RURBAN FINANCIAL CORP
Form 10-Q
November 14, 2006

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

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

For the quarterly period ended September 30, 2006

OR

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

For the transition period from __________ to __________

Commission file number 0-13507

RURBAN FINANCIAL CORP.

(Exact name of registrant as specified in its charter)

Ohio	34-1395608
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

401 Clinton Street, Defiance, Ohio 43512
(Address of principal executive offices)
(Zip Code)
(419) 783-8950
(Registrant s telephone number, including area code)
None
(Former name, former address and former fiscal year, if changed since last report.)

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 the registrant was required to file such reports, and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

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

Large Accelerate Filer o Accelerated Filer o Non-Accelerated Filer þ

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

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

Common Shares, without par value	**5,027,433 shares**
(class)	**(Outstanding at November 13, 2006)**

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

The interim condensed consolidated financial statements of Rurban Financial Corp. (Rurban or the Company) are unaudited; however, the information contained herein reflects all adjustments which are, in the opinion of management, necessary for a fair presentation of financial condition and results of operations for the interim periods presented. All adjustments reflected in these financial statements are of a normal recurring nature in accordance with Rule 10-01 of Regulation S-X. Results of operations for the three and nine months ended September 30, 2006 are not necessarily indicative of results for the complete year.

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Rurban Financial Corp.
Condensed Consolidated Balance Sheets
September 30, 2006 and December 31, 2005

Assets

	(Unaudited) September 30, 2006	December 31, 2005
Cash and due from banks	$ 18,333,213	$ 12,650,839
Interest-bearing deposits	150,000	150,000
Available-for-sale securities	127,863,121	139,353,329
Loans held for sale	282,100	224,000
Loans, net of unearned income	364,343,193	327,048,229
Allowance for loan losses	(4,521,911)	(4,699,827)
Premises and equipment	13,790,324	13,346,632
Purchased software	4,722,746	3,916,913
Federal Reserve and Federal Home Loan Bank stock	3,994,000	3,607,500
Foreclosed assets held for sale, net	490,256	2,309,900
Interest receivable	3,399,893	3,010,355
Goodwill	13,517,292	8,917,373
Core deposits and other intangibles	6,027,386	3,742,333
Cash value of life insurance	10,706,737	10,443,487
Other	6,888,763	6,521,213
Total assets	$ 569,987,113	$ 530,542,276

See notes to condensed consolidated financial statements (unaudited)

Note: *The balance sheet at December 31, 2005 has been derived from the audited consolidated financial statements at that date.*

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Rurban Financial Corp.
Condensed Consolidated Balance Sheets (continued)
September 30, 2006 and December 31, 2005

Liabilities and Stockholders Equity

	(Unaudited) September 30, 2006	December 31, 2005
Liabilities		
Deposits		
Demand	$ 44,369,103	$ 52,073,751
Savings, interest checking and money market	133,184,971	124,206,115
Time	234,623,570	208,558,046
Total deposits	412,177,644	384,837,912
Notes payable	2,468,646	938,572
Federal Home Loan Bank advances	38,500,000	45,500,000
Federal funds purchased	800,000	4,600,000
Retail repurchase agreements	31,784,052	6,080,420
Trust preferred securities	20,620,000	20,620,000
Interest payable	2,108,320	1,373,044
Other liabilities	5,417,278	12,141,680
Total liabilities	513,875,940	476,091,628
Commitments and Contingent Liabilities		
Stockholders Equity		
Common stock, $2.50 stated value; authorized 10,000,000 shares; issued 5,027,433; outstanding September 30, 2006 5,027,433 and December 31, 2005 5,027,433	12,568,583	12,568,583
Additional paid-in capital	14,852,930	14,835,110
Retained earnings	29,998,511	28,702,817
Accumulated other comprehensive loss	(1,308,851)	(1,655,862)
Total stockholders equity	56,111,173	54,450,648
Total liabilities and stockholders equity	$ 569,987,113	$ 530,542,276

See notes to condensed consolidated financial statements (unaudited)

Note: The balance sheet at December 31, 2005 has been derived from the audited consolidated financial statements at that date.

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Rurban Financial Corp.
Condensed Consolidated Statements of Income (Unaudited)
Three Months Ended

	September 30, 2006	September 30, 2005
Interest Income		
Loans		
Taxable	$ 6,641,379	$ 4,187,543
Tax-exempt	18,326	17,898
Securities		
Taxable	1,306,979	1,095,151
Tax-exempt	183,466	71,264
Other	7,323	57,498
Total interest income	8,157,473	5,429,354
Interest Expense		
Deposits	3,017,993	1,615,308
Other borrowings	67,773	67,162
Retail repurchase agreements	182,007	23,874
Federal Home Loan Bank advances	667,749	440,175
Trust preferred securities	466,417	300,360
Total interest expense	4,401,939	2,446,879
Net Interest Income	3,755,534	2,982,475
Provision (Credit) for Loan Losses	35,000	(382,000)
Net Interest Income After Provision (Credit) for Loan Losses	3,720,534	3,364,475
Non-interest Income		
Data service fees	3,785,037	3,042,996
Trust fees	753,449	767,969
Customer service fees	542,518	526,197
Net gains on loan sales	283,123	28,895
Net realized gains on sales of available-for-sale securities		34,050
Loan servicing fees	96,754	79,186
Gain (loss) on sale of assets	25,914	(36,011)
Other	415,961	151,328
Total non-interest income	5,902,756	4,594,610

See notes to condensed consolidated financial statements (unaudited)

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Rurban Financial Corp.
Condensed Consolidated Statements of Income (Unaudited) (continued)
Three Months Ended

	September 30, 2006	September 30, 2005
Non-interest Expense		
Salaries and employee benefits	$ 4,253,924	$ 3,607,270
Net occupancy expense	468,855	312,661
Equipment expense	1,445,073	1,294,686
Data processing fees	146,703	99,085
Professional fees	481,132	467,951
Marketing expense	168,031	144,954
Printing and office supplies	126,765	115,320
Telephone and communications	467,692	388,900
Postage and delivery expense	142,957	77,979
State, local and other taxes	188,464	146,683
Employee expense	235,429	225,032
Other	389,631	338,556
Total non-interest expense	8,514,656	7,219,077
Income Before Income Tax	1,108,634	740,008
Provision for Income Taxes	294,893	247,824
Net Income	$ 813,741	$ 492,184
Basic Earnings Per Share	$ 0.16	$ 0.11
Diluted Earnings Per Share	$ 0.16	$ 0.11
Dividends Declared Per Share	$ 0.05	$ 0.05

See notes to condensed consolidated financial statements (unaudited)

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Rurban Financial Corp.
Condensed Consolidated Statements of Income (Unaudited)
Nine Months Ended

	September 30, 2006	September 30, 2005
Interest Income		
Loans		
Taxable	$ 18,238,590	$ 12,098,708
Tax-exempt	45,718	48,227
Securities		
Taxable	3,953,438	3,134,559
Tax-exempt	451,869	165,462
Other	57,635	159,716
Total interest income	22,747,250	15,606,672
Interest Expense		
Deposits	7,695,387	4,012,052
Other borrowings	120,220	204,365
Retail repurchase agreements	465,560	60,328
Federal Home Loan Bank advances	1,684,415	1,581,052
Trust preferred securities	1,331,615	842,170
Total interest expense	11,297,197	6,699,967
Net Interest Income	11,450,053	8,906,705
Provision (Credit) for Loan Losses	337,321	(30,000)
Net Interest Income After Provision (Credit) for Loan Losses	11,112,732	8,936,705
Non-interest Income		
Data service fees	10,312,757	9,312,961
Trust fees	2,361,127	2,351,509
Customer service fees	1,635,272	1,409,199
Net gains on loan sales	415,833	46,243
Net realized gains on sales of available-for-sale securities		25,300
Loan servicing fees	301,233	225,326
Gain (loss) on sale of assets	85,346	(18,935)
Other	1,067,739	513,714
Total non-interest income	16,179,307	13,865,317

See notes to condensed consolidated financial statements (unaudited)

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Rurban Financial Corp.
Condensed Consolidated Statements of Income (Unaudited) (continued)
Nine Months Ended

	September 30, 2006	September 30, 2005
Non-interest Expense		
Salaries and employee benefits	$ 11,906,909	$ 10,339,614
Net occupancy expense	1,334,722	897,058
Equipment expense	4,168,534	3,831,477
Data processing fees	402,661	303,781
Professional fees	1,525,399	1,697,020
Marketing expense	536,977	308,925
Printing and office supplies	453,110	397,153
Telephone and communications	1,277,707	1,144,334
Postage and delivery expense	397,217	236,006
State, local and other taxes	512,757	380,036
Employee expense	745,341	726,561
Other	1,283,228	1,163,450
Total non-interest expense	24,544,562	21,425,415
Income Before Income Tax	2,747,477	1,376,607
Provision for Income Taxes	697,668	359,661
Net Income	$ 2,049,809	$ 1,016,946
Basic Earnings Per Share	$ 0.41	$ 0.22
Diluted Earnings Per Share	$ 0.41	$ 0.22
Dividends Declared Per Share	$ 0.15	$ 0.15

See notes to condensed consolidated financial statements (unaudited)

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RURBAN FINANCIAL CORP.
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY (UNAUDITED)

	Three Months Ended		Nine Months Ended	
	September 30, 2006	September 30, 2005	September 30, 2006	September 30, 2005
Balance at beginning of period	$ 54,026,126	$ 50,599,536	$ 54,450,648	$ 50,305,795
Net Income	813,741	492,184	2,049,809	1,016,946
Other comprehensive income (loss):				
Net change in unrealized gains (losses) on securities available for sale, net	1,516,738	(582,396)	347,011	(393,135)
Total comprehensive income (loss)	2,330,479	(90,212)	2,396,820	623,811
Cash dividend	(251,372)	(228,566)	(754,113)	(685,443)
Stock options exercised				36,595
Stock option expense	5,940		17,818	
Balance at end of period	$ 56,111,173	$ 50,280,758	$ 56,111,173	$ 50,280,758

See notes to condensed consolidated financial statements (unaudited)

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Rurban Financial Corp.
Condensed Consolidated Statements of Cash Flows (Unaudited)
Nine Months Ended

	September 30, 2006	September 30, 2005
Operating Activities		
Net income	$ 2,049,809	$ 1,016,946
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	2,640,971	2,280,844
Provision for loan losses	337,321	(30,000)
Expense of stock option plan	17,818	
Amortization of premiums and discounts on securities	170,767	143,019
Amortization of intangible assets	366,947	77,815
Deferred income taxes	(847,663)	83,746
Gain from sale of loans	(415,833)	(46,243)
Gain on sales of foreclosed assets	(92,432)	19,221
FHLB Stock Dividends	(386,500)	(82,400)
(Gain) loss on sales of premises and equipment	7,086	(286)
Net realized gains on available-for-sale securities		(25,300)
Changes in		
Proceeds from sale of loans held for sale	15,207,292	4,468,743
Originations of loans held for sale	(14,849,559)	(4,309,600)
Interest receivable	(389,538)	(455,632)
Other assets	(223,486)	343,478
Interest payable and other liabilities	(1,005,408)	(22,740)
Net cash provided by operating activities	2,587,592	3,461,611
Investing Activities		
Purchases of available-for-sale securities	(13,783,842)	(30,171,309)
Proceeds from maturities of available-for-sale securities	10,417,559	13,792,631
Proceeds from the sales of available-for-sale securities	15,240,716	5,310,512
Net change in loans	(38,187,317)	(4,223,001)
Purchase of premises and equipment	(3,728,676)	(2,760,567)
Proceeds from assumption of net liabilities in business acquisition		48,645,686
Cash paid to shareholders of Diverse Computer Marketers, Inc Acquisition	(4,803,577)	
Cash paid to shareholders of Exchange Bank Acquisition	(6,526,646)	
Proceeds from sales of premises and equipment	38,741	288,553
Proceeds from the sale of foreclosed assets	2,670,459	1,573,627
Net cash provided by (used in) investing activities	(38,662,583)	32,456,132

See notes to condensed consolidated financial statements (unaudited)

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Rurban Financial Corp.
Condensed Consolidated Statements of Cash Flows (Unaudited) (continued)
Nine Months Ended

	September 30, 2006	September 30, 2005
Financing Activities		
Net increase (decrease) in demand deposits, money market, interest checking and savings accounts	$ 1,274,208	$ (2,126,650)
Net increase (decrease) in certificates of deposit	26,065,524	(19,389,270)
Net increase in securities sold under agreements to repurchase	25,703,630	2,541,001
Net decrease in federal funds purchased	(3,800,000)	(5,400,000)
Proceeds from note payable	2,500,000	
Proceeds from Federal Home Loan Bank advances	27,900,000	12,500,000
Repayment of Federal Home Loan Bank advances	(34,900,000)	(34,500,000)
Repayment of notes payable	(2,231,884)	(1,026,862)
Dividends paid	(754,113)	(685,443)
Proceeds from stock options exercised		36,595
Net cash provided by (used in) financing activities	41,757,365	(37,740,629)
(Decrease) Increase in Cash and Cash Equivalents	5,682,374	(1,822,886)
Cash and Cash Equivalents, Beginning of Year	12,650,839	10,617,766
Cash and Cash Equivalents, End of Period	$ 18,333,213	$ 8,794,880
Supplemental Cash Flows Information		
Interest paid	$ 10,561,921	$ 6,522,908
Transfer of loans to foreclosed assets	$ 459,923	$ 3,126,638

See notes to condensed consolidated financial statements (unaudited)

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RURBAN FINANCIAL CORP.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
NOTE A BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions for Form 10-Q. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. The financial statements reflect all adjustments that are, in the opinion of management, necessary to fairly present the financial position, results of operations and cash flows of the Company. Those adjustments consist only of normal recurring adjustments. Results of operations for the three and nine months ended September 30, 2006 are not necessarily indicative of results for the complete year.

The condensed consolidated balance sheet of the Company as of December 31, 2005 has been derived from the audited condensed consolidated balance sheet of the Company as of that date.

For further information, refer to the consolidated financial statements and footnotes included in the Company s Annual Report on Form 10-K for the year ended December 31, 2005.

Reclassifications

Certain reclassifications have been made to the 2005 financial statements to conform to the 2006 financial statement presentation. These reclassifications had no effect on net income.

Stock Based Compensation

Effective January 1, 2006, the Company adopted Statement of Financial Standards (SFAS) No. 123(R) using the modified prospective method, and accordingly, will not restate prior period results. SFAS 123(R) requires compensation expense to be recognized for all stock options granted after the date of adoption and for all previously granted stock options that vest after the date of adoption. The fair value of stock options is determined using the Black-Scholes valuation model, which is consistent with the Company s valuation methodology previously utilized for options in the footnote disclosures required under SFAS No. 123. The impact of this adoption on the financial statements for the period ended September 30, 2006 is not considered material.

Prior to January 1, 2006, the Company accounted for its stock option plan under the recognition and measurement principles of APB Opinion No. 25, *Accounting for Stock Issued to Employees,* and related interpretations. Under APB Opinion No. 25, no stock-based employee compensation cost was reflected in net income, as all options granted under the Company s stock option plan had an exercise price equal to the market value of the underlying common stock on the grant date.

As of September 30, 2006, the Company had 19,000 nonvested options outstanding and there was $77,220 of total unrecognized compensation cost related to these nonvested options. This cost is expected to be recognized monthly on a straight-line basis as each option is vested through December 21, 2010.

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The following table illustrates the effect on net income and earnings per share if expense had been measured using the fair value recognition provisions of SFAS No. 123(R).

	Three Months Ended September 30, 2006		
	Using Previous Accounting	SFAS 123(R) Adjustment	As Reported
Income before tax expense	$ 1,114,574	$ (5,940)	$ 1,108,634
Income taxes	294,893		294,893
Net income	$ 819,681	$ (5,940)	$ 813,741
Earnings per share:			
Basic	$ 0.16		$ 0.16
Diluted	$ 0.16		$ 0.16

	Nine Months Ended September 30, 2006		
	Using Previous Accounting	SFAS 123(R) Adjustment	As Reported
Income before tax expense	$ 2,765,295	$ (17,818)	$ 2,747,477
Income taxes	697,668		697,668
Net income	$ 2,067,627	$ (17,818)	$ 2,049,809
Earnings per share:			
Basic	$ 0.41		$ 0.41
Diluted	$ 0.41		$ 0.41

	Three Months Ended September 30, 2005		
	As Reported	SFAS 123(R) Adjustment	Proforma
Net income before tax expense	$ 740,008	$ (2,970)	$ 737,038
Income taxes	247,824		247,824
Net Income	$ 492,184	$ (2,970)	$ 489,214
Earnings per share:			
Basic	$ 0.11		$ 0.11
Diluted	$ 0.11		$ 0.11

	Nine Months Ended September 30, 2005		
		SFAS 123(R)	

	As Reported	Adjustment	Proforma
Income before tax expense	$ 1,376,607	$ (640,765)	$ 735,842
Income taxes	359,661		359,661
Net income	$ 1,016,946	$ (640,765)	$ 376,181
Earnings per share:			
Basic	$ 0.22		$ 0.08
Diluted	$ 0.22		$ 0.08

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NOTE B EARNINGS PER SHARE

Earnings per share (EPS) have been computed based on the weighted average number of shares outstanding during the periods presented. For the periods ended September 30, 2006 and 2005, stock options totaling 287,217 and 235,066 common shares, respectively, were not considered in computing EPS as they were anti-dilutive. The number of shares used in the computation of basic and diluted earnings per share was:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Basic earnings per share	5,027,433	4,573,033	5,027,433	4,570,266
Diluted earnings per share	5,027,704	4,574,492	5,030,084	4,584,070

NOTE C LOANS, RISK ELEMENTS AND ALLOWANCE FOR LOAN LOSSES

Total loans on the balance sheet are comprised of the following classifications at:

	September 30, 2006	December 31, 2005
Commercial	$ 83,215,678	$ 79,359,126
Commercial real estate	89,135,547	68,071,738
Agricultural	44,536,988	40,236,664
Residential real estate	93,539,693	89,086,024
Consumer	53,016,300	48,876,788
Lease financing	1,189,694	1,661,126
Total loans	364,633,900	327,291,466
Less		
Net deferred loan fees, premiums and discounts	(290,707)	(243,237)
Loans, net of unearned income	$ 364,343,193	$ 327,048,229
Allowance for loan losses	$ (4,521,911)	$ (4,699,827)

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The following is a summary of the activity in the allowance for loan losses account for the three and nine months ended September 30, 2006 and 2005.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Balance, beginning of period	$ 4,438,139	$ 5,210,464	$ 4,699,827	$ 4,899,063
Provision charged to expense	35,000	(382,000)	337,321	(30,000)
Recoveries	267,422	304,140	565,065	1,419,602
Loans charged off	(218,650)	(318,648	(1,080,302)	(1,474,709)
Balance, end of period	$ 4,521,911	$ 4,813,956	$ 4,521,911	$ 4,813,956

The following schedule summarizes nonaccrual, past due and impaired loans at:

	September 30, 2006	December 31, 2005
Non-accrual loans	$ 5,626,000	$ 6,270,000
Accruing loans which are contractually past due 90 days or more as to interest or principal payments	10,000	5,200
Total non-performing loans	$ 5,636,000	$ 6,275,200

Individual loans determined to be impaired were as follows:

	September 30, 2006	December 31, 2005
Loans with no allowance for loan losses allocated	$ 2,135,000	$ 1,676,000
Loans with allowance for loan losses allocated	1,811,000	4,460,000
Total impaired loans	$ 3,946,000	$ 6,136,000
Amount of allowance allocated	$ 831,000	$ 1,993,000

NOTE D REGULATORY MATTERS

The Company, The State Bank and Trust Company (State Bank) and The Exchange Bank (Exchange Bank) are subject to various regulatory capital requirements administered by federal and state banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary, actions by regulators. If undertaken, these actions could have a direct material adverse effect on the Company s financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company, State Bank and Exchange Bank must meet specific capital guidelines that involve quantitative measures of assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

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Quantitative measures established by regulation to ensure capital adequacy require the Company, State Bank and Exchange Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital to average assets (as defined) in the regulations. As of September 30, 2006 and 2005, the Company, State Bank and Exchange Bank exceeded all well-capitalized requirements to which they are subject.

As of December 31, 2005, the most recent notification to the regulators categorized the State Bank and Exchange Bank as well-capitalized under the regulatory framework for prompt corrective action. To be categorized as well-capitalized, State Bank and Exchange Bank must maintain capital ratios as set forth in the following table. There are no conditions or events since that notification that management believes have changed State Bank s or Exchange Bank s categorization as well capitalized.

The Company s consolidated, and State Bank s and Exchange Bank s actual capital amounts (in millions) and ratios, as of September 30, 2006 and December 31, 2005 are also presented in the following table.

	Actual		**Minimum Required For Capital Adequacy Purposes**		**To Be Well Capitalized Under Prompt Corrective Action Provisions**	
	Amount	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
As of September 30, 2006						
Total Capital						
(to Risk-Weighted Assets)						
Consolidated	$62.4	16.3%	$30.7	8.0%	$	N/A
State Bank	38.4	12.2	25.1	8.0	31.4	10.0
Exchange Bank	7.8	13.1	4.7	8.0	5.9	10.0
Tier I Capital						
(to Risk-Weighted Assets)						
Consolidated	57.0	14.9	15.3	4.0		N/A
State Bank	35.2	11.2	12.6	4.0	18.8	6.0
Exchange Bank	7.0	11.9	2.4	4.0	3.6	6.0
Tier I Capital						
(to Average Assets)						
Consolidated	57.0	10.3	22.1	4.0		N/A
State Bank	35.2	7.6	18.5	4.0	23.2	5.0
Exchange Bank	7.0	7.9	3.6	4.0	4.4	5.0
As of December 31, 2005						
Total Capital						
(to Risk-Weighted Assets)						
Consolidated	$67.8	19.3%	$28.1	8.0%	$	N/A
State Bank	36.6	13.0	22.6	8.0	28.2	10.0
Exchange Bank	7.5	13.8	4.4	8.0	5.5	10.0
Tier I Capital						
(to Risk-Weighted Assets)						
Consolidated	62.1	17.7	14.0	4.0		N/A

State Bank	33.5	11.9	11.3	4.0	16.9	6.0
Exchange Bank	6.9	12.6	2.2	4.0	3.3	6.0
Tier I Capital (to Average Assets)						
Consolidated	62.1	14.4	17.2	4.0		N/A
State Bank	33.5	8.0	16.7	4.0	20.8	5.0
Exchange Bank	6.9	8.5	3.2	4.0	4.1	5.0

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NOTE E CONTINGENT LIABILITIES

There are various contingent liabilities that are not reflected in the consolidated financial statements, including claims and legal actions arising in the ordinary course of business. In the opinion of management, after consultation with legal counsel, the ultimate disposition of these matters is not expected to have a material effect on the Company s consolidated financial condition or results of operations.

NOTE F NEW ACCOUNTING PRONOUNCEMENTS

In March 2006, the FASB issued Statement of Financial Accounting Standards No. 156, *Accounting for Servicing of Financial Assets: an amendment of FASB Statement No. 140* (FAS 140 and FAS 156). FAS 140 establishes, among other things, the accounting for all separately recognized servicing assets and servicing liabilities. This Statement amends FAS 140 to require that all separately recognized servicing assets and servicing liabilities be initially measured at fair value, if practicable. This Statement permits, but does not require, the subsequent measurement of separately recognized servicing assets and servicing liabilities at fair value. Under this Statement, an entity can elect subsequent fair value measurement to account for its separately recognized servicing assets and servicing liabilities. Adoption of this Statement is required as of the beginning of the first fiscal year that begins after September 15, 2006. The Company is currently measuring the effects of SFAS No. 156 and looks to adopt it in the first quarter of 2007. At this time, the Company believes that the adoption of SFAS No. 156 will have an immaterial impact on the financial position and results of operations of the Company.

In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109* (FIN 48), which clarifies the accounting for uncertainty in tax positions. This Interpretation requires that the Company recognize in the financial statements, the impact of a tax position, if that position is more likely than not of being sustained on audit, based on the technical merits of the position. The provisions of FIN 48 are effective as of the beginning of our 2007 fiscal year, with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings. The Company is currently evaluating the impact of adopting FIN 48 on its financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (FAS 157). FAS 157 enhances existing guidance for measuring assets and liabilities using fair value. Prior to the issuance of FAS 157, guidance for applying fair value was incorporated in several accounting pronouncements. FAS 157 provides a single definition of fair value, together with a framework for measuring it, and requires additional disclosure about the use of fair value to measure assets and liabilities. FAS 157 also emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and sets out a fair value hierarchy with the highest priority being quoted prices in active markets. Under FAS 157, fair value measurements are disclosed by level within that hierarchy. While FAS 157 does not add any new fair value measurements, it does change current practice. Changes to practice include: (1) a requirement for an entity to include its own credit standing in the measurement of its liabilities; (2) a modification of the transaction price presumption; (3) a prohibition on the use of block discounts when valuing large blocks of securities for broker-dealers and investment companies; and (4) a requirement to adjust the value of restricted stock for the effect of the restriction even if the restriction lapses within one year. FAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company has not determined the impact of adopting FAS 157 on its financial statements.

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NOTE G COMMITMENTS AND CREDIT RISK

As of September 30, 2006, loan commitments and unused lines of credit totaled $91,065,000, standby letters of credit totaled $591,000 and no commercial letters of credit were outstanding.

NOTE H SEGMENT INFORMATION

The reportable segments are determined by the products and services offered, primarily distinguished between banking and data processing operations. Other segments include the accounts of the holding company, Rurban, which provides management and operational services to its subsidiaries; Rurban Operations Corp., which provides operational services for the Company s subsidiaries as described in Item 2. Management Discussion and Analysis of Financial Condition and Results of Operations; and Reliance Financial Services, N.A., which provides trust and financial services to customers nationwide. Information reported internally for performance assessment follows.

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NOTE H SEGMENT INFORMATION (Continued)
As of and for the nine months ended September 30, 2006

Income statement information:	Banking	Data Processing	Other	Total Segments	Intersegment Elimination	Consolidated Totals
Net interest income (expense)	$ 12,898,783	$ (164,635)	$ (1,284,095)	$ 11,450,053		$ 11,450,053
Non-interest income external customers	3,279,579	10,312,757	2,586,971	16,179,307		16,179,307
Non-interest income other segments		1,206,824	3,158,435	4,365,259	(4,365,259)	
Total revenue	16,178,362	11,354,946	4,461,311	31,994,619	(4,365,259)	27,629,360
Non-interest expense	16,308,394	9,117,085	3,484,342	28,909,821	(4,365,259)	24,544,562
Significant non-cash items:						
Depreciation and amortization	618,779	1,839,815	182,377	2,640,971		2,640,971
Provision for loan losses	337,321			337,321		337,321
Income tax expense (benefit)	437,205	760,873	(500,410)	697,668		697,668
Segment profit (loss)	$ 1,513,762	$ 1,476,987	$ (940,940)	$ 2,049,809	$	$ 2,049,809
Balance sheet information:						
Total assets	$ 553,658,309	$ 19,981,151	$ 11,827,875	$ 585,467,335	$ (15,480,222)	$ 569,987,113
Goodwill and intangibles	12,270,962	7,273,716		19,544,678		19,544,678
Premises and equipment expenditures	386,232	2,519,955	112,709	3,018,896		3,018,896

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NOTE H SEGMENT INFORMATION (Continued)
As of and for the nine months ended September 30, 2005

Income statement information:	Banking	Data Processing	Other	Total Segments	Intersegment Elimination	Consolidated Totals
Net interest income (expense)	$ 9,955,738	$ (183,276)	$ (865,757)	$ 8,906,705		$ 8,906,705
Non-interest income external customers	2,159,638	9,312,961	92,718	11,565,317		13,865,317
Non-interest income other segments		1,016,193	1,321,091	2,337,284	(2,337,284)	
Total revenue	12,115,376	10,145,878	548,052	22,809,306	(2,337,284)	22,772,022
Non-interest expense	11,872,865	8,357,156	3,532,678	23,762,699	(2,337,284)	21,425,415
Significant non-cash items:						
Depreciation and amortization	482,951	1,712,128	85,765	2,280,844		2,280,844
Provision for loan losses	(30,000)			(30,000)		(30,000)
Income tax expense (benefit)	150,152	648,504	(438,995)	359,661		359,661
Segment profit (loss)	$ 712,325	$ 1,140,218	$ (835,597)	$ 1,016,946	$	$ 1,016,946
Balance sheet information:						
Total assets	$ 433,565,505	$ 10,182,412	$ 15,405,372	$ 459,153,289	$ (20,571,189)	$ 438,582,100
Goodwill and intangibles	7,300,167			7,300,167		7,300,167
Premises and equipment expenditures	700,081	1,935,221	125,265	2,760,567		2,760,567

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NOTE H SEGMENT INFORMATION (Continued)

As of and for the three months ended September 30, 2006

Income statement information:	Banking	Data Processing	Other	Total Segments	Intersegment Elimination	Consolidated Totals
Net interest income (expense)	$ 4,265,179	$ (67,045)	$ (442,600)	$ 3,755,534		$ 3,755,534
Non-interest income external customers	1,180,606	3,785,037	937,113	5,902,756		5,902,756
Non-interest income other segments		366,823	1,017,005	1,383,828	(1,383,828)	
Total revenue	5,445,785	4,084,815	1,511,518	11,042,118	(1,383,828)	9,658,290
Non-interest expense	5,390,224	3,361,095	1,147,165	9,898,484	(1,383,828)	8,514,656
Significant non-cash items:						
Depreciation and amortization	208,502	653,730	60,995	923,227		923,227
Provision for loan losses	35,000			35,000		35,000
Income tax expense (benefit)	205,231	246,065	(156,403)	294,893		294,893
Segment profit (loss)	$ 629,172	$ 477,655	$ (293,086)	$ 813,741	$	$ 813,741
Balance sheet information:						
Total assets	$ 553,658,309	$ 19,981,151	$ 1,827,875	$ 575,467,335	$ (15,480,222)	$ 559,987,113
Goodwill and intangibles	12,270,962	7,273,716		19,544,678		19,544,678
Premises and equipment expenditures	3,353	303,676	9,270	316,299		316,299

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NOTE H SEGMENT INFORMATION (Continued)

As of and for the three months ended September 30, 2005

Income statement information:	Banking	Data Processing	Other	Total Segments	Intersegment Elimination	Consolidated Totals
Net interest income (expense)	$ 3,347,683	$ (58,972)	$ (306,236)	$ 2,982,475		$ 2,982,475
Non-interest income external customers	770,013	3,042,996	781,601	4,594,610		4,594,610
Non-interest income other segments		366,826	410,848	777,674	(777,674)	
Total revenue	4,117,696	3,350,850	886,213	8,354,759	(777,674)	7,577,085
Non-interest expense	4,051,078	2,845,219	1,100,454	7,996,751	(777,674)	7,219,077
Significant non-cash items:						
Depreciation and amortization	183,340	569,276	32,132	784,748		784,748
Provision for loan losses	(382,000)			(382,000)		(382,000)
Income tax expense (benefit)	166,848	214,296	(133,320)	247,824		247,824
Segment profit (loss)	$ 452,708	$ 291,335	$ (251,859)	$ 492,184	$	$ 492,184
Balance sheet information:						
Total assets	$ 433,565,505	$ 10,182,412	$ 15,405,372	$ 459,153,289	$ (20,571,189)	$ 438,582,100
Goodwill and intangibles	7,300,167			7,300,167		7,300,167
Premises and equipment expenditures	366,076	392,296	77,996	836,368		836,368

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NOTE I ACQUISITIONS

On September 2, 2006, Rurbanc Data Services, Inc (RDSI), the bank data processing subsidiary of Rurban Financial Corp. (Rurban), completed its acquisition of Diverse Computer Marketers, Inc., a Michigan corporation, and a related Indiana corporation, DCM Indiana, Inc. Rurban subsequently merged DCM Indiana, Inc. into Diverse Computer Marketers, Inc. (DCM). DCM now operates as a separate subsidiary of RDSI. As a result of this acquisition, the Company will have an opportunity to grow its item processing business.

Under the terms of the Stock Purchase Agreement, RDSI acquired all of the outstanding stock of the DCM Companies from their shareholders for an aggregate purchase price of $4.9 million. An additional $250,000 is payable to the shareholders contingent upon the continuation of profitable growth over the first year of combined operations. The entire purchase price was paid in cash. The results of DCM s operations have been included in Rurban s consolidated statement of income from the date of acquisition.

The following tables summarize the estimated fair values of the net assets acquired and the computation of the purchase price and goodwill related to the acquisitions.

Assets:	
Cash	$ 96,423
Accounts receivable	547,533
Premises and equipment	213,585
Goodwill and other intangibles	7,290,383
Other assets	152,303
Total Assets	8,300,227
Liabilities:	
Accounts payable	1,188,289
Borrowings	1,284,427
Other liabilities	927,511
Total Liabilities	3,400,227
Net assets acquired	$ 4,900,000

The significant intangible assets acquired include the customer related intangible of $2,389,000, the Trademark of $180,000 and the non-compete agreements of $83,000, which have useful lives of 180, 120 and 36 months, respectively, and will be amortized using the straight-line method. The $4.6 million of goodwill was assigned entirely to the data processing unit and is not expected to be deductible for tax purposes. This analysis is based upon an initial third party opinion and is subject to change for up to twelve months.

Under terms of the Stock Purchase Agreement, and immediately prior to the closing, the disaster recovery services portion of the DCM business was spun-off. As DCM records did not include separate financial information for the disaster recovery services, historical financial information for the purchased portion of the business is not available. Therefore, pro forma information that discloses the results of operations as though the business combination had been completed at the beginning of the period is not included.

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

Cautionary Statement Regarding Forward-Looking Information

Management s Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements that are provided to assist in the understanding of anticipated future financial performance. Forward-looking statements provide current expectations or forecasts of future events and are not guarantees of future performance. Examples of forward-looking statements include: (a) projections of income or expense, earnings per share, the payments or non-payments of dividends, capital structure and other financial items; (b) statements of plans and objectives of the Company or our management or Board of Directors, including those relating to products or services; (c) statements of future economic performance; and (d) statements of assumptions underlying such statements. Words such as believes, anticipates, expects, intends, targeted, and similar expressions are intended to identify forward-looking statements, but are not the exclusive means of identifying those statements. Forward-looking statements are based on management s expectations and are subject to a number of risks and uncertainties. Although management believes that the expectations reflected in such forward-looking statements are reasonable, actual results may differ materially from those expressed or implied in such statements. Risks and uncertainties that could cause actual results to differ materially include, without limitation, changes in interest rates, changes in the competitive environment, and changes in banking regulations or other regulatory or legislative requirements affecting bank holding companies. Additional detailed information concerning a number of important factors which could cause actual results to differ materially from the forward-looking statements contained in Management s Discussion and Analysis of Financial Condition and Results of Operations is available in the Company s filings with the Securities and Exchange Commission, under the Securities Exchange Act of 1934, including the disclosure under the heading Item 1A. Risk Factors of Part I of the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2005. Undue reliance should not be placed on the forward-looking statements, which speak only as of the date hereof. Except as may be required by law, the Company undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date on which the statement is made to reflect unanticipated events.

Overview of Rurban

Rurban is a bank holding company registered with the Federal Reserve Board. Rurban s wholly-owned subsidiaries, The State Bank and Trust Company (State Bank) and The Exchange Bank (Exchange Bank), are engaged in commercial banking. Rurban s subsidiary, Rurbanc Data Services, Inc. (RDSI), provides computerized data processing services to community banks and businesses.

Rurban Statutory Trust I (RST) was established in August 2000. In September 2000, RST completed a pooled private offering of 10,000 Capital Securities with a liquidation amount of $1,000 per security. The proceeds of the offering were loaned to the Company in exchange for junior subordinated debentures of the Company with terms substantially similar to the Capital Securities. The sole assets of RST are the junior subordinated debentures, and the back-up obligations, in the aggregate, constitute a full and unconditional guarantee by the Company of the obligations of RST under the Capital Securities.

Rurban Statutory Trust II (RST II) was established in August 2005. In September 2005, RST II completed a pooled private offering of 10,000 Capital Securities with a liquidation amount of $1,000 per security. The proceeds of the offering were loaned to the Company in exchange for junior subordinated debentures of the Company with terms substantially similar to the Capital Securities. The sole assets of RST II are the junior

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subordinated debentures, and the back-up obligations, in the aggregate, constitute a full and unconditional guarantee by the Company of the obligations of RST II under the Capital Securities.

Rurban Operations Corp. (ROC) was formed in December 2005 and its first day of operation commenced January 3, 2006. ROC serves as a central location for the performance of the following functions that provides services for all of the Company s subsidiaries: human resources, marketing, facilities maintenance, loan operations, loan accounting, collections, file room, internet banking, credit analysis, VISA processing, mortgage operations, technology, training and development, deposit operations, operations administration, accounting, and a call center.

RFCBC, Inc, (RFCBC) is an Ohio corporation and wholly-owned subsidiary of the Company that was incorporated in August 2004. RFCBC operates as a loan subsidiary in servicing and working out problem loans.

Reliance Financial Services, N.A. (Reliance), a wholly owned subsidiary of State Bank, provides trust and financial services to customers nationwide.

Diverse Computer Marketers, Inc (DCM), a wholly owned subsidiary of RDSI, provides item processing services to financial services to over 50 financial institutions throughout the midwest.

Critical Accounting Policies

Note 1 to the Notes to the Consolidated Financial Statements included in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2005 describes the significant accounting policies used in the development and presentation of the Company s financial statements. The accounting and reporting policies of the Company are in accordance with accounting principles generally accepted in the United States and conform to general practices within the banking industry. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions. The Company s financial position and results of operations can be affected by these estimates and assumptions and are integral to the understanding of reported results. Critical accounting policies are those policies that management believes are the most important to the portrayal of the Company s financial condition and results, and they require management to make estimates that are difficult, subjective, or complex.

Allowance for Loan Losses The allowance for loan losses provides coverage for probable losses inherent in the Company s loan portfolio. Management evaluates the adequacy of the allowance for loan losses each quarter based on changes, if any, in underwriting activities, loan portfolio composition (including product mix and geographic, industry or customer-specific concentrations), trends in loan performance, regulatory guidance and economic factors. This evaluation is inherently subjective, as it requires the use of significant management estimates. Many factors can affect management s estimates of specific and expected losses, including volatility of default probabilities, rating migrations, loss severity and economic and political conditions. The allowance is increased through provisions charged to operating earnings and reduced by net charge-offs.

The Company determines the amount of the allowance based on relative risk characteristics of the loan portfolio. The allowance recorded for commercial loans is based on reviews of individual credit relationships and an analysis of the migration of commercial loans and actual loss experience. The allowance recorded for

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homogeneous consumer loans is based on an analysis of loan mix, risk characteristics of the portfolio, fraud loss and bankruptcy experiences, and historical losses, adjusted for current trends, for each homogeneous category or group of loans. The allowance for credit losses relating to impaired loans is based on the loan s observable market price, the collateral for certain collateral-dependent loans, or the discounted cash flows using the loan s effective interest rate. Regardless of the extent of the Company s analysis of customer performance, portfolio trends or risk management processes, certain inherent but undetected losses are probable within the loan portfolio. This is due to several factors, including inherent delays in obtaining information regarding a customer s financial condition or changes in their unique business conditions, the subjective nature of individual loan evaluations, collateral assessments and the interpretation of economic trends. Volatility of economic or customer-specific conditions affecting the identification and estimation of losses for larger non-homogeneous credits and the sensitivity of assumptions utilized to establish allowances for homogenous groups of loans are also factors. The Company estimates a range of inherent losses related to the existence of these exposures. The estimates are based upon the Company s evaluation of imprecise risk associated with the commercial and consumer allowance levels and the estimated impact of the current economic environment. To the extent that actual results differ from management s estimates, additional loan loss provisions may be required that could adversely impact earnings for future periods.

Goodwill and Other Intangibles The Company records all assets and liabilities acquired in purchase acquisitions, including goodwill and other intangibles, at fair value as required by SFAS 141. Goodwill is subject, at a minimum, to annual tests for impairment. Other intangible assets are amortized over their estimated useful lives using straight-line or accelerated methods, and are subject to impairment if events or circumstances indicate a possible inability to realize the carrying amount. The initial goodwill and other intangibles recorded and subsequent impairment analysis requires management to make subjective judgments concerning estimates of how the acquired asset will perform in the future. Events and factors that may significantly effect the estimates include, among others, customer attrition, changes in revenue growth trends, specific industry conditions and changes in competition. A decrease in earnings resulting from these or other factors could lead to an impairment of goodwill that could adversely impact earnings of future periods.

Impact of Accounting Changes

In March 2006, the FASB issued Statement of Financial Accounting Standards No. 156, *Accounting for Servicing of Financial Assets: an amendment of FASB Statement No. 140* (FAS 140 and FAS 156). FAS 140 establishes, among other things, the accounting for all separately recognized servicing assets and servicing liabilities. This Statement amends FAS 140 to require that all separately recognized servicing assets and servicing liabilities be initially measured at fair value, if practicable. This Statement permits, but does not require, the subsequent measurement of separately recognized servicing assets and servicing liabilities at fair value. Under this Statement, an entity can elect subsequent fair value measurement to account for its separately recognized servicing assets and servicing liabilities. Adoption of this Statement is required as of the beginning of the first fiscal year that begins after September 15, 2006. The Company is currently measuring the effects of SFAS No. 156 and looks to adopt it in the first quarter of 2007. At this time, the Company believes that the adoption of SFAS No. 156 will not have a material impact on the financial position or results of operations of the company.

In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109* (FIN 48), which clarifies the accounting for uncertainty in tax positions. This Interpretation requires that the Company recognize in the financial statements, the impact of a tax position, if that position is more likely than not of being sustained on audit, based on the technical merits of the position. The provisions of FIN 48 are effective as of the beginning of our 2007 fiscal year, with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings. The Company is currently evaluating the impact of adopting FIN 48 on its financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (FAS 157). FAS 157 enhances existing guidance for measuring assets and liabilities using fair value. Prior to the issuance of FAS 157, guidance for applying fair value was incorporated in several accounting pronouncements. FAS 157 provides a single definition of fair value, together with a framework for measuring it, and requires additional disclosure about the use of fair value to measure assets and liabilities. FAS 157 also emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and sets out a fair value hierarchy with the highest priority being quoted prices in active markets. Under FAS 157, fair value measurements are disclosed by level within that hierarchy. While FAS 157 does not add any new fair value measurements, it does change current practice. Changes to practice include: (1) a requirement for an entity to include its own credit standing in the measurement of its liabilities; (2) a modification of the transaction price presumption; (3) a prohibition on the use of block discounts when valuing large blocks of securities for broker-dealers and investment companies; and (4) a requirement to adjust the value of restricted stock for the effect of the restriction even if the restriction lapses within one year. FAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Rurban Financial Corp has not determined the impact of adopting FAS 157 on its financial statements.

Three Months Ended September 30, 2006 compared to Three Months Ended September 30, 2005

Net Income: Net income for the third quarter of 2006 was $814,000, or $0.16 per diluted share, compared to $492,000, or $0.11 per diluted share, for the third quarter of 2005. This quarterly increase in net income was driven by a $1.3 million increase in non-interest income and a $773,000 increase in net interest income, offset by a $417,000 increase in the provision for loan losses and a $1.3 million increase in non-interest expense and a $47,000 increase in income tax expense. The Company s efficiency ratio improved to 88.15% for the third quarter of 2006 compared to 94.54% for the third quarter of 2005.

Net Interest Income: The Banking Group s improving asset quality, loan growth, acquisitions and portfolio mix had a positive impact on net interest margin. Net interest income was $3.8 million, up $773,000 or 25.9 percent, from the 2005 third quarter. Average earning assets rose $110.0 million or 27.7 percent over the 12-month period, of which approximately $72.9 million was derived from the acquisition of Exchange Bank at year-end 2005. Year-over-year, the net interest margin was unchanged at 3.10 percent; the $8.9 million decline in non-performing assets over the course of the year, combined with a lower cost of funds from deposits acquired in the Exchange Bank acquisition, and the approximately $60.4 million in deposits from the two branches purchased in the Lima market in June of 2005, were offset by rising funding costs, which gradually eroded the interest margin from its first quarter 2006 high of 3.37 percent.

Provision for Loan Losses: The provision for loan losses was $35,000 in the third quarter of 2006 compared to a $(382,000) credit for the third quarter of 2005. The low provision was due in part to the Company s very low loss experience in the 2006-third quarter, which reflected net recoveries of $54,000. For the third quarter ended September 30, 2006, net charge-offs as a percentage of average loans was (0.06%) annualized. Asset quality continues to improve. At quarter end, consolidated non-performing

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assets, including those of RFCBC (the loan workout subsidiary) and Exchange Bank, were $6.1 million or 1.07% of total assets compared with $15.0 million or 3.43% of total assets for the prior year third quarter.

Non-interest Income: Non-interest income was $5.9 million for the third quarter of 2006 compared with $4.6 million for the prior-year third quarter, an increase of $1.3 million or 28.5 percent. RDSI, Rurban s data processing subsidiary, accounts for approximately $3.8 million or 64.1 percent of non-interest income and 56.7 percent of the growth; the remainder was derived from mortgage banking activities ($254,000 from gains on sale) and a swing of $61,900 from the sale of other assets, partially offset by a $34,000 lower level of securities gains than last year. The quarter was also impacted by a $265,000 increase in other income, which was driven by the payments on impaired loans and the sale of previously charged-off loans at Exchange Bank.

Non-interest Expense: Revenue for the quarter continued to grow faster than non-interest expense; year-over-year expense growth was $1.3 million or 17.9 percent compared with revenue growth of $2.1 million or 27.5 percent. The $1.3 million expense increase was primarily due to the addition of Exchange Bank s $1.2 million of operating expenses, partially offset by a $438,000 improvement in State Bank s operating expenses since the acquisition of the Lima branches in the second quarter of 2005.

Nine Months September 30, 2006 compared to Nine Months September 30, 2005

Net Income: On a consolidated basis, Rurban had net income of $2.0 million or $0.41 per diluted share for the nine months ended September 30, 2006 compared to $1.0 million or $0.22 per diluted share for the nine months ended September 30, 2005. This represents a $1.0 million or 101.57% increase in comparison of the nine-month periods. Significant changes between the two quarters include a $2.5 million increase in net interest income, a $2.3 million increase in total non-interest income offset by a $3.1 million increase in non-interest expense, a $367,000 increase in the provision for loan losses and a $338,000 increase in income tax expense. The efficiency of the Company improved to 88.8% for the nine months ended September 30, 2006 from 94.1% for the nine months ended September 30, 2005. The increase in earning assets associated with the two acquisitions that the Company completed last year was the primary cause of this improvement.

Net Interest Income: For the nine months ended September 30, 2006, net interest income increased $2.5 million to $11.5 million, a 28.6% increase from the nine-month period ended September 30, 2005. This increase is the result of a $6.1 million increase in loan interest, an $819,000 increase in taxable securities interest and a $286,000 increase in tax-exempt interest, outpacing the increase in the cost of funds of $4.6 million. Of the $4.6 million increase in interest expense, deposit interest expense increased by $3.7 million, trust preferred securities interest increased by $489,000, Retail Repurchase Agreements increased by $405,000, and Federal Home Loan Bank advance interest increased by $103,000.

Provision for Loan Losses: The provision for loan losses was $337,000 for the nine months ended September 30, 2006 compared to $(30,000) for the nine months ended September 30, 2005. This represents a $367,000 increase in comparison of the nine month periods and is more representative of future provisions. The following asset quality ratios as of the end of their respective periods demonstrate the continued low level provision:

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(dollars in , 000)	September 30, 2006	December 31, 2005	September 30, 2005
Non-performing loans	$5,636	$6,270	$12,507
Allowance for loan losses / Total loans	1.24%	1.44%	1.77%
Allowance for loan losses/Non-performing loans	80.2%	75.0%	38.5%

Non-interest Income: Non-interest income was $16.2 million for the nine months ended September 30, 2006 compared with $13.9 million for the nine months ended September 30, 2005. Of the $2.3 million increase, RDSI accounted for $1.0 million or 43.21%. Customer service fees increased $226,000 and gain on the sales of loans increased $370,000 in the first three quarters of 2006 compared to the first three quarters of 2005. Management attributes these increases to the Exchange Bank and Lima Market branch acquisitions and the bank s increased emphasis on loan sales to the secondary market. Another increase includes other non-interest income, which increased $554,000, largely driven by gains on the sale of OREO properties and recoveries on Exchange Bank loans charged off prior to the acquisition date.

Non-interest Expense: For the nine months ended September 30, 2006, total non-interest expense was $24.5 million. This represents a $3.1 million increase from the $21.4 million reported for the nine months ended September 30, 2005. Of this $3.1 million increase, salaries and employee benefits increased $1.6 million or 15.16% to $11.9 million at September 30, 2006. Net occupancy expense increased $438,000 to $1.3 million and equipment expense increased $337,000 to $4.2 million in comparison of the two nine month periods ended September 30, 2006 and 2005. These increases are direct results of the acquisitions made in 2005. Professional fees decreased $172,000 from $1.7 million for the nine months ended September 30, 2005 to $1.5 million for the nine months ended September 30, 2006, primarily as a result of the decrease in non-performing loans.

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Changes in Financial Condition

September 30, 2006 vs. December 31, 2005

At September 30, 2006, total assets were $570.0 million, representing an increase of $39.4 million or 7.43% over December 31, 2005. The increase was primarily attributable to an increase of $37.3 million or 11.40% in loans, while available-for-sale securities decreased $11.5 million during the nine month period. The entire securities portfolio of Exchange Bank was liquidated in the first quarter of 2006 and only a portion was reinvested in securities. The remaining portion of the $11.5 million reduction in the securities portfolio was invested in the loan portfolio which, in turn, contributed to the increase in net interest income.

From December 31, 2005 to September 30, 2006, foreclosed assets held for sale decreased from $2.3 million to $490,000. At quarter end, consolidated non-performing assets, including those of RFCBC (the loan workout subsidiary) and Exchange Bank, were $6.1 million or 1.07% of total assets, compared with $15.0 million or 3.43% of total assets at September 30, 2005. This decrease in non-interest-earning/non-performing assets has also had a positive impact on net interest income.

At September 30, 2006, liabilities totaled $513.9 million, an increase of $37.8 million since December 31, 2005. Of this increase, significant changes include total deposits, which increased $27.3 million (7.10%), Federal Home Loan Bank Advances which decreased $7.0 million (15.38%), repurchase agreements which increased $25.7 million (422.76%), federal funds purchased which decreased $3.8 million (82.61%) and other liabilities which decreased $6.7 million (55.38%). Of the $27.3 million increase in total deposits, time deposits increased $26.1 million and savings, interest checking and money market deposits increased $9.0 million, while demand deposits decreased $7.7 million during the period. Of the $6.7 million decrease in other liabilities, $6.5 million is the result of the cash paid to the shareholders of Exchange as part of the acquisition.

Capital Resources

At September 30, 2006, actual capital levels (in millions) and minimum required levels were as follows:

	Actual		Minimum Required For Capital Adequacy Purposes		Minimum Required To Be Well Capitalized Under Prompt Corrective Action Regulations	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital (to risk weighted assets)						
Consolidated	$62.4	16.3%	$30.7	8.0%	$	N/A
State Bank	38.4	12.2	25.1	8.0	31.4	10.0
Exchange Bank	7.8	13.1	4.7	8.0	5.9	10.0

The Company, State Bank and Exchange Bank were categorized as well capitalized at September 30, 2006.

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LIQUIDITY

Liquidity relates primarily to the Company s ability to fund loan demand, meet deposit customers withdrawal requirements and provide for operating expenses. Assets used to satisfy these needs consist of cash and due from banks, federal funds sold, interest earning deposits in other financial institutions, securities available-for sale and loans held for sale. These assets are commonly referred to as liquid assets. Liquid assets were $146.6 million at September 30, 2006 compared to $152.4 million at December 31, 2005.

The Company s residential first mortgage portfolio of $93.5 million at September 30, 2006 and $89.1 million at December 31, 2005, which can and has been used to collateralize borrowings, is an additional source of liquidity. Management believes its current liquidity level is sufficient to meet its liquidity needs. At September 30, 2006, all eligible mortgage loans were pledged under a Federal Home Loan Bank (FHLB) blanket lien.

The cash flow statements for the periods presented provide an indication of the Company s sources and uses of cash as well as an indication of the ability of the Company to maintain an adequate level of liquidity. A discussion of the cash flow statements for the nine months ended September 30, 2006 and 2005 follows.

The Company experienced positive cash flows from operating activities for the nine months ended September 30, 2006 and 2005. Net cash provided from operating activities was $2.6 million and $3.5 million respectively, for the nine months ended September 30, 2006 and 2005.

Net cash flow from investing activities was $(38.7) million and $32.5 million for the nine months ended September 30, 2006 and 2005, respectively. The changes in net cash from investing activities at September 30, 2006 include loan growth of $38.2 million, available-for-sale securities purchases totaling $13.8 million, the payment to the Exchange shareholders of $6.5 million, the payment to the shareholders of Diverse Computer Marketers of $4.8 million, which were partially offset by investment security maturities and sales of $25.6 million and the sale of $2.7 million in foreclosed assets. The changes in net cash from investing activities at September 30, 2005 include an increase of $48.6 million from the assumption of net liabilities in the Lima Market branch acquisitions, offset by $30.2 million in available-for-sale securities purchases and a $4.2 million increase in the loan portfolio.

Net cash flow from financing activities was $41.8 million and $(37.7) million for the nine month periods ended September 30, 2006 and 2005. The 2006 financing activities include a $27.3 million increase in deposits, and a $25.7 million increase in repurchase agreements, offset by a net decrease in FHLB advances of $7.0 million, and a decrease of $3.8 million in fed funds purchased. For the nine months ended September 30, 2005, net FHLB advances decreased $22.0 million, fed funds purchased decreased $5.4 million and deposits decreased $21.5 million.

Off-Balance-Sheet Borrowing Arrangements:

Significant additional off-balance-sheet liquidity is available in the form of FHLB advances, unused federal funds lines from correspondent banks, and the national certificate of deposit market.

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Approximately $76.3 million of the Company s $93.5 million residential first mortgage loan portfolio qualifies to collateralize FHLB borrowings and was pledged to meet FHLB collateralization requirements as of September 30, 2006. In addition to residential first mortgage loans, $20.4 million in investment securities are pledged to meet FHLB collateralization requirements. Based on the current collateralization requirements of the FHLB, approximately $15.9 million of additional borrowing capacity existed at September 30, 2006.

As of September 30, 2006, the Company had unused federal funds lines totaling $20.1 million from four correspondent banks. At December 31, 2005, the Company had $20.9 million in federal fund lines. Federal funds borrowed were $800,000 at September 30, 2006 and $4.6 million at December 31, 2005.

The Company s contractual obligations as of September 30, 2006 were evident in long-term debt obligations, other debt obligations, operating lease obligations and other long-term liabilities. Long-term debt obligations are comprised of FHLB advances of $38.5 million. Other debt obligations are comprised of Trust Preferred Securities of $20.6 million. The operating lease obligation is a lease on the ROC operations building of $99,600 per year, the RDSI-North building of $162,000 per year, the new Northtowne branch of State Bank of $60,000 per year and the DCM Lansing and Indiana facilities which total $108,000 and $60,000, respectively. Other long-term liabilities are comprised of time deposits of $234.6 million.

ASSET LIABILITY MANAGEMENT

Asset liability management involves developing and monitoring strategies to maintain sufficient liquidity, maximize net interest income and minimize the impact that significant fluctuations in market interest rates would have on earnings. The business of the Company and the composition of its balance sheet consists of investments in interest-earning assets (primarily loans, mortgage-backed securities, and securities available for sale) which are primarily funded by interest-bearing liabilities (deposits and borrowings). With the exception of loans, which are originated and held for sale, all of the financial instruments of the Company are for other than trading purposes. All of the Company s transactions are denominated in U.S. dollars with no specific foreign exchange exposure. In addition, the Company has limited exposure to commodity prices related to agricultural loans. The impact of changes in foreign exchange rates and commodity prices on interest rates are assumed to be insignificant. The Company s financial instruments have varying levels of sensitivity to changes in market interest rates resulting in market risk. Interest rate risk is the Company s primary market risk exposure; to a lesser extent, liquidity risk also impacts market risk exposure. Interest rate risk is the exposure of a banking institution s financial condition to adverse movements in interest rates. Accepting this risk can be an important source of results and profitability and stockholder value; however, excessive levels of interest rate risk could pose a significant threat to the Company s earnings and capital base. Accordingly, effective risk management that maintains interest rate risks at prudent levels is essential to the Company s safety and soundness.

Evaluating a financial institution s exposure to changes in interest rates includes assessing both the adequacy of the management process used to control interest rate risk and the organization s quantitative level of exposure. When assessing the interest rate risk management process, the Company seeks to ensure that appropriate policies, procedures, management information systems, and internal controls are in place to maintain interest rate risks at prudent levels of consistency and continuity. Evaluating the quantitative level of interest rate risk exposure requires the Company to assess the existing and potential future effects of changes in interest rates on its consolidated financial condition, including capital adequacy, earnings, liquidity, and asset quality (when appropriate).

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The Federal Reserve Board, together with the Office of the Comptroller of the Currency and the Federal Deposit Insurance Company, adopted a Joint Agency Policy Statement on interest rate risk effective June 26, 1996. The policy statement provides guidance to examiners and bankers on sound practices for managing interest rate risk, and serves as the basis for ongoing evaluation of the adequacy of interest rate risk management at supervised institutions. The policy statement also outlines fundamental elements of sound management that have been identified in prior Federal Reserve guidance and discusses the importance of these elements in the context of managing interest rate risk. Specifically, the guidance emphasizes the need for active Board of Director and senior management oversight and a comprehensive risk management process that effectively identifies, measures, and controls interest rate risk.

Financial institutions derive their income primarily from the excess of interest collected over interest paid. The rates of interest an institution earns on its assets and owes on its liabilities generally are established contractually for a period of time. Since market interest rates change over time, an institution is exposed to lower profit margins (or losses) if it cannot adapt to interest rate changes. For example, assume that an institution s assets carry intermediate or long term fixed rates and that those assets are funded with short-term liabilities. If market interest rates rise by the time the short-term liabilities must be refinanced, the increase in the institution s interest expense on its liabilities may not be sufficiently offset if assets continue to earn at the long-term fixed rates. Accordingly, an institution s profits could decrease on existing assets because the institution will either have lower net interest income or possibly, net interest expense. Similar risks exist when assets are subject to contractual interest rate ceilings, or rate sensitive assets are funded by longer-term, fixed-rate liabilities in a declining rate environment.

There are several ways an institution can manage interest rate risk including: 1) matching repricing periods for new assets and liabilities, for example, by shortening terms of new loans or investments; 2) selling existing assets or repaying certain liabilities; and 3) hedging existing assets, liabilities, or anticipated transactions. An institution might also invest in more complex financial instruments intended to hedge or otherwise change interest rate risk. Interest rate swaps, futures contacts, options on futures contracts, and other such derivative financial instruments can be used for this purpose. Because these instruments are sensitive to interest rate changes, they require management s expertise to be effective. The Company has not purchased derivative financial instruments in the past.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The following table provides information about the Company s financial instruments used for purposes other than trading that are sensitive to changes in interest rates as of September 30, 2006. It does not present when these items may actually reprice. For loans receivable, securities, and liabilities with contractual maturities, the table presents principal cash flows and related weighted-average interest rates by contractual maturities as well as the Company s historical experience of the impact of interest rate fluctuations on the prepayment of loans and mortgage backed securities. For core deposits (demand deposits, interest-bearing checking, savings, and money market deposits) that have no contractual maturity, the table presents principal cash flows and, as applicable, related weighted-average interest rates based upon the Company s historical experience, management s judgment and statistical analysis, as applicable, concerning their most likely withdrawal behaviors. The current interest rates for core deposits have been assumed to apply for future periods in this table as the actual interest rates that will need to be paid to maintain these deposits are not currently known. Weighted average variable rates are based upon contractual rates existing at the reporting date.

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Principal/Notional Amount Maturing or Assumed to Withdraw In:
(Dollars in Thousands)

Comparison of 2006 to 2005:	First Year	Years 2 5	Thereafter	Total
Total rate-sensitive assets:				
At September 30, 2006	$ 201,940	$ 169,048	$ 125,644	$ 496,632
At December 31, 2005	215,721	162,891	92,014	470,626
Increase (decrease)	$ (13,784)	$ 6,157	$ 33,629	$ 26,006
Total rate-sensitive liabilities:				
At September 30, 2006	$ 230,863	$ 228,539	$ 46,949	$ 506,351
At December 31, 2005	200,846	221,267	40,464	462,577
Increase (decrease)	$ 30,017	$ 7,272	$ 6,484	$ 43,773

The above table reflects expected maturities, not expected repricing. The contractual maturities adjusted for anticipated prepayments and anticipated renewals at current interest rates, as shown in the preceding table, are only part of the Company s interest rate risk profile. Other important factors include the ratio of rate-sensitive assets to rate sensitive liabilities (which takes into consideration loan repricing frequency, but not when deposits may be repriced) and the general level and direction of market interest rates. For core deposits, the repricing frequency is assumed to be longer than when such deposits actually reprice. For some rate sensitive liabilities, their repricing frequency is the same as their contractual maturity. For variable rate loans receivable, repricing frequency can be daily or monthly. For adjustable rate loans receivable, repricing can be as frequent as annually for loans whose contractual maturities range from one to thirty years. While increasingly aggressive local market competition in lending rates has pushed loan rates lower, the Company s increased reliance on non-core funding sources has restricted the Company s ability to reduce funding rates in concert with declines in lending rates.

The Company manages its interest rate risk by the employment of strategies to assure that desired levels of both interest-earning assets and interest-bearing liabilities mature or reprice with similar time frames. Such strategies include: 1) loans receivable which are renewed (and repriced) annually, 2) variable rate loans, 3) certificates of deposit with terms from one month to six years and 4) securities available for sale which mature at various times primarily from one through ten years, 5) federal funds borrowings with terms of one day to 90 days, and 6) FHLB borrowings with terms of one day to ten years.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

With the participation of the President and Chief Executive Officer (the principal executive officer) and the Executive Vice President and Chief Financial Officer (the principal financial officer) of the Company, the Company s management has evaluated the effectiveness of the Company s disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)) as of the end of the quarterly period covered by this Quarterly Report on Form 10-Q. Based on that evaluation, the Company s President and Chief Executive Officer and Executive Vice President and Chief Financial Officer have concluded that:

information required to be disclosed by the Company in this Quarterly Report on Form 10-Q and other reports which the Company files or submits under the Exchange Act would be accumulated and communicated to the Company s management, including its principal

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executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure;

- information required to be disclosed by the Company in this Quarterly Report on Form 10-Q and other reports which the Company files or submits under the Exchange Act would be recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms; and
- the Company s disclosure controls and procedures are effective as of the end of the quarterly period covered by this Quarterly Report on Form 10-Q to ensure that material information relating to the Company and its consolidated subsidiaries is made known to them, particularly during the period in which this Quarterly Report on Form 10-Q is being prepared.

Changes in Internal Control Over Financial Reporting

There were no changes in the Company s internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) that occurred during the Company s fiscal quarter ended September 30, 2006, that have materially affected or are reasonably likely to materially affect, the Company s internal control over financial reporting.

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PART II OTHER INFORMATION

Item 1. Legal Proceedings

There are no material pending legal proceedings against the Company or any of its subsidiaries other than ordinary, routine litigation incidental to their respective businesses. In the opinion of management, this litigation should not, individually or in the aggregate, have a material adverse effect on the Company s results of operations or financial condition.

Item 1A. Risk Factors

An investment in our common shares involves certain risks, including those identified and described in Part I, Item 1A. Risk Factors of the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2005, as well as cautionary statements contained in this Form 10-Q. These risk factors could materially affect the Company s business, financial condition or future results. There have been no material change in the risk factors previously disclosed in the Company s Form 10-K.

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

a. Not applicable

b. Not applicable c. The following table provides information regarding repurchases of the Company s common shares during the nine months ended September 30, 2006:

Period	Total Number of Shares Purchased (1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs
July 1 through July 31, 2006	355	$11.09		
August 1 through August 31, 2006	1,554	$11.29		
September 1 through September 30, 2006	923	$11.55		

(1) All of the repurchased shares were purchased by Reliance Financial Services, N.A., an indirect subsidiary of the Company, in its capacity as the administrator of

the Company s Employee Stock Ownership and Savings Plan.

Item 3. Defaults Upon Senior Securities

Not applicable

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

Not applicable

Item 5. Other Information

Not applicable

Item 6. Exhibits

31.1 Rule 13a-14(a)/15d-14(a) Certification (Principal Executive Officer)

31.2 Rule 13a-14(a)/15d-14(a) Certification (Principal Financial Officer)

32.1 Section 1350 Certification (Principal Executive Officer)

32.2 Section 1350 Certification (Principal Financial Officer)

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SIGNATURES

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

RURBAN FINANCIAL CORP.

Date: November 14, 2006

By: /s/ Kenneth A. Joyce
Kenneth A. Joyce
President & Chief Executive Officer

By: /s/ Duane L. Sinn
Duane L. Sinn
Executive Vice President & Chief Financial Officer