

Bancorp, Inc.  
Form 10-Q  
November 09, 2007  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

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**FORM 10-Q**

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(Mark One)

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

For the quarterly period ended: September 30, 2007

OR

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

For the transition period from:            to

Commission file number: 51018

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**THE BANCORP, INC.**

*(Exact name of registrant as specified in its charter)*

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**Delaware**  
*(State or other jurisdiction of  
incorporation or organization)*

**405 Silverside Road**  
**Wilmington, DE 19809**

**23-3016517**  
*(IRS Employer  
Identification No.)*

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*(Address of principal executive offices)*

*(Zip code)*

**Registrant's telephone number, including area code: (302) 385-5000**

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

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

(Check one): Large accelerated filer  Accelerated filer  Non-accelerated filer

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

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

As of November 5, 2007 there were 13,823,237 outstanding shares of Common Stock, \$1.00 par value.

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**Table of Contents****PART I FINANCIAL INFORMATION**

Item 1. Financial statements

**The Bancorp, Inc. and Subsidiary****Consolidated Balance Sheets**

|  | September 30,<br>2007<br>(unaudited) | December 31,<br>2006 |
|--|--------------------------------------|----------------------|
|  | (in thousands)                       |                      |
| <b>ASSETS</b>  |                                      |                      |
| Cash and cash equivalents  |                                      |                      |
| Cash and due from banks  | \$ 20,869                            | \$ 13,405            |
| Interest bearing deposits  | 1,748                                | 1,668                |
| Federal funds sold   | 87,394                               | 122,048              |
| Total cash and cash equivalents  | 110,011                              | 137,121              |
| Investment securities, available-for-sale  | 117,790                              | 115,946              |
| Loans and leases held for sale   |                                      | 2,996                |
| Loans, net of deferred loan costs  | 1,262,333                            | 1,061,823            |
| Allowance for loan and lease losses  | (9,527)                              | (8,400)              |
| Loans, net   | 1,252,806                            | 1,056,419            |
| Premises and equipment, net  | 3,867                                | 3,951                |
| Accrued interest receivable  | 8,602                                | 8,537                |
| Other real estate  | 1,566                                |                      |
| Goodwill   | 3,951                                | 3,951                |
| Other assets   | 9,594                                | 8,913                |
| Total assets   | \$ 1,508,187                         | \$ 1,334,838         |
| <b>LIABILITIES</b>   |                                      |                      |
| Deposits   |                                      |                      |
| Demand (non-interest bearing)  | \$ 95,186                            | \$ 97,326            |
| Savings, money market and interest checking  | 610,672                              | 517,099              |
| Time deposits  | 377,792                              | 435,751              |
| Time deposits, \$100,000 and over  | 22,274                               | 19,079               |
| Total deposits   | 1,105,924                            | 1,069,255            |
| Securities sold under agreements to repurchase   | 3,845                                | 8,145                |
| Short-term borrowings  | 230,000                              | 100,000              |
| Accrued interest payable   | 3,346                                | 6,476                |
| Other liabilities  | 2,488                                | 2,054                |
| Total liabilities  | 1,345,603                            | 1,185,930            |
| <b>SHAREHOLDERS EQUITY</b>   |                                      |                      |
| Preferred stock -authorized 5,000,000 shares of \$0.01 par value; issued and outstanding, 112,591 and 118,628 shares at September 30, 2007 and December 31, 2006, respectively | 1                                    | 1                    |

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|   |              |              |
|---|--------------|--------------|
| Common stock authorized, 20,000,000 shares of \$1.00 par value; issued shares 13,823,237 and 13,724,023 at September 30, 2007 and December 31, 2006, respectively | 13,823       | 13,724       |
| Additional paid-in capital  | 127,288      | 125,572      |
| Retained earnings   | 22,141       | 10,881       |
| Accumulated other comprehensive loss  | (669)        | (1,270)      |
| Total shareholders equity   | 162,584      | 148,908      |
| Total liabilities and shareholders equity   | \$ 1,508,187 | \$ 1,334,838 |

The accompanying notes are an integral part of these statements.

**Table of Contents****The Bancorp Inc.****Consolidated Statements of Income**

|   | For the three months ended        |                       | For the nine months ended |                       |
|---|-----------------------------------|-----------------------|---------------------------|-----------------------|
|   | September 30,<br>2007             | September 30,<br>2006 | September 30,<br>2007     | September 30,<br>2006 |
|   | (unaudited)                       |                       |                           |                       |
|   | (in thousands, except share data) |                       |                           |                       |
| Interest income   |                                   |                       |                           |                       |
| Loans, including fees   | \$ 25,418                         | \$ 19,329             | \$ 71,529                 | \$ 50,118             |
| Investment securities   | 1,647                             | 1,708                 | 4,924                     | 4,881                 |
| Federal funds sold  | 405                               | 802                   | 2,718                     | 2,311                 |
|   | 27,470                            | 21,839                | 79,171                    | 57,310                |
| Interest expense  |                                   |                       |                           |                       |
| Deposits  | 12,219                            | 9,991                 | 37,265                    | 23,436                |
| Securities sold under agreements to repurchase                | 12                                | 20                    | 40                        | 42                    |
| Short-term borrowings   | 1,486                             | 543                   | 2,747                     | 1,513                 |
|   | 13,717                            | 10,554                | 40,052                    | 24,991                |
| Net interest income   | 13,753                            | 11,285                | 39,119                    | 32,319                |
| Provision for loan and lease losses                           | 750                               | 825                   | 2,250                     | 2,125                 |
| Net interest income after provision for loan and lease losses | 13,003                            | 10,460                | 36,869                    | 30,194                |
| Non-interest income   |                                   |                       |                           |                       |
| Service fees on deposit accounts                              | 228                               | 224                   | 693                       | 609                   |
| Merchant credit card deposit fees                             | 244                               | 278                   | 750                       | 861                   |
| Loss on sales of investment securities                        |                                   |                       | (2)                       |                       |
| Leasing income  | 385                               | 227                   | 1,885                     | 1,032                 |
| ACH Processing Fees   | 61                                | 149                   | 244                       | 475                   |
| Other   | 243                               | 211                   | 772                       | 845                   |
| Total non-interest income                                     | 1,161                             | 1,089                 | 4,342                     | 3,822                 |
| Non-interest expense  |                                   |                       |                           |                       |
| Salaries and employee benefits                                | 3,699                             | 2,960                 | 10,648                    | 9,302                 |
| Occupancy expense   | 704                               | 673                   | 2,160                     | 1,995                 |
| Data processing expense                                       | 747                               | 570                   | 2,107                     | 1,781                 |
| Advertising   | 172                               | 117                   | 521                       | 415                   |
| Professional fees   | 416                               | 492                   | 1,579                     | 1,276                 |
| Other   | 1,963                             | 1,379                 | 5,424                     | 4,288                 |
| Total non-interest expense                                    | 7,701                             | 6,191                 | 22,439                    | 19,057                |
| Net income before income tax                                  | 6,463                             | 5,358                 | 18,772                    | 14,959                |
| Income tax  | 2,609                             | 2,074                 | 7,413                     | 5,652                 |
| Net income  | 3,854                             | 3,284                 | 11,359                    | 9,307                 |

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|   |            |            |            |            |
|---|------------|------------|------------|------------|
| Less preferred stock dividends and accretion        | (17)       | (29)       | (52)       | (83)       |
| Income allocated to Series A preferred shareholders | (31)       | (17)       | (92)       | (57)       |
| Net income available to common shareholders         | \$ 3,806   | \$ 3,238   | \$ 11,215  | \$ 9,167   |
| Net income per share basic                          | \$ 0.28    | \$ 0.24    | \$ 0.81    | \$ 0.67    |
| Net income per share diluted                        | \$ 0.27    | \$ 0.23    | \$ 0.78    | \$ 0.64    |
| Weighted average shares basic                       | 13,812,944 | 13,685,520 | 13,787,093 | 13,662,718 |
| Weighted average shares diluted                     | 14,301,852 | 14,341,277 | 14,374,789 | 14,273,151 |

The accompanying notes are an integral part of these statements.

**Table of Contents****THE BANCORP INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY****For the nine months ended September 30, 2007****(unaudited)**

|  |                 |                    | Additional         |                      | Accumulated<br>other<br>comprehensive |           | Comprehensive | Total      |
|--|-----------------|--------------------|--------------------|----------------------|---------------------------------------|-----------|---------------|------------|
|  | Common<br>Stock | Preferred<br>Stock | paid-in<br>capital | Retained<br>earnings | loss                                  | income    |               |            |
| Balance at January 1, 2007   | \$ 13,724       | \$ 1               | \$ 125,572         | \$ 10,881            | \$ (1,270)                            | \$ 12,656 |               | \$ 148,908 |
| Cumulative effect of change in Accounting<br>Principle FIN-48              |                 |                    |                    |                      |                                       |           |               |            |
| Accounting for Uncertainty in Income Taxes                                 |                 |                    |                    | (47)                 |                                       |           |               | (47)       |
| Balance at January 1, 2007, revised  | 13,724          | 1                  | 125,572            | 10,834               | (1,270)                               | 12,656    |               | 148,861    |
| Net Income   |                 |                    |                    | 11,359               |                                       |           | 11,359        | 11,359     |
| Preferred Shares converted to Common Shares                                | 7               |                    | (7)                |                      |                                       |           |               |            |
| Common Stock issued from option exercise, net of<br>excess benefits        | 92              |                    | 1,479              |                      |                                       |           |               | 1,571      |
| Cash dividends on Series A preferred stock                                 |                 |                    |                    | (52)                 |                                       |           |               | (52)       |
| Stock-based compensation expense   |                 |                    | 244                |                      |                                       |           |               | 244        |
| Other comprehensive income, net of reclassification<br>adjustments and tax |                 |                    |                    |                      | 601                                   | 601       |               | 601        |
| Balance at September 30, 2007  | \$ 13,823       | \$ 1               | \$ 127,288         | \$ 22,141            | \$ (669)                              | \$ 11,960 |               | \$ 162,584 |

The accompanying notes are an integral part of these statements.



**Table of Contents****The Bancorp, Inc.****Statements of Cash Flows**

(in thousands)

(unaudited)

|  | <b>For the nine months ended<br/>September 30,</b> |                   |
|--|--|-------------------|
|  | <b>2007</b>  | <b>2006</b>       |
| <b>Operating activities</b>  |  |                   |
| Net income   | \$ 11,359  | \$ 9,307          |
| Adjustments to reconcile net income to net cash provided by operating activities |  |                   |
| Depreciation and amortization  | 1,579  | 1,502             |
| Provision for loan and lease losses  | 2,250  | 2,125             |
| Net amortization (accretions) of premium (discount)                              | (43)   | (10)              |
| Net loss on sales of investment securities                                       | 2  |                   |
| Share based compensation expense   | 244  | 230               |
| Increase in accrued interest receivable  | (65)   | (1,778)           |
| Increase (decrease) in interest payable  | (3,130)  | 2,992             |
| Increase in other assets   | (1,314)  | (786)             |
| Increase (decrease) in other liabilities   | 434  | (2,417)           |
| <b>Net cash provided by operating activities</b>                                 | <b>11,316</b>                                      | <b>11,165</b>     |
| <b>Investing activities</b>  |  |                   |
| Purchase of investment securities  | (2,489)  | (11,649)          |
| Proceeds from calls/maturity of investment securities                            | 1,582  | 4                 |
| Purchase of loans  | (1,495)  | (6,455)           |
| Net increase in loans  | (198,708)  | (259,518)         |
| Purchases of premises and equipment  | (1,132)  | (901)             |
| <b>Net cash used in investing activities</b>                                     | <b>(202,242)</b>                                   | <b>(278,519)</b>  |
| <b>Financing activities</b>  |  |                   |
| Net increase in deposits   | 36,669   | 288,879           |
| Net decrease in securities sold under agreements to repurchase                   | (4,300)  | (727)             |
| Net increase from Federal funds purchased  | 80,000   |                   |
| Net increase from Federal Home Loan advances                                     | 50,000   | 35,000            |
| Dividends on Series A preferred stock  | (52)   | (57)              |
| Net proceeds from the exercise of options  | 1,237  | 685               |
| Excess tax benefit from share-based payment arrangements                         | 262  | 164               |
| <b>Net cash provided by financing activities</b>                                 | <b>163,816</b>                                     | <b>323,944</b>    |
| <b>Net (decrease) increase in cash and cash equivalents</b>                      | <b>(27,110)</b>                                    | <b>56,590</b>     |
| <b>Cash and cash equivalents, beginning of year</b>                              | <b>137,121</b>                                     | <b>117,093</b>    |
| <b>Cash and cash equivalents, end of period</b>                                  | <b>\$ 110,011</b>                                  | <b>\$ 173,683</b> |

Supplemental disclosure:

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|  |           |           |
|--|-----------|-----------|
| Interest Paid  | \$ 42,241 | \$ 21,999 |
| Taxes Paid   | \$ 7,565  | \$ 8,337  |
| Supplemental disclosure of noncash investing and financing activities: |           |           |
| Transfer of loans to other real estate owned.                          | \$ 1,566  | \$        |

The accompanying notes are an integral part of these statements.

**Table of Contents****THE BANCORP, INC. AND SUBSIDIARY****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****Note 1. Significant Accounting Policies**

## Basis of Presentation

The financial statements and related footnote disclosures of The Bancorp, Inc. (Company) as of September 30, 2007 and for the three and nine month periods ended September 30, 2007 and 2006 are unaudited. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted in this Form 10-Q pursuant to the rules and regulations of the Securities and Exchange Commission. However, in the opinion of management, these interim financial statements include all necessary adjustments to fairly present the results of the interim periods presented. The unaudited interim consolidated financial statements should be read in conjunction with the audited financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2006. The results of operations for the three and nine month periods ended September 30, 2007 may not necessarily be indicative of the results of operations for the full year ending December 31, 2007.

**Note 2. Stock-based Compensation**

The Company accounts for its stock options and phantom stock units under Statement of Financial Accounting Standards (SFAS) No. 123(R), *Share-based Payment*, that addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for (a) equity instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. Under SFAS No. 123(R), all forms of share-based payments to employees, including employee stock options and phantom stock units, would be treated the same as other forms of compensation by recognizing the related cost in income. The expense of the award would generally be measured at fair value at the grant date. The impact of this standard is reflected in the net earnings and related per share amounts for the quarters and nine months ended September 30, 2007 and 2006. At September 30, 2007, the Company has two stock-based compensation plans, which are more fully described in its Form 10-K report.

The fair value of each option and phantom stock unit grant is estimated on the date of the grant using the Black-Scholes option-pricing model. The significant assumptions utilized in applying the Black-Scholes option pricing model are the risk-free interest rate, expected term, dividend yield, and expected volatility. The risk-free interest rate is the implied yield currently available on U.S. Treasury zero-coupon issues with a remaining term equal to the expected term used in the assumption for the model. The expected term of an option or phantom award is based on historical experience of similar awards. The dividend yield is determined by dividing per share and phantom stock unit dividend by the grant date stock price. The expected volatility is based on the volatility of the Company's stock price over a historical period comparable to the expected term. The weighted-average assumptions used in the Black-Scholes valuation model for the stock options are shown below.

|                         | <b>For the nine<br/>months ended<br/>September 30,<br/>2007</b> | <b>For the nine<br/>months ended<br/>September 30,<br/>2006</b> |
|-------------------------|---|---|
| Risk-free interest rate | 4.56%   | 4.57%   |
| Expected term           | 5.4   | 7.0   |
| Dividend                | 0.00%   | 0.00%   |
| Expected volatility     | 29.52%  | 27.48%  |

As of September 30, 2007 there was \$162,000 of total unrecognized compensation cost related to unvested share-based compensation arrangements granted under the plans; that cost is expected to be recognized over a period of 2.5 years. Cash received from option exercises for the periods ending September 30, 2007 and 2006 was \$1.2 million and \$685,000 respectively. Included in net income for the nine months ended September 30, 2007 and 2006 was compensation expense of \$244,000 and \$230,000 respectively. The following tables are a summary of activity in the plans as of September 30, 2007 and changes during the period then ended:

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Options:

|  | For the nine months ended |                                 |                                     |                           |
|--|---------------------------|---------------------------------|-------------------------------------|---------------------------|
|  | Shares                    | Weighted-Average Exercise Price | Average Remaining Contractual Years | Aggregate Intrinsic Value |
| Outstanding at beginning of the period | 1,588,908                 | 12.10                           |                                     |                           |
| Granted                                | 17,000                    | 24.02                           |                                     |                           |
| Exercised                              | 92,171                    | 13.42                           |                                     |                           |
| Forfeited                              |                           |                                 |                                     |                           |
| Outstanding at end of period           | 1,513,737                 | 12.15                           | 5.85                                | \$ 9,645,804              |
| Options exercisable at end of period   | 1,501,237                 | 12.05                           | 5.82                                | \$ 9,645,804              |

Phantom units of 10,000 shares were granted in 2007 and vest on December 31, 2007.

**Note 3. Earnings Per Share**

*Basic earnings per share* for a particular period of time is calculated by dividing net income by the weighted average number of common shares outstanding during that period.

*Diluted earnings per share* is calculated by dividing net income by the weighted average number of common shares and common share equivalents. The Company's only outstanding common share equivalents are phantom stock units and options to purchase its common stock.

The following table shows the Company's earnings per share for the periods presented:

|  | For the three months ended |   |                  |
|--|----------------------------|---|------------------|
|  | Income (numerator)         | Shares (denominator) (dollars in thousands) | Per share amount |
| Basic earnings per share   |                            |   |                  |
| Net income available to common shareholders                          | \$ 3,806                   | 13,812,944                                  | \$ 0.28          |
| Effect of dilutive securities  |                            |   |                  |
| Phantom Stock Units  |                            | 5,590                                       |                  |
| Options  |                            | 483,318                                     | (0.01)           |
| Diluted earnings per share   |                            |   |                  |
| Net income available to common stockholders plus assumed conversions | \$ 3,806                   | 14,301,852                                  | \$ 0.27          |

Stock options for 18,000 shares, exercisable at prices between \$20.98 and \$25.43 per share, were outstanding at September 30, 2007 but were not included in the weighted-average shares because the exercise price was greater than the market price.

For the nine months ended  
September 30, 2007

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|  | Income<br>(numerator) | Shares<br>(denominator)<br>(dollars in thousands) | Per<br>share<br>amount |
|--|-----------------------|---|------------------------|
| <b>Basic earnings per share</b>                                      |                       |   |                        |
| Net income available to common shareholders                          | \$ 11,215             | 13,787,093  | \$ 0.81                |
| <b>Effect of dilutive securities</b>                                 |                       |   |                        |
| Phantom Stock Units  |                       | 1,615   |                        |
| Options  |                       | 586,081   | (0.03)                 |
| <b>Diluted earnings per share</b>                                    |                       |   |                        |
| Net income available to common stockholders plus assumed conversions | \$ 11,215             | 14,374,789  | \$ 0.78                |

Stock options for 12,000 shares, exercisable at prices between \$24.18 and \$25.43 per share, were outstanding at September 30, 2007 but were not included in the weighted-average shares because the exercise prices was greater than the market price.

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|  | For the three months ended<br>September 30, 2006 |   |                        |
|--|--|---|------------------------|
|  | Income<br>(numerator)                            | Shares<br>(denominator)<br>(dollars in thousands) | Per<br>share<br>amount |
| <b>Basic earnings per share</b>                                      |  |   |                        |
| Net income available to common shareholders                          | \$ 3,238   | 13,685,520  | \$ 0.24                |
| <b>Effect of dilutive securities</b>                                 |  |   |                        |
| Phantom Stock Units  |  | 3,876   |                        |
| Options  |  | 651,881   | (0.01)                 |
| <b>Diluted earnings per share</b>                                    |  |   |                        |
| Net income available to common stockholders plus assumed conversions | \$ 3,238   | 14,341,277  | \$ 0.23                |

|  | For the nine months ended<br>September 30, 2006 |   |                        |
|--|---|---|------------------------|
|  | Income<br>(numerator)                           | Shares<br>(denominator)<br>(dollars in thousands) | Per<br>share<br>amount |
| <b>Basic earnings per share</b>                                      |   |   |                        |
| Net income available to common shareholders                          | \$ 9,167  | 13,662,718  | \$ 0.67                |
| <b>Effect of dilutive securities</b>                                 |   |   |                        |
| Phantom Stock Units  |   | 3,105   |                        |
| Options  |   | 607,328   | (0.03)                 |
| <b>Diluted earnings per share</b>                                    |   |   |                        |
| Net income available to common stockholders plus assumed conversions | \$ 9,167  | 14,273,151  | \$ 0.64                |

**Note 4. Investment securities**

The amortized cost, gross unrealized gains and losses, and fair values of the Company's investment securities available-for-sale at September 30, 2007 and December 31, 2006 are summarized as follows (in thousands):

|                                   | September 30, 2007 |                              |                               |            |
|-----------------------------------|--------------------|------------------------------|-------------------------------|------------|
|                                   | Amortized<br>Cost  | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair Value |
| U.S. Government agency securities | \$ 59,963          | \$ 5                         | \$ (2)                        | \$ 59,966  |
| Mortgage backed securities        | 5,564              | 16                           | (606)                         | 4,974      |
| Other securities                  | 53,293             | 27                           | (470)                         | 52,850     |
|                                   | \$ 118,820         | \$ 48                        | \$ (1,078)                    | \$ 117,790 |

|                                   | December 31, 2006 |                              |                               |            |
|-----------------------------------|-------------------|------------------------------|-------------------------------|------------|
|                                   | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair Value |
| U.S. Government agency securities | \$ 59,952         | \$                           | \$ (1,327)                    | \$ 58,625  |
| Mortgage backed securities        | 5,726             | 43                           | (550)                         | 5,219      |

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|                  |            |        |            |            |
|------------------|------------|--------|------------|------------|
| Other securities | 52,193     | 205    | (296)      | 52,102     |
|                  | \$ 117,871 | \$ 248 | \$ (2,173) | \$ 115,946 |

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The amortized cost and fair value of the Company's investment securities available-for-sale at September 30, 2007, by contractual maturity, are shown below (in thousands). Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

|   | Amortized<br>Cost | Fair<br>Value |
|---|-------------------|---------------|
| Due before one year                                       | \$ 3,000          | \$ 3,000      |
| Due after one year through five years                     | 76,731            | 76,377        |
| Due after five years through ten years                    | 5,781             | 5,680         |
| Due after ten years                                       | 26,282            | 25,707        |
| Federal Home Loan and Atlantic Central Bankers Bank stock | 7,026             | 7,026         |
|   | \$ 118,820        | \$ 117,790    |

**Note 5. Loans**

Major classifications of loans are as follows (in thousands):

|   | September 30,<br>2007<br>Amount | December 31,<br>2006<br>Amount |
|---|---------------------------------|--------------------------------|
| Commercial                              | \$ 282,339                      | \$ 199,397                     |
| Commercial mortgage                     | 383,397                         | 327,639                        |
| Construction                            | 314,543                         | 275,079                        |
| Total commercial loans                  | 980,279                         | 802,115                        |
| Direct financing leases, net            | 89,564                          | 92,947                         |
| Residential mortgage                    | 50,553                          | 62,413                         |
| Consumer loans and others               | 142,221                         | 108,374                        |
|   | 1,262,617                       | 1,065,849                      |
| Deferred loan costs                     | (284)                           | (1,030)                        |
| Total loans, net of deferred loan costs | \$ 1,262,333                    | \$ 1,064,819                   |

**Note 7. Reclassifications**

Certain prior period amounts have been reclassified to conform to the current year's presentation.

**Note 8. Recent Accounting Pronouncements**

Effective January 1, 2007, the Company adopted the provisions of Financial Accounting Standards Board (FASB) Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109*. FIN 48 establishes a recognition threshold and measurement for income tax positions recognized in the Company's financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. In evaluating a tax position for recognition, the Company evaluates whether it is more-likely-than-not that a tax position will be sustained upon examination, including resolution of related appeals or litigation processes, based on the technical merits of the position. If the tax position meets the more-likely-than-not recognition threshold, the tax position is measured and recognized in the Company's financial statements as the largest amount of tax benefit that has a greater than 50% likelihood of being realized upon ultimate resolution. In adopting the provisions of FIN 48, the Company recorded a cumulative-effect





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adjustment to reduce retained earnings by \$47,000. The Company recognizes interest and penalties, if any, accrued related to the liability in the provision for income taxes. To the extent interest and penalties are ultimately not assessed, amounts accrued as part of the liability would be adjusted in the Company's provision for income taxes.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. SFAS No. 157 does not require any new fair value measurements but, rather, it provides enhanced guidance to other pronouncements that require or permit assets or liabilities to be measured at fair value. However, the application of SFAS No. 157 may change how fair value is determined. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The Company does not expect that the adoption of SFAS 157 will have a material impact upon its results of operations, financial position or cash flows.

On February 15, 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. The fair value option established by SFAS 159 permits, but does not require, all entities to choose to measure eligible items at fair value at specified election dates. An entity would report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. SFAS 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The Company is currently assessing what, if any, the impact of the adoption of SFAS 159 would be on its results of operations, financial position and cash flows.

**Note 9. Mergers and Acquisitions**

On July 13, 2007, The Company entered into a Purchase and Assumption Agreement with BankFirst, a South Dakota banking corporation, to acquire substantially all of the assets of BankFirst's Stored Value Solutions business. The business to be acquired includes stored value card, automated teller machine sponsorship and credit and debit card merchant processing businesses. The stored value (or prepaid) card business, which is the principal business, provides customized and secure program development and prepaid card issuing services to national stored value card program managers. The purchase price is \$60.6 million, payable in approximately \$12.1 million shares of the Company's common stock (valued at the average closing price of the Company's common stock during the 30 trading days prior to closing) plus \$48.4 million in cash. The Company has deposited \$1.0 million in escrow as an earnest money deposit. The Purchase and Assumption Agreement contains customary representations, warranties, covenants and closing conditions, including the condition that the Company receive all necessary regulatory and other approvals (principally approval of the Federal Deposit Insurance Corporation, or FDIC, under the Bank Merger Act). If such approvals are not obtained, the earnest money deposit will be returned to the Company. The Company expects that substantially all of the current employees of the Stored Value Solutions business will remain with the business. The Company exercised its right to extend the date of termination of the Purchase and Assumption Agreement from September 30, 2007 to January 31, 2008.

As part of the transaction, the parties have entered into a Transition Services Agreement to provide an orderly transition of the Stored Value Solutions business from BankFirst to the Company. The Company has also agreed, in a separate registration rights agreement, to register the common stock it will issue, as described above, under the Securities Act of 1933, as amended and any applicable state securities laws. The Company has also agreed to take over the premises in Sioux Falls, South Dakota currently leased by BankFirst and used, in part, for the Stored Value Solutions business, and to sublease a portion of those premises to BankFirst for its continuing operations.

**Note 10. Shareholders' equity**

The Company announced on June 4, 2007 that the Board of Directors has adopted a Share Repurchase Plan that authorizes the Company to purchase up to 750,000 shares of its common stock, representing approximately 5.5% of the Company's current total common shares outstanding. Under the plan, the Company may make purchases from time to time through open market or privately negotiated transactions. This plan may be modified or discontinued at any time. As of September 30, 2007 no shares had been repurchased under the plan.

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**Part I Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION**

*Forward-Looking Statements*

*When used in this Form 10-Q, the words believes anticipates expects and similar expressions are intended to identify forward-looking statements. Such statements are subject to certain risks and uncertainties more particularly described in Item 1A, under the caption Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2006. These risks and uncertainties could cause actual results to differ materially. Readers are cautioned not place undue reliance on these forward-looking statements, which speak only as of the date hereof. We undertake no obligation to publicly release the results of any revisions to forward-looking statements which we may make to reflect events or circumstances after the date of this Quarterly Report on Form 10-Q or to reflect the occurrence of unanticipated events except as required by applicable law.*

*In the following discussion we provide information about our results of operations, financial condition, liquidity and asset quality. We intend that this information facilitate your understanding and assessment of significant changes and trends related to our financial condition and results of operations. You should read this section in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operation included in our Annual Report on Form 10-K for the year ended December 31, 2006.*

**Critical Accounting Policies and Estimates**

Our accounting and reporting policies conform with accounting principles generally accepted in the United States of America and general practices within the financial services industry. The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Actual results could differ from those estimates.

We believe that the determination of our allowance for loan and lease losses involves a higher degree of judgment and complexity than our other significant accounting policies. We determine our allowance for loan and lease losses with the objective of maintaining a reserve level we believe to be sufficient to absorb our estimated probable credit losses. We base our determination of the adequacy of the allowance on periodic evaluations of our loan portfolio and other relevant factors. However, this evaluation is inherently subjective as it requires material estimates, including, among others, expected default probabilities, the amount of loss we may incur on a defaulted loan, expected commitment usage, the amounts and timing of expected future cash flows on impaired loans, value of collateral, estimated losses on consumer loans and residential mortgages, and historical loss experience. We also evaluate economic conditions, uncertainties in estimating losses and inherent risks in the loan portfolio. All of these factors may be susceptible to significant change. To the extent actual outcomes differ from our estimates, we may need additional provisions for loan losses that would adversely impact our earnings.

We account for income taxes under the liability method whereby we determine deferred tax assets and liabilities based on the difference between the carrying values on our financial statements and the tax basis of assets and liabilities as measured by the enacted tax rates which will be in effect when these differences reverse. Deferred tax expense (benefit) is the result of changes in deferred tax assets and liabilities.

**Results of Operations**

***Third quarter 2007 to third quarter 2006***

*Net Income:* Net income for the third quarter of 2007 was \$3.9 million, compared to net income of \$3.3 million for the third quarter of 2006. Diluted earnings per share were \$0.27 in the third quarter of 2007 as compared to \$0.23 for the third quarter of 2006. Return on average assets was 1.11% and return on average equity was 9.76% for the third quarter of 2007, as compared to 1.20% and 9.30%, respectively for the third quarter of 2006.

*Net Interest Income:* Our interest income for the third quarter of 2007 increased to \$27.5 million from \$21.8 million in the third quarter of 2006, while our net interest income increased to \$13.8 million from \$11.3 million. Our average loans increased to \$1.213 billion for the third quarter of 2007 from \$899.4 million for the third quarter of 2006. The primary reason for the increases in our interest income and net interest income was our ability to increase our earning assets through continued organic growth of our loan portfolio, as well as a change in our interest earning asset mix as we reduced our average funds position.

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Our net interest margin for the third quarter 2007 decreased to 4.05% from 4.21% for the third quarter of 2006, a decrease of 16 basis points (.16%). The margin decline was due to continued competitive pressures on both interest-earning assets and interest-earning liabilities which results in overall margin compression.

For the third quarter of 2007 the average yield on our interest-earning assets decreased to 8.08% from 8.16% for the third quarter of 2006, a decrease of 8 basis points (.08%). Cost of interest-bearing deposits decreased to 4.79% for the third quarter of 2007 from 4.83% for the third quarter of 2006, a decrease of 4 basis points (.04%). Average interest-bearing deposits increased to \$1.021 billion from \$827.9 million, an increase of \$192.7 million or 23.3%.

*Average Daily Balances.* The following table presents the average daily balances of assets, liabilities and stockholders' equity and the respective interest earned or paid on interest-earning assets and interest-bearing liabilities, as well as average rates, for the periods indicated:

|  | Three Months ended September 30, |           |              |                 |           |              |
|--|----------------------------------|-----------|--------------|-----------------|-----------|--------------|
|  | 2007                             |           |              | 2006            |           |              |
|  | Average Balance                  | Interest  | Average Rate | Average Balance | Interest  | Average Rate |
|  | (dollars in thousands)           |           |              |                 |           |              |
| <b>Assets:</b>                               |                                  |           |              |                 |           |              |
| Interest-earning assets:                     |                                  |           |              |                 |           |              |
| Loans net of unearned discount               | \$ 1,213,002                     | \$ 25,418 | 8.38%        | \$ 899,376      | \$ 19,329 | 8.60%        |
| Investment securities                        | 114,361                          | 1,647     | 5.76%        | 113,352         | 1,708     | 6.03%        |
| Interest bearing deposits                    | 1,689                            | 5         | 1.18%        | 1,030           |           | 0.00%        |
| Federal funds sold                           | 30,536                           | 400       | 5.24%        | 57,301          | 802       | 5.60%        |
| Net interest-earning assets                  | 1,359,588                        | 27,470    | 8.08%        | 1,071,059       | 21,839    | 8.16%        |
| Allowance for loan and lease losses          | (9,748)                          |           |              | (7,022)         |           |              |
| Other assets                                 | 42,179                           |           |              | 33,201          |           |              |
|  | \$ 1,392,019                     |           |              | \$ 1,097,238    |           |              |
| <b>Liabilities and Shareholders' Equity:</b> |                                  |           |              |                 |           |              |
| Deposits:                                    |                                  |           |              |                 |           |              |
| Demand (non-interest bearing)                | \$ 90,463                        |           |              | \$ 79,954       |           |              |
| Interest bearing deposits:                   |                                  |           |              |                 |           |              |
| Interest checking                            | 100,060                          | \$ 800    | 3.20%        | 63,650          | \$ 411    | 2.58%        |
| Savings and money market                     | 535,143                          | 5,953     | 4.45%        | 320,641         | 3,939     | 4.91%        |
| Time   | 385,387                          | 5,466     | 5.67%        | 443,585         | 5,641     | 5.09%        |
| Total interest bearing deposits              | 1,020,590                        | 12,219    | 4.79%        | 827,876         | 9,991     | 4.83%        |
| Short-term borrowings                        | 113,641                          | 1,486     | 5.23%        | 38,780          | 543       | 5.60%        |
| Other borrowed funds                         | 2,503                            | 12        | 1.92%        | 4,985           | 20        | 1.60%        |
| Net interest bearing liabilities             | 1,136,734                        | 13,717    | 4.83%        | 871,641         | 10,554    | 4.84%        |
| Other liabilities                            | 6,876                            |           |              | 4,357           |           |              |
| Shareholders' equity                         | 157,946                          |           |              | 141,286         |           |              |
|  | \$ 1,392,019                     |           |              | \$ 1,097,238    |           |              |
| Net yield on average interest earning assets |                                  | \$ 13,753 | 4.05%        |                 | \$ 11,285 | 4.21%        |



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In the third quarter of 2007, average interest-earning assets increased to \$1.360 billion, an increase of \$288.5 million, or 26.9%, from the third quarter of 2006.

*Provision for Loan and Lease Losses.* Our provision for loan and lease losses was \$750,000 for the third quarter of 2007 compared to \$825,000 for the third quarter of 2006. For more information about our provisions and allowance for loan and lease losses and our loss experience see Financial Condition Allowance for Loan and Lease Losses below.

*Non-Interest Income.* Non-interest income was \$1.2 million for the third quarter of 2007 as compared to \$1.1 million for the third quarter of 2006, an increase of \$72,000 or 6.6%. The principal reasons for the increase in non-interest income were an increase from leasing income and other income. Leasing income increased to \$385,000 from \$227,000, an increase of \$158,000 or 69.6%. The increase in other leasing income resulted from the resale of vehicles at the end of the lease term. ACH processing fees decreased to \$61,000 during the third quarter of 2007 from \$149,000 during the third quarter of 2006, a decrease of \$88,000 or 59.1%. The decrease in ACH processing fees is a result of an evaluation of risk performed on the portfolio resulting in some discontinued business relationships.

*Non-Interest Expense.* Total non-interest expense was \$7.7 million for the third quarter of 2007, as compared to \$6.2 million for third quarter of 2006, an increase of \$1.5 million or 24.4%. Salaries and employee benefits amounted to \$3.7 million for the third quarter of 2007 as compared to \$3.0 million for the third quarter of 2006, an increase of \$739,000 or 25.0%. Our increase in salaries reflects our increased staff to meet the demands of our business growth. Data processing expense increased \$177,000 from \$570,000 during the third quarter of 2006 to \$747,000 during the third quarter of 2007. This increase is a result of upgrades in our telephone and processing capabilities as a result of growth in our health savings account portfolio and our internet banking platform. Other expense increased \$584,000 to \$2.0 million during the third quarter of 2007 from \$1.4 million during the third quarter of 2006, or 42.3%. This is a result of increases in telephone expense and FDIC insurance expense. Telephone increased approximately 48%, from \$140,000 at September 30, 2006 to \$209,000 at September 30, 2007, as a result of an increase in our health savings and lending portfolios. FDIC insurance increased 212% or \$117,000, from \$55,000 as a result of increased costs associated with maintaining deposits.

***First nine months of 2007 to first nine months of 2006***

*Net Income:* Net income for the first nine months of 2007 was \$11.4 million, compared to net income of \$9.3 million for the first nine months of 2006. Diluted earnings per share were \$0.78 in the first nine months of 2007 as compared to \$0.64 for the first nine months of 2006. Return on average assets was 1.12% and return on average equity was 9.81% for first nine months of 2007, as compared to 1.24% and 8.97%, respectively for the first nine months of 2006.

*Net Interest Income:* Our interest income for the first nine months of 2007 increased to \$79.2 million from \$57.3 million in the first nine months of 2006, while our net interest income increased to \$39.1 million from \$32.3 million. Our average loans increased to \$1.140 billion for first nine months of 2007 from \$802.1 million for the first nine months of 2006. As stated above, the primary reason for the increases in our interest income and net interest income was our ability to increase our earning assets through continued organic growth of our loan portfolio.

Our net interest margin for the first nine months 2007 decreased to 3.93% from 4.41% for the first nine months of 2006, a decrease of 48 basis points (.48%). The margin decline was due to continued competitive pressures on both interest-earning assets and interest-earning liabilities which results in overall margin compression. Additionally, average demand deposits decreased \$17.1 million as the result of a shift in deposits to higher yielding accounts as well as a decrease in deposits associated with our processing business, as a result of reducing risks within our processing business.

In the first nine months of 2007 the average yield on our interest-earning assets increased to 7.94% from 7.83% for first nine months of 2006 an increase of 11 basis points (.11%). Cost of interest-bearing deposits increased to 4.78% for the first nine months of 2007 from 4.31% for the first nine months of 2006, an increase of 47 basis points (0.47%). Average interest bearing deposits increased to \$1.04 billion from \$724.3 million, an increase of \$316.0 million or 43.6%.

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*Average Daily Balances.* The following table presents the average daily balances of assets, liabilities and stockholders' equity and the respective interest earned or paid on interest-earning assets and interest-bearing liabilities, as well as average rates, for the periods indicated:

|  | Nine Months ended September 30, |           |   |                    |           |                 |
|--|---------------------------------|-----------|---|--------------------|-----------|-----------------|
|  | 2007                            |           |   | 2006               |           |                 |
|  | Average<br>Balance              | Interest  | Average<br>Rate<br>(dollars in thousands) | Average<br>Balance | Interest  | Average<br>Rate |
| <b>Assets:</b>                               |                                 |           |   |                    |           |                 |
| Interest-earning assets:                     |                                 |           |   |                    |           |                 |
| Loans net of unearned discount               | \$ 1,139,842                    | \$ 71,529 | 8.37%                                     | \$ 802,072         | \$ 50,118 | 8.33%           |
| Investment securities                        | 113,997                         | 4,924     | 5.76%                                     | 112,316            | 4,881     | 5.79%           |
| Interest bearing deposits                    | 1,689                           | 16        | 1.26%                                     | 1,030              | 1         | 0.13%           |
| Federal funds sold                           | 73,208                          | 2,702     | 4.92%                                     | 60,695             | 2,310     | 5.07%           |
| Net interest-earning assets                  | 1,328,736                       | 79,171    | 7.94%                                     | 976,113            | 57,310    | 7.83%           |
| Allowance for loan and lease losses          | (9,242)                         |           |   | (6,390)            |           |                 |
| Other assets                                 | 37,521                          |           |   | 34,987             |           |                 |
|  | \$ 1,357,015                    |           |   | \$ 1,004,710       |           |                 |
| <b>Liabilities and Shareholders' Equity:</b> |                                 |           |   |                    |           |                 |
| Deposits:                                    |                                 |           |   |                    |           |                 |
| Demand (non-interest bearing)                | \$ 77,441                       |           |   | \$ 94,534          |           |                 |
| Interest bearing deposits:                   |                                 |           |   |                    |           |                 |
| Interest checking                            | 91,292                          | \$ 2,085  | 3.05%                                     | 59,080             | \$ 1,035  | 2.34%           |
| Savings and money market                     | 524,298                         | 17,878    | 4.55%                                     | 309,216            | 10,064    | 4.34%           |
| Time   | 424,729                         | 17,302    | 5.43%                                     | 355,995            | 12,337    | 4.62%           |
| Total interest bearing deposits              | 1,040,319                       | 37,265    | 4.78%                                     | 724,291            | 23,436    | 4.31%           |
| Short-term borrowings                        | 72,751                          | 2,747     | 5.03%                                     | 39,048             | 1,513     | 5.17%           |
| Other borrowed funds                         | 3,003                           | 40        | 1.78%                                     | 4,132              | 42        | 1.36%           |
| Net interest bearing liabilities             | 1,116,073                       | 40,052    | 4.78%                                     | 767,471            | 24,991    | 4.34%           |
| Other liabilities                            | 9,177                           |           |   | 4,326              |           |                 |
| Shareholders' equity                         | 154,324                         |           |   | 138,379            |           |                 |
|  | \$ 1,357,015                    |           |   | \$ 1,004,710       |           |                 |
| Net yield on average interest earning assets |                                 | \$ 39,119 | 3.93%                                     |                    | \$ 32,319 | 4.41%           |

*Provision for Loan and Lease Losses.* Our provision for loan and lease losses was \$2.3 million for the first nine months of 2007 compared to \$2.1 million for the first nine months of 2006. For more information about our provision and allowance for loan and lease losses and our loss experience see Financial Condition Allowance for Loan and Lease Losses below.

*Non-Interest Income.* Non-interest income was \$4.3 million for the first nine months of 2007 as compared to \$3.8 million in the first nine months of 2006, an increase of \$520,000 or 13.6%. The principal reason for the increase in our non-interest income was an increase in leasing income to \$1.9 million for the nine months ended September 30, 2007, an increase of \$853,000 or 82.7%. The increase in other leasing income resulted from a gain on sale of lease assets recognized at the end of a lease with a large leasing relationship. Other income decreased to \$772,000 for the first nine months of 2007 from \$845,000 in the same period of 2006. Other income had increased in the second quarter of 2006 as the result of a one-time fee received from MasterCard for its initial public offering during the second quarter of 2006.

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*Non-Interest Expense.* Total non-interest expense was \$22.4 million for the first nine months of 2007, as compared to \$19.1 million for the first nine months of 2006, an increase of \$3.4 million or 17.7%. Salaries and employee benefits amounted to \$10.6 million for the first nine months of 2007 as compared to \$9.3 million for the first nine months of 2006. The increase in salaries and employee benefits resulted from an increase in commercial lending and private client staffs. Data processing expense increased to \$2.1 million for the nine months ended September 30, 2007 from \$1.8 million for the same period in 2006. The increase of approximately



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\$326,000 reflects upgrades to our computer system to enhance our image archiving abilities. Professional fees increased \$303,000 to \$1.6 million as a result of increased costs of internal auditing and legal fees associated with regulatory and compliance matters. Other expense increased to \$5.4 million from \$4.2 million, an increase of \$1.1 million. The increase is a result of increase in costs associated with growth in our private client and commercial loan business and staffing costs.

**Liquidity and Capital Resources**

Liquidity defines our ability to generate funds to support asset growth, meet deposit withdrawals, satisfy borrowing needs and otherwise operate on an ongoing basis. We invest the funds we do not need for operation primarily in overnight federal funds.

The primary source of funds for our financing activities has been cash inflows from net increases in deposits, which were \$81.8 million in the nine months of 2007. We have also used sources outside of our core deposit products to fund our loan growth including Federal Home Loan Bank advances and repurchase agreements. As of September 30, 2007, we had \$230.0 million of outstanding short-term borrowings which consisted of \$150.0 million of outstanding Federal Home Loan Bank advances, \$80.0 million of outstanding Federal Funds purchased, and \$3.8 million in repurchase agreements. The increase in advances and Federal Funds purchased is the result of lower cost as compared to the brokered deposit market.

Funding was directed primarily at cash outflows required for loans, which were \$198.7 million in the first nine months of 2007. At September 30, 2007, we had outstanding commitments to fund loans, including unused lines of credit, of \$398.3 million.

We must comply with capital adequacy guidelines issued by the FDIC. A bank must, in general, have a leverage ratio of 5.0%, a ratio of Tier I capital to risk-weighted assets of 6.0% and a ratio of total capital to risk-weighted assets of 10.0% in order to be considered well capitalized. A Tier I leverage ratio is the ratio of Tier 1 capital to average assets for the period. Tier I capital includes common shareholders equity, certain qualifying perpetual preferred stock and minority interests in equity accounts of consolidated subsidiaries, less goodwill. At September 30, 2007 we were well capitalized under banking regulations.

The following table sets forth our regulatory capital amounts and ratios for the periods indicated:

|   | <b>Tier 1 capital<br/>to average<br/>assets ratio</b> | <b>Tier 1 capital<br/>to risk-weighted<br/>assets ratio</b> | <b>Total capital<br/>to risk-weighted<br/>assets ratio</b> |
|---|---|---|--|
| <b>AS OF SEPTEMBER 30, 2007</b>                       |   |   |  |
| The Company   | 11.52%  | 12.57%  | 13.33%   |
| The Bancorp Bank                                      | 10.62%  | 11.56%  | 12.31%   |
| Well capitalized institution (under FDIC regulations) | 5.00%   | 6.00%   | 10.00%   |
| <b>AS OF DECEMBER 31, 2006:</b>                       |   |   |  |
| The Company   | 12.28%  | 13.50%  | 14.28%   |
| The Bancorp Bank                                      | 11.36%  | 12.44%  | 13.22%   |
| Well capitalized institution (under FDIC regulations) | 5.00%   | 6.00%   | 10.00%   |

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The management of rate sensitive assets and liabilities is essential to controlling interest rate risk and optimizing interest margins. An interest rate sensitive asset or liability is one that, within a defined time period, either matures or experiences an interest rate change in line with general market rates. Interest rate sensitivity measures the relative volatility of a bank's interest margin resulting from changes in market interest rates.

We monitor and control interest rate risk through a variety of techniques, including use of traditional interest rate sensitivity analysis (also known as "gap analysis"). Traditional gap analysis involves arranging our interest-earning assets and interest-bearing liabilities by repricing periods and then computing the difference (or "interest rate sensitivity gap") between the assets and liabilities that are estimated to reprice during each time period and cumulatively through the end of each time period.

Gap analysis requires estimates as to when individual categories of interest-sensitive assets and liabilities will reprice, and assumes that assets and liabilities assigned to the same repricing period will reprice at the same time and in the same amount. Gap analysis does not account for the fact that repricing of assets and liabilities is discretionary and subject to competitive and other pressures. A gap is considered positive when the amount of interest rate sensitive assets exceeds the amount of interest rate sensitive liabilities. A gap is considered negative when the amount of interest rate sensitive liabilities exceeds interest rate sensitive assets. During a period of falling interest rates, a positive gap would tend to adversely affect net interest income, while a negative gap would tend to result in an increase in net interest income. During a period of rising interest rates, a positive gap would tend to result in an increase in net interest income while a negative gap would tend to affect net interest income adversely.

The following table sets forth the estimated maturity/repricing structure of our interest-earning assets and interest-bearing liabilities at September 30, 2007. Except as stated below, the amounts of assets or liabilities shown which reprice or mature during a particular period were determined in accordance with the contractual terms of each asset or liability. The majority of interest-bearing demand deposits and savings deposits are assumed to be "core" deposits, or deposits that will generally remain with us regardless of market interest rates. Therefore, 50% of the core interest checking deposits and 25% of core savings and money market deposits are shown as maturing or repricing within the "1-90 days" column with the remainder shown in the "1-3 years" column. We estimate the repricing characteristics of these deposits based on historical performance, past experience at other institutions and other deposit behavior assumptions. However, we may choose not to reprice liabilities proportionally to changes in market interest rates for competitive or other reasons. Payments of fixed-rate loans and mortgage-backed securities are scheduled based on their anticipated cash flow, including prepayments based on historical data and current market trends. The table does not necessarily indicate the impact of general interest rate movements on our net interest income because the repricing of certain categories of assets and liabilities is beyond our control as, for example, prepayments of loans and withdrawal of deposits. As a result, certain assets and liabilities indicated as repricing within a stated period may in fact reprice at different times and at different rate levels.

|  | 1-90<br>Days           | 91-364<br>Days | 1-3<br>Years   | 3-5<br>Years   | Over 5<br>Years |
|--|------------------------|----------------|----------------|----------------|-----------------|
|  | (dollars in thousands) |                |                |                |                 |
| <b>Interest earning assets:</b>                |                        |                |                |                |                 |
| Loans, net of deferred loan costs              | \$ 722,803             | \$ 73,202      | \$ 231,501     | \$ 139,414     | \$ 95,413       |
| Investments, available for sale                | 3,000                  | 76,377         | 5,680          | 25,707         | 7,026           |
| Interest bearing deposits                      | 1,748                  |                |                |                |                 |
| Federal funds sold                             | 87,394                 |                |                |                |                 |
| <b>Total interest earning assets</b>           | <b>814,945</b>         | <b>149,579</b> | <b>237,181</b> | <b>165,121</b> | <b>102,439</b>  |
| <b>Interest bearing liabilities:</b>           |                        |                |                |                |                 |
| Interest checking                              | 48,049                 |                | 48,049         |                |                 |
| Savings and money market                       | 128,644                |                | 385,930        |                |                 |
| Time deposits                                  | 166,603                | 232,659        | 804            |                |                 |
| Securities sold under agreements to repurchase | 3,845                  |                |                |                |                 |
| Short-term borrowings                          | 230,000                |                |                |                |                 |
| <b>Total interest bearing liabilities</b>      | <b>577,141</b>         | <b>232,659</b> | <b>434,783</b> |                |                 |

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|                                |            |             |              |            |            |
|--------------------------------|------------|-------------|--------------|------------|------------|
| Gap                            | \$ 237,804 | \$ (83,080) | \$ (197,602) | \$ 165,121 | \$ 102,439 |
| Cumulative gap                 | \$ 237,804 | \$ 154,724  | \$ (42,878)  | \$ 122,243 | \$ 224,682 |
| Gap to assets ratio            | 16%        | -6%         | -13%         | 11%        | 7%         |
| Cumulative gap to assets ratio | 16%        | 10%         | -3%          | 8%         | 15%        |

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The method used to analyze interest rate sensitivity in this table has a number of limitations. Certain assets and liabilities may react differently to changes in interest rates even though they reprice or mature in the same or similar time periods. The interest rates on certain assets and liabilities may change at different times than changes in market interest rates, with some changing in advance of changes in market rates and some lagging behind changes in market rates. Additionally, the actual prepayments and withdrawals we experience when interest rates change may deviate significantly from those assumed in calculating the data shown in the table.

**Financial Condition**

*General.* Our total assets at September 30, 2007 were \$1.508 billion, of which our total loans were \$1.262 billion. At December 31, 2006 our total assets were \$1.335 billion, of which our total loans were \$1.064 billion. Our portfolio of commercial, commercial mortgage and construction loans grew \$178.2 million, or 22.2%, from year-end 2006 to \$980.3 million at September 30, 2007.

*Investment portfolio.* For detailed information on the composition and maturity distribution of our investment portfolio, see Note 3 to the Notes to Financial Statements contained in this Quarterly Report on Form 10-Q.

*Loan Portfolio.* Total loans increased to \$1.262 billion at September 30, 2007 from \$1.064 billion at December 31, 2006, an increase of \$197.5 million or 18.6%.

The following table summarizes our loan portfolio by loan category for the periods indicated (in thousands):

|   | September 30,<br>2007<br>Amount | December 31,<br>2006<br>Amount |
|---|---------------------------------|--------------------------------|
| Commercial                              | \$ 282,339                      | \$ 199,397                     |
| Commercial mortgage                     | 383,397                         | 327,639                        |
| Construction                            | 314,543                         | 275,079                        |
| <br>                                    |                                 |                                |
| Total commercial loans                  | 980,279                         | 802,115                        |
| Direct financing leases, net            | 89,564                          | 92,947                         |
| Residential mortgage                    | 50,553                          | 62,413                         |
| Consumer loans and others               | 142,221                         | 108,374                        |
|   | 1,262,617                       | 1,065,849                      |
| Deferred loan costs                     | (284)                           | (1,030)                        |
| <br>                                    |                                 |                                |
| Total loans, net of deferred loan costs | \$ 1,262,333                    | \$ 1,064,819                   |

*Allowance for Loan and Lease Losses.* Management reviews the adequacy of our allowance for loan and lease losses on at least a quarterly basis to ensure that the provision for loan losses which we charge against

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earnings is in an amount necessary to maintain our allowance at a level that is appropriate, based on management's estimate of probable losses. Our estimates of loan and lease losses are intended to, and, in management's opinion, do, meet the criteria for accrual of loss contingencies in accordance with Statement of Financial Accounting Standards, or SFAS, No. 5, Accounting for Contingencies, and SFAS No. 114, as amended,

Accounting by Creditors for Impairment of a Loan. The process of evaluating this adequacy has two basic elements: first, the identification of problem loans or leases based on current financial information and the fair value of the underlying collateral; and second, a methodology for estimating general loss reserves inherent in the portfolio. For loans or leases classified as special mention, substandard or doubtful, we record all estimated losses at the time we classify the loan or lease. This specific portion of the allowance is the total of potential, although unconfirmed, losses for individually classified loans. Because we immediately charge off all identified losses, no portion of the allowance for loan losses is restricted to any individual loan or groups of loans, and the entire allowance is available to absorb any and all loan losses.

The second phase of our analysis represents an allocation of the allowance. This methodology analyzes pools of loans that have similar characteristics and applies historical loss experience and other factors for each pool to determine its allocable portion of the allowance. This estimate is intended to represent the potential unconfirmed and inherent losses within the portfolio. Individual loan pools are created for major loan categories: commercial loans, commercial mortgages, construction loans and direct lease financing, and for the various types of loans to individuals. We augment our historical experience for each loan pool by accounting for such items as: current economic conditions, current loan portfolio performance, loan policy or management changes, loan concentrations, increases in our lending limit, the average loan size, and other factors as appropriate.

Although the performance of our loan portfolio has been above that of our peers, and we do not currently foresee a change in that performance, our analysis for purposes of deriving the historical loss component of the allowance includes factors in addition to our historical loss experience, such as management's experience with similar loan and lease portfolios at other institutions, the historic loss experience of our peers and statistical information from various industry reports such as the FDIC's Quarterly Banking Profile.

While we consider our allowance for loan and lease losses to be adequate based on information currently available, future additions to the allowance may be necessary due to changes in economic conditions or management's assumptions as to future delinquencies, recoveries and losses and management's intent with regard to the disposition of loans and leases. We review the adequacy of the allowance on at least a quarterly basis to ensure that the provision for loan and lease losses that has been charged against earnings is an amount necessary to maintain the allowance at a level that is appropriate based on management's assessment of probably estimated losses. The following table summarizes our credit loss experience for each of the periods indicated:

|   | Nine months ended<br>September 30, |           | For the year ended<br>December 31, |
|---|------------------------------------|-----------|------------------------------------|
|   | 2007                               | 2006      | 2006                               |
|   | (dollars in thousands)             |           |                                    |
| Balance in the allowance for loan and lease losses at beginning of period | \$ 8,400                           | \$ 5,513  | \$ 5,513                           |
| Loans charged-off:  |                                    |           |                                    |
| Commercial  | 300                                |           | 8                                  |
| Lease financing   | 35                                 | 62        | 93                                 |
| Construction  | 874                                |           |                                    |
| Consumer  | 8                                  |           |                                    |
| <b>Total</b>  | <b>1,217</b>                       | <b>62</b> | <b>101</b>                         |
| Recoveries:   |                                    |           |                                    |
| Consumer  | 13                                 |           | 1                                  |
| Commercial  | 73                                 |           |                                    |
| Lease financing   | 8                                  | 7         | 12                                 |
| <b>Total</b>  | <b>94</b>                          | <b>7</b>  | <b>13</b>                          |
| Net charge-offs (recoveries)  | 1,123                              | 55        | 88                                 |
| Provision charged to operations   | 2,250                              | 2,125     | 2,975                              |

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|   |          |          |          |
|---|----------|----------|----------|
| Balance in allowance for loan and lease losses at end of period | \$ 9,527 | \$ 7,583 | \$ 8,400 |
| Net charge-offs/average loans                                   | 0.84%    | 0.01%    | 0.01%    |

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*Net Charge-offs.* Net charge-offs of \$1.1 million for the nine months ended September 30, 2007 represent a \$1.1 million increase over net charge-offs for the same period in 2006. Specifically, this number is comprised of charge-offs of \$1.2 million offset by recoveries of \$94,000. The charge-offs for the nine months consisted of a \$874,000 charge on one construction loan and a \$300,000 charge-off on one commercial loan of which \$62,000 was recovered.

*Non-Performing Loans.* Loans are considered to be non-performing if they are on a non-accrual basis or terms have been renegotiated to provide a reduction or deferral of interest or principal because of a weakening in the financial positions of the borrowers. A loan which is past due 90 days or more and still accruing interest remains on accrual status only when it is both adequately secured as to principal and is in the process of collection. We had \$-0- non-accrual or renegotiated loans at September 30, 2006 compared to \$2.3 million of non-accrual loans at September 30, 2007. Loans past due 90 days or more, defined as four or more monthly payments in arrears, still accruing interest amounted to \$374,000 and \$7.3 million at September 30, 2007 and 2006 respectively. The increase in nonperforming assets at September 30, 2007, in relation to December 31, 2006, of \$3.6 million was mainly due to a commercial loan for one borrower placed on non-accrual within the second quarter of 2007. The increase in nonperforming assets was partially offset by a decrease in loans past due 90 days or more of \$294,000.

| (in thousands)                                    | September 30,<br>2007 | December 31,<br>2006 | September 30,<br>2006 |
|---|-----------------------|----------------------|-----------------------|
| <b>Non-performing loans:</b>                      |                       |                      |                       |
| Non-accrual loans                                 | \$ 2,329              | \$ 668               | \$ 7,266              |
| Loans past due 90 days or more and still accruing | 374                   | 668                  | 7,266                 |
| <br>Total non-performing loans                    | <br>2,703             | <br>668              | <br>7,266             |
| Other real estate owned                           | 1,566                 |                      |                       |
| <br>Total non-performing assets                   | <br>4,269             | <br>668              | <br>7,266             |

*Deposits.* A primary source for funding our growth is through deposit accumulation. We offer a variety of deposit accounts with a range of interest rates and terms, including savings accounts, checking accounts, money market savings accounts and certificates of deposit. Management is focused on growing our core deposits accounts which include demand, interest checking, savings and money markets as these accounts typically represent low cost deposits. As we develop and grow our core deposit relationships, we have used, and continue to use, the brokered certificate of deposit market to meet loan funding needs. It is management's expectation that core deposit growth will replace a portion of the certificates of deposit as they mature. Additionally certain products we offer have an element of seasonality; for example merchant processing volume is greater in the first and fourth quarters and as a result the corresponding deposits are also greater in those periods. To offset the effects of the seasonality management will use certificates of deposit for funding. At September 30, 2007, we had total deposits of \$1.106 billion as compared to \$1.069 billion at December 31, 2006, an increase of \$36.7 million or 3.43%. The following table presents the average balance and rates paid on deposits for the periods indicated:

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|                               | For the Nine months ended<br>September 30, 2007 |                 | For the year ended<br>December 31, 2006 |                 |
|-------------------------------|---|-----------------|---|-----------------|
|                               | Average<br>balance                              | Average<br>Rate | Average<br>balance                      | Average<br>Rate |
| Demand (non-interest bearing) | \$ 77,441                                       |                 | \$ 90,144                               |                 |
| Interest checking             | 91,292  | 3.05%           | 60,990                                  | 2.39%           |
| Savings and money market      | 524,298   | 4.55%           | 321,220                                 | 4.40%           |
| Time                          | 424,729   | 5.43%           | 391,716                                 | 4.85%           |
| Total deposits                | \$ 1,117,760                                    | 4.45%           | \$ 864,070                              | 4.00%           |

**Borrowings**

At September 30, 2007 we had \$150.0 million in advances from the Federal Home Loan Bank. The advances mature on a daily basis and are collateralized with investment securities and loans. Additionally, we had \$3.8 million in securities sold under agreements to repurchase and \$80.0 million in Federal funds purchased which also mature on a daily basis.

**Shareholders equity**

At September 30, 2007 we had \$162.6 million in shareholders equity. During the first nine months of 2007 we issued 92,171 shares from the exercise of stock options with net proceeds of approximately \$1.2 million. We also issued 7,043 common stock shares in connection with conversions of our Series A preferred stock. Cash dividends paid on Series A preferred stock were \$52,000 for the nine months ended September 30, 2007. Accumulated other comprehensive loss decreased \$601,000 due to increased valuations in our investment portfolio.



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

There has been no material change in our assessment of our sensitivity to market risk since our presentation in our Annual Report on Form 10-K for the year ended December 31, 2006 except as set forth in Part I, Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations in this Quarterly Report on Form 10-Q.

**Item 4. Controls and Procedures**

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in Securities Exchange Act of 1934 reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our chief executive officer and our chief financial officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, our management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and our management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Under the supervision of our chief executive officer and chief financial officer, we have carried out an evaluation of the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based upon that evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures are effective at the reasonable assurance level.

There have been no significant changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially effect, our internal control over financial reporting during the quarter ended September 30, 2007.

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**PART II OTHER INFORMATION**

**ITEM 6. EXHIBITS**

The Exhibits furnished as part of this Quarterly Report on Form 10-Q are identified in the Exhibit Index immediately following the signature page of this Report. Such Exhibit Index is incorporated herein by reference.

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**SIGNATURE**

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

November 9, 2007  
Date

November 9, 2007  
Date

THE BANCORP INC.  
(Registrant)

/s/ Betsy Z. Cohen  
Betsy Z. Cohen  
Chief Executive Officer

/s/ Martin F. Egan  
Martin F. Egan  
Senior Vice President, Chief Financial Officer and  
Secretary

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**EXHIBIT INDEX**

| <b>Exhibit No.</b> | <b>Description</b>   |
|--------------------|--|
| 3.1                | Certificate of Incorporation <sup>(1)</sup>                          |
| 3.2                | Bylaws <sup>(1)</sup>  |
| 10.1               | Purchase and Assumption Agreement dated July 13, 2007 <sup>(2)</sup> |
| 10.2               | Transition Services Agreement dated July 13, 2007                    |
| 31.1               | Rule 13a-14(a)/15d-14(a) Certifications                              |
| 31.2               | Rule 13a-14(a)/15d-14(a) Certifications                              |
| 32.1               | Section 1350 Certifications  |
| 32.2               | Section 1350 Certifications  |

- 
- (1) Filed previously as an exhibit to our Registration Statement on Form S-4, as amended, registration number 333-117385, and by this reference incorporated herein.
- (2) Filed previously as an exhibit to our Form 10-Q, for the quarterly period ended June 30, 2007, and by this reference incorporated herein.