COMMUNITY TRUST BANCORP INC /KY/
Form 10-Q
May 09, 2006

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**SECURITIES AND EXCHANGE COMMISSION**
WASHINGTON, D.C. 20549

**FORM 10-Q**

| | |
|---|---|
| [X] | QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 |
| | For the quarterly period ended March 31, 2006 |
| | |
| | Or |
| | |
| [ ] | TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 |
| | For the transition period from _____________ to _____________ |

**Commission file number 0-11129**

**COMMUNITY TRUST BANCORP, INC.**
*(Exact name of registrant as specified in its charter)*

| | |
|---|---|
| **Kentucky** | **61-0979818** |
| *(State or other jurisdiction of incorporation or organization)* | *IRS Employer Identification No.* |
| | |
| **346 North Mayo Trail**<br>**Pikeville, Kentucky**<br>*(address of principal executive offices)* | **41501**<br>*(Zip Code)* |

**(606) 432-1414**
*(Registrant's telephone number)*

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 ü | 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.

| | | |
|---|---|---|
| Large accelerated filer | Accelerated filer ü | 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 ü |
|---|---|

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practical date.

Common stock - 15,030,043 shares outstanding at April 30, 2006

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## PART I - FINANCIAL INFORMATION

### Item 1. Condensed Consolidated Financial Statements

The accompanying information has not been audited by independent registered public accountants; however, in the opinion of management such information reflects all adjustments necessary for a fair presentation of the results for the interim period. All such adjustments are of a normal and recurring nature.

The accompanying condensed consolidated financial statements are presented in accordance with the requirements of Form 10-Q and consequently do not include all of the disclosures normally required by accounting principles generally accepted in the United States of America or those normally made in the Registrant's annual report on Form 10-K. Accordingly, the reader of the Form 10-Q should refer to the Registrant's Form 10-K for the year ended December 31, 2005 for further information in this regard.

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**Community Trust Bancorp, Inc.**
**Condensed Consolidated Balance Sheets**
*(unaudited)*

| *(dollars in thousands)* | March 31 2006 | December 31 2005 |
|---|---|---|
| **Assets:** | | |
| Cash and due from banks | $ 84,977 | $ 91,066 |
| Federal funds sold | 75,293 | 31,145 |
| Securities available-for-sale at fair value (amortized cost of $491,688 and $402,241, respectively) | 484,323 | 395,572 |
| Securities held-to-maturity at amortized cost (fair value of $44,531 and $46,528, respectively) | 46,690 | 48,444 |
| Loans held for sale | 1,367 | 135 |
| | | |
| Loans | 2,101,236 | 2,107,344 |
| Allowance for loan losses | (28,124) | (29,506) |
| Net loans | 2,073,112 | 2,077,838 |
| | | |
| Premises and equipment, net | 57,695 | 57,966 |
| Goodwill | 63,523 | 63,523 |
| Core deposit intangible (net of accumulated amortization of $4,477 and $4,319, respectively) | 3,027 | 3,186 |
| Federal Reserve Bank and Federal Home Loan Bank stock | 26,999 | 26,682 |
| Other assets | 50,787 | 53,656 |
| **Total assets** | 2,967,793 | 2,849,213 |
| | | |
| **Liabilities and shareholders' equity:** | | |
| Deposits | | |
| Noninterest bearing | 463,169 | 445,929 |
| Interest bearing | 1,846,622 | 1,800,622 |
| Total deposits | 2,309,791 | 2,246,551 |
| | | |
| Repurchase agreements | 161,538 | 129,156 |
| Federal funds purchased and other short-term borrowings | 32,020 | 17,485 |
| Advances from Federal Home Loan Bank | 122,690 | 122,835 |
| Long-term debt | 59,500 | 59,500 |
| Other liabilities | 22,422 | 19,741 |
| **Total liabilities** | 2,707,961 | 2,595,268 |
| | | |
| **Shareholders' equity:** | | |
| Preferred stock, 300,000 shares authorized and unissued | | |
| Common stock, $5 par value, shares authorized 25,000,000; | | |
| Shares outstanding 2006 - 15,015,208; 2005 - 14,997,369 | 75,076 | 74,987 |
| Capital surplus | 148,009 | 147,626 |
| Retained earnings | 41,533 | 35,667 |
| Accumulated other comprehensive loss, net of tax | (4,786) | (4,335) |
| **Total shareholders' equity** | 259,832 | 253,945 |
| | | |
| **Total liabilities and shareholders' equity** | $ 2,967,793 | $ 2,849,213 |

See notes to condensed consolidated financial statements.

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**Community Trust Bancorp, Inc.**
**Condensed Consolidated Statements of Income and Other Comprehensive Income**
*(unaudited)*

| | Three Months Ended March 31 | |
|---|---|---|
| *(in thousands except per share data)* | **2006** | **2005** |
| **Interest income:** | | |
| Interest and fees on loans, including loans held for sale | $ 38,083 | $ 30,467 |
| Interest and dividends on securities | | |
| Taxable | 4,440 | 4,757 |
| Tax exempt | 520 | 537 |
| Other, including interest on federal funds sold | 924 | 442 |
| **Total interest income** | 43,967 | 36,203 |
| **Interest expense:** | | |
| Interest on deposits | 13,830 | 8,946 |
| Interest on repurchase agreements and other short-term borrowings | 1,846 | 619 |
| Interest on advances from Federal Home Loan Bank | 1,001 | 1,240 |
| Interest on long-term debt | 1,314 | 1,314 |
| **Total interest expense** | 17,991 | 12,119 |
| **Net interest income** | 25,976 | 24,084 |
| Provision for loan losses | 0 | 1,367 |
| **Net interest income after provision for loan losses** | 25,976 | 22,717 |
| **Noninterest income:** | | |
| Service charges on deposit accounts | 4,552 | 4,047 |
| Gains on sales of loans, net | 304 | 305 |
| Trust income | 881 | 740 |
| Other | 2,387 | 2,908 |
| **Total noninterest income** | 8,124 | 8,000 |
| **Noninterest expense:** | | |
| Salaries and employee benefits | 10,965 | 10,261 |
| Occupancy, net | 1,772 | 1,541 |
| Equipment | 1,214 | 998 |
| Data processing | 921 | 1,140 |
| Legal and professional fees | 627 | 834 |
| Stationery, printing, and office supplies | 281 | 373 |
| Taxes other than payroll, property, and income | 829 | 787 |
| FDIC insurance | 72 | 72 |
| Other | 3,396 | 3,201 |
| **Total noninterest expense** | 20,077 | 19,207 |
| **Income before income taxes** | 14,023 | 11,510 |
| Income taxes | 4,255 | 3,549 |
| **Net income** | 9,768 | 7,961 |

| | | | | |
|---|---|---|---|---|
| Other comprehensive income, net of tax: | | | | |
| Unrealized holding losses on securities available-for-sale | | (451) | | (2,929) |
| **Comprehensive income** | $ | 9,317 | $ | 5,032 |
| | | | | |
| Basic earnings per share | $ | 0.65 | $ | 0.54 |
| Diluted earnings per share | | 0.64 | | 0.53 |
| | | | | |
| Weighted average shares outstanding-basic | | 15,011 | | 14,857 |
| Weighted average shares outstanding-diluted | | 15,252 | | 15,148 |

See notes to condensed consolidated financial statements.

**Community Trust Bancorp, Inc.**
**Condensed Consolidated Statements of Cash Flows**
*(unaudited)*

| | Three months ended March 31 | |
|---|---|---|
| *(in thousands)* | **2006** | **2005** |
| **Cash flows from operating activities:** | | |
| Net income | $ 9,768 | $ 7,961 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 1,446 | 1,213 |
| Provision for loan and other real estate losses | 24 | 1,367 |
| Gains on sale of mortgage loans held for sale | (304) | (305) |
| Gains (losses) on sale of assets, net | (30) | (6) |
| Proceeds from sale of mortgage loans held for sale | 14,991 | 12,817 |
| Funding of mortgage loans held for sale | (15,919) | (12,512) |
| Amortization of securities premiums, net | 299 | 376 |
| Changes in: | | |
| Other liabilities | 2,681 | 2,606 |
| Other assets | 2,335 | 871 |
| **Net cash provided by operating activities** | 15,291 | 14,388 |
| | | |
| **Cash flows from investing activities:** | | |
| Securities available-for-sale: | | |
| Proceeds from sales | 10,000 | 1,800 |
| Proceeds from prepayments and maturities | 16,248 | 19,456 |
| Purchase of securities | (115,955) | (11,232) |
| Securities held-to-maturity: | | |
| Proceeds from prepayments and maturities | 1,715 | 2,849 |
| Change in loans, net | 4,377 | (36,320) |
| Purchase of premises, equipment, and other real estate | (1,016) | (531) |
| Proceeds from sale of premises and equipment | 2 | 21 |
| Proceeds from sale of other real estate and other repossessed assets | 848 | 539 |
| Additions in other real estate owned | (33) | (153) |
| **Net cash used in investing activities** | (83,814) | (23,571) |
| | | |
| **Cash flows from financing activities:** | | |
| Change in deposits, net | 63,240 | 25,438 |
| Change in repurchase agreements and other short-term borrowings, net | 46,917 | 27,118 |
| Payments on advances from Federal Home Loan Bank | (145) | (136) |
| Issuance of common stock | 440 | 437 |
| Excess tax benefits from stock-based compensation | 33 | 0 |
| Dividends paid | (3,903) | (3,566) |
| **Net cash provided by financing activities** | 106,582 | 49,291 |
| Net increase in cash and cash equivalents | 38,059 | 40,108 |
| Cash and cash equivalents at beginning of year | 122,211 | 129,580 |
| **Cash and cash equivalents at end of period** | $ 160,270 | $ 169,688 |

See notes to condensed consolidated financial statements.

**Community Trust Bancorp, Inc.**
**Notes to Condensed Consolidated Financial Statements**

**Note 1 - Summary of Significant Accounting Policies**

In the opinion of management, the unaudited condensed consolidated financial statements include all adjustments (which consist of normal recurring accruals) necessary, to present fairly the condensed consolidated financial position as of March 31, 2006, the results of operations for the three months ended March 31, 2006 and 2005, and the cash flows for the three months ended March 31, 2006 and 2005. In accordance with accounting principles generally accepted in the United States of America for interim financial information, these statements do not include certain information and footnote disclosures required by accounting principles generally accepted in the United States of America for complete annual financial statements. Financial information as of December 31, 2005 has been derived from the audited consolidated financial statements of Community Trust Bancorp, Inc. (the "Corporation"). The results of operations for the three months ended March 31, 2006 and 2005 and the cash flows for the three months ended March 31, 2006 and 2005 are not necessarily indicative of the results to be expected for the full year. For further information, refer to the consolidated financial statements and footnotes thereto for the year ended December 31, 2005, included in the Corporation's Annual Report on Form 10-K.

Principles of Consolidation - The unaudited condensed consolidated financial statements include the accounts of the Corporation and its separate and distinct, wholly owned subsidiaries Community Trust Bank, Inc. (the "Bank") and Community Trust and Investment Company. All significant intercompany transactions have been eliminated in consolidation.

Ø **Stock-Based Employee Compensation** - In December 2004, Statement of Financial Accounting Standards ("SFAS") No. 123R, *Share-Based Payment*, was issued. SFAS No. 123R is a revision of SFAS No. 123, *Accounting for Stock-Based Compensation*, and supersedes Accounting Principles Board ("APB") Opinion No. 25, *Accounting for Stock Issued to Employees*. SFAS No. 123R requires the cost resulting from all share-based payment transactions be recognized in the financial statements, and establishes fair value as the measurement objective in accounting for share-based payment arrangements. In March 2005, the Securities and Exchange Commission issued Staff Accounting Bulletin Number 107 that provided additional guidance to public companies relating to share-based payment transactions and the implementation of SFAS 123R. On January 1, 2006, the Corporation adopted SFAS No. 123R using the "modified prospective" method. As further discussed under Note 2 - Stock-Based Compensation, the adoption of SFAS 123R resulted in $161 thousand of compensation expense for the three months ended March 31, 2006.

Ø **Accounting for Conditional Asset Retirement Obligations -** In March 2005, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations* ("FIN 47"), to clarify the term "conditional asset retirement" as used in SFAS 143, *Accounting for Asset Retirement Obligations*. FIN 47 requires that a liability be recognized for the fair value of a conditional asset retirement obligation when incurred, if the fair value of the liability can be reasonably estimated. Uncertainty about the timing or method of settlement of a conditional asset retirement obligation would be factored into the measurement of the liability when sufficient information exists. This interpretation is effective no later than the end of fiscal years ending after December 15, 2005. Accordingly, the Corporation will adopt FIN 47 no later than the fourth fiscal quarter in 2006. Management is currently assessing the impact FIN 47 may have on the Corporation's consolidated balance sheet; however, the adoption of FIN 47 is not expected to have a material impact on the Corporation's financial position, results of operations, or cash flows.

Ø **Accounting for Servicing of Financial Assets -** In March 2006, SFAS No. 156, *Accounting for Servicing of Financial Assets*, was issued. SFAS No. 156 amends SFAS No. 140, *Accounting Transfers and Servicing of Financial*

*Assets and Extinguishment of Liabilities*, with respect to the accounting for separately recognized servicing assets and servicing liabilities. SFAS No. 156 (1) requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset; (2) requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value; (3) if practicable, permits an entity to choose either the amortization or fair value method following subsequent measurement methods for each class of separately recognized servicing assets and servicing liabilities; (4) and at its initial adoption, permits a one-time reclassification of available-for-sale securities to trading securities by entities with recognized servicing rights, without calling into question the treatment of other available-for-sale securities under SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, provided that the available-for-sale securities are identified in some manner as offsetting the entity's exposure to changes in fair value of servicing assets or servicing liabilities that a servicer elects to subsequently measure at fair value. SFAS No. 156 requires separate presentation of servicing assets and servicing liabilities subsequently measured at fair value in the statement of financial position and additional disclosures for all separately recognized servicing assets and servicing liabilities. SFAS No. 156 is effective as of the first of the fiscal year beginning after September 15, 2006. The adoption of this statement is not expected to have a material effect on the Corporation's consolidated financial statements.

**Note 2 - Stock-Based Compensation**

On January 1, 2006, the Corporation adopted SFAS No. 123R which requires that companies measure and recognize compensation expense at an amount equal to the fair value of share-based payments granted under compensation arrangements. Prior to January 1, 2006, the Corporation accounted for its stock-based compensation plans under the recognition and measurement principles of APB Opinion 25 and related interpretations, and no compensation expense was recognized for stock option grants since all options granted had an exercise price equal to the market value of the underlying common stock on the date of grant.

The Corporation adopted SFAS 123R using the “modified prospective” method, which results in no restatement of prior period amounts. Under this method, the provisions of SFAS 123R apply to all awards granted or modified after the date of adoption. In addition, compensation expense must be recognized for any unvested stock option awards outstanding as of the date of adoption over the remaining vesting period. The Corporation calculates the fair value of options using a Black-Scholes option pricing model. For the three months ended March 31, 2006, the Corporation’s compensation expense related to stock option grants was $161 thousand ($95 thousand after tax and $0.01 per basic and diluted share) and as of March 31, 2006, there was a total of $2.0 million of unrecognized compensation expense related to unvested stock option awards that will be recognized as expense as the awards vest over a weighted average period of 1.57 years. SFAS 123R also requires the benefits of tax deductions in excess of recognized compensation expense to be reported in the Statement of Cash Flows as a financing cash inflow rather than an operating cash inflow. In addition, SFAS 123R required a modification to the Corporation’s calculation of the dilutive effect of stock option awards on earnings per share. For companies that adopt SFAS 123R using the “modified prospective” method, disclosure of pro forma information for periods prior to adoption must continue to be made. The following table sets forth the effect of the change from applying the Corporation's previous method of accounting for share-based payment arrangements with employees:

| *(in thousands except per share data)* | **Current Method** | **Previous Method** |
| --- | --- | --- |
| Income from continuing operations | $ 14,023 | $ 14,184 |
| Income before income taxes | 14,023 | 14,184 |
| Net income | 9,768 | 9,863 |
| Cash flow from operations | 15,291 | 15,324 |

| | | |
|---|---|---|
| Cash flow from financing activities | 106,582 | 106,549 |
| | | |
| Basic earnings per share | 0.65 | 0.64 |
| | | |
| Diluted earnings per share | 0.64 | 0.63 |

The following table sets forth the pro forma effect on net income and earnings per share as if the fair value method had been applied to the three month period ended March 31, 2005:

| *(in thousands except per share data)* | | **Three Months Ended March 31 2005** |
|---|---|---|
| Net income, as reported | $ | 7,961 |
| Less: Total stock-based employee compensation expense determined under a fair value based method for all awards, net of related income tax effect | | (216) |
| Pro forma net income | $ | 7,745 |
| | | |
| Earnings per share: | | |
| Basic - as reported | $ | 0.54 |
| Basic - pro forma | | 0.52 |
| Diluted - as reported | | 0.53 |
| Diluted - pro forma | | 0.51 |

The fair value of options granted during the three months ended March 31, 2006 and 2005 was established at the date of grant using a Black-Scholes option pricing model with the weighted average assumptions as follows:

| | **Three Months Ended March 31** | | | |
|---|---|---|---|---|
| | | **2006** | | **2005** |
| Expected dividend yield | | 3.21% | | 3.11% |
| Risk-free interest rate | | 4.53% | | 3.92% |
| Expected volatility | | 36.39% | | 37.66% |
| Expected term (in years) | | 7.5 | | 6.5 |
| Weighted average fair value of options | $ | 10.51 | $ | 9.72 |

For stock options granted in 2006, the Corporation has elected to apply the simplified method for “plain vanilla” options to determine the expected term, as provided by the Securities and Exchange Commission’s Staff Accounting Bulletin Number 107.

**Note 3 - Securities**

Securities are classified into held-to-maturity and available-for-sale categories. Held-to-maturity securities are those that the Corporation has the positive intent and ability to hold to maturity and are reported at amortized cost. Available-for-sale securities are those that the Corporation may decide to sell if needed for liquidity, asset-liability management or other reasons. Available-for-sale securities are reported at fair value, with unrealized gains or losses included as a separate component of equity, net of tax.

The amortized cost and fair value of securities at March 31, 2006 are summarized as follows:

**Available-for-Sale**

| *(in thousands)* | Amortized Cost | Fair Value |
|---|---|---|
| U.S. Treasury and Government agencies | $ 2,005 | $ 2,005 |
| State and political subdivisions | 45,381 | 46,220 |
| U.S. agency mortgage-backed pass through certificates | 281,846 | 274,291 |
| Collateralized mortgage obligations | 1,002 | 1,007 |
| Total debt securities | 330,234 | 323,523 |
| Marketable equity securities | 161,454 | 160,800 |
| **Total available-for-sale securities** | $ 491,688 | $ 484,323 |

**Held-to-Maturity**

| *(in thousands)* | Amortized Cost | Fair Value |
|---|---|---|
| State and political subdivisions | $ 3,134 | $ 2,839 |
| U.S. agency mortgage-backed pass through certificates | 43,556 | 41,692 |
| **Total held-to-maturity securities** | $ 46,690 | $ 44,531 |

The amortized cost and fair value of securities as of December 31, 2005 are summarized as follows:

**Available-for-Sale**

| *(in thousands)* | Amortized Cost | Fair Value |
|---|---|---|
| U.S. Treasury and Government agencies | $ 2,005 | $ 2,005 |
| State and political subdivisions | 45,911 | 46,932 |
| U.S. agency mortgage-backed pass through certificates | 295,822 | 288,631 |
| Collateralized mortgage obligations | 1,003 | 1,012 |
| Other debt securities | 17,500 | 16,992 |
| Total debt securities | 362,241 | 355,572 |
| Marketable equity securities | 40,000 | 40,000 |
| **Total available-for-sale securities** | $ 402,241 | $ 395,572 |

**Held-to-Maturity**

| *(in thousands)* | Amortized Cost | Fair Value |
|---|---|---|
| State and political subdivisions | $ 3,134 | $ 2,982 |
| U.S. agency mortgage-backed pass through certificates | 45,310 | 43,546 |
| **Total held-to-maturity securities** | $ 48,444 | $ 46,528 |

**Note 4 - Loans**

Major classifications of loans are summarized as follows:

| *(in thousands)* | March 31 2006 | December 31 2005 |
|---|---|---|
| Commercial construction | $ 119,776 | $ 115,721 |
| Commercial secured by real estate | 661,520 | 665,911 |

| | | |
|---|---|---|
| Commercial other | 298,679 | 301,828 |
| Real estate construction | 50,454 | 51,232 |
| Real estate mortgage | 545,343 | 542,809 |
| Consumer | 411,263 | 414,920 |
| Equipment lease financing | 14,201 | 14,923 |
| **Total loans** | $ 2,101,236 | $ 2,107,344 |

**Note 5 - Borrowings**

Short-term debt consists of the following:

| *(in thousands)* | **March 31 2006** | **December 31 2005** |
|---|---|---|
| Subsidiaries: | | |
| Repurchase agreements | $ 161,538 | $ 129,156 |
| Federal funds purchased | 32,020 | 17,485 |
| **Total short-term debt** | $ 193,558 | $ 146,641 |

On April 28, 2006, the Corporation entered into a revolving note agreement for a line of credit in the amount of $12 million, all of which is currently available to meet any future cash needs. The agreement will mature on April 28, 2007.

All federal funds purchased and the majority of repurchase agreements mature and reprice daily. The average rates paid for federal funds purchased and repurchase agreements on March 31, 2006 were 4.51% and 4.55%, respectively.

Federal Home Loan Bank advances consisted of the following monthly amortizing and term borrowings:

| *(in thousands)* | **March 31 2006** | **December 31 2005** |
|---|---|---|
| Monthly amortizing | $ 1,690 | $ 1,835 |
| Term | 121,000 | 121,000 |
| | $ 122,690 | $ 122,835 |

The advances from the Federal Home Loan Bank that require monthly principal payments were due for repayment as follows:

| | Principal Payments Due by Period at March 31, 2006 | | | | |
|---|---|---|---|---|---|
| *(in thousands)* | **Total** | **Within 1 Year** | **1-5 Years** | **5-10 Years** | **After 10 Years** |
| Outstanding advances, weighted average interest rate - 4.96% | $ 1,690 | $ 584 | $ 1,054 | $ 35 | $ 17 |

The term advances that require the total payment to be made at maturity follow:

| *(in thousands)* | **March 31 2006** | **December 31 2005** |
|---|---|---|
| Advance #144, 2.88%, due 8/30/06 | $ 40,000 | $ 40,000 |
| Advance #145, 3.31%, due 8/30/07 | 40,000 | 40,000 |
| Advance #146, 3.70%, due 8/30/08 | 40,000 | 40,000 |

| | | | | |
|---|---|---|---|---|
| Advance #148, 1.76%, due 6/6/13 | | 1,000 | | 1,000 |
| | $ | 121,000 | $ | 121,000 |

The advances are collateralized by Federal Home Loan Bank stock of $22.7 million and certain first mortgage loans totaling $165.6 million as of March 31, 2006. Advances totaling $122.7 million at March 31, 2006 had fixed interest rates ranging from 1.00% to 7.05% with a weighted average rate of 3.31%.

Long-term debt consists of the following:

| *(in thousands)* | | **March 31 2006** | | **December 31 2005** |
|---|---|---|---|---|
| Junior subordinated debentures, 9.00%, due 3/31/27 | $ | 34,500 | $ | 34,500 |
| Junior subordinated debentures, 8.25%, due 3/31/32 | | 25,000 | | 25,000 |
| **Total long-term debt** | $ | 59,500 | $ | 59,500 |

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

### Overview

Community Trust Bancorp, Inc. (the “Corporation”) is a bank holding company headquartered in Pikeville, Kentucky. At March 31, 2006, the Corporation owned one commercial bank and one trust company. Through its subsidiaries, the Corporation has eighty-one banking locations in eastern, northeast, central, and south central Kentucky and southern West Virginia, two loan production offices in Kentucky, and five trust offices across Kentucky. The banking locations are segmented into nineteen markets within four regions. The Corporation had total assets of $3.0 billion and total shareholders’ equity of $259.8 million as of March 31, 2006. The Corporation’s common stock is listed on NASDAQ under the symbol CTBI. Current market participants are FTN Midwest Research Securities Corp., Cleveland, Ohio; Goldman, Sachs & Co., New York, New York; Howe Barnes Investments, Inc., Chicago, Illinois; J.J.B. Hilliard, W.L. Lyons, Inc., Louisville, Kentucky; Keefe, Bruyette & Woods, Inc., New York, New York; Merrill Lynch, Pierce, Fenner & Smith Incorporated, New York, New York; Monroe Securities, Inc., Chicago, Illinois; Morgan Stanley & Co., Incorporated, New York, New York; and Sandler O'Neill & Partners, New York, New York.

### Critical Accounting Policies and Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires the appropriate application of certain accounting policies, many of which require us to make estimates and assumptions about future events and their impact on amounts reported in our consolidated financial statements and related notes. Since future events and their impact cannot be determined with certainty, the actual results will inevitably differ from our estimates. Such differences could be material to the consolidated financial statements.

We believe the application of accounting policies and the estimates required therein are reasonable. These accounting policies and estimates are constantly reevaluated, and adjustments are made when facts and circumstances dictate a change. Historically, we have found our application of accounting policies to be appropriate, and actual results have not differed materially from those determined using necessary estimates.

Our accounting policies are more fully described in the consolidated financial statements and footnotes thereto for the year ended December 31, 2005, included in the Corporation's Annual Report on Form 10-K. We have identified the following critical accounting policies:

**Loans -** Loans are reported at the carrying value of unpaid principal reduced by unearned interest and an allowance for loan losses. Income is recorded on the level yield basis. Interest accrual is discontinued when management believes, after considering economic and business conditions, collateral value, and collection efforts, that the borrower's financial condition is such that collection of interest is doubtful. Any loan greater than 90 days past due must be well secured and in the process of collection to continue accruing interest. Cash payments received on nonaccrual loans generally are applied against principal, and interest income is only recorded once principal recovery is reasonably assured. Loans are not reclassified as accruing until principal and interest payments are brought current and future payments appear reasonably certain.

**Allowance for Loan Losses -** The adequacy of the allowance is reviewed quarterly by management using a methodology that includes several key factors. The Corporation utilizes an internal risk grading system for commercial credits, and those larger commercial credits identified through this grading system as having weaknesses are individually reviewed for the customer's ability and potential to repay their loans. The customer's cash flow, adequacy of collateral held for the loan, and other options available to the Corporation including legal avenues are all evaluated. Based upon this individual credit evaluation, a specific allocation to the allowance may be made for the loan.

For other commercial loans that are not individually evaluated, an allowance allocation is determined by applying an eight-quarter moving average historical loss rate for this group of loans. Consumer installment and residential mortgage loans are not individually risk graded. Allowance allocations are provided for these pools of loans based upon an eight-quarter moving average historical loss rate for each of these categories of loans.

An unallocated portion of the allowance is also determined in recognition of the inherent inability to precisely determine the loss potential in any particular loan or pool of loans. The factors considered by management in determining this amount of inherent risk include delinquency trends, current economic conditions and trends, strength of the supervision and administration of the loan portfolio, level of nonperforming loans, trend in loan losses, recovery rates associated with previously charged-off loans, concentrations within commercial credits, problem loan identification strengths and weaknesses, collateral evaluation strengths and weaknesses, and the level of financial statement exceptions. These factors are reviewed quarterly and weighted as deemed appropriate by management. The total of these weighted factors is then applied against the total loan portfolio and the allowance is adjusted accordingly.

**Investments -** Management determines the classification of securities at purchase. In accordance with Statement of Financial Accounting Standards ("SFAS") No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, the Corporation classifies securities into held-to-maturity or available-for-sale categories. Held-to-maturity securities are those which the Corporation has the positive intent and ability to hold to maturity and are reported at amortized cost. Available-for-sale securities are those the Corporation may decide to sell if needed for liquidity, asset/liability management, or other reasons. Available-for-sale securities are reported at fair value, with unrealized gains and losses included as a separate component of shareholders' equity, net of tax. If declines in fair value are not temporary, the carrying value of the securities is written down to fair value as a realized loss.

Gains or losses on disposition of securities are computed by specific identification for all securities except for shares in mutual funds, which are computed by average cost. Interest and dividend income, adjusted by amortization of purchase premium or discount, is included in earnings.

**Loans Held for Sale -** Mortgage loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated market value in the aggregate. Net unrealized losses, if any, are recognized in a valuation allowance by charges to income.

**Goodwill -** The Corporation evaluates total goodwill for impairment, based upon SFAS No. 142, *Goodwill and Other Intangible Assets* and SFAS No. 147, *Acquisitions of Certain Financial Institutions*, using fair value techniques including multiples of price/equity. Goodwill is evaluated for impairment on an annual basis.

**Segments -** Management analyzes the operation of the Corporation assuming one operating segment, community banking services. The Corporation, through its operating subsidiaries, offers a wide range of consumer and commercial community banking services. These services include: (i) residential and commercial real estate loans; (ii) checking accounts; (iii) regular and term savings accounts and savings certificates; (iv) full service securities brokerage services; (v) consumer loans; (vi) debit cards; (vii) annuity and life insurance products; (viii) Individual Retirement Accounts and Keogh plans; (ix) commercial loans; (x) trust services; and (xi) commercial demand deposit accounts.

**Dividends**

The following schedule shows the quarterly cash dividends paid for the past six quarters:

| Pay Date | Record Date | Amount Per Share |
|---|---|---|
| April 1, 2006 | March 15, 2006 | $0.26 |
| January 1, 2006 | December 15, 2005 | $0.26 |
| October 1, 2005 | September 15, 2005 | $0.24 |
| July 1, 2005 | June 15, 2005 | $0.24 |
| April 1, 2005 | March 15, 2005 | $0.24 |
| January 1, 2005 | December 15, 2004 | $0.24 |

**Statement of Income Review**

The Corporation reported earnings for the first quarter 2006 of $9.8 million or $0.65 per share compared to $8.0 million or $0.54 per share earned during the first quarter of 2005 and $8.9 million or $0.59 per share earned during the fourth quarter of 2005. The Corporation's basic earnings per share for the first quarter 2006 reflects an increase of 20.4% over the first quarter 2005 and 10.2% over the fourth quarter 2005.

The Corporation had basic weighted average shares outstanding of 15.0 million and 14.9 million, respectively, for the three months ended March 31, 2006 and 2005. The following table sets forth on an annualized basis the return on average assets and return on average shareholders’ equity for the three months ended March 31, 2006 and 2005:

| | Three months ended March 31 | |
|---|---|---|
| | **2006** | **2005** |
| Return on average shareholders' equity | 15.27% | 13.50% |
| Return on average assets | 1.36 | 1.18 |

The Corporation's efficiency ratio for the quarter ended March 31, 2006 was 58.21% compared to 59.13% for the quarter ended March 31, 2005 and 55.34% for the quarter ended December 31, 2005.

**Net Interest Income**

The Corporation's net interest margin for the first quarter 2006 of 4.02% was an increase of 5 basis points from the first quarter 2005 but a decrease of 10 basis points from prior quarter. Net interest income for the quarter ended March 31, 2006 was a 7.9% increase from the quarter ended March 31, 2005 but a 2.4% decrease from prior quarter as the 2.0% increase in interest income was offset by a 9.0% increase in interest expense as deposits grew faster than loans and funds were deployed into lower yielding investments.

The following table summarizes the annualized net interest spread and net interest margin for the three months ended March 31, 2006 and 2005.

| | Three months ended March 31 | |
|---|---|---|
| | **2006** | **2005** |
| Yield on interest earning assets | 6.76% | 5.91% |
| Cost of interest bearing funds | 3.34 | 2.36 |
| Net interest spread | 3.42% | 3.55% |
| | | |
| Net interest margin | 4.02% | 3.97% |

***Provision for Loan Losses***

The analysis of the changes in the allowance for loan losses and selected ratios is set forth below:

| | Three months ended March 31 | |
|---|---|---|
| *(in thousands)* | **2006** | **2005** |
| | | |
| Allowance balance at January 1 | $ 29,506 | $ 27,017 |
| Additions to allowance charged against operations | 0 | 1,367 |
| Recoveries credited to allowance | 979 | 1,077 |
| Losses charged against allowance | (2,361) | (1,952) |
| Allowance balance at March 31 | $ 28,124 | $ 27,509 |
| | | |
| Allowance for loan losses to period-end loans | 1.34% | 1.42% |
| Average loans, net of unearned income | $ 2,096,842 | $ 1,920,843 |
| Provision for loan losses to average loans, annualized | 0.00% | 0.29% |
| Loan charge-offs net of recoveries, to average loans, annualized | 0.27% | 0.18% |

Net loan charge-offs for the quarter ended March 31, 2006 were $1.4 million, or 0.3% of average loans annualized, compared to $0.9 million, or 0.2% of average loans annualized, for the quarter ended March 31, 2005 and $2.9 million, or 0.6% of average loans annualized, for the quarter ended December 31, 2005. Our reserve for losses on loans as a percentage of total loans outstanding at March 31, 2006 decreased to 1.34% from the 1.42% at March 31, 2005 and the 1.40% at December 31, 2005. The adequacy of the allowance for loan losses is reviewed quarterly by management using a methodology that includes several key factors. The Corporation utilizes an internal risk grading system for commercial credits, and those larger commercial credits identified through this grading system as having weaknesses are individually reviewed for the customer's ability and potential to repay their loans. The customer’s cash flow, adequacy of collateral held for the loan, and other options available to the Corporation including legal avenues are all evaluated. Based upon this individual credit evaluation, a specific allocation to the allowance may be made for the loan. As a result of this evaluation, management determined that no additional provision expense was required for the quarter ended March 31, 2006.

***Noninterest Income***

Noninterest income for the quarter ended March 31, 2006 increased 1.6% from the quarter ended March 31, 2005 but decreased 9.1% from the quarter ended December 31, 2005. Noninterest income from deposits increased as expected from the first quarter of 2005 and, as expected, was less than the fourth quarter of 2005 due to the seasonality of our Overdraft Honor program. The fair value of mortgage servicing rights increased during the quarter; however, since all

previous temporary write-downs were recaptured in previous quarters, no recapture of prior write-downs was taken during the first quarter 2006. The decrease in loan related fees for the quarter ended March 31, 2006 resulted from reclassifications made relating to Financial Accounting Standard No. 91 ("FAS 91"), *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*. The decrease in loan related fees along with a corresponding decrease in interest income were offset by reductions in certain noninterest expenses relating to FAS 91.

The following table displays the quarterly activity in the various significant noninterest income accounts.

| **Noninterest Income Summary** | | | | | | |
|---|---|---|---|---|---|---|
| *(in thousands)* | | **1Q 2006** | | **4Q 2005** | | **1Q 2005** |
| Deposit related fees | $ | 4,552 | $ | 4,820 | $ | 4,047 |
| Loan related fees | | 624 | | 1,414 | | 1,218 |
| Mortgage servicing rights | | 0 | | 94 | | 226 |
| Trust revenue | | 881 | | 837 | | 740 |
| Gains on sales of loans | | 304 | | 389 | | 305 |
| Other revenue | | 1,763 | | 1,386 | | 1,464 |
| Total noninterest income | $ | 8,124 | $ | 8,940 | $ | 8,000 |

***Noninterest Expense***

Although reclassifications relating to FAS 91 in the first quarter 2006 had a positive impact on certain noninterest expense categories, total noninterest expense for the quarter ended March 31, 2006 of $20.1 million was a 4.5% increase from the $19.2 million for the first quarter 2005 and a 1.0% increase from the fourth quarter 2005. The increase in noninterest expense was primarily attributable to increases in personnel expense associated with annual salary adjustments and staffing of new branches. Personnel expense was also impacted by $161 thousand related to the adoption in the first quarter 2006 of Statement of Financial Accounting Standard No. 123R, Share-Based Payment. Noninterest expense also increased due to expenditures for technology and communication upgrades to the Corporation's core operating systems. Additionally, an unfunded commitment provision expense was booked in March 2006 in the amount of $145 thousand.

**Balance Sheet Review**

The Corporation’s total assets grew 7.3% from March 31, 2005 and 4.2% from December 31, 2005 to $3.0 billion at March 31, 2006. Loans outstanding increased 8.5% from March 31, 2005 but remained relatively stable compared to December 31, 2005 at $2.1 billion at March 31, 2006. The investment portfolio increased 5.8% from March 31, 2005 and 19.6% from December 31, 2005 to $531.0 million at March 31, 2006. Deposits including repurchase agreements increased 8.6% from March 31, 2005 and 4.0% from December 31, 2005 to $2.5 billion at March 31, 2006. The Corporation experienced growth in both noninterest bearing and interest bearing deposits during the first quarter. Total deposit growth, including repurchase agreements, for the quarter was $95.6 million with $17.2 million in noninterest bearing growth and $78.4 million in interest bearing growth.

Shareholders’ equity of $259.8 million on March 31, 2006 was a 9.1% increase from the $238.1 million on March 31, 2005 and an increase of 2.3% from the $253.9 million on December 31, 2005. The Corporation's annualized dividend yield to shareholders as of March 31, 2006 was 3.07%.

***Loans***

The Corporation's loan portfolio grew at a rate of 8.5% from March 31, 2005 but decreased 0.3% from December 31, 2005. Year over year growth included loans from the acquisition of Heritage Bank of Danville. New loan production

was seasonally stable during the first quarter compared to prior quarter; however, payoffs and paydowns of existing loans accelerated.

The following tables summarize the Corporation's nonperforming loans as of March 31, 2006 and December 31, 2005.

| *(in thousands)* | **Nonaccrual loans** | **As a % of Loan Balances by Category** | **Restructured Loans** | **As a % of Loan Balances by Category** | **Accruing Loans Past Due 90 Days or More** | **As a % of Loan Balances by Category** | **Total Loan Balances** |
|---|---|---|---|---|---|---|---|
| **March 31, 2006** | | | | | | | |
| Commercial construction | $ 0 | 0.00% | $ 0 | 0.00% | $ 0 | 0.00% | $ 119,776 |
| Commercial secured by real estate | 3,732 | 0.56 | 654 | 0.10 | 1,861 | 0.28 | 661,520 |
| Commercial other | 3,072 | 1.03 | 79 | 0.03 | 326 | 0.11 | 298,679 |
| Consumer real estate construction | 141 | 0.28 | 0 | 0.00 | 83 | 0.16 | 50,454 |
| Consumer real estate secured | 4,121 | 0.76 | 0 | 0.00 | 1,690 | 0.31 | 545,343 |
| Consumer other | 6 | 0.00 | 0 | 0.00 | 188 | 0.05 | 411,263 |
| Equipment lease financing | 0 | 0.00 | 0 | 0.00 | 0 | 0.00 | 14,201 |
| Total | $ 11,072 | 0.53% | $ 733 | 0.03% | $ 4,148 | 0.20% | $ 2,101,236 |

| *(in thousands)* | **Nonaccrual loans** | **As a % of Loan Balances by Category** | **Restructured Loans** | **As a % of Loan Balances by Category** | **Accruing Loans Past Due 90 Days or More** | **As a % of Loan Balances by Category** | **Total Loan Balances** |
|---|---|---|---|---|---|---|---|
| **December 31, 2005** | | | | | | | |
| Commercial construction | $ 0 | 0.00% | $ 0 | 0.00% | $ 0 | 0.00% | $ 115,721 |
| Commercial secured by real estate | 4,150 | 0.62 | 0 | 0.00 | 4,706 | 0.71 | 665,911 |
| Commercial other | 3,918 | 1.30 | 80 | 0.03 | 858 | 0.28 | 301,828 |
| Consumer real estate construction | 112 | 0.22 | 819 | 1.60 | 172 | 0.34 | 51,232 |
| Consumer real estate secured | 4,032 | 0.74 | 0 | 0.00 | 1,970 | 0.36 | 542,809 |
| Consumer other | 7 | 0.00 | 0 | 0.00 | 578 | 0.14 | 414,920 |
| Equipment lease financing | 0 | 0.00 | 0 | 0.00 | 0 | 0.00 | 14,923 |
| Total | $ 12,219 | 0.58% | $ 899 | 0.04% | $ 8,284 | 0.39% | $ 2,107,344 |

During the first quarter of 2006, the Corporation continued its improvement in asset quality matrices. Nonperforming loans at March 31, 2006 of $16.0 million, or 0.8% of total loans was a 10.9%, or $2.0 million, decrease from March 31, 2005 and a 25.5%, or $5.4 million, decrease from December 31, 2005.

Foreclosed properties at March 31, 2006 were $5.0 million compared to $5.0 million on March 31, 2005 and $5.4 million on December 31, 2005.

*.Allowance for Loan Losses*

The allowance for loan losses balance is maintained by management at a level considered adequate to cover anticipated probable losses based on past loss experience, general economic conditions, information about specific borrower situations including their financial position and collateral values, and other factors and estimates which are subject to change over time. This analysis is completed quarterly and forms the basis for allocation of the loan loss reserve and what charges to the provision may be required. For further discussion of the allowance for loan losses, see the Critical Accounting Policies and Estimates section presented earlier in Item 2.

As a result of our continually improving credit experience, the improvement in credit quality trends, and a reduction in overall losses, no allocation to the reserve for losses on loans was made during the quarter. The reserve for losses on loans as a percentage of total loans outstanding decreased to 1.34% at March 31, 2006 from the 1.42% at March 31, 2005 and the 1.40% at December 31, 2005.

***Securities***

The Corporation uses its securities held-to-maturity for production of income and to manage cash flow needs through expected maturities. The Corporation uses its securities available-for-sale for income and balance sheet liquidity management. Securities available-for-sale reported at fair value increased from $395.6 million as of December 31, 2005 to $484.3 million at March 31, 2006; the excess of cost over market increased from $6.7 million to $7.4 million. Securities held-to-maturity decreased from $48.4 million to $46.7 million during the same period. Total securities as a percentage of total assets were 15.6% as of December 31, 2005 and 17.9% as of March 31, 2006.

***Liquidity and Capital Resources***

The Corporation’s liquidity objectives are to ensure that funds are available for the subsidiary bank to meet deposit withdrawals and credit demands without unduly penalizing profitability. Additionally, the Corporation's objectives ensure that funding is available for the Corporation to meet ongoing cash needs while maximizing profitability. The Corporation continues to identify ways to provide for liquidity on both a current and long-term basis. The subsidiary bank relies mainly on core deposits, certificates of deposits of $100,000 or more, repayment of principal and interest on loans and securities and federal funds sold and purchased to create long-term liquidity. The subsidiary bank also has available the sale of securities under repurchase agreements, securities available-for-sale, and Federal Home Loan Bank ("FHLB") borrowings as secondary sources of liquidity.

Due to the nature of the markets served by the subsidiary bank, management believes that the majority of its certificates of deposit of $100,000 or more are no more volatile than its core deposits. During periods of interest rate volatility, these deposit balances have remained stable as a percentage of total deposits. In addition, an arrangement has been made with a correspondent bank for the purchase of federal funds on an unsecured basis, up to $20 million, if necessary, to meet the Corporation’s liquidity needs.

The Corporation owns securities with an estimated fair value of $484.3 million that are designated as available-for-sale and available to meet liquidity needs on a continuing basis. The Corporation also has available Federal Home Loan Bank advances for both liquidity and management of its asset/liability position. FHLB advances decreased slightly to $122.7 million at March 31, 2006 from $122.8 million at December 31, 2005. FHLB borrowing capacity at March 31, 2006 was $262 million. Long-term debt remained at $59.5 million from December 31, 2005 to March 31, 2006. At March 31, 2006, the Corporation had $75.3 million in federal funds sold compared to $31.1 million at December 31, 2005. Additionally, management projects cash flows from the Corporation's investment

portfolio to generate additional liquidity over the next 90 days.

The Corporation generally relies upon net inflows of cash from financing activities, supplemented by net inflows of cash from operating activities, to provide cash for its investing activities. As is typical of many financial institutions, significant financing activities include deposit gathering, use of short-term borrowing facilities such as federal funds purchased and securities sold under repurchase agreements, and issuance of long-term debt. The Corporation currently has a $12 million revolving line of credit, all of which is currently available to meet any future cash needs. The Corporation's primary investing activities include purchases of securities and loan originations.

The investment portfolio continues to consist of high-quality short-term issues. The majority of the investment portfolio is in U.S. Government and agency issuances. The average life of the portfolio is 2.56 years. Available-for-sale ("AFS") securities comprise 91.2% of the total investment portfolio. At the end of the first quarter, the AFS portfolio was 186% of equity capital. Seventy-five percent of the pledge eligible portfolio is pledged.

The Corporation's stock repurchase program began in December 1998 with the authorization to acquire up to 500,000 shares and was increased by an additional 1,000,000 shares in July 2000 and in May 2005. During the first three months of 2006, the Corporation acquired no shares of the Corporation's stock. As of March 31, 2006, a total of 1.9 million shares have been repurchased through this program, leaving 0.6 million shares available for repurchase.

In conjunction with maintaining a satisfactory level of liquidity, management monitors the degree of interest rate risk assumed on the consolidated balance sheet. The Corporation monitors its interest rate risk by use of the static gap model and dynamic gap model at the one-year interval. The Corporation uses the Sendero system to monitor its interest rate risk. The static gap model monitors the difference in interest rate sensitive assets and interest rate sensitive liabilities as a percentage of total assets that mature within the specified time frame. The dynamic gap model goes further in that it assumes that interest rate sensitive assets and liabilities will be reinvested. The Corporation desires an interest sensitivity gap of not more than fifteen percent of total assets at the one-year interval.

The Corporation's principal source of funds used to pay dividends to shareholders and service long-term debt is the dividends it receives from the subsidiary bank. Various federal statutory provisions, in addition to regulatory policies and directives, limit the amount of dividends that subsidiary banks can pay without prior regulatory approval. These restrictions have had no major impact on the Corporation's dividend policy or its ability to service long-term debt, nor is it anticipated that they would have any major impact in the foreseeable future. During the remainder of 2006, approximately $44.7 million plus any remaining 2006 net profits can be paid by the Corporation's banking subsidiary without prior regulatory approval.

The primary source of capital for the Corporation is retained earnings. The Corporation paid cash dividends of $0.26 per share during the first three months of 2006. Basic earnings per share for the same period was $0.65. The Corporation retained 60% of earnings for the first three months of 2006.

Under guidelines issued by banking regulators, the Corporation and its subsidiary bank are required to maintain a minimum Tier 1 risk-based capital ratio of 4% and a minimum total risk-based ratio of 8%. In order to be considered "well-capitalized" the Corporation must maintain ratios of 6% and 10%, respectively. Risk-based capital ratios weight the relative risk factors of all assets and consider the risk associated with off-balance sheet items. The Corporation must also maintain a minimum Tier 1 leverage ratio of 4%. The well-capitalized ratio for Tier 1 leverage is 5%. The Corporation's Tier 1 leverage, Tier 1 risk-based, and total risk-based ratios were 9.01%, 11.28%, and 12.52%, respectively, as of March 31, 2006, all exceeding the threshold for meeting the definition of well-capitalized.

As of March 31, 2006, management is not aware of any current recommendations by banking regulatory authorities which, if they were to be implemented, would have, or would be reasonably likely to have, a material adverse impact on the Corporation's liquidity, capital resources, or operations.

***Impact of Inflation and Changing Prices***

The majority of the Corporation's assets and liabilities are monetary in nature. Therefore, the Corporation differs greatly from most commercial and industrial companies that have significant investment in nonmonetary assets, such as fixed assets and inventories. However, inflation does have an important impact on the growth of assets in the banking industry and on the resulting need to increase equity capital at higher than normal rates in order to maintain an appropriate equity to assets ratio. Inflation also affects other expenses, which tend to rise during periods of general inflation.

Management believes one of the most significant impacts on financial and operating results is the Corporation's ability to react to changes in interest rates. Management seeks to maintain an essentially balanced position between interest rate sensitive assets and liabilities in order to protect against the effects of wide interest rate fluctuations.

**FORWARD-LOOKING STATEMENTS**

Certain of the statements contained herein that are not historical facts are forward-looking statements within the meaning of the Private Securities Litigation Reform Act. The Corporation's actual results may differ materially from those included in the forward-looking statements. Forward-looking statements are typically identified by words or phrases such as "believe," "expect," "anticipate," "intend," "estimate," "may increase," "may fluctuate," and similar express future or conditional verbs such as "will," "should," "would," and "could." These forward-looking statements involve risks and uncertainties including, but not limited to, economic conditions, portfolio growth, the credit performance of the portfolios, including bankruptcies, and seasonal factors; changes in general economic conditions including the performance of financial markets, the performance of coal and coal related industries, prevailing inflation and interest rates, realized gains from sales of investments, gains from asset sales, and losses on commercial lending activities; results of various investment activities; the effects of competitors' pricing policies, of changes in laws and regulations on competition and of demographic changes on target market populations' savings and financial planning needs; industry changes in information technology systems on which we are highly dependent; failure of acquisitions to produce revenue enhancements or cost savings at levels or within the time frames originally anticipated or unforeseen integration difficulties; the adoption by the Corporation of an FFIEC policy that provides guidance on the reporting of delinquent consumer loans and the timing of associated credit charge-offs for financial institution subsidiaries; and the resolution of legal proceedings and related matters. In addition, the banking industry in general is subject to various monetary and fiscal policies and regulations, which include those determined by the Federal Reserve Board, the Federal Deposit Insurance Corporation, and state regulators, whose policies and regulations could affect the Corporation's results. These statements are representative only on the date hereof, and the Corporation undertakes no obligation to update any forward-looking statements made.

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

Interest rate risk management focuses on maintaining consistent growth in net interest income within Board-approved policy limits. The Corporation uses an earnings simulation model to analyze net interest income sensitivity to movements in interest rates. Given a 200 basis point increase to the yield curve used in the simulation model, it is estimated net interest income for the Corporation would increase by 5.50 percent over one year and by 4.77 percent over two years. A 200 basis point decrease in the yield curve would decrease net interest income by an estimated 5.58 percent over one year and by 4.01 percent over two years. For further discussion of the Corporation's market risk, see the Management's Discussion and Analysis of Financial Condition and Results of Operations--Liquidity and Market Risk included in the Annual Report on Form 10-K for the year ended December 31, 2005.

**Item 4. Controls and Procedures**

The Corporation's management is responsible for establishing and maintaining effective disclosure controls and procedures, as defined under Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934. As of March 31, 2006, an evaluation was performed under the supervision and with the participation of management, including the Chief Executive Officer and the Executive Vice President/Treasurer, of the effectiveness of the design and operation of the Corporation's disclosure controls and procedures. Based on that evaluation, management concluded that disclosure controls and procedures as of March 31, 2006 were effective in ensuring material information required to be disclosed in this quarterly report on Form 10-Q was recorded, processed, summarized, and reported on a timely basis. Additionally, there were no changes in the Corporation's internal control over financial reporting that occurred during the quarter ended March 31, 2006 that have materially affected, or are reasonably likely to materially affect, the Corporation's internal control over financial reporting.

Management's responsibilities related to establishing and maintaining effective disclosure controls and procedures include maintaining effective internal controls over financial reporting that are designed to produce reliable financial statements in accordance with accounting principles generally accepted in the United States. There have been no significant changes in the Corporation's internal controls or in other factors that could significantly affect internal controls subsequent to March 31, 2006.

## PART II - OTHER INFORMATION

| | | |
|---|---|---|
| Item 1. | Legal Proceedings | None |
| Item 1A. | Risk Factors | None |
| Item 2. | Unregistered Sales of Equity Securities and Use of Proceeds | None |
| Item 3. | Defaults Upon Senior Securities | None |
| Item 4. | Submission of Matters to a Vote of Security Holders | None |
| Item 5. | Other Information:<br>The Corporation's Principal Executive Officer and Principal Financial Officer have furnished to the SEC the certifications with respect to this Form 10-Q that are required by Sections 302 and 906 of the Sarbanes-Oxley Act of 2002 | |
| Item 6. | a. Exhibits: | |
| | (1) Certifications Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 | Exhibit 31.1<br>Exhibit 31.2 |
| | (2) Certifications Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 | Exhibit 32.1<br>Exhibit 32.2 |

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Corporation has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

| | **COMMUNITY TRUST BANCORP, INC.** |
|---|---|
| Date: May 9, 2006 | By: /s/ Jean R. Hale |
| | Chairman, President and CEO |
| | By: /s/ Kevin J. Stumbo |
| | Executive Vice President and Treasurer |