from issuance of common stock                 | 3,280             | 4,147      |
| Excess tax benefits from stock-based compensation          | 114               | 584        |
| Acquisition of treasury stock                              | (16,377)          | (4,253)    |
| <i>Net cash (used in) provided by financing activities</i> | <b>(305,730)</b>  | 323,438    |
| <b>Net (Decrease) Increase in Cash and Due From Banks</b>  | <b>(10,049)</b>   | 30,068     |
| <b>Cash and Due From Banks at Beginning of Period</b>      | <b>355,018</b>    | 368,043    |
| <b>Cash and Due From Banks at End of Period</b>            | <b>\$ 344,969</b> | \$ 398,111 |
| <b>Supplemental Disclosures of Cash Flow Information</b>   |                   |            |
| Cash paid during the period for:                           |                   |            |
| Interest   | <b>\$ 106,789</b> | \$ 71,168  |
| Income taxes   | <b>1,117</b>      | 2,500      |
| <i>See Notes to Consolidated Financial Statements</i>      |                   |            |

**Table of Contents****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 U.S. generally accepted accounting principles (U.S. GAAP) 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. GAAP for complete financial statements. The preparation of financial statements in accordance with U.S. GAAP requires management to make estimates and assumptions that affect the amounts of assets and liabilities as of the date of the financial statements as well as revenues and expenses during the period. Actual results could differ from those estimates. 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, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007.

**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 2.2 million and 1.4 million anti-dilutive stock options for the three months ended March 31, 2007 and 2006, respectively.

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

|   | <b>Three months ended<br/>March 31</b> |             |
|---|--|-------------|
|   | <b>2007</b>                            | <b>2006</b> |
|   | (in thousands)                         |             |
| Weighted average shares outstanding (basic)   | <b>173,273</b>                         | 170,869     |
| Impact of common stock equivalents            | <b>1,605</b>                           | 2,297       |
| Weighted average shares outstanding (diluted) | <b>174,878</b>                         | 173,166     |

Total comprehensive income was \$43.4 million and \$34.5 million for the three months ended March 31, 2007 and 2006, 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 thirteen separate banks as of March 31, 2007, 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.

**Table of Contents****NOTE D Income Taxes**

In June 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). The interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. Specifically, the interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return.

The Corporation adopted the provisions of FIN 48 on January 1, 2007. As a result of adoption, the Corporation recognized a \$220,000 decrease in existing reserves for unrecognized tax positions, which was accounted for as an increase to the January 1, 2007 balance of retained earnings.

As of the adoption date, the Corporation had unrecognized income tax benefits of \$4.1 million, all of which if recognized, would impact the effective tax rate. Also as of the adoption date, the Corporation had \$1.4 million in accrued interest related to unrecognized tax benefits. The Corporation recognizes interest accrued related to unrecognized tax benefits as components of income tax expense. Penalties, if incurred, would also be recognized in income tax expense. There have been no material changes to unrecognized tax benefits as of March 31, 2007.

The Corporation, or one of its subsidiaries, files income tax returns in the U.S. federal jurisdiction, and various states. In many cases, uncertain tax positions are related to tax years that remain subject to examination by the relevant taxable authorities. With few exceptions, the Corporation is no longer subject to U.S. Federal, state and local examinations by tax authorities for years before 2003.

**NOTE E Stock-Based Compensation**

As required by Statement of Financial Accounting Standards No. 123R, *Share-Based Payment*, the fair value of equity awards to employees is recognized as compensation expense over the period during which employees are required to provide service in exchange for such awards. 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 the related tax impacts for equity awards recognized in the consolidated income statements:

|                      | <b>Three months ended</b> |               |
|----------------------|---------------------------|---------------|
|                      | <b>March 31</b>           |               |
|                      | <b>2007</b>               | <b>2006</b>   |
|                      | <b>(in thousands)</b>     |               |
| Compensation expense | <b>\$ 508</b>             | <b>\$ 344</b> |
| Tax benefit          | <b>(70)</b>               | <b>(133)</b>  |
| Net income effect    | <b>\$ 438</b>             | <b>\$ 211</b> |

Under the Option Plans, options are granted to key employees 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 1 and become fully vested after a three-year cliff-vesting period. Certain events, as specified in the Option Plans and agreements, would result in the acceleration of the vesting period. As of March 31, 2007, the Option Plans had 14.9 million shares reserved for the future grants through 2013.

**Table of Contents****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 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 quarter ended March 31:

|                                | <b>Pension Plan</b> |             | <b>Post-retirement Plan</b> |             |
|--------------------------------|---------------------|-------------|-----------------------------|-------------|
|                                | <b>2007</b>         | <b>2006</b> | <b>2007</b>                 | <b>2006</b> |
|                                | (in thousands)      |             |                             |             |
| Service cost                   | \$ 626              | \$ 609      | \$ 108                      | \$ 143      |
| Interest cost                  | 925                 | 864         | 142                         | 185         |
| Expected return on plan assets | (1,137)             | (1,057)     | (1)                         | (1)         |
| Net amortization and deferral  | 175                 | 202         | (57)                        | (80)        |
| Net periodic benefit cost      | \$ 589              | \$ 618      | \$ 192                      | \$ 247      |

**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 Frederick, Howard, Montgomery, Prince George's and Baltimore Counties and Baltimore City. The total purchase price was approximately \$306.0 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 \$2.4 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 was accounted for using purchase accounting, which requires the allocation of the total purchase price 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.

**NOTE H Derivative Financial Instruments**

As of March 31, 2007, interest rate swaps with a notional amount of \$300.0 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 are similar 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).



**Table of Contents**

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 to other income or expense. For interest rate swaps accounted for as fair value hedges, ineffectiveness is the difference between the changes in the fair value of the interest rate swaps and the hedged items, in this case the certificates of deposit. The Corporation's analysis of hedge effectiveness indicated they were highly effective as of March 31, 2007. For the quarter ended March 31, 2007, a net loss of \$96,000 was recorded in other expense, representing the net impact of the change in fair values of the interest rate swaps and the certificates of deposit, compared to a net loss of \$61,000 recorded for the quarter ended March 31, 2006.

The Corporation entered into a forward-starting interest rate swap with a notional amount of \$150.0 million in October 2005 in anticipation of the issuance of \$150.0 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. The Corporation settled this derivative on its contractual maturity date in January 2006 with a total payment of \$5.5 million to the counterparty, including a \$1.4 million charge to other comprehensive loss (net of \$751,000 tax effect) recorded during the first quarter of 2006. 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 \$120,000.

In February 2007, the Corporation entered into a forward-starting interest swap with a notional amount of \$100.0 million in anticipation of the issuance of subordinated debt in April 2007. 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 March 31, 2007, \$221,000 had been recorded as an other comprehensive loss representing the estimated fair value of the swap on that date, net of a \$119,000 tax effect. The Corporation settled this derivative on its contractual maturity date in April 2007 with a total payment of \$232,000 to the counterparty that resulted in an increase of \$70,000 to other comprehensive income (net of \$38,000 tax effect). 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 \$14,000.

**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 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:

|                              | <b>March 31</b>    |             |
|------------------------------|--------------------|-------------|
|                              | <b>2007</b>        | <b>2006</b> |
|                              | (in thousands)     |             |
| Commitments to extend credit | <b>\$4,547,736</b> | \$4,268,227 |
| Standby letters of credit    | <b>719,028</b>     | 689,842     |
| Commercial letters of credit | <b>27,023</b>      | 26,334      |

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.

## **Table of Contents**

During the first quarter of 2007, the Corporation recorded a contingent loss of \$5.5 million related to losses that may be incurred due to the potential repurchase of approximately \$34 million of residential mortgage loans and home equity loans originated and sold in the secondary market by the Corporation's Resource Bank affiliate. Certain residential mortgage loans and home equity loans are sold to secondary market purchasers under standard representations and warranties regarding the origination of the loans, as well as a standard agreement to repurchase the loans under specified circumstances, including failure of the borrower to timely make any of the first three payments following the sale of the loan.

### **NOTE J Stock Repurchases**

The Corporation periodically repurchases shares of its common stock under repurchase plans approved by the Board of Directors. These repurchases have historically been through open market transactions and have complied with all regulatory restrictions on the timing and amount of such repurchases. Shares may also be repurchased through an Accelerated Share Repurchase Program (ASR), which allows shares to be purchased immediately from an investment bank. The investment bank, in turn, repurchases shares on the open market over a period that is determined by the average daily trading volume of the Corporation's shares, among other factors, with a purchase price adjustment made between the parties at the end of the program based on the cost of shares purchased by the investment bank. In 2006, the Corporation settled an ASR related to an approved stock repurchase plan by paying \$3.4 million to an investment bank.

In 2006, the Corporation's Board of Directors approved a stock repurchase plan for 2.1 million shares through June 30, 2007. During the first quarter of 2007, the Corporation repurchased 1.0 million shares, representing the remaining shares available under this plan.

In April 2007, the Corporation's Board of Directors approved a stock repurchase plan for 1.0 million shares through December 31, 2007. Repurchases under this plan are expected to occur through open market acquisitions.

### **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 entered into in October 2005. 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 May 2007, the Corporation issued \$100.0 million of ten-year subordinated notes, which mature on May 1, 2017 and carry a fixed rate of 5.75% and an effective rate of approximately 5.95% as a result of issuance costs. Interest is paid semi-annually in May and November of each year.

### **NOTE L New Accounting Standards**

In September 2006, the FASB ratified Emerging Issues Task Force (EITF) 06-4, Accounting for Deferred Compensation and Post-retirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements (EITF 06-4). EITF 06-4 addresses accounting for endorsement split-dollar life insurance arrangements that provide a benefit to an employee that extends to post-retirement periods. EITF 06-4 would require that the post-retirement benefit aspects of an endorsement-type split-dollar life insurance arrangement be recognized as a liability by the employer and that the obligation is not settled upon entering into an insurance arrangement. EITF 06-4 is effective for fiscal years beginning after December 15, 2007, or January 1, 2008 for the Corporation. The Corporation is currently evaluating the impact of EITF 06-4 on the consolidated financial statements.

## **Table of Contents**

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, Fair Value Measurement (Statement 157). Statement 157 defines fair value, establishes a framework for measuring fair value in U.S. GAAP, and expands disclosure requirements for fair value measurements. Statement 157 does not require any new fair value measurements and is effective for financial statements issued for fiscal years beginning after November 15, 2007, or January 1, 2008 for the Corporation. The Corporation is currently evaluating the impact of Statement 157 on the consolidated financial statements.

In February 2007, the FASB issued Statement No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115 (Statement 159). Statement 159 permits entities to choose to measure many financial instruments and certain other items at fair value and amends Statement 115 to, among other things, require certain disclosures for amounts for which the fair value option is applied. Additionally, this standard provides that an entity may reclassify held-to-maturity and available-for-sale securities to the trading account when the fair value option is elected for such securities, without calling into question the intent to hold other securities to maturity in the future. This standard is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007, or January 1, 2008 for the Corporation. Early adoption is permitted as of the beginning of a fiscal year that begins on or before November 15, 2007, provided the entity also elects to apply the provisions of Statement 157. The Corporation has not completed its assessment of SFAS 159 and the impact, if any, on the consolidated financial statements.

In March 2007, the FASB ratified EITF 06-10, Accounting for Deferred Compensation and Postretirement Benefit Aspects of Collateral Assignment Split-Dollar Life Insurance Arrangements (EITF 06-10). EITF 06-10 addresses accounting for collateral assignment split-dollar life insurance arrangements that provide a benefit to an employee that extends to postretirement periods. EITF 06-10 provides guidance for determining the liability for the postretirement benefit aspects of collateral assignment-type split-dollar life insurance arrangements, as well as the recognition and measurement of the associated asset on the basis of the terms of the collateral assignment agreement. EITF 06-10 is effective for fiscal years beginning after December 15, 2007, or January 1, 2008 for the Corporation. The Corporation is currently evaluating the impact of EITF 06-10 on the consolidated financial statements.

### **NOTE M Reclassifications**

Certain amounts in the 2006 consolidated financial statements and notes have been reclassified to conform to the 2007 presentation.

**Table of Contents**

**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 the Corporation's provision for loan losses and may reduce the Corporation's net income.

Fluctuations in the value of the Corporation's equity portfolio, or assets under management by the Corporation's investment management and trust services, could have an 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 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 77% of revenues for the quarter ended March 31, 2007. Growth in net interest income is dependent upon balance sheet growth and/or maintaining 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

**Table of Contents**

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 following table presents a summary of the Corporation's earnings and selected performance ratios:

|  | <b>Three months ended</b> |             |
|--|---------------------------|-------------|
|  | <b>March 31</b>           |             |
|  | <b>2007</b>               | <b>2006</b> |
| Net income (in thousands)                        | <b>\$41,128</b>           | \$43,879    |
| Diluted net income per share                     | <b>\$ 0.24</b>            | \$ 0.25     |
| Annualized return on average assets              | <b>1.12%</b>              | 1.32%       |
| Annualized return on average equity              | <b>11.06%</b>             | 12.83%      |
| Annualized return on average tangible equity (1) | <b>20.34%</b>             | 23.01%      |
| Net interest margin (2)                          | <b>3.74%</b>              | 3.88%       |

(1) Calculated as net income, adjusted for intangible amortization (net of tax), divided by average shareholders equity, excluding goodwill and intangible assets.

(2) Presented on a fully taxable-equivalent (FTE) basis, using 35% Federal tax rate. See also Net Interest Income section of Management's Discussion and Analysis.

The \$2.8 million, or 6.3%, decline in net income for the quarter ended March 31, 2007 was due to an increase in other expenses of \$12.9 million, or 14.6%, offset by an increase in net interest income of \$6.7 million, or 5.9%, and an increase in other income of \$2.5 million, or 6.7%. The increase in other expenses was due to a number of factors, most notably, a \$5.5 million contingent loss recorded during the first quarter of 2007 related to losses that may be incurred due to the repurchase of residential mortgage loans and home equity loans that had been originated and sold in the secondary market.

The increase in net interest income was due to external growth through acquisitions and interest recoveries from previously charged off loans, offset by the 14 basis point decline in net interest margin. The decrease in net interest margin was caused, in part, by deposits shifting from lower cost core demand and savings accounts to higher cost certificates of deposit. Interest recoveries totaled \$3.7 million and \$493,000 for the three months ended March 31, 2007 and 2006, respectively. Interest recoveries in the first quarter of 2007 were almost entirely due to a \$3.4 million interest recovery related to one commercial mortgage loan.

The following summarizes some of the more significant factors that influenced the Corporation's results for the three months ended March 31, 2007.

**Interest Rates** Changes in the interest rate environment can impact both the Corporation's net interest income and its non-interest income. The term interest rate environment generally refers to both the level of interest rates and the shape of the U. S. Treasury yield curve, which is a plot of the yields on treasury issues over various maturity periods. Typically, the shape of the yield curve is upward sloping, with longer-term rates exceeding short-term rates. For the past twelve months, the yield curve has remained relatively flat, and at times, downward sloping, with minimal differences between long and short-term rates, resulting in a negative impact to the Corporation's net interest income and net interest margin.

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 twice since March 31, 2006, for a total increase of 50 basis points (from 4.75% to 5.25%). The Corporation's prime lending rate had a corresponding increase, from 7.75% to 8.25%, resulting in an increase in the rates on floating rate loans. More significantly, 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. Additionally, as rates have increased, customers

## **Table of Contents**

have shifted funds from lower 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, decreased to 4.65% at March 31, 2007, as compared to 4.86% at March 30, 2006. The decreasing yield on longer-term investments and the increasing yields on short-term rates have resulted in an inversion of the yield curve.

The Corporation manages its risk associated with changes in interest rates through the techniques described in the Market Risk section of Management's Discussion.

**Interest-bearing Deposits** The Corporation's interest-bearing deposits increased from 2006 to 2007 through a combination of acquisitions and internal growth.

During the first quarter of 2007, the Corporation experienced a shift from lower cost interest-bearing demand and savings deposit accounts (47.0% of total interest-bearing deposits in 2007, compared to 51.3% in 2006) to higher cost certificates of deposit (53.0% in 2007, compared to 48.7% in 2006). The shift to higher cost deposits, as well as increasing deposit rates, has resulted in a decline in net interest margin.

**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 influenced by economic conditions and other factors, but can be managed through conservative underwriting and sound collection policies and procedures.

The Corporation continued to maintain excellent asset quality for the first quarter of 2007, attributable to its credit culture and underwriting policies. The Corporation experienced annualized net recoveries to average loans of less than one basis point in the first quarter of 2007 in comparison to annualized net charge-offs of 0.03% in the first quarter of 2006.

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. Finally, decreases in the values of underlying collateral as a result of market or economic conditions could affect asset quality.

**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. Declines in bank stock portfolio values could have a detrimental impact on the Corporation's ability to recognize gains in the future.

**Earning Assets** The Corporation's interest-earning assets increased from 2006 to 2007 through a combination of acquisitions and internal loan growth.

During the first quarter of 2007, the Corporation experienced a slight shift in its composition of interest-earning assets from investments (21.1% of total average interest-earning assets in 2007, compared to 22.6% in 2006) to loans (77.0% in 2007, compared to 75.3% in 2006). 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.

**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.

**Table of Contents**

Results for the first quarter of 2007 in comparison to the first quarter of 2006 were impacted due to a full three-month contribution by Columbia in 2007, compared to a two-month contribution in 2006.

Acquisitions have long been a supplement to the Corporation's internal growth. This recent acquisition provides the opportunity for additional growth, as it has allowed 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 sound 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 subsidiary 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.

**Net Interest Income**

Net interest income increased \$6.7 million, or 5.9%, to \$121.8 million in 2007 from \$115.0 million in 2006. The increase was due to average balance growth, with total interest-earning assets increasing 10.4%, offset by a lower net interest margin. The average FTE yield on interest-earning assets increased 54 basis points (an 8.4% increase) over 2006 while the cost of interest-bearing liabilities increased 75 basis points (a 24.2% increase).



**Table of Contents**

The following table provides a comparative average balance sheet and net interest income analysis for the first quarter of 2007 as compared to the same period in 2006. 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.

|                                      | Three months ended March 31 |            |                |                      |            |                |
|--------------------------------------|-----------------------------|------------|----------------|----------------------|------------|----------------|
|                                      | 2007                        |            |                | 2006                 |            |                |
|                                      | Average<br>Balance          | Interest   | Yield/<br>Rate | Average<br>Balance   | Interest   | Yield/<br>Rate |
| <b>ASSETS</b>                        |                             |            |                |                      |            |                |
| Interest-earning assets:             |                             |            |                |                      |            |                |
| Loans and leases (1)                 | \$ 10,414,698               | \$ 196,558 | 7.65%          | \$ 9,227,642         | \$ 161,883 | 7.11%          |
| Taxable investment securities (2)    | 2,190,230                   | 24,619     | 4.50           | 2,186,073            | 22,539     | 4.13           |
| Tax-exempt investment securities (2) | 492,709                     | 6,228      | 5.06           | 435,959              | 5,185      | 4.76           |
| Equity securities (2)                | 178,488                     | 2,129      | 4.79           | 145,011              | 1,559      | 4.33           |
| Total investment securities          | 2,861,427                   | 32,976     | 4.61           | 2,767,043            | 29,283     | 4.24           |
| Loans held for sale                  | 207,856                     | 3,684      | 7.09           | 199,441              | 3,458      | 6.94           |
| Other interest-earning assets        | 48,328                      | 596        | 4.97           | 63,388               | 663        | 4.23           |
| Total interest-earning assets        | 13,532,309                  | 233,814    | 6.99%          | 12,257,514           | 195,287    | 6.45%          |
| Noninterest-earning assets:          |                             |            |                |                      |            |                |
| Cash and due from banks              | 315,969                     |            |                | 358,481              |            |                |
| Premises and equipment               | 192,002                     |            |                | 177,761              |            |                |
| Other assets                         | 899,843                     |            |                | 786,918              |            |                |
| Less: Allowance for loan losses      | (107,683)                   |            |                | (101,999)            |            |                |
| <i>Total Assets</i>                  | <b>\$ 14,832,440</b>        |            |                | <b>\$ 13,478,675</b> |            |                |
| <b>LIABILITIES AND EQUITY</b>        |                             |            |                |                      |            |                |
| Interest-bearing liabilities:        |                             |            |                |                      |            |                |
| Demand deposits                      | \$ 1,657,714                | \$ 6,904   | 1.69%          | \$ 1,666,506         | \$ 5,575   | 1.36%          |
| Savings deposits                     | 2,295,822                   | 13,811     | 2.44           | 2,272,771            | 10,561     | 1.88           |
| Time deposits                        | 4,457,363                   | 50,493     | 4.59           | 3,744,503            | 34,054     | 3.69           |
| Total interest-bearing deposits      | 8,410,899                   | 71,208     | 3.43           | 7,683,780            | 50,190     | 2.65           |
| Short-term borrowings                | 1,552,495                   | 19,054     | 4.93           | 1,487,295            | 15,306     | 4.13           |
| Long-term debt                       | 1,450,016                   | 18,619     | 5.14           | 995,478              | 12,113     | 4.93           |
| Total interest-bearing liabilities   | 11,413,410                  | 108,881    | 3.85%          | 10,166,553           | 77,609     | 3.10%          |

Noninterest-bearing  
liabilities:

|                 |                  |           |
|-----------------|------------------|-----------|
| Demand deposits | <b>1,721,135</b> | 1,765,897 |
| Other           | <b>189,297</b>   | 159,401   |

|                          |                   |            |
|--------------------------|-------------------|------------|
| <i>Total Liabilities</i> | <b>13,323,842</b> | 12,091,851 |
| Shareholders' equity     | <b>1,508,598</b>  | 1,386,824  |

|   |                      |               |
|---|----------------------|---------------|
| <i>Total Liabilities and Shareholders' Equity</i> | <b>\$ 14,832,440</b> | \$ 13,478,675 |
|---|----------------------|---------------|

|   |                   |              |            |       |
|---|-------------------|--------------|------------|-------|
| Net interest income/net interest margin (FTE) | <b>124,933</b>    | <b>3.74%</b> | 117,678    | 3.88% |
| Tax equivalent adjustment                     | <b>(3,158)</b>    |              | (2,635)    |       |
| Net interest income                           | <b>\$ 121,775</b> |              | \$ 115,043 |       |

(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.

**Table of Contents**

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

|                                  | <b>2007 vs. 2006</b>           |                  |                  |
|----------------------------------|--------------------------------|------------------|------------------|
|                                  | <b>Increase (decrease) due</b> |                  |                  |
|                                  | <b>To change in</b>            |                  |                  |
|                                  | <b>Volume</b>                  | <b>Rate</b>      | <b>Net</b>       |
|                                  | <b>(in thousands)</b>          |                  |                  |
| Interest income on:              |                                |                  |                  |
| Loans and leases                 | \$ 21,818                      | \$ 12,857        | \$ 34,675        |
| Taxable investment securities    | 43                             | 2,037            | 2,080            |
| Tax-exempt investment securities | 708                            | 335              | 1,043            |
| Equity securities                | 391                            | 179              | 570              |
| Loans held for sale              | 151                            | 75               | 226              |
| Other interest-earning assets    | (172)                          | 105              | (67)             |
| <i>Total interest income</i>     | <b>\$ 22,939</b>               | <b>\$ 15,588</b> | <b>\$ 38,527</b> |
| Interest expense on:             |                                |                  |                  |
| Demand deposits                  | \$ (29)                        | \$ 1,358         | \$ 1,329         |
| Savings deposits                 | 108                            | 3,142            | 3,250            |
| Time deposits                    | 7,178                          | 9,261            | 16,439           |
| Short-term borrowings            | 697                            | 3,051            | 3,748            |
| Long-term debt                   | 5,969                          | 537              | 6,506            |
| <i>Total interest expense</i>    | <b>\$ 13,923</b>               | <b>\$ 17,349</b> | <b>\$ 31,272</b> |

Interest income increased \$38.5 million, or 19.7%, due to increases in both average balances of interest-earning assets and rates. Interest income increased \$22.9 million as a result of a \$1.3 billion, or 10.4%, increase in average balances, while an increase of \$15.6 million was realized from a 54 basis point increase in rates. Columbia contributed \$11.4 million to the increase in interest income.

The increase in average interest-earning assets was primarily due to loan growth, and partially due to investment growth. The following summarizes the growth in average loans, by type:

|                   |                          | <b>Three months ended</b>     |              | <b>Increase (decrease)</b> |          |
|-------------------|--------------------------|-------------------------------|--------------|----------------------------|----------|
|                   |                          | <b>March 31</b>               |              |                            |          |
|                   |                          | <b>2007</b>                   | <b>2006</b>  | <b>\$</b>                  | <b>%</b> |
|                   |                          | <b>(dollars in thousands)</b> |              |                            |          |
| Commercial        | industrial and financial | \$ 2,670,641                  | \$ 2,278,597 | \$ 392,044                 | 17.2%    |
| Commercial        | agricultural             | 360,601                       | 327,929      | 32,672                     | 10.0     |
| Real estate       | commercial mortgage      | 3,239,179                     | 2,944,676    | 294,503                    | 10.0     |
| Real estate       | residential mortgage     | 701,918                       | 589,665      | 112,253                    | 19.0     |
| Real estate       | home equity              | 1,441,741                     | 1,333,897    | 107,844                    | 8.1      |
| Real estate       | construction             | 1,396,527                     | 1,163,368    | 233,159                    | 20.0     |
| Consumer          |                          | 516,335                       | 518,330      | (1,995)                    | (0.4)    |
| Leasing and other |                          | 87,756                        | 71,180       | 16,576                     | 23.3     |

|              |                      |              |              |       |
|--------------|----------------------|--------------|--------------|-------|
| <i>Total</i> | <b>\$ 10,414,698</b> | \$ 9,227,642 | \$ 1,187,056 | 12.9% |
|--------------|----------------------|--------------|--------------|-------|

18

---

**Table of Contents**

Loan growth was particularly strong in the commercial loan and commercial mortgage loan categories, which together increased \$719.2 million, or 13.0%, with the Columbia acquisition contributing \$162.8 million to the increase. The Corporation experienced internal commercial loan growth throughout almost all commercial loan types, while the commercial mortgage loan growth was primarily in adjustable rate mortgages. Additional growth was due to an increase in construction loans due primarily to the Columbia acquisition, which contributed \$161.8 million to the \$233.2 million increase. Finally, residential mortgage loans and home equity loans increased \$220.1 million, or 11.4%. This growth was primarily due to internal growth across both categories and partially due to the Columbia acquisition, which added \$90.7 million to the increase.

The average yield on loans during the first quarter of 2007 was 7.65%, a 54 basis point, or 7.6%, increase over 2006. This mainly reflects the impact of floating and adjustable rate loans, which reprice to higher rates when interest rates rise, as they have over the past twelve months.

Average investment securities increased \$94.4 million, or 3.4%. Excluding the impact of the Columbia acquisition, average investments decreased \$51.6 million, or 1.9%. This decrease was due to the sale of approximately \$250 million of lower yielding investment securities during the first quarter of 2007, at a total gain of \$777,000, whose proceeds were used to repay higher cost Federal funds purchased. The average yield on investment securities increased 37 basis points from 4.24% in 2006 to 4.61% in 2007.

The increase in interest income (FTE) was largely offset by an increase in interest expense of \$31.3 million, or 40.3%, to \$108.9 million in the first quarter of 2007 from \$77.6 million in the first quarter of 2006. The increase in interest expense was partially due to a 75 basis point, or 24.2%, increase in the cost of total interest-bearing liabilities in the first quarter of 2007 in comparison to the same period in 2006. The remaining increase was due to a \$1.2 billion, or 12.3%, increase in interest-bearing liabilities, due primarily to internal growth and partially due to the Columbia acquisition contributing \$6.8 million to the increase.

The following table summarizes the growth in average deposits, by type:

|                            | Three months ended   |                     | Increase (decrease)    |             |
|----------------------------|----------------------|---------------------|------------------------|-------------|
|                            | 2007                 | 2006                | \$                     | %           |
|                            |                      |                     | (dollars in thousands) |             |
| Noninterest-bearing demand | \$ 1,721,135         | \$ 1,765,897        | \$ (44,762)            | (2.5)%      |
| Interest-bearing demand    | 1,657,714            | 1,666,506           | (8,792)                | (0.5)       |
| Savings                    | 2,295,822            | 2,272,771           | 23,051                 | 1.0         |
| Time deposits              | 4,457,363            | 3,744,503           | 712,860                | 19.0        |
| <i>Total</i>               | <b>\$ 10,132,034</b> | <b>\$ 9,449,677</b> | <b>\$ 682,357</b>      | <b>7.2%</b> |

The Corporation experienced significant growth in time deposits, of which \$306.3 million was due to the Columbia acquisition. The remaining time deposit increase of \$406.5 million was due to favorable interest rates making time deposits an attractive investment alternative for customers. The net decrease in noninterest-bearing and interest-bearing demand and savings accounts of \$30.5 million, or 0.5%, was mitigated by a \$135.9 million increase related to external growth from the Columbia acquisition. The internal decrease of \$166.4 million in noninterest-bearing and interest-bearing demand and savings accounts was due to customers shifting from these accounts to higher yielding time deposits.

Average borrowings increased \$519.7 million, or 20.9%, from the first quarter of 2006. Excluding the impact of the Columbia acquisition, average short-term borrowings decreased \$20.8 million, or 1.5%, to \$1.3 billion, while average long-term debt increased \$432.2 million, or 44.1%, to \$1.4 billion. The increase in long-term debt was primarily due to an increase in FHLB advances as longer-term rates were

**Table of Contents**

locked, and partially due to the average balance impact of the January 2006 issuance of \$154.6 million of junior subordinated deferrable interest debentures. See Note K, Long-term Debt in the Notes to Consolidated Financial Statements for further discussion.

**Provision and Allowance for Loan Losses**

The following table presents ending balances of loans outstanding (net of unearned income):

|                                     | <b>March 31<br/>2007</b> | December 31<br>2006<br>(in thousands) | March 31<br>2006 |
|-------------------------------------|--------------------------|---------------------------------------|------------------|
| Commercial industrial and financial | <b>\$ 2,730,456</b>      | \$ 2,603,224                          | \$ 2,412,836     |
| Commercial agricultural             | <b>365,036</b>           | 361,962                               | 325,140          |
| Real-estate commercial mortgage     | <b>3,257,914</b>         | 3,213,809                             | 3,020,376        |
| Real-estate residential mortgage    | <b>699,528</b>           | 696,836                               | 612,584          |
| Real-estate home equity             | <b>1,425,948</b>         | 1,455,439                             | 1,406,076        |
| Real-estate construction            | <b>1,377,791</b>         | 1,428,809                             | 1,343,364        |
| Consumer                            | <b>514,007</b>           | 523,066                               | 516,789          |
| Leasing and other                   | <b>77,495</b>            | 91,178                                | 81,545           |
|                                     | <b>\$ 10,448,175</b>     | \$ 10,374,323                         | \$ 9,718,710     |

Approximately \$4.6 billion, or 44.4%, of the Corporation's loan portfolio was in commercial mortgage and construction loans at March 31, 2007, compared to 44.9% at March 31, 2006. While the Corporation does not have a concentration of credit risk with any single borrower, repayments on loans in these portfolios can be negatively influenced by decreases in real estate values. The Corporation mitigates this risk through stringent underwriting policies and procedures.

**Table of Contents**

The following table presents the activity in the Corporation's allowance for loan losses:

|  | <b>Three months ended<br/>March 31</b> |              |
|--|--|--------------|
|  | <b>2007</b>                            | 2006         |
|  | (dollars in thousands)                 |              |
| Loans outstanding at end of period (net of unearned)       | <b>\$ 10,448,175</b>                   | \$ 9,718,710 |
| Daily average balance of loans and leases                  | <b>\$ 10,414,698</b>                   | \$ 9,227,642 |
| <i>Balance at beginning of period</i>                      | <b>\$ 106,884</b>                      | \$ 92,847    |
| Loans charged off:   |  |              |
| Commercial financial and agricultural                      | <b>361</b>                             | 879          |
| Real estate mortgage                                       | <b>42</b>                              | 81           |
| Consumer   | <b>790</b>                             | 461          |
| Leasing and other  | <b>167</b>                             | 79           |
| <i>Total loans charged off</i>                             | <b>1,360</b>                           | 1,500        |
| Recoveries of loans previously charged off:                |  |              |
| Commercial financial and agricultural                      | <b>770</b>                             | 381          |
| Real estate mortgage                                       | <b>64</b>                              | 94           |
| Consumer   | <b>393</b>                             | 331          |
| Leasing and other  | <b>191</b>                             | 51           |
| <i>Total recoveries</i>                                    | <b>1,418</b>                           | 857          |
| Net loans (recovered) charged off                          | <b>(58)</b>                            | 643          |
| Provision for loan losses                                  | <b>957</b>                             | 1,000        |
| Allowance purchased  |  | 12,991       |
| <i>Balance at end of period</i>                            | <b>\$ 107,899</b>                      | \$ 106,195   |
| Net (recoveries) charge-offs to average loans (annualized) |  | 0.03%        |
| Allowance for loan losses to loans outstanding             | <b>1.03%</b>                           | 1.09%        |

The following table summarizes the Corporation's non-performing assets as of the indicated dates:

|  | <b>March<br/>31</b> | December<br>31 | March 31 |
|--|---------------------|----------------|----------|
|--|---------------------|----------------|----------|

Edgar Filing: FULTON FINANCIAL CORP - Form 10-Q

|                                     | 2007             | 2006                   | 2006      |
|-------------------------------------|------------------|------------------------|-----------|
|                                     |                  | (dollars in thousands) |           |
| Non-accrual loans                   | <b>\$ 37,914</b> | \$ 33,113              | \$ 34,716 |
| Loans 90 days past due and accruing | <b>13,467</b>    | 20,632                 | 13,126    |
| Other real estate owned             | <b>6,576</b>     | 4,103                  | 2,011     |
| Total non-performing assets         | <b>\$ 57,957</b> | \$ 57,848              | \$ 49,853 |
| Non-accrual loans/total loans       | <b>0.36%</b>     | 0.32%                  | 0.36%     |
| Non-performing assets/total assets  | <b>0.40%</b>     | 0.39%                  | 0.35%     |
| Allowance/non-performing loans      | <b>210%</b>      | 199%                   | 222%      |

The provision for loan losses for the first quarter of 2007 totaled \$957,000, a decrease of \$43,000, or 4.3%, from the same period in 2006. During the first quarter of 2007, net recoveries totaled \$58,000, or less than



**Table of Contents**

one basis point as a percentage of average loans on an annualized basis, an improvement of \$701,000 over the \$643,000 in net charge-offs, or 0.03% of average loans, recorded during the first quarter of 2006. Non-performing assets increased to \$58.0 million, or 0.40% of total assets, at March 31, 2007, from \$49.9 million, or 0.35% of total assets, at March 31, 2006. Total non-performing assets increased \$109,000 from December 31, 2006.

Management believes that the allowance balance of \$107.9 million at March 31, 2007 is adequate to cover losses inherent in the loan portfolio on that date and is appropriate based on applicable accounting standards.

**Other Income**

The following table presents the components of other income:

|   | <b>Three months ended</b> |             | <b>Increase (decrease)</b> |          |
|---|---------------------------|-------------|----------------------------|----------|
|   | <b>2007</b>               | <b>2006</b> | <b>\$</b>                  | <b>%</b> |
|   |                           |             | (dollars in thousands)     |          |
| Investment management and trust services            | <b>\$ 9,810</b>           | \$ 10,032   | \$ (222)                   | (2.2)%   |
| Service charges on deposit accounts                 | <b>10,627</b>             | 10,247      | 380                        | 3.7      |
| Other service charges and fees                      | <b>7,375</b>              | 6,654       | 721                        | 10.8     |
| Gains on sales of mortgage of loans                 | <b>5,393</b>              | 4,772       | 621                        | 13.0     |
| Other   | <b>4,078</b>              | 2,237       | 1,841                      | 82.3     |
| <i>Total, excluding investment securities gains</i> | <b>\$ 37,283</b>          | \$ 33,942   | \$ 3,341                   | 9.8%     |
| Investment securities gains                         | <b>1,782</b>              | 2,665       | (883)                      | (33.1)   |
| <i>Total</i>  | <b>\$ 39,065</b>          | \$ 36,607   | \$ 2,458                   | 6.7%     |

Excluding investment security gains, total other income increased \$3.3 million, or 9.8%, with the Columbia acquisition contributing \$565,000 of this increase.

Investment management and trust services decreased by \$371,000, excluding the acquisition of Columbia. The decrease was almost entirely due to a \$314,000, or 8.1%, decrease in brokerage revenue. The increase in service charges on deposit accounts was due to a \$197,000 increase contributed by the Columbia acquisition, with additional increases of \$289,000 and \$102,000 in cash management fees and overdraft fees, respectively, offset by a \$208,000 decrease in other service charges earned on both business and personal deposit accounts. The increase in other service charges and fees was primarily due to an increase of \$684,000 in foreign currency processing revenues as a result of the recent acquisition of a foreign currency processing company. Additional increases were due to letter of credit fees (\$130,000, or 10.8%) and debit card fees (\$198,000, or 11.5%), offset by decreases in merchant fees of \$324,000, or 15.9%. The increase in gains on sales of mortgage loans resulted from the spread on sales increasing 21 basis points, or 22.6%, offset partially by a \$42.6 million, or 8.3%, decrease in sales volumes resulting from the increase in longer-term mortgage rates.

Investment securities gains decreased \$833,000, or 33.1%. Investment securities gains during the first quarter of 2007 and 2006 consisted of net realized gains on the sale of equity securities of \$999,000 and \$2.7 million, respectively. Investment security gains on the sale of available for sale debt securities for the first quarter of 2007 and 2006 were \$779,000 and \$12,000, respectively.

**Table of Contents****Other Expenses**

The following table presents the components of other expenses:

|                                | <b>Three months ended</b> |             | <b>Increase (decrease)</b> |          |
|--------------------------------|---------------------------|-------------|----------------------------|----------|
|                                | <b>March 31</b>           |             |                            |          |
|                                | <b>2007</b>               | <b>2006</b> | <b>\$</b>                  | <b>%</b> |
|                                |                           |             | (dollars in thousands)     |          |
| Salaries and employee benefits | <b>\$ 56,293</b>          | \$ 49,929   | \$ 6,364                   | 12.7%    |
| Net occupancy expense          | <b>10,196</b>             | 8,589       | 1,607                      | 18.7     |
| Equipment expense              | <b>3,715</b>              | 3,593       | 122                        | 3.4      |
| Data processing                | <b>3,202</b>              | 2,909       | 293                        | 10.1     |
| Advertising                    | <b>2,409</b>              | 2,253       | 156                        | 6.9      |
| Telecommunications             | <b>1,983</b>              | 2,092       | (109)                      | (5.2)    |
| Intangible amortization        | <b>1,983</b>              | 1,852       | 131                        | 7.1      |
| Supplies                       | <b>1,481</b>              | 1,592       | (111)                      | (7.0)    |
| Postage                        | <b>1,449</b>              | 1,301       | 148                        | 11.4     |
| Professional fees              | <b>1,197</b>              | 1,408       | (211)                      | (15.0)   |
| Operating risk loss            | <b>5,914</b>              | 1,099       | 4,815                      | 438.1    |
| Other                          | <b>11,083</b>             | 11,399      | (316)                      | (2.8)    |
| <i>Total</i>                   | <b>\$ 100,905</b>         | \$ 88,016   | \$ 12,889                  | 14.6%    |

The increase in salaries and employee benefits includes a \$4.3 million, or 10.7%, increase in salaries, driven by the Columbia acquisition, which added approximately \$1.4 million to the increase, as well as an increase in total average full-time equivalent employees and normal salary increases for existing employees. Also contributing to the increase in salaries was a \$644,000 increase related to corporate and affiliate senior management bonuses and a \$164,000 increase in stock compensation expense. Employee benefits increased \$1.2 million, or 14.2%, primarily due to increases in healthcare costs and pension expenses and partially due to the Columbia acquisition.

The increase in net occupancy expense was partially due to the Columbia acquisition, which contributed \$504,000 to the increase. The remaining increase was due to additional rental expense and depreciation of real property as a result of growth in the branch network in the first quarter of 2007 in comparison to 2006.

The increase in operating risk loss was due to the \$5.5 million contingent loss recorded during the first quarter of 2007 related to losses that may be incurred due to the repurchase of residential mortgage loans and home equity loans that had been originated and sold in the secondary market.

**Income Taxes**

Income tax expense for the first quarter of 2007 was \$17.9 million, a \$905,000, or 4.8%, decrease from \$18.8 million in 2006. The Corporation's effective tax rate was fairly consistent over both periods, at approximately 30.3% in 2007 and 29.9% in 2006. The effective rate is lower than the Federal statutory rate of 35% due mainly to investments in tax-free municipal securities and Federal tax credits from investments in low and moderate-income housing partnerships.

**Table of Contents**

**FINANCIAL CONDITION**

Total assets of the Corporation decreased \$248.6 million, or 1.7%, to \$14.7 billion at March 31, 2007, compared to \$14.9 billion at December 31, 2006 mainly as a result of sales of investment securities and payoffs of borrowings with the proceeds.

The Corporation experienced a \$73.9 million, or 0.7%, increase in loans, including a moderate increase in commercial loan and commercial mortgage loans, offset by slight decreases in construction and home equity loans. Commercial loans and commercial mortgages increased \$174.4 million, or 2.8%, while construction loans decreased \$51.0 million, or 3.6%, and home equity loans decreased \$29.5 million, or 2.0%.

Investment securities decreased \$256.6 million, or 8.9%, due to the sale of approximately \$250 million of securities, the proceeds from which were largely used to reduce Federal funds purchased.

In comparison to December 31, 2006, deposits remained relatively unchanged, with decreases in noninterest-bearing demand deposits and interest-bearing savings accounts of \$48.6 million, or 1.2%, offset by an increase in time deposits of \$51.9 million, or 1.2%. The decrease in noninterest bearing demand and interest-bearing savings accounts was largely due to a decrease in business accounts, offset partially by an increase in personal accounts. The increase in time deposits resulted from the price sensitivity of customers who have taken advantage of favorable interest rates offered on time deposits in the recent interest rate and competitive environment.

Short-term borrowings, which consist mainly of Federal funds purchased and customer cash management accounts, decreased \$542.4 million, or 32.3%, during the first quarter of 2007. The decrease was mainly in Federal funds purchased, which decreased \$580.0 million, or 56.7%, offset slightly by an increase in short-term promissory notes of \$80.3 million, or 28.8%. As discussed above, the proceeds from certain investment security sales were used to repay higher rate Federal funds purchased. In addition, new FHLB advances totaling \$290.0 million were primarily used to reduce Federal funds purchased.

**Capital Resources**

Total shareholders' equity increased \$5.6 million, or 0.4%, during the first quarter of 2007. Equity increased due to net income of \$41.1 million and \$2.3 million in other comprehensive income, offset by \$25.5 million in cash dividends paid to shareholders and \$16.4 million in treasury stock purchases.

The Corporation periodically repurchases shares of its common stock under repurchase plans approved by the Board of Directors. These repurchases have historically been through open market transactions and have complied with all regulatory restrictions on the timing and amount of repurchases. Shares may also be repurchased through an

Accelerated Share Repurchase program (ASR), which allows shares to be repurchased immediately from an investment bank. The investment bank, in turn, repurchases shares on the open market over a period that is determined by the average daily trading volume of the Corporation's shares, among other factors, with a purchase price adjustment made between the parties at the end of the program based on the cost of shares purchased by the investment bank. Shares repurchased have been added to treasury stock and are accounted for at cost. These shares are periodically reissued for various corporate needs.

In 2006, the Corporation's Board of Directors approved a stock repurchase plan for 2.1 million shares through June 30, 2007. During the first quarter of 2007, the Corporation repurchased 1.0 million shares, representing the remaining shares available under this plan. In April 2007, the Corporation's Board of Directors approved a stock repurchase plan for 1.0 million shares through December 31, 2007.

**Table of Contents**

The Corporation and its subsidiary banks are subject to various regulatory capital requirements administered by banking regulators. Failure to meet minimum capital requirements can initiate certain actions by regulators that could have a material effect on the Corporation's financial statements. The regulations require that banks maintain minimum amounts and ratios of total and Tier I capital (as defined in the regulations) to risk weighted assets (as defined), and Tier I capital to average assets (as defined). As of March 31, 2007, the Corporation and each of its bank subsidiaries met the minimum requirements. In addition, the Corporation and each of its bank subsidiaries' capital ratios exceeded the amounts required to be considered well-capitalized as defined in the regulations. The following table summarizes the Corporation's capital ratios in comparison to regulatory requirements:

|  |                 |                 | <b>Regulatory Minimum</b> |                    |
|--|-----------------|-----------------|---------------------------|--------------------|
|  | <b>March 31</b> | <b>December</b> | <b>Capital</b>            | <b>Well</b>        |
|  | <b>2007</b>     | <b>31</b>       | <b>Adequacy</b>           | <b>Capitalized</b> |
|  |                 | <b>2006</b>     |                           |                    |
| Total Capital (to Risk Weighted Assets)  | <b>11.9%</b>    | 11.7%           | 8.0%                      | 10.0%              |
| Tier I Capital (to Risk Weighted Assets) | <b>10.0%</b>    | 9.9%            | 4.0%                      | 6.0%               |
| Tier I Capital (to Average Assets)       | <b>7.7%</b>     | 7.7%            | 3.0%                      | 5.0%               |

**Liquidity**

The Corporation must maintain a sufficient level of liquid assets to meet the cash needs of its customers, who, as depositors, may want to withdraw funds or who, as borrowers, need credit availability. Liquidity is provided on a continuous basis through scheduled and unscheduled principal and interest payments on outstanding loans and investments and through the availability of deposits and borrowings. The Corporation also maintains secondary sources that provide liquidity on a secured and unsecured basis to meet short-term liquidity needs.

The Corporation's sources and uses of cash were discussed in general terms in the net interest income section of Management's Discussion. The Consolidated Statements of Cash Flows provide additional information. The Corporation generated \$97.2 million in cash from operating activities during the first quarter of 2007, mainly due to first quarter net income and a net decrease in loans held for sale. Cash flows from investing activities were \$198.5 million, due to proceeds from sales and maturities of investment securities exceeding purchases. Financing activities resulted in a net cash outflow of \$305.7 million, due to decreases of short-term borrowings, offset partially by proceeds received from additional long-term debt.

Liquidity must also be managed at the Fulton Financial Corporation Parent Company level. For safety and soundness reasons, banking regulations limit the amount of cash that can be transferred from subsidiary banks to the Parent Company in the form of loans and dividends. Generally, these limitations are based on the subsidiary banks' regulatory capital levels and their net income. As a result of increased stock repurchase plans and acquisition activity the Parent Company's cash needs have increased in recent years, requiring additional sources of funds.

In May 2007, the Corporation issued \$100.0 million of subordinated ten-year notes, which mature on May 1, 2017 at an effective rate of approximately 5.95%. Interest paid semi-annually in May and November of each year.

The Corporation also has a revolving line of credit agreement with an unaffiliated bank. Under the terms of the agreement, the Corporation can borrow up to \$100.0 million with interest calculated at the one-month London Interbank Offering Rate (LIBOR) plus 0.35%. The credit agreement requires the Corporation to maintain certain financial ratios related to capital strength and earnings. The Corporation was in compliance with all required covenants under the credit agreement as of March 31, 2007. As of March 31, 2007, there was \$57.1 million borrowed against this line.

**Table of Contents**

These borrowing arrangements supplement the liquidity available from subsidiaries through dividends and borrowings and provide some flexibility in Parent Company cash management. Management continues to monitor the liquidity and capital needs of the Parent Company and will implement appropriate strategies, as necessary, to remain well capitalized and to meet its cash needs.

**Table of Contents**

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

Market risk is the exposure to economic loss that arises from changes in the values of certain financial instruments. The types of market risk exposures generally faced by financial institutions include interest rate risk, equity market price risk, foreign currency risk and commodity price risk. Due to the nature of its operations, only equity market price risk and interest rate risk are significant to the Corporation.

**Equity Market Price Risk**

Equity market price risk is the risk that changes in the values of equity investments could have a material impact on the financial position or results of operations of the Corporation. The Corporation's equity investments consist primarily of common stocks of publicly traded financial institutions (cost basis of approximately \$93.9 million and fair value of \$90.0 million at March 31, 2007). The Corporation's financial institutions stock portfolio had gross unrealized gains of approximately \$1.4 million at March 31, 2007.

Although the carrying value of financial institutions stock accounted for only 0.6% of the Corporation's total assets, the unrealized gains on the portfolio represent a potential source of revenue. The Corporation has a history of periodically realizing gains from this portfolio and, if values were to decline more significantly, or for an extended period of time, this revenue source could be lost.

Management continuously monitors the fair value of its equity investments and evaluates current market conditions and operating results of the companies. Periodic sale and purchase decisions are made based on this monitoring process. None of the Corporation's equity securities are classified as trading. Future cash flows from these investments are not provided in the table on page 28 as such investments do not have maturity dates.

The Corporation has evaluated, based on existing accounting guidance, whether any unrealized losses on individual equity investments constituted other-than-temporary impairment, which would require a write-down through a charge to earnings. Based on the results of such evaluations, the Corporation recorded write-downs of \$117,000 for specific equity securities, which were deemed to exhibit other-than-temporary impairment in value as of March 31, 2007.

Additional impairment charges may be necessary depending upon the performance of the equity markets in general and the performance of the individual investments held by the Corporation.

In addition to its equity portfolio, the Corporation's investment management and trust services revenue could be impacted by fluctuations in the securities markets. A portion of the Corporation's trust revenue is based on the value of the underlying investment portfolios. If securities markets contract, the Corporation's revenue could be negatively impacted. In addition, the ability of the Corporation to sell its equities brokerage services is dependent, in part, upon consumers' level of confidence in the outlook for rising securities prices.

**Interest Rate Risk**

Interest rate risk creates exposure in two primary areas. First, changes in rates have an impact on the Corporation's liquidity position and could affect its ability to meet obligations and continue to grow. Second, movements in interest rates can create fluctuations in the Corporation's net income and changes in the economic value of its equity.

The Corporation employs various management techniques to minimize its exposure to interest rate risk. An Asset/Liability Management Committee (ALCO), consisting of key financial and senior management personnel, meets on a bi-weekly basis. The ALCO is responsible for reviewing the interest rate sensitivity position of the Corporation, approving asset and liability management policies, and overseeing the formulation and implementation of strategies regarding balance sheet positions and earnings.

**Table of Contents**

The following table provides information about the Corporation's interest rate sensitive financial instruments. The table provides expected cash flows and weighted average rates for each significant interest rate sensitive financial instrument, by expected maturity period. None of the Corporation's financial instruments are classified as trading. All dollar amounts are in thousands.

|                            | <b>Expected Maturity Period</b> |                    |                    |                    |                  |                    | <b>Total</b>        | <b>Estimated Fair Value</b> |
|----------------------------|---------------------------------|--------------------|--------------------|--------------------|------------------|--------------------|---------------------|-----------------------------|
|                            | <b>Year 1</b>                   | <b>Year 2</b>      | <b>Year 3</b>      | <b>Year 4</b>      | <b>Year 5</b>    | <b>Beyond</b>      |                     |                             |
| Fixed rate loans           |                                 |                    |                    |                    |                  |                    |                     |                             |
| (1)                        | \$ 884,263                      | \$ 607,086         | \$ 495,016         | \$ 352,157         | \$ 253,648       | \$ 619,019         | \$ 3,211,189        | \$ 3,157,312                |
| <i>Average rate</i>        | 6.66%                           | 6.46%              | 6.56%              | 6.72%              | 6.78%            | 6.42%              | 6.58%               |                             |
| Floating rate              |                                 |                    |                    |                    |                  |                    |                     |                             |
| loans (1) (7) (8)          | 3,208,574                       | 784,253            | 643,169            | 536,916            | 446,094          | 1,610,136          | 7,229,142           | 7,195,942                   |
| <i>Average rate</i>        | 8.23%                           | 7.72%              | 7.74%              | 7.76%              | 7.26%            | 6.76%              | 7.71%               |                             |
| Fixed rate                 |                                 |                    |                    |                    |                  |                    |                     |                             |
| investments (2)            | 494,138                         | 442,619            | 479,352            | 463,653            | 200,646          | 307,025            | 2,387,433           | 2,353,345                   |
| <i>Average rate</i>        | 4.23%                           | 4.02%              | 4.07%              | 3.96%              | 4.14%            | 5.32%              | 4.24%               |                             |
| Floating rate              |                                 |                    |                    |                    |                  |                    |                     |                             |
| investments (2)            | 44                              | 1,569              |                    | 500                |                  | 86,710             | 88,823              | 89,362                      |
| <i>Average rate</i>        | 5.12%                           | 5.01%              |                    | 6.24%              |                  | 5.55%              | 5.54%               |                             |
| Other                      |                                 |                    |                    |                    |                  |                    |                     |                             |
| interest-earning           |                                 |                    |                    |                    |                  |                    |                     |                             |
| assets                     | 224,099                         |                    |                    |                    |                  |                    | 224,099             | 224,099                     |
| <i>Average rate</i>        | 7.08%                           |                    |                    |                    |                  |                    | 7.08%               |                             |
| <b>Total</b>               | <b>\$4,811,118</b>              | <b>\$1,835,527</b> | <b>\$1,617,537</b> | <b>\$1,353,226</b> | <b>\$900,388</b> | <b>\$2,622,890</b> | <b>\$13,140,686</b> | <b>\$13,020,060</b>         |
| <b><i>Average rate</i></b> | <b>7.48%</b>                    | <b>6.41%</b>       | <b>6.29%</b>       | <b>6.19%</b>       | <b>6.43%</b>     | <b>6.47%</b>       | <b>6.78%</b>        |                             |
| Fixed rate                 |                                 |                    |                    |                    |                  |                    |                     |                             |
| deposits (3)               | \$3,515,704                     | \$ 443,770         | \$ 140,473         | \$ 98,856          | \$ 63,296        | \$ 181,438         | \$ 4,443,537        | \$ 4,433,120                |
| <i>Average rate</i>        | 4.59%                           | 4.34%              | 4.27%              | 4.52%              | 4.73%            | 4.61%              | 4.56%               |                             |
| Floating rate              |                                 |                    |                    |                    |                  |                    |                     |                             |
| deposits (4)               | 1,681,906                       | 265,789            | 265,789            | 254,081            | 247,830          | 3,076,645          | 5,792,040           | 5,792,041                   |
| <i>Average rate</i>        | 3.04%                           | 1.06%              | 1.06%              | 0.96%              | 0.90%            | 0.75%              | 1.46%               |                             |
| Fixed rate                 |                                 |                    |                    |                    |                  |                    |                     |                             |
| borrowings (5)             | 320,726                         | 94,667             | 98,266             | 264,290            | 20,268           | 415,637            | 1,213,854           | 1,217,277                   |
| <i>Average rate</i>        | 5.47%                           | 4.60%              | 5.03%              | 5.23%              | 5.15%            | 5.27%              | 5.24%               |                             |
| Floating rate              |                                 |                    |                    |                    |                  |                    |                     |                             |
| borrowings (6)             | 1,142,617                       | 191,000            |                    |                    |                  | 166,565            | 1,500,182           | 1,500,182                   |
| <i>Average rate</i>        | 4.77%                           | 4.59%              |                    |                    |                  | 4.69%              | 4.74%               |                             |
| <b>Total</b>               | <b>\$6,660,953</b>              | <b>\$ 995,226</b>  | <b>\$ 504,528</b>  | <b>\$ 617,227</b>  | <b>\$331,394</b> | <b>\$3,840,285</b> | <b>\$12,949,613</b> | <b>\$12,942,620</b>         |
| <b><i>Average rate</i></b> | <b>4.27%</b>                    | <b>3.54%</b>       | <b>2.73%</b>       | <b>3.36%</b>       | <b>1.89%</b>     | <b>1.59%</b>       | <b>3.26%</b>        |                             |

- (1) Amounts are based on contractual payments and maturities, adjusted for expected prepayments.
- (2) Amounts are based on contractual maturities; adjusted for expected prepayments on mortgage-backed securities, collateralized mortgage obligations and expected calls on agency and municipal securities.
- (3) Amounts are based on contractual maturities of time deposits.
- (4) Estimated based on history of deposit flows.
- (5) Amounts are based on contractual maturities of debt instruments, adjusted for possible calls.
- (6) Amounts include Federal Funds purchased, short-term promissory notes, floating FHLB



advances and  
securities sold  
under agreements  
to repurchase,  
which mature in  
less than 90 days,  
in addition to  
junior  
subordinated  
deferrable interest  
debentures.

(7) Floating rate  
loans include  
adjustable rate  
mortgages.

(8) Line of credit  
amounts are  
based on  
historical cash  
flow assumptions,  
with an average  
life of  
approximately  
5 years.

The preceding table and discussion addressed the liquidity implications of interest rate risk and focused on expected contractual cash flows from financial instruments. Expected maturities, however, do not necessarily estimate the net interest income impact of interest rate changes. Certain financial instruments, such as adjustable rate loans, have repricing periods that differ from expected cash flows. Fair value adjustments related to acquisitions and overdraft deposit balances are not included in the preceding table.

The Corporation uses three complementary methods to measure and manage interest rate risk. They are static gap analysis, simulation of earnings, and estimates of economic value of equity. Using these measurements in tandem provides a reasonably comprehensive summary of the magnitude of interest rate

**Table of Contents**

risk in the Corporation, level of risk as time evolves, and exposure to changes in interest rate relationships. Static gap provides a measurement of repricing risk in the Corporation's balance sheet as of a point in time. This measurement is accomplished through stratification of the Corporation's assets and liabilities into repricing periods. The sum of assets and liabilities in each of these periods are compared for mismatches within that maturity segment. Core deposits having no contractual maturities are placed into repricing periods based upon historical balance performance. Repricing for mortgage loans, mortgage-backed securities and collateralized mortgage obligations includes the effect of expected cash flows. Estimated prepayment effects are applied to these balances based upon industry projections for prepayment speeds. The Corporation's policy limits the cumulative six-month gap to plus or minus 15% of total rate sensitive earning assets. The cumulative six-month gap as of March 31, 2007 was a negative 0.9% and the cumulative six-month ratio of rate sensitive assets to rate sensitive liabilities (RSA/RSL) was 0.98. Simulation of net interest income and net income is performed for the next twelve-month period. A variety of interest rate scenarios are used to measure the effects of sudden and gradual movements upward and downward in the yield curve. These results are compared to the results obtained in a flat or unchanged interest rate scenario. Simulation of earnings is used primarily to measure the Corporation's short-term earnings exposure to rate movements. The Corporation's policy limits the potential exposure of net interest income to 10% of the base case net interest income for a 100 basis point shock in interest rates, 15% for a 200 basis point shock and 20% for a 300 basis point shock. A shock is an immediate upward or downward movement of interest rates across the yield curve based upon changes in the prime rate. The shocks do not take into account changes in customer behavior that could result in changes to mix and/or volumes in the balance sheet nor do they account for competitive pricing over the forward 12-month period. The following table summarizes the expected impact of interest rate shocks on net interest income:

| <b>Rate Shock</b> | <b>Annual<br/>change<br/>in net<br/>interest<br/>income</b> | <b>% Change</b> |
|-------------------|---|-----------------|
| + 300 bp          | + \$28.4<br>million   | + 5.8%          |
| + 200 bp          | + \$19.0<br>million   | + 3.9%          |
| + 100 bp          | + \$9.6<br>million  | + 2.0%          |
| - 100 bp          | - \$11.7<br>million   | - 2.4%          |
| - 200 bp          | - \$25.9<br>million   | - 5.3%          |
| - 300 bp          | - \$40.0<br>million   | - 8.2%          |

Economic value of equity estimates the discounted present value of asset cash flows and liability cash flows. Discount rates are based upon market prices for like assets and liabilities. Upward and downward shocks of interest rates are used to determine the comparative effect of such interest rate movements relative to the unchanged environment. This measurement tool is used primarily to evaluate the longer-term re-pricing risks and options in the Corporation's balance sheet. A policy limit of 10% of economic equity may be at risk for every 100 basis point shock movement in interest rates. As of March 31, 2007, the Corporation was within policy limits for every basis point shock movement in interest rates.

**Table of Contents**

**Item 4. Controls and Procedures**

The Corporation carried out an evaluation, under the supervision and with the participation of the Corporation's management, including the Corporation's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, the Corporation's Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this quarterly report, the Corporation's disclosure controls and procedures are effective. Disclosure controls and procedures are controls and procedures that are designed to ensure that information required to be disclosed in Corporation reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. There have been no changes in our internal control over financial reporting during the fiscal quarter covered by this quarterly report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents**

**PART II OTHER INFORMATION**

**Item 1. Legal Proceedings**

Not applicable.

**Item 1A. Risk Factors**

Information responsive to this item as of December 31, 2006 appears under the heading, "Risk Factors" within the Corporation's Form 10-K for the year ended December 31, 2006, except for the following risk factor, which has been updated.

***Changes in economic conditions and the composition of the Corporation's loan portfolio could lead to higher loan charge-offs or an increase in the Corporation's provision for loan losses and may reduce the Corporation's net income.***

Changes in national and regional economic conditions could impact the loan portfolios of the Corporation's subsidiary banks. For example, an increase in unemployment, a decrease in real estate values or increases in interest rates, as well as other factors, could weaken the economies of the communities the Corporation serves. Weakness in the market areas served by the Corporation's subsidiary banks could depress its earnings and consequently its financial condition because:

customers may not want or need the Corporation's products or services;

borrowers may not be able to repay their loans;

the value of the collateral securing the Corporation's loans to borrowers may decline; and

the quality of the Corporation's loan portfolio may decline.

Any of the latter three scenarios could require the Corporation to charge-off a higher percentage of its loans and/or increase its provision for loan losses, which would reduce its net income.

The second and third scenarios could also result in potential repurchase liability to the Corporation on residential mortgage loans originated and sold into the secondary market. Except for The Columbia Bank, the Corporation's bank subsidiaries originate mortgages through mortgage divisions. One subsidiary in particular, Resource Bank, originates a variety of residential products through its Resource Mortgage Division to meet customer demand. These products include conventional residential mortgages that meet published guidelines of Fannie Mae and Freddie Mac for sale into the secondary market, which are generally considered prime loans, and loans that deviate from those guidelines. This latter category of loans includes loans with higher loan to value ratios, loans with no or limited verification of a borrower's income or net worth stated on the loan application, and loans to borrowers with lower credit ratings, referred to as FICO scores. The general market for these alternative loan products across the country has declined as a result of moderating real estate prices, increased payment defaults by borrowers and increased loan foreclosures. In particular, Resource Bank has recently experienced an increase in requests from investors for Resource Bank to repurchase loans sold to those investors due to claimed loan payment defaults in one particular loan product. This resulted in the Corporation recording a \$5.5 million contingent loss during the first quarter of 2007. This charge reflects losses that may be incurred due to potential repurchases of residential mortgage loans and home equity loans originated and sold in the secondary market. The Corporation cannot be assured that additional payment defaults and related repurchase requests with respect to loans originated and sold by Resource Bank will not continue, which may result in additional related charges, which would adversely affect the Corporation's net income.

In addition, the amount of the Corporation's provision for loan losses and the percentage of loans it is required to charge-off may be impacted by the overall risk composition of the loan portfolio. In recent years, the amount of the Corporation's commercial loans (including agricultural loans) and commercial mortgages has increased, comprising a greater percentage of its overall loan portfolio. These loans are inherently more

**Table of Contents**

risky than certain other types of loans, such as residential mortgage loans. While the Corporation believes that its allowance for loan losses as of March 31, 2007 is sufficient to cover losses inherent in the loan portfolio on that date, the Corporation may be required to increase its loan loss provision or charge-off a higher percentage of loans due to changes in the risk characteristics of the loan portfolio, thereby reducing its net income. To the extent any of the Corporation's subsidiary banks rely more heavily on loans secured by real estate, a decrease in real estate values could cause higher loan losses and require higher loan loss provisions.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

| Period                | Total<br>number of<br>shares<br>purchased | Average<br>price<br>paid per<br>share | Total number<br>of<br>shares<br>purchased<br>as part of a<br>publicly<br>announced<br>plan<br>or program | Maximum<br>number of<br>shares<br>that may yet<br>be<br>purchased<br>under<br>the plan or<br>program |
|-----------------------|---|---------------------------------------|--|--|
| (01/01/07 - 01/31/07) | 521,000                                   | \$ 15.83                              | 521,000  | 517,490  |
| (02/01/07 - 02/28/07) | 424,000                                   | \$ 15.79                              | 424,000  | 93,490   |
| (03/01/07 - 03/31/07) | 93,490                                    | \$ 15.37                              | 93,490   |  |

On March 21, 2006, a stock repurchase plan was approved by the Board of Directors to repurchase up to 2.1 million shares through December 31, 2006. On December 19, 2006 the Board of Directors extended the stock repurchase plan through June 30, 2007. As of March 31, 2007, 2.1 million shares were repurchased under this plan. No stock repurchases were made outside the plan and all were made under the guidelines of Rule 10b-18 and in compliance with Regulation M.

**Item 3. Defaults Upon Senior Securities and Use of Proceeds**

Not applicable.

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

Not applicable.

**Item 5. Other Information**

Not applicable.

**Item 6. Exhibits**

See Exhibit Index for a list of the exhibits required by Item 601 of Regulation S-K and filed as part of this report.

**Table of Contents**

**FULTON FINANCIAL CORPORATION AND SUBSIDIARIES  
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.

FULTON FINANCIAL CORPORATION

Date: May 10, 2007

/s/ R. Scott Smith, Jr.  
R. Scott Smith, Jr.  
Chairman, Chief Executive Officer and  
President

Date: May 10, 2007

/s/ Charles J. Nugent  
Charles J. Nugent  
Senior Executive Vice President and  
Chief Financial Officer  
33

---

**Table of Contents**

**EXHIBIT INDEX**  
**Exhibits Required Pursuant**  
**to Item 601 of Regulation S-K**

- 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 Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

34