RURBAN FINANCIAL CORPORATION

Moderator: Valda Colbart
October 20, 2005
3:00 p.m. CT

Operator: Good afternoon and welcome, ladies and gentlemen, to the Rurban Financial Corp third quarter earnings conference call and Webcast.

At this time, I'd like to inform you that this conference is being recorded, and that all participants are in a listen-only mode. We will open the conference up for question-and-answers after the presentation.

I'll now turn the conference over to Valda Colbart, Investor Relations Officer; please go ahead, Valda.

Valda Colbart: Good afternoon everyone. I would like to remind you that this conference call is being broadcast over the Internet live, and will also be archived and available at our Web site www.rurbanfinancial.net until, November 10, 2005.

Joining me on today's call are Ken Joyce, President and CEO; Jim Adams, Chief Financial Officer, and Executive Vice President; Rob Constien, Chairman, President and CEO of Reliance Financial Services; and Hank Thiemann, President and CEO of RFCBC Inc. We will be available to answer your questions following our brief opening remarks.

But before we get started, I'd like to make our usual Safe Harbor statement and remind everyone that comments made during this conference call regarding Rurban's anticipated future performance are forward-looking and therefore involve risks and uncertainties that could cause the results or developments to differ significantly from those indicated in these statements. These risks and uncertainties include, but are not limited to risks and uncertainties inherent in general and local banking, insurance and mortgage conditions, competitive factors specific to markets in which the company and its subsidiaries operate. Future interest rate levels, legislative and regulatory decisions or capital market conditions and other factors set forth in the company's filings with the Securities and Exchange Commission.

I will now turn the call over to Ken Joyce, President and CEO. Ken.

Ken Joyce: Thank you, Valda. And welcome to the Rurban Financial Corp's third quarter Webcast. And thank you for joining us this afternoon to discuss the third quarter results.

This morning, we announced third quarter income of 492,000 or 11 cents per share. This compares with a loss of almost 114,000 in the last quarter, an income of 699,000 for the same quarter one year ago. The important considerations for viewing this quarter's numbers in comparison to last quarter's and one year ago numbers, are continued asset improvement, improving net interest income and stable net interest margins, investment in Rurban's future growth. I'll discuss these one at a time.

Our asset quality continues the march of quarterly improvements, which is contributing incrementally to improved earnings. There are a number of related issues that contribute to this improvement. Our non performing loans have decreased by $1 million for this quarter, over last quarter, and by four million over the last 12 months. The improvement in classified loans mirrors the non performing loan improvement, but it is more dramatic, improving by 3.5 million since the last quarter, and 14.4 million from one year ago. We expect this trend to continue as the portfolio appears strong. Net charge offs continue to be extremely low, evidence that the reserves we have taken are adequate to address the risk in our portfolio. We will be examining ways to further accelerate this improvement in the fourth quarter.

Our loan portfolio has expanded since the beginning of this year, and the average loans were nearly 5.5 million higher this quarter than second quarter. This increase in average loans combined with the net interest margin unchanged from the second quarter contributed to improvement in net interest income. The net interest margin is unchanged from last quarter, and we are pleased to – I am pleased that it appears to be stabilizing at this point.

Like many banks we are also being challenge by the current rate environment, and we have a deposit premium for the Lima acquisition which is partially amortized and charged into our interest expense. I would expect to see continuing improvement in outstanding loan balances as we began to gain traction in the Lima market. Loans in that market grew by 39 percent, although this was off a low base of loans that we acquired in the branch purchase. I am very encouraged by this acquisition of the team in place in Lima. We should see a continued improvement in loan and deposit generation as these branches stabilize, following the acquisition in late June. This acquisition is not contributing to profit at this time, but based on our experience this quarter, we believe Lima will be a profit contributor by the first quarter of 2006 as we originally projected.

We have also been making investments in preparation of the Exchange Bancshares acquisition. The Exchange Shareholders held a special meeting on October the 11th, and about 97 percent of the voting shareholders approved the acquisition. We are now awaiting regulatory approval from the Federal Reserve Board in Washington DC. We are optimistic that we will have regulatory approval and close the transaction by the end of November. We continue to prepare for this acquisition, designating an experienced member of our management team as the future CEO and we have recently hired a senior lender who has been very successful in the greater Toledo marketplace. Both of these individuals are anxiously awaiting finalization of this transaction, so that we can begin their new responsibilities.

While having this management team ready to go has negatively impacted our profit in the short term, it will quicken the return on the substantial investment we are making in the Exchange acquisition.

We recognize that our bank efficiency ratios are still too high, and we are taking action to bring those ratios inline in 2006. These ratios were historically out of line for two reasons. We have added to the overhead as a result of the earlier regulatory issues we encountered primarily centered around credit quality. It takes some time to carefully dismantle this overhead, while leaving in place, the necessary controls to prevent reoccurrence of the problems, and implementing at the same time a structure to service customers in this fast paced, customer demanding environment.

The second reason for the poor efficiencies is the excessive overhead in terms of the lead bank's branch system. This will be addressed beginning in the fourth quarter of this year. We continue the implementation of the expense control program on our lead bank. And we are getting the efficiencies that we have targeted. As I have mentioned in the past, we expect to have a significant reduction to the efficiency numbers achieved by year end as we bring in Exchange, gaining local efficiencies, and servicing Exchange with our existing overhead structure.

We are also addressing the efficiency ratio from the numerator side. We have engaged Sheroian and Associates, as our marketing firm. We are looking to this firm to assist us in efficiently and rationally promoting our products, guiding us in establishing presence in our new markets and building a brand that is less dependent upon pricing for client decisions.

As part of this effort, we are investing specific effort to revise our retail marketing strategy. We will talk more about this in future quarters. Also addressing the revenue side of the efficiency ratio is a soft opening of our Fort Wayne loan production office this past quarter. We have transferred one of our most experienced lenders with connections to the Fort Wayne market. And he is already showing solid progress.

At this time, I will turn the Webcast over to Jim Adams, our Chief Financial Officer. And Jim will provide you with some more details behind the financials for the quarter. Jim.

James Adams: Thank you, Kevin and good afternoon everyone. As you've seen in our press release, there's been a lot of activity flowing through our third quarter financials, with the acquisition of the Lima branches. And I'll attempt to sort through those numbers for you.

As you recall, this quarter is the first full quarter that the Lima branches are reflected in our numbers, so that the income and expense change from the second quarter become amplified. So let's discuss the changes at each of the major categories, in order to facilitate a better understanding of each of these.

First, interest income totaled 5.4 million during the third quarter, and increased by $296,000 from second quarter 2005 levels. The Lima market provided approximately 153,000 in incremental loan income and provided an additional amount of excess liquidity which was partially used to increase investment portfolio holdings. These added another $102,000 to the interest income component for a total of $255,000 in interest income.

Second, interest expense amounted to 2.4 million in the third quarter, and rose approximately $241,000 from the second quarter. The Lima branches accounted for about 381,000 in interest costs on deposits. However, keep in mind that a portion of the excess liquidity obtained from the branch acquisitions through the purchase of deposit liabilities, was used to liquidate higher cost borrowed funds. This action reduced that portion of our interest expense, by almost $114,000 resulting in a net increase in interest expense of $267,000. Additionally, on September 15 of this year, Rurban issued 10 million of trust preferred securities, to fund the cash portion of the acquisition of Exchange Bancshares. For the first quarter coupon period – the trust preferred securities have an effective rate of 5.89 percent for the first quarterly coupon period. And this added an additional 25,000 in interest expense during the current quarter.

Third, net interest income totaled almost three million for the third quarter, an increase of $55,000. As our net interest margin remained flat from the second to the third quarter at 3.10 percent, the increase in net interest income was primarily attributable to the increase in average earning assets. The impact on net interest income due to the Lima market expansion was to reduce net interest income by approximately $12,000. So as we further sort through the numbers we can see that the increase of 55,000 in net interest income for the third quarter, from second quarter levels was driven by improvements in the core franchise. As Ken has indicated, the traction in this new market is gaining momentum, and we continue to remain optimistic of our reaching our goals for business development.

Fourth, non interest income totaled 4.4 million for the third quarter, declining slightly from second quarter levels. The primary reason for the decline was the loss realized under disposition of certain repossessed assets of 36,000, versus the gain recognized during the second quarter of last year – second quarter of this year of 56,000. Non interest revenues resulting from the Lima expansion were approximately 93,000 during the third quarter.

Fifth, non operating expenses totaled slightly over seven million this quarter, a decline of 234,000 from second quarter. This is despite the addition of approximately 446,000 of normal operating expenses, contributed by the Lima branches. For the second quarter, you need to factor out one time internal costs of approximately $326,000 of merger related expenses, along with the branch market optimization study. But that normalized operating expenses were $6.9 million for the second quarter.

Bottom line, although we added 446,000 in infrastructure costs from the Lima branches, we've improved efficiencies, and reduced operating costs throughout the corporation resulting in a net reoccurring increase in operating expenses of approximately $92,000.

At this time, I'll turn the Webcast back over to Ken. Ken.

Ken Joyce: Well thank you, Jim. As Jim mentioned, we are pleased to have the trust preferred financing in place at very attractive funding costs. The after tax cost of those funds will be about four percent, which is an amazing cost to leverage the use of capital. These funds will facilitate the acquisition of Exchange. And allow us to consider options such as capital injections, stock buybacks, or acquisitions in the future.

We have completed a branch facility and branching plan study. This was conducted by Market Insights out of Chicago. The charge in this study was to evaluate the existing brand sites of State Bank and Trust, including the Lima market and Exchange. We have created a first round branching optimization plan that includes investing almost $11 million over the next five years to achieve our targeted growth. This plan will also include optimizing the existing branch network. And this will contribute to improved efficiencies. We will talk more about this in the fourth quarter, as we finalize the plan and complete the Exchange acquisition subject to regulatory approval.

Our non banking subsidiaries continue their growth patterns. RDSI has increased data processing revenue 10 percent on a quarter to quarter comparison to 2004 and over 12 percent on a year-to-date comparison. There were three banks added this past quarter for data processing services, and four banks were added for item processing services.

Reliance Financial Services, our trust and investment subsidiary is also continuing its success. At this time, I will turn the Webcast back to Valda, to allow for questions from the investment community. Valda.

Valda Colbart: Thank you, Ken. It's now time for the question-and-answer session. If you are using a speakerphone, please pick up the handset before pressing any numbers. If you have a question, we would like for you to press star one on your push button telephone. That's star one if you have a question. And if for some reason someone asks a question that you would like to, and you need to withdraw that question just press star two. So again, if you have any questions, please press star one on your telephone and we will take the question in the order they are received. We'll standby for just a few moments.

Operator: And we do have a question from Ross Haberman with Haberman Funds.

Ross Haberman: Good morning, gentlemen, how are you?

James Adams: Hey, Ross, pretty good.

Ross Haberman: Good afternoon I should say, excuse me. How are you?

Ken Joyce: Good afternoon, yes.

Ross Haberman: Jim, I just – I got a little lost on your description of the less reoccurring or non reoccurring expenses. And if could be a pain and ask you to clarify, looking at the seven million of non interest expense this quarter, did I understand you to say that roughly 300,000 of that seven million is non reoccurring.

James Adams: That was – that 300,000 were additional merger related expenses, Ross that we had in the third quarter – I'm sorry, the second quarter of 2005 of this year.

Ross Haberman: The second quarter.

James Adams: So let me cut right to the chase OK. We had net income of 492,000. I think this is where you're going in your question. You know, the Lima market acquisition that was a drag on net income to the tune of about 130,000. So if you add that back, that's where our normalized earnings would have been for the quarter.

Ross Haberman: OK. And just one other question, as of the end of the quarter, with all of the acquisitions how does that leave your interest rate sensitivity, positive, negative or what?

James Adams: We're still positively GAP'd.

Ross Haberman: OK. Thank you.

James Adams: You're welcome.

Operator: And we'll take our next question from George Geissbuhler with Sweeney Cartwright.

George Geissbuhler: Good afternoon, guys.

James Adams: Hey, George.

Valda Colbart: Hi, George.

Ken Joyce: How are you doing, George?

George Geissbuhler: Just a couple of questions here. Do you guys currently do the data processing for Exchange and Luckey now?

Ken Joyce: Yes, we do as a matter of fact.

George Geissbuhler: So that should really help the transition there, I would think.

Ken Joyce: It's going to make it a very unique transition, you're correct.

George Geissbuhler: Any kind of feel for what kind of efficiency ration Exchange or Luckey has?

Ken Joyce: They're fairly high. They've had some credit difficulties. We're very encouraged where they're at with those credit challenges at this point. So that's impaired their efficiency ratio.

George Geissbuhler: And do you think there will be any opportunity there as far as will you be keeping all of their branches? Or how will that….

Ken Joyce: Yes, we will be keeping their branches. They've got two branches that are very significant in terms of good sized deposits. And clearly, would have a very positive contribution. They've got three that are in the metropolitan Toledo market.

George Geissbuhler: Yes, I knew there's one. Was it Perrysburg or was it two? I really kind of forgot.

Ken Joyce: Yeah, there's one in Perrysburg, one in Holland, and one in Sylvania.

George Geissbuhler: OK.

Ken Joyce: And those are under – probably the wrong term is under utilized, but they do not get anywhere near their full potential.

George Geissbuhler: So there's good potential there, you think.

Ken Joyce: We think there's outstanding potential.

George Geissbuhler: And then the other – the last question I had was the Fort Wayne, a lot of banks use that loan production as a way to get started there. Is your game plan there to eventually have a full blown bank branch there? Is that kind of the game plan to see how this loan production office goes?

Ken Joyce: You know, we've announced in the past that we have a number of areas that are of interest to us. And that is that is one that is of interest to us, yes.

George Geissbuhler: OK. That's all I had. Thanks so much.

Ken Joyce: OK. Take care, George.

George Geissbuhler: OK. Thanks.

Valda Colbart: While we are waiting to see if we have any more questions, we would like to remind everyone that we would be happy to e-mail you directly regarding Rurban Financial Corp corporate events, earnings releases, key presentations. If you would like to take advantage of this, please visit our Web site at www.RurbanFinancial.net, and click on the investor section and then e-mail alert service to sign up.

Operator: And we have a follow up question from Ross Haberman, please go ahead.

Ross Haberman: Do you guys have much exposure in the areas where Delphi had their plants? And what's your thought about that?

James Adams: We really don't, Ross not where Delphi was located, at least in the markets that we currently serve.

Ken Joyce: Yeah, Ross, we're in – we're kind of in northwest Ohio, so we've got feeders to a lot of the automobile industry in terms of our small business that we lend to. Right now, we don't see any impact of that. So we're not concerned about that at this point, except as it may affect the overall general economy of course.

Ross Haberman: OK. And a follow up, generally, what are you seeing on loan demand? And what would you say is your strongest market area to date?

Ken Joyce: Well our loan demand as we look at sort of the northwest Ohio section that we operate in under the State Bank and Trust flag is not real strong. We see that as probably consistent with sort of community growth numbers. We are very excited about what we're seeing in the Lima market. And that's basically a bigger pond for us to play in. And we've also been very fortunate to get some very skilled players down there. We're very pleased with David Anderson who is leading that charge down there. And we're very optimistic about that.

Also the, I'm pleasantly surprised about the fast start that the Fort Wayne operation had. We'll see some closings and that in the fourth quarter, that look promising. But we've got somebody over there who has worked that market before and is recognized over there.

Ross Haberman: And Jim, just one question, I was looking at the quarterly numbers and non interest expense. These professional fees are roughly 467,000. Is that all related to the work outs of the REO? And do you see that number coming down significantly over the next couple of quarters?

James Adams: Ross, we definitely do. You know, as you look at the changes there in professional fees, and how much they dropped just from the second quarter to the third quarter, and, you know, we should continue to see those trends downward.

Ross Haberman: OK.

Ken Joyce: Ross, this is Ken. We are working hard to get those issues resolved by year end and come into 2006 clean, if we can possibly accomplish that.

Ross Haberman: OK. The best of luck. And don't hesitate to negotiate with lawyers. They're a dime a dozen.

Ken Joyce: We can't comment on that.

Ross Haberman: I can say that. I'm married to one. Thank you.

James Adams: That's only because our attorney's are listening in Ross.

Ross Haberman: Well I said it, you didn't. Thank you.

Ken Joyce: Thank you.

Valda Colbart: Thank you.

Operator: And there are no other questions in the queue at this time, but as a reminder, if you do have a question please press star one at this time. And we'll pause for just a moment.

And if there are no further questions, I'll now turn the conference back to Ken Joyce, please go ahead.

Ken Joyce: OK. Thank you. I want to thank everyone for spending the time to better understand your company by engaging in this Webcast. We remain very optimistic about the future of Rurban Financial. And I remain a buyer of our company stock. Thank you very much.

Operator: Thank you. And that does conclude our conference for today.

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