f u l t o n   f i n a n c i a l   c o r p o r a t i o n

**Banking Subsidiaries:**

Fulton Bank
Lebanon Valley Farmers Bank
Swineford National Bank
Lafayette Ambassador Bank
FNB Bank, N.A.
Hagerstown Trust
Delaware National Bank
The Bank
The Peoples Bank of Elkton
Skylands Community Bank
Premier Bank
Resource Bank
First Washington State Bank

*Residential lending offered through Fulton Mortgage Company and Resource Mortgage*

**Financial Services Affiliates:**

Fulton Financial Advisors, N.A.
Dearden, Maguire, Weaver, and Barrett, LLC
Fulton Insurance Services Group, Inc.

One Penn Square, P.O. Box 4887, Lancaster, PA 17604, 1-800-FULTON-4, www.fult.com

# Working together beautifully.

## FULTON FINANCIAL CORPORATION

*2004 Annual Report*

**AT FULTON FINANCIAL**, our strategy for creating value is somewhat unique in our industry. We find that our approach has much in common with the attractive colors and distinctive shapes that complement one another within a kaleidoscope.

In a kaleidoscope, unique and shining pieces of glass come together to create a series of beautiful patterns. In much the same way, our affiliate banks and financial services companies work in concert with one another to create value for you, our shareholder. Our family of independent community banks, each a reflection of the market it serves, works in harmony to create a strong corporation that is able to deliver attractive returns for investors.

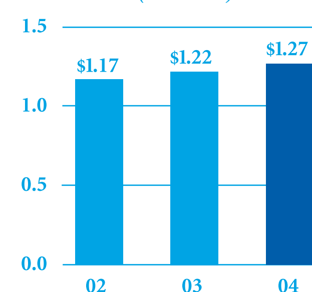
While our presence continues to expand geographically and our company grows and responds to the changing financial services industry over time, our corporate philosophy and commitment to our successful business model remains constant. We believe our focus on creating success for our customers, our employees and our communities will continue to benefit you, our shareholder, in the years to come.

## Financial Highlights

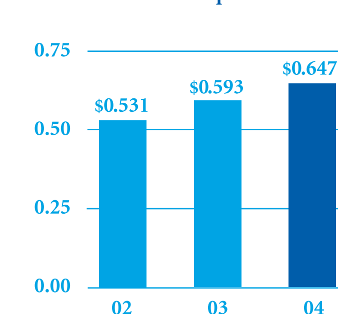
*(Dollars in thousands, except per-share data)*

| per-share data | 2004 | 2003 | 2002 | percent change 2004/2003 | percent change 2003/2002 |
|---|---|---|---|---|---|
| Net income (diluted) | $ 1.27 | $ 1.22 | $ 1.17 | 4% | 4% |
| Cash dividends | 0.647 | 0.593 | 0.531 | 9% | 12% |
| Shareholders' equity | 9.88 | 8.33 | 7.75 | 19% | 7% |
| **at year end** | | | | | |
| Total assets | $ 11,158,000 | $ 9,767,000 | $ 8,388,000 | 14% | 16% |
| Loans, net of unearned | 7,585,000 | 6,160,000 | 5,317,000 | 23% | 16% |
| Deposits | 7,896,000 | 6,752,000 | 6,246,000 | 17% | 8% |
| Shareholders' equity | 1,242,000 | 947,000 | 864,000 | 31% | 10% |
| Shares outstanding | 125,720,000 | | | | |
| Number of shareholders | 45,440 | | | | |
| Number of employees | 3,700 | | | | |

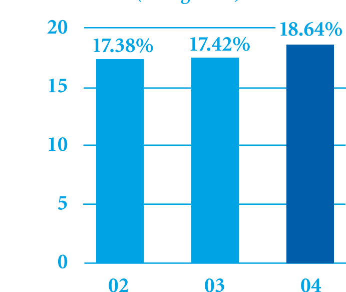
Net income per share
*(diluted)*




Dividends per share




Return on average equity
*(tangible)* *




* *Net income divided by average shareholders' equity, net of goodwill and intangible assets.*

letter to our shareholders

# *Working together beautifully.*

Three simple words that sum up how Fulton Financial's affiliate banks and financial services companies create success for our shareholders, our customers, our employees and our communities. We hope you have been pleased with how our unique business model has translated into strong performance and attractive returns for you, our shareholder, through the years. We are pleased to report continued solid performance for 2004 as well.

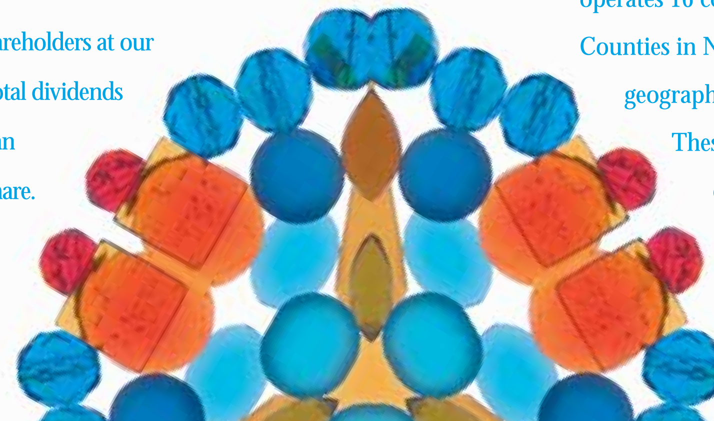
In 2004, our net income per share increased 4.1% to $1.27 on total net income of $152.9 million. These results represent a return on average assets of 1.48% and a return on average tangible equity of 18.64%. The Corporation's total capital was $1.2 billion at December 31, 2004, representing a book value per share of $9.88 and a tangible book value per share of $6.78.

Fulton Financial Corporation's stock closed the year at $23.31 per share, compared to the 2003 close of $20.86, which is adjusted for the five percent stock dividend paid in June 2004. Long-term shareholders have realized an attractive return on their investment in Fulton Financial. For example, if you owned 100 shares of Fulton Financial Corporation common stock on June 30, 1982, when the Corporation was formed, your investment was $1,750. By doing nothing more than holding on to those shares, as of December 31, 2004, you would have owned 1,645 shares, valued at $38,345, for a compounded annual rate of return of 15% over the 23-year period. If you had taken advantage of our dividend reinvestment plan, that same investment of $1,750 in 1982 would have had a 2004 year-end market value of $83,833, representing 3,596 shares, for a compounded annual rate of return of 19%.

We ended the year with $11.2 billion in assets and a market capitalization of $2.9 billion, which makes us the second largest commercial bank headquartered in the Third Federal Reserve District. As of December 31, 2004, we operated 224 branches located in Pennsylvania, New Jersey, Delaware, Maryland and Virginia.

Our consistent performance is reflected in our financial highlights and in the following milestones and accomplishments:

- We had the honor of presiding over the Market Opening Ceremony at the NASDAQ Stock Exchange. Fulton Financial has been listed on the NASDAQ exchange (ticker symbol: FULT) since 1985, and it was a privilege to be able to recognize the achievements of our employees during this nationally televised ceremony.
- Resource Bank, headquartered in Virginia Beach, became a part of Fulton Financial and enabled us to establish a presence in several thriving Virginia markets. The addition of Resource Bank, along with that of Premier Bank in August of 2003, positively impacted the Corporation's loan and deposit growth as well as our results of operations.
- We enjoyed the opportunity to meet with nearly 2,000 of our shareholders at our annual meeting. At that time, we announced that shareholders' total dividends would increase by 8.3% due to a five percent stock dividend and an increase in the regular quarterly cash dividend to 16.5 cents per share.

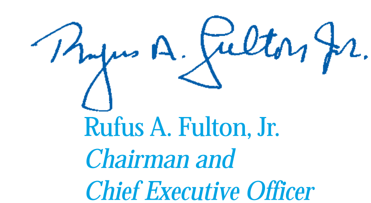




- At the annual meeting, we also unveiled a significantly enhanced corporate website. The newly designed site has much more information of interest to investors, including stock information, deposit market share information, analyst estimates, an event calendar, email notification and a frequently-asked questions page. Be sure to visit us at *www.fult.com*.
- We recognized the outstanding service and dedication of three members of our board of directors who had reached the Corporation's mandatory retirement age: Fred Fichthorn, chairman of the board of F&M Hat Company, who joined the board in 1993; Sam Jones, founder of SJ Transportation Company, who joined the board in 1997; and Stu Raub, retired chairman of the board of Industrial Piping Systems, Inc., who joined the board in 1982. We also welcomed Tom Hunt, chairman of the Resource Bank board, to the Corporation's board of directors. Tom is president of Management Marketing Services, Inc. and is president and chairman of Digital Access Control, Inc.
- We completed our acquisition of First Washington State Bank, which is based in Windsor, NJ. First Washington has assets of approximately $494 million and operates 16 community banking offices in Mercer, Monmouth and Ocean Counties in New Jersey. Our union with First Washington enhances our geographic franchise by expanding our presence into central New Jersey. These additional banking offices now provide increased convenience for our existing customers in northern and southern New Jersey and eastern Pennsylvania. Following this acquisition, Abraham S. Opatut joined the Fulton Financial board. Abe is president of Colonial Foods Inc. and Colonial Marketing Associates.
- In January 2005, we announced our intent to acquire SVB Financial Services, Inc. and its banking subsidiary, Somerset Valley Bank, based in Somerville, NJ. This acquisition enables us to further solidify our presence in New Jersey markets and further enhance banking convenience for our existing New Jersey customers. With the addition of First Washington and Somerset Valley, we will serve 14 of the 21 counties in New Jersey and offer 64 community banking locations in those markets.

In the coming months, we will continue to focus on maintaining our strong asset quality, growing our net interest margin, increasing our non-interest income by continuing to aggressively market Fulton Financial Advisors and our mortgage lending activities throughout our company, expanding our franchise geographically into high-growth areas, increasing loan activity and growing core deposits. We believe that the results we achieve through these activities will enable us to continue to earn your confidence.

As always, we thank you for the investment you have made in Fulton Financial and appreciate your confidence in both our philosophy and our team.

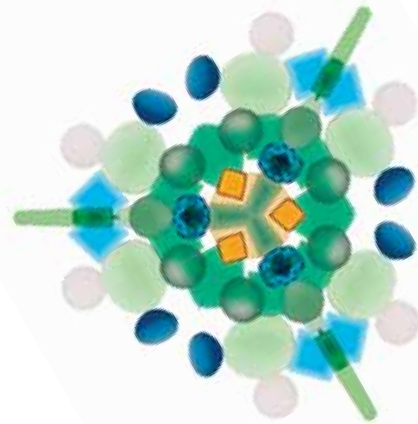


Rufus A. Fulton, Jr.
*Chairman and*
*Chief Executive Officer*

R. Scott Smith, Jr.
*President and*
*Chief Operating Officer*

# Working together

seamlessly to create value for our shareholders, customers, employees and communities.



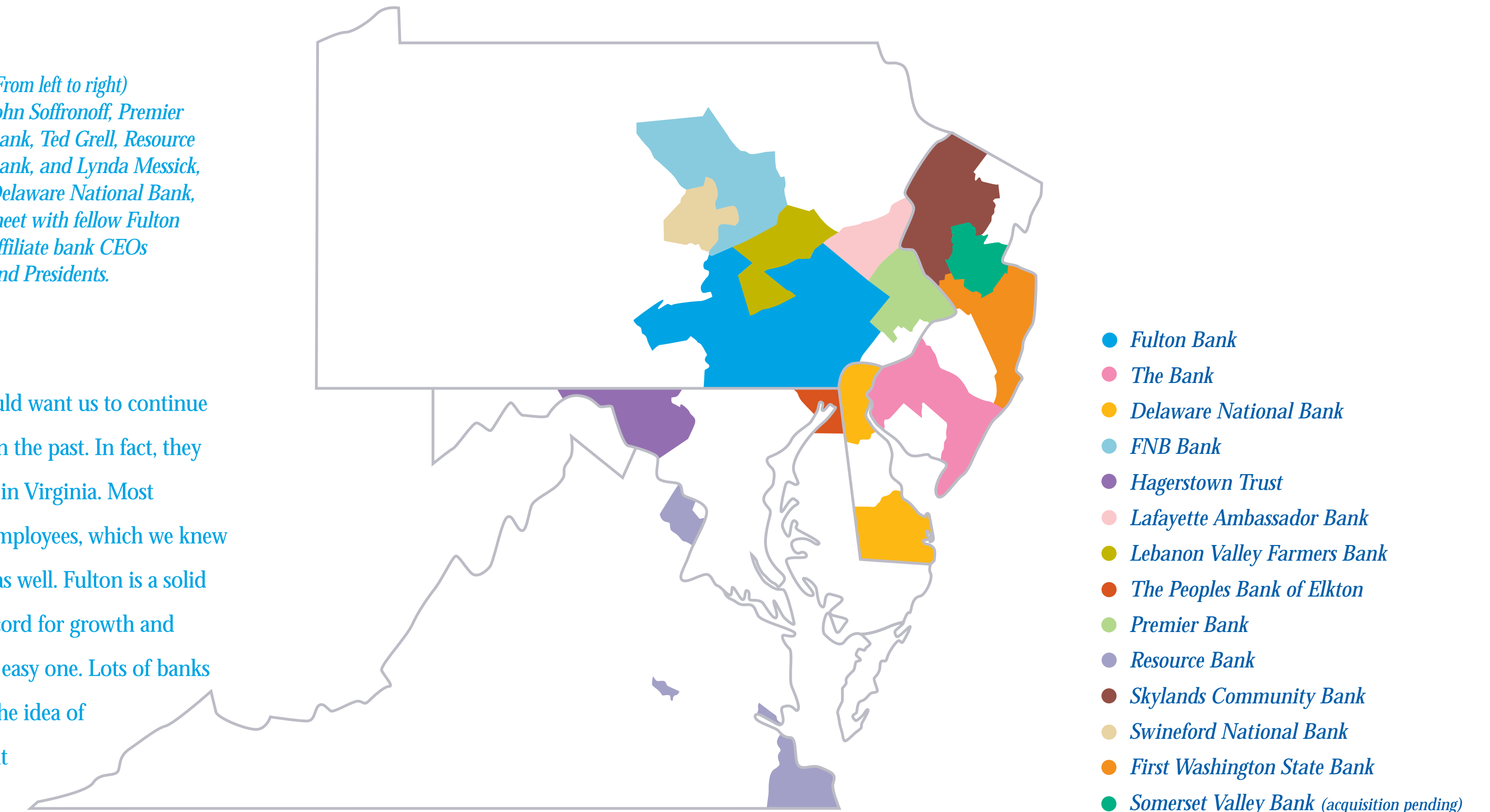
Our decentralized business model drives everything we do here at Fulton Financial. It exemplifies who we are, what we believe in, and where we're headed. As our company has grown, it is this model, with its network of independent affiliates, that has distinguished us from our peers.

At its simplest, our unique model allows each bank that joins our Corporation to retain the qualities that create value for its customers - the bank's name, its employees, its board of directors, and its local decision-making ability. Frequently, so little changes after a bank becomes a part of the Fulton family that some of the bank's customers might not realize a change has taken place at all!

This autonomy enables each of our banks to make strong, individual contributions to the overall success of Fulton Financial. Your investment in Fulton Financial is actually an investment in 13 thriving community banks, each guided by a common philosophy, code of ethics, and set of overall financial goals. Our model and the hard work of our talented employees help create consistent strong performance over time, which, in turn, leads to a strong investment for you, our shareholder. Our way of doing business enables Fulton Financial to compare favorably to our peers and to the top 50 banks in the country in many key performance measures, year after year.

*(From left to right) John Soffronoff, Premier Bank, Ted Grell, Resource Bank, and Lynda Mesick, Delaware National Bank, meet with fellow Fulton affiliate bank CEOs and Presidents.*

Our philosophy has enabled us to continue to grow by attracting new, high performing banks to our franchise. Most recently, we expanded into high growth areas in Virginia with our acquisition of Resource Bank. When asked why the bank decided to join with Fulton Financial, Ted Grell, Resource Bank's CEO and president, said "Fulton Financial's management made it clear that if we joined the company, they would want us to continue doing what had made us so successful in the past. In fact, they wanted to help us expand our presence in Virginia. Most importantly, they wanted to keep our employees, which we knew would help keep our customers happy as well. Fulton is a solid organization with a wonderful track record for growth and strong earnings, so our decision was an easy one. Lots of banks had approached us over the years, but the idea of joining with one of them never felt right until we found Fulton."

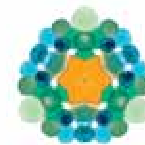


*(From left to right) Kathy Jeffers, Vice President/Relationship Manager with Fulton Financial Advisors, meets with Kim Mertz and Susan Kent of Fine Line Homes to discuss their company's retirement plan.*

# Working together

effectively to offer a wide range of financial products and services to meet the unique needs of each of our customers.

*Mike Firestine, Senior Vice President/Senior Agricultural Loan Officer and farmer, at the Irvin Z. Brubaker family's dairy farm in Lebanon County, PA.*

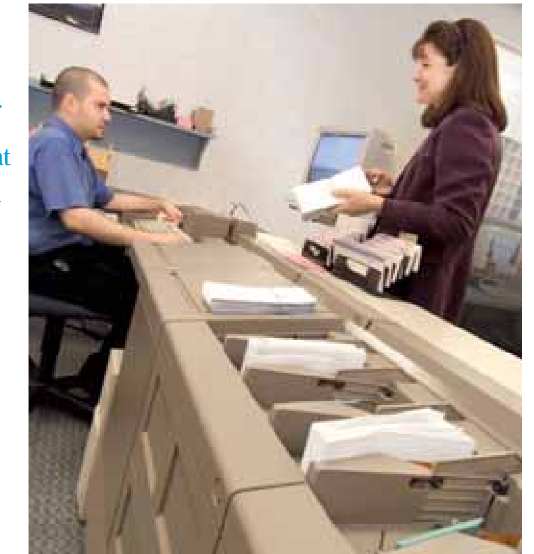


Although our affiliate banks operate as individual community banks, because they are part of a multi-billion-dollar corporation, the products and services each can offer match the depth and sophistication of those offered by many of the largest banks in the country.

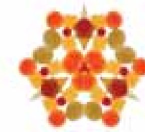
Our unique business model enables us to share specialized expertise across the entire company to meet the unique needs of each retail or business customer. Through the strength of our multi-bank holding company, each of our affiliate banks can provide products and services other independent community banks may not be able to offer. For example, our purchase of a sizeable agricultural loan portfolio just over a year ago, together with the farm and agricultural business relationships we've enjoyed for more than 120 years, have made us the largest agricultural bank lender in the Northeast. Since our agricultural relationship managers are farmers themselves, we are able to offer farmers and agribusinesses very personalized service and an in-depth understanding of the products they need and want.

What's more, our highly trained, experienced staff can offer the sophisticated products many larger commercial clients desire. Through Fulton Financial Advisors, we offer efficient, qualified retirement plan administration services to more than 350 plan sponsors and service nearly $1 billion in assets. We also provide cash reserve investment management, an extremely innovative product that combines daily liquidity and enhanced investment return to more than 125 clients. We service approximately $700 million in assets through this program. In addition, through our Cash Management Department, we provide lockbox services that allow companies to have their customers send payments directly to the bank, where they are processed, imaged and deposited quickly and efficiently.

Because of the collective strength of our individual affiliates, we can provide the depth of products and services our customers need to meet their unique financial goals and objectives.



*Fulton's Lockbox area, where payments are received, a digital image is made, and funds are immediately deposited into a business customer's account.*



Another strength of our business model is that we are able to capitalize on the wide array of services offered by a company of our size, but deliver them in a highly personalized style that is more frequently associated with small community banks. Although our company is one of the largest 50 banks in the country, each of our affiliate banks is deeply rooted in the community it serves. This focus enables them to provide the personalized service and local leadership you won't necessarily find with larger banks.

# Working together

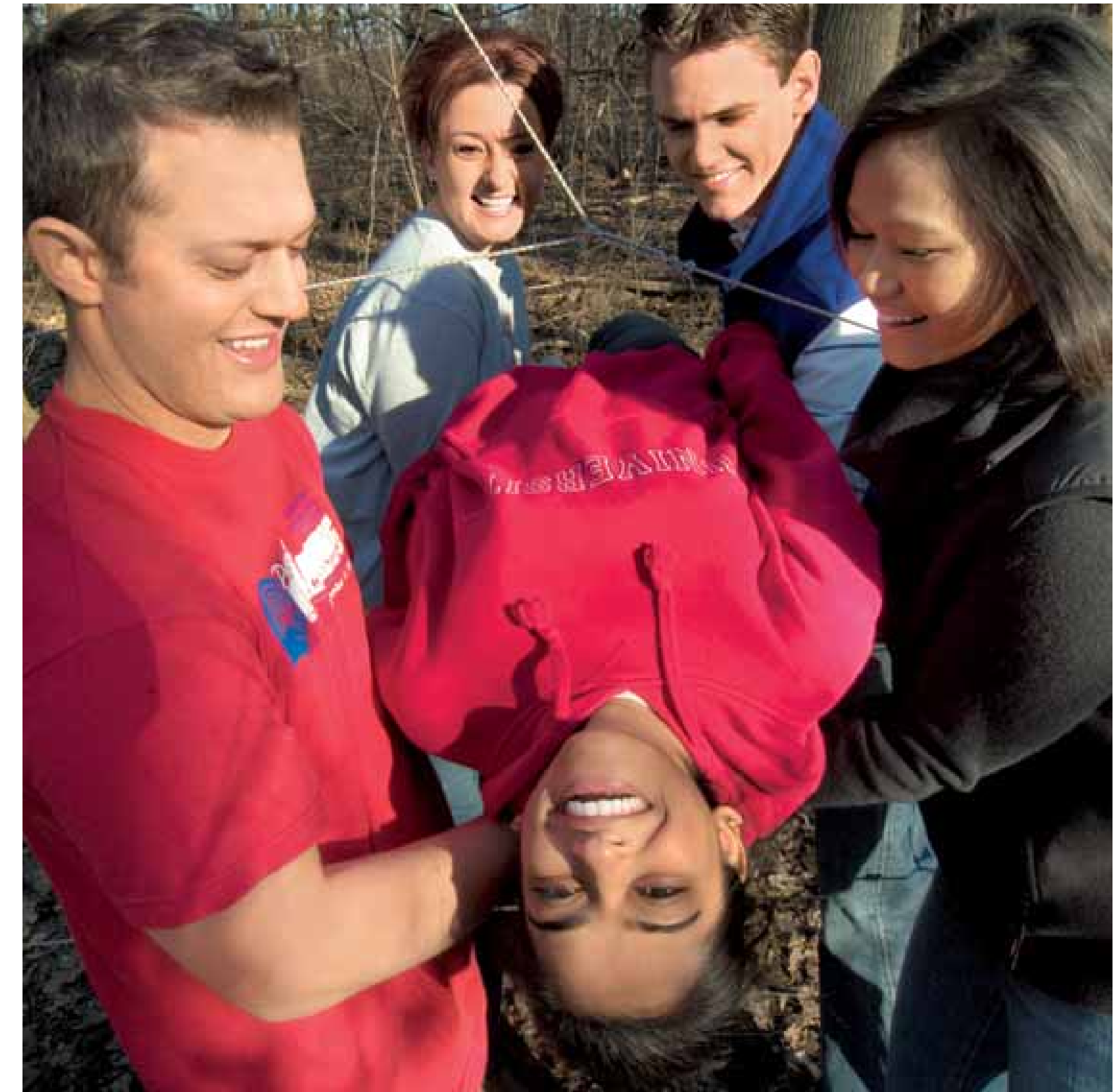
## creatively to provide service that's both prompt and personal.

*Angela Snyder (right), President of Retail Services at The Bank, reviews a loan request with Vice President Sharon Bianchi, manager of the Mantua branch.*

We know the key to offering this exceptional customer service is recruiting, retaining and rewarding highly talented employees. That's why we invest significant time and energy into providing competitive salaries, comprehensive benefits, and training and development programs. These help our employees to achieve career success, and their satisfaction with their jobs enhances the level of service they provide to our customers.

From developing leaders within our company through our Management Training Program to enabling employees to make decisions in their local markets, Fulton Financial is committed to the success of our strongest asset - our employees.

After all, having a group of satisfied employees, working together beautifully towards a common goal, not only fosters individual growth and corporate success, but also yields strong performance and rock-solid customer relationships.



*Members of Fulton Financial's Management Training Program work together on a team-building exercise.*

## FULTON FINANCIAL CORPORATION SENIOR MANAGEMENT

Rufus A. Fulton, Jr.
*Chairman and Chief Executive Officer*

R. Scott Smith, Jr.
*President and Chief Operating Officer*

Charles J. Nugent
*Senior Executive Vice President and Chief Financial Officer*

Richard J. Ashby, Jr.
*Executive Vice President*

*(From left to right)*
*Richard J. Ashby, Jr., Rufus A. Fulton, Jr., R. Scott Smith, Jr., Charles J. Nugent*

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Clark S. Frame
Patrick J. Freer
Rufus A. Fulton, Jr.
Eugene H. Gardner
Charles V. Henry III, Esq.
J. Robert Hess
George W. Hodges
Carolyn R. Holleran
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Thomas W. Hunt
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Joseph J. Mowad, M.D.
Abraham S. Opatut
Mary Ann Russell
John O. Shirk, Esq.
R. Scott Smith, Jr.
Gary A. Stewart

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Harlowe R. Prindle
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E. Philip Wenger
James S. Wisotzkey

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Charles V. Henry III, Esq.
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Wendie DiMatteo Holsinger
Donald W. Lesher, Jr.
Robert J. Longo
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Richard F. Erdley
Ann E. Kaye
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Michael R. Wimer
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L. Anderson Daub
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Joseph J. Mowad, M.D.
Joanne E. Wade

### Hagerstown Trust

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James C. Bryan
Raymond A. Grahe
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Doris E. Lehman
Bernard P. Lesky
Paul C. Mellott, Jr.
Lynn F. Meyers, Esq.

### Delaware National Bank

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Jeffrey M. Fried
Amy A. Higgins
Mark E. Huntley
Greg N. Johnson
Terry A. Megee
Lynda A. Messick
Ronald T. Moore
Paul H. Mylander
Ralph W. Simpers
David T. Wilgus
Gordon E. Wood Sr., Esq.

### The Bank

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Jeffrey G. Albertson, Esq.
Dennis N. DeSimone
Lawrence M. DiVietro, Jr.
Sandra J. Gubbine
Scott H. Kintzing
Warner A. Knobe
Ross Levitsky, Esq.
Sarah (Sally) Love
Robert R. McHarness
Angela M. Snyder
Daniel G. Timms, D.D.S.
Paul J. Tully

### The Peoples Bank of Elkton

Harry C. Brown
Judy E. Hart
Donald S. Hicks
Mark E. Huntley
Robert O. Palsgrove
David K. Williams, Jr.

### Skylands Community Bank

Norman S. Baron
Daniel M. DiCarlo, Jr.
Michael Halpin
Raymond Nisivoccia, C.P.A.
Denis H. O'Rourke
Paul J. Pinizzotto
Dominick V. Romano
Leslie E. Smith, Jr.
Mark F. Strauss, Esq.
Norman Worth

### Premier Bank

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Clark S. Frame
John J. Ginley
Thomas E. Mackell, M.D.
Barry J. Miles, Sr.
Daniel A. Nesi, M.D.
Neil W. Norton
Thomas M. O'Mara
Michael J. Perucci
Brian R. Rich
Ezio U. Rossi
Richard F. Ryon
Gerald Schatz
John C. Soffronoff
Irving N. Stein
HelenBeth Garofalo Vilcek
John A. Zebrowski

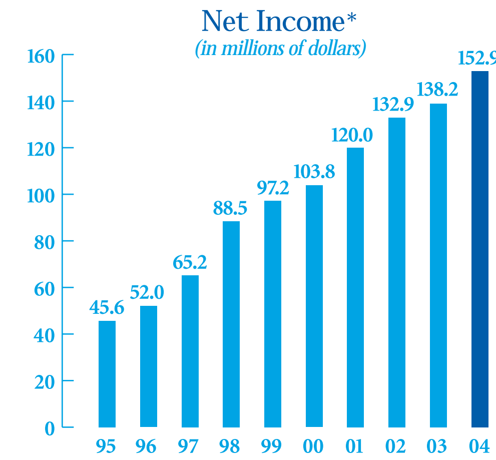
### Resource Bank

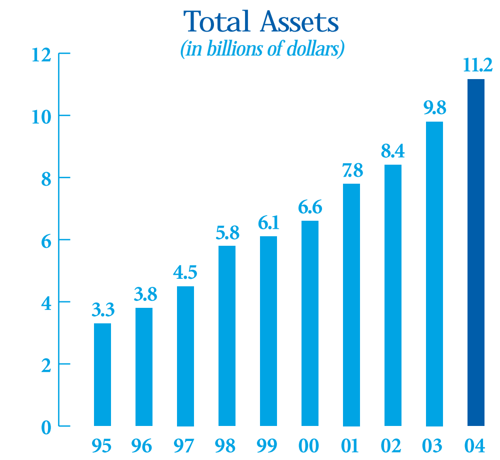
Alfred E. Abiouness
T.A. Grell, Jr.
Thomas W. Hunt
Louis R. Jones
A. Russell Kirk
Lawrence N. Smith
Elizabeth Addington Twohy

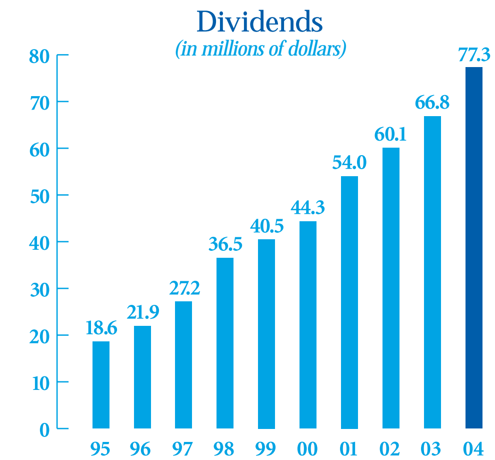
### First Washington State Bank

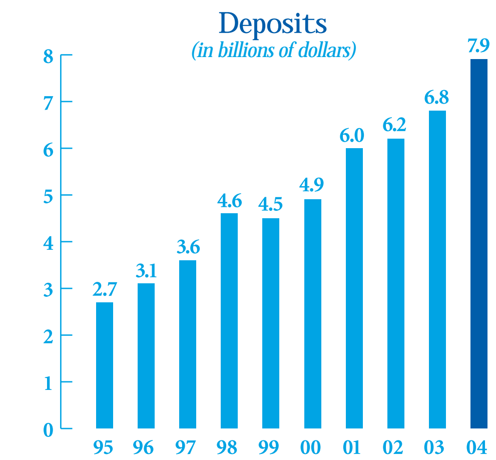
James N. Corcodilos
Harry Horowitz
James R. Johnson, Jr.
Jerry Kokes
Joe J. Mayes, Jr.
Abraham S. Opatut
Steven I. Pfeffer
C. Herbert Schneider
Ross Wishnick

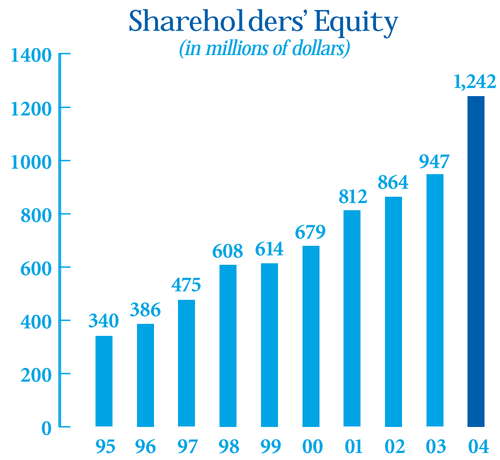
## 10 Years In Review (1995–2004)

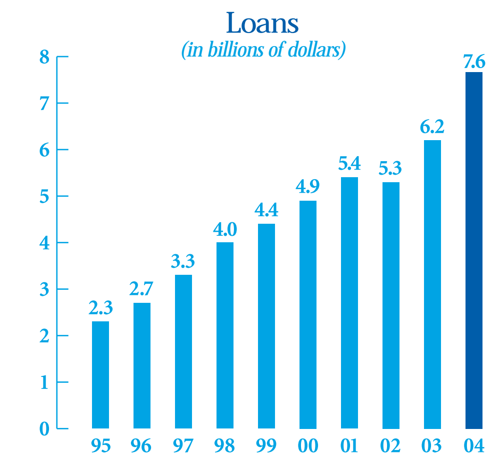



The data above represent both internal and external growth. Prior year amounts have not been restated to reflect acquisitions.
**For 2001, amount is income before $6.4 million of merger-related expenses.*



## INVESTOR INFORMATION

### Stock Listing

Common shares of Fulton Financial Corporation are traded under the symbol "FULT" and are listed in the National Market System of NASDAQ.

### Dividend Calendar

Dividends on Fulton Financial Corporation's common stock are customarily payable on or about the 15th of January, April, July and October.

### Dividend Reinvestment Plan and Direct Deposit of Cash Dividends

Fulton Financial Corporation offers its shareholders the convenience of a Dividend Reinvestment and Stock Purchase Plan and the direct deposit of cash dividends.

Holders of stock may have their quarterly dividends automatically reinvested in additional shares of the Corporation's common stock by utilizing the Dividend Reinvestment Plan.

Shareholders participating in the Plan may also make voluntary cash contributions not to exceed $5,000 per month.

In addition, shareholders also have the option of having their cash dividends sent directly to their financial institution for deposit into their savings or checking account.

Shareholders may receive information on either the Dividend Reinvestment and Stock Purchase Plan or direct deposit of cash dividends by writing to:

Stock Transfer Department
Fulton Financial Advisors, N. A.
P.O. Box 3215
Lancaster, PA 17604-3215

or calling: (717) 291-2546
or 1-800-626-0255.

### Form 10-K

A copy of the Corporation's Annual Report to the Securities and Exchange Commission, Form 10-K, can be viewed on the Corporation's website at *www.fult.com.*
In addition, copies may be obtained without charge to shareholders by writing to:

George R. Barr, Secretary
Fulton Financial Corporation
P.O. Box 4887
Lancaster, PA 17604-4887

**The annual meeting and luncheon of shareholders of Fulton Financial Corporation** will be held on Wednesday, April 13, 2005, at noon in the Great American Hall of the Hershey Lodge and Convention Center, West Chocolate Avenue and University Drive, Hershey, PA. Please note that any shareholder who would like to attend MUST HAVE A RESERVATION. You may let us know that you will attend by returning the Reservation Form included in your proxy mailing.

Your reservation will help ensure that we have adequate seating for all shareholders who plan to join us that day.

| Description | Page |
| --- | --- |
| 5-Year Consolidated Summary of Financial Results | 2 |
| Management's Discussion and Analysis of Results of Operations and Financial Condition | 3 |
| Consolidated Balance Sheets | 33 |
| Consolidated Statements of Income | 34 |
| Consolidated Statements of Shareholders' Equity and Comprehensive Income | 35 |
| Consolidated Statements of Cash Flows | 36 |
| Notes to Consolidated Financial Statements | 37 |
| Management Report on Internal Control Over Financial Reporting | 68 |
| Reports of Independent Registered Public Accounting Firm | 69 |
| Quarterly Consolidated Results of Operations (Unaudited) | 72 |

**5-YEAR CONSOLIDATED SUMMARY OF FINANCIAL RESULTS**
**(dollars in thousands, except per-share data)**

| | For the Year | | | | |
|---|---|---|---|---|---|
| | **2004** | 2003 | 2002 | 2001 | 2000 |
| **SUMMARY OF INCOME** | | | | | |
| Interest income | **$ 493,643** | $ 435,531 | $ 469,288 | $ 518,680 | $ 519,661 |
| Interest expense | **135,994** | 131,094 | 158,219 | 227,962 | 243,874 |
| Net interest income | **357,649** | 304,437 | 311,069 | 290,718 | 275,787 |
| Provision for loan losses | **4,717** | 9,705 | 11,900 | 14,585 | 15,024 |
| Other income | **138,864** | 134,370 | 114,012 | 102,057 | 76,717 |
| Other expenses | **273,615** | 231,559 | 223,765 | 218,234 | 186,209 |
| Income before income taxes | **218,181** | 197,543 | 189,416 | 159,956 | 151,271 |
| Income taxes | **65,264** | 59,363 | 56,468 | 46,367 | 44,437 |
| Net income | **$ 152,917** | $ 138,180 | $ 132,948 | $ 113,589 | $ 106,834 |
| **PER-SHARE DATA (1)** | | | | | |
| Net income (basic) | **$ 1.28** | $ 1.23 | $ 1.17 | $ 1.00 | $ 0.95 |
| Net income (diluted) | **1.27** | 1.22 | 1.17 | 0.99 | 0.95 |
| Cash dividends | **0.647** | 0.593 | 0.531 | 0.481 | 0.430 |
| **RATIOS** | | | | | |
| Return on average assets | **1.48%** | 1.57% | 1.68% | 1.51% | 1.52% |
| Return on average equity | **14.31** | 15.45 | 15.86 | 14.58 | 15.85 |
| Return on average equity (tangible) (2) | **18.64** | 17.42 | 17.38 | 15.81 | 16.29 |
| Net interest margin | **3.83** | 3.82 | 4.35 | 4.27 | 4.31 |
| Efficiency ratio | **55.10** | 52.80 | 52.60 | 55.60 | 52.80 |
| Average equity to average assets | **10.30** | 10.20 | 10.60 | 10.40 | 9.60 |
| Dividend payout ratio | **50.50** | 48.20 | 45.40 | 48.10 | 45.30 |
| **PERIOD-END BALANCES** | | | | | |
| Total assets | **$11,158,351** | $9,767,288 | $8,387,778 | $7,770,711 | $7,364,804 |
| Loans, net of unearned income | **7,584,547** | 6,159,994 | 5,317,068 | 5,373,020 | 5,374,659 |
| Deposits | **7,895,524** | 6,751,783 | 6,245,528 | 5,986,804 | 5,502,703 |
| Federal Home Loan Bank advances and long-term debt | **684,236** | 568,730 | 535,555 | 456,802 | 559,503 |
| Shareholders' equity | **1,242,290** | 946,936 | 863,742 | 811,454 | 731,171 |
| **AVERAGE BALANCES** | | | | | |
| Total assets | **$10,343,328** | $8,802,138 | $7,900,500 | $7,520,071 | $7,019,523 |
| Loans, net of unearned income | **6,901,452** | 5,589,663 | 5,381,950 | 5,341,497 | 5,131,651 |
| Deposits | **7,285,134** | 6,505,371 | 6,052,667 | 5,771,089 | 5,245,019 |
| Federal Home Loan Bank advances and long-term debt | **637,654** | 566,437 | 476,415 | 500,162 | 476,590 |
| Shareholders' equity | **1,068,464** | 894,469 | 838,213 | 779,014 | 673,971 |

(1) Adjusted for stock dividends and stock splits.
(2) Net income divided by average shareholders' equity, net of goodwill and intangible assets.

## *MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION*

Management's Discussion and Analysis of Financial Condition and Results of Operations (Management's Discussion) concerns Fulton Financial Corporation (the Corporation), a financial holding company registered under the Bank Holding Company Act and incorporated under the laws of the Commonwealth of Pennsylvania in 1982, and its wholly-owned subsidiaries. This discussion and analysis should be read in conjunction with the consolidated financial statements and other financial information presented in this report.

### FORWARD-LOOKING STATEMENTS

The Corporation has made, and may continue to make, certain forward-looking statements with respect to acquisition and growth strategies, market risk, the effect of competition on net interest margin and net interest income, investment strategy and income growth, investment securities gains, other than temporary impairment of investment securities, deposit and loan growth, asset quality, balances of risk-sensitive assets to risk-sensitive liabilities, employee benefits and other expenses, amortization of goodwill and intangible assets, capital and liquidity strategies and other financial and business matters for future periods. The Corporation cautions that these forward-looking statements are subject to various assumptions, risks and uncertainties. Because of the possibility that the underlying assumptions may change, actual results could differ materially from these forward-looking statements.

In addition to the factors identified herein, the following could cause actual results to differ materially from such forward-looking statements: pricing pressures on loan and deposit products, actions of bank and non-bank competitors, changes in local and national economic conditions, changes in regulatory requirements, actions of the Federal Reserve Board (FRB), creditworthiness of current borrowers, customers' acceptance of the Corporation's products and services and acquisition pricing and the ability of the Corporation to continue making acquisitions.

The Corporation's forward-looking statements are relevant only as of the date on which such statements are made. By making any forward-looking statements, the Corporation assumes no duty to update them to reflect new, changing or unanticipated events or circumstances.

### OVERVIEW

As a financial institution with a focus on traditional banking activities, the Corporation generates the majority of its revenue through net interest income, the difference between interest income earned on loans and investments and interest paid on deposits and borrowings. Growth in net interest income is dependent upon balance sheet growth and maintaining or increasing the net interest margin, which is net interest income as a percentage of average interest-earning assets. The Corporation also generates revenue through fees earned on the various services and products offered to its customers and through sales of assets, such as loans or investments. Offsetting these revenue sources are provisions for credit losses on loans, administrative expenses and income taxes.

The Corporation's net income for 2004 increased $14.7 million, or 10.7%, from $138.2 million in 2003 to $152.9 million in 2004. Diluted net income per share increased $0.05, or 4.1%, from $1.22 per share in 2003 to $1.27 per share in 2004. In 2004, the Corporation realized a return on average assets of 1.48% and a return on average tangible equity of 18.64% compared to 1.57% and 17.42% in 2003. Net income for 2003 increased $5.2 million, or 3.9%, from $132.9 million in 2002 to $138.2 million in 2003. Diluted net income per share increased $0.05, or 4.3%, from $1.17 per share in 2002 to $1.22 per share in 2003.

The increase in earnings in 2004 was driven by a $53.2 million, or 17.5%, increase in net interest income due to both internal and external growth and a stable net interest margin. Contributing to this increase was a $6.6 million, or 5.8%, increase in other income (excluding securities gains), primarily as a result of acquisitions, and a $5.0 million, or 51.4%, reduction in the provision for loan losses due to continued strong asset quality. These items were was offset by a $42.1 million, or 18.2%, increase in other expenses, as a result of both internal and external growth, and a $2.1 million, or 10.8%, reduction in investment securities gains.

The following summarizes some of the more significant factors that influenced the Corporation's 2004 results.

***MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION***

Acquisitions – In August 2003, the Corporation acquired Premier Bancorp, Inc. (Premier), a $600 million bank holding company located in Doylestown, Pennsylvania whose primary subsidiary was Premier Bank, strengthening its presence in eastern Pennsylvania markets. In December 2003, the Corporation acquired approximately $165 million of agricultural loans in Central Pennsylvania and Delaware. In April 2004, the Corporation acquired Resource Bankshares Corporation, (Resource), an $885 million financial holding company located in Virginia Beach, Virginia whose primary subsidiary was Resource Bank. This was the Corporation's first acquisition in Virginia, allowing it to enter a new geographic market. Results for 2004 in comparison to 2003 were impacted by these acquisitions (referred to collectively as the "Acquisitions").

On December 31, 2004, the Corporation acquired First Washington FinancialCorp (First Washington), of Windsor, New Jersey. First Washington was a $490 million bank holding company whose primary subsidiary was First Washington State Bank, which operates sixteen community banking offices in Mercer, Monmouth, and Ocean Counties in New Jersey. The accounts of First Washington are included in the Corporation's December 31, 2004 consolidated balance sheet, however, First Washington did not impact average balances or the consolidated statement of income.

On January 11, 2005, the Corporation entered into a merger agreement to acquire SVB Financial Services, Inc. (SVB) of Somerville, New Jersey. SVB is a $475 million bank holding company whose primary subsidiary is Somerset Valley Bank, which operates eleven community banking offices in Somerset, Hunterdon and Middlesex counties in New Jersey. The acquisition is expected to be completed in the third quarter of 2005. For additional information on the terms of this pending acquisition, see Note Q, "Mergers and Acquisitions", in the Notes to Consolidated Financial Statements.

Acquisitions have long been a supplement to the Corporation's internal growth. These recent and pending acquisitions provide the opportunity for additional growth as they will allow the Corporation's existing products and services to be sold in new markets. The Corporation's acquisition strategy focuses on high growth areas with strong market demographics and targets organizations that have a comparable corporate culture, strong performance and good asset quality, among other factors. Under its "supercommunity" banking philosophy, acquired organizations generally retain their status as separate legal entities, unless consolidation with an existing affiliate bank is practical. Back office functions are generally consolidated to maximize efficiencies.

Merger and acquisition activity in the financial services industry has been very competitive in recent years, as evidenced by the prices paid for certain acquisitions. While the Corporation has been an active acquirer, management is committed to basing its pricing on rational economic models. Management will continue to focus on generating growth in the most cost-effective manner.

Asset Quality – Asset quality refers to the underlying credit characteristics of borrowers and the likelihood that defaults on contractual loan payments will result in charge-offs of account balances. Asset quality is generally a function of economic conditions, but can be managed through conservative underwriting and sound collection policies and procedures.

The Corporation has been able to maintain strong asset quality through different economic cycles, attributable to its credit culture and underwriting policies. This trend continued in 2004 as asset quality measures such as non-performing assets to total assets and net charge-offs to average loans improved in comparison to 2003, allowing a reduction in the provision for loan losses. While overall asset quality has remained strong, deterioration in quality of one or several significant accounts could have a detrimental impact and result in losses that may not be foreseeable based on current information. In addition, rising interest rates could increase the total payments of borrowers and could have a negative impact on their ability to pay according to the terms of their loans.

***MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION***

Interest Rates – During the second half of 2004, the FRB increased short-term interest rates a total of 1.25%, with the overnight borrowing, or Federal funds, rate ending the year at 2.25%. The average Federal funds rate for the year increased 22 basis points from 1.13% in 2003 to 1.35% in 2004 and the average prime lending rate increased from 4.13% in 2003 to 4.35% in 2004. This increase in rates resulted in an expansion of the Corporation's net interest margin during 2004 after decreasing significantly during 2003. While the net interest margin for the year increased only slightly, the improvement is evident in the quarterly trend, which is shown in the following table:

| | **2004** | 2003 |
|---|---|---|
| 1st Quarter | **3.79%** | 4.06% |
| 2nd Quarter | **3.73** | 3.91 |
| 3rd Quarter | **3.88** | 3.62 |
| 4th Quarter | **3.92** | 3.74 |
| Year to Date | **3.83** | 3.82 |

Unlike short-term interest rates, longer-terms rates remained relatively flat, with ten-year United States Treasury rates beginning and ending the year at about the same level. However, this level was higher than the historic lows experienced during 2002 and 2003 and, consequently, mortgage refinance activity continued its relative slowdown which started during the third and fourth quarter of 2003. Long-term interest rate levels also continued to affect the Corporation's deposit mix as funds from maturing time deposits continued to flow into core demand and savings accounts as customers were reluctant to lock into the relatively low rates being offered on time deposit products.

In a rising rate environment, the Corporation expects improvements in net interest income, as discussed in the "Market Risk" section of Management's Discussion. Increasing long-term rates, however, tend to have a detrimental impact on mortgage loan origination volumes and related mortgage-banking income.

Regulatory Environment – The Corporation is a registered financial holding company and its subsidiary banks are depository institutions whose deposits are insured by the Federal Deposit Insurance Corporation (FDIC). The Corporation and its subsidiaries are subject to various regulations and examinations by bank regulatory authorities, including the Federal Reserve, the FDIC, the Office of the Comptroller of the Currency and certain state agencies. The financial services industry has been subjected to heightened scrutiny by bank regulatory authorities in the areas of Bank Secrecy Act compliance and other anti-money laundering rules and regulations. As a result the Corporation has hired additional staff for compliance related activities.

As a publicly traded company, the Corporation is also subject to Securities and Exchange Commission (SEC) regulations, which govern the frequency and content of financial information required to be made available to the public. Recent legislative and regulatory actions of the Federal government have significantly changed financial reporting requirements, primarily as a result of the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley). For the 2004 financial statements and footnotes, Sarbanes-Oxley required management to issue a report on the effectiveness of its internal controls over financial reporting. In addition, the Corporation's independent public accountants were required to issue an opinion on management's report and the Corporation's internal controls over financial reporting. These reports can be found after the Consolidated Financial Statements and Notes to Consolidated Financial Statements.

The burden of compliance with the new reporting requirements has been significant for all publicly traded companies, including the Corporation. The cost includes both the time devoted by its employees to complete the documentation and testing of controls and the expense for engaging professionals to assist in the process. In addition, the Corporation experienced a significant increase in independent accountant fees related to the internal controls testing process. See additional information in the "Other Expenses" section of Management's Discussion.

## RESULTS OF OPERATIONS

### Net Interest Income

Net interest income is the most significant component of the Corporation's net income, accounting for approximately 75% of total 2004 revenues, excluding investment securities gains. The ability to manage net interest income over a variety of interest rate and economic environments is important to the success of a financial institution. Growth in net interest income is generally dependent upon balance sheet growth and maintaining or growing the net interest margin. The "Market Risk" section of Management's Discussion beginning on page 25 provides additional information on the policies and procedures used by the Corporation to manage net interest income. The following table summarizes the average balances and interest earned or paid on the Corporation's interest-earning assets and interest-bearing liabilities.

| | Year Ended December 31 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| (dollars in thousands) | 2004 | | | 2003 | | | 2002 | | |
| **ASSETS** | **Average Balance** | **Interest** | **Yield/ Rate** | Average Balance | Interest | Yield/ Rate | Average Balance | Interest | Yield/ Rate |
| Interest-earning assets: | | | | | | | | | |
| Loans and leases (1) | **$ 6,901,452** | **$ 396,731** | **5.75%** | $ 5,589,663 | $ 341,393 | 6.11% | $ 5,381,950 | $ 370,318 | 6.88% |
| Taxable inv. securities (2) | **2,161,195** | **76,792** | **3.55** | 2,170,889 | 77,450 | 3.57 | 1,605,077 | 84,139 | 5.24 |
| Tax-exempt inv. securities (2) | **264,578** | **9,553** | **3.61** | 266,426 | 10,436 | 3.92 | 229,938 | 9,835 | 4.28 |
| Equity securities (2) | **133,870** | **4,023** | **3.01** | 129,584 | 4,076 | 3.15 | 113,422 | 4,066 | 3.58 |
| Total investment securities | **2,559,643** | **90,368** | **3.53** | 2,566,889 | 91,962 | 3.58 | 1,948,437 | 98,040 | 5.03 |
| Short-term investments | **97,759** | **6,544** | **6.69** | 47,122 | 2,176 | 4.62 | 27,741 | 930 | 3.35 |
| Total interest-earning assets | **9,558,854** | **493,643** | **5.16** | 8,203,684 | 435,531 | 5.31 | 7,358,128 | 469,288 | 6.38 |
| Non-interest-earning assets: | | | | | | | | | |
| Cash and due from banks | **316,170** | | | 279,980 | | | 253,503 | | |
| Premises and equipment | **128,902** | | | 123,172 | | | 123,658 | | |
| Other assets (2) | **424,385** | | | 270,611 | | | 238,441 | | |
| Less: Allowance for loan losses | **(84,983)** | | | (75,309) | | | (73,230) | | |
| *Total Assets* | **$ 10,343,328** | | | $ 8,802,138 | | | $ 7,900,500 | | |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | | | | | | | | |
| Interest-bearing liabilities: | | | | | | | | | |
| Demand deposits | **$ 1,364,953** | **$ 7,201** | **0.53%** | $ 1,158,333 | $ 6,011 | 0.52% | $ 910,934 | $ 6,671 | 0.73% |
| Savings deposits | **1,846,503** | **11,928** | **0.65** | 1,655,325 | 10,770 | 0.65 | 1,516,832 | 16,453 | 1.08 |
| Time deposits | **2,693,414** | **70,650** | **2.62** | 2,496,234 | 77,417 | 3.10 | 2,579,441 | 102,270 | 3.96 |
| Total interest-bearing deposits | **5,904,870** | **89,779** | **1.52** | 5,309,892 | 94,198 | 1.77 | 5,007,207 | 125,394 | 2.50 |
| Short-term borrowings | **1,238,073** | **15,182** | **1.23** | 738,527 | 7,373 | 1.00 | 434,402 | 6,598 | 1.52 |
| Long-term debt | **637,654** | **31,033** | **4.87** | 566,437 | 29,523 | 5.21 | 476,415 | 26,227 | 5.51 |
| Total interest-bearing liabilities | **7,780,597** | **135,994** | **1.75** | 6,614,856 | 131,094 | 1.98 | 5,918,024 | 158,219 | 2.67 |
| Noninterest-bearing liabilities: | | | | | | | | | |
| Demand deposits | **1,380,264** | | | 1,195,479 | | | 1,045,460 | | |
| Other | **114,003** | | | 97,334 | | | 98,803 | | |
| *Total Liabilities* | **9,274,864** | | | 7,907,669 | | | 7,062,287 | | |
| Shareholders' equity | **1,068,464** | | | 894,469 | | | 838,213 | | |
| *Total Liabs. and Equity* | **$ 10,343,328** | | | $ 8,802,138 | | | $ 7,900,500 | | |
| Net interest income | | **357,649** | | | 304,437 | | | 311,069 | |
| Net yield on earning assets | | | **3.74** | | | 3.71 | | | 4.23 |
| Tax equivalent adjustment (3) | | **9,176** | | | 9,698 | | | 9,193 | |
| Net interest margin | | **$ 366,825** | **3.83%** | | $ 314,135 | 3.82% | | $ 320,262 | 4.35% |

(1) Includes non-performing loans.
(2) Balances include amortized historical cost for available for sale securities. The related unrealized holding gains (losses) are included in other assets.
(3) Based on marginal Federal income tax rate and statutory interest expense disallowances.

***MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION***

The following table sets forth a summary of changes in interest income and interest expense resulting from changes in volumes (average balances) and changes in rates:

| | **2004 vs. 2003 Increase (decrease) due To change in** | | | 2003 vs. 2002 Increase (decrease) due To change in | | |
|---|---|---|---|---|---|---|
| | **Volume** | **Rate** | **Net** | Volume | Rate | Net |
| | | | (in thousands) | | | |
| Interest income on: | | | | | | |
| Loans and leases | **$ 76,352** | **$ (21,014)** | **$ 55,338** | $ 14,292 | $ (43,217) | $ (28,925) |
| Taxable investment securities | **(345)** | **(313)** | **(658)** | 29,660 | (36,349) | (6,689) |
| Tax-exempt investment securities | **(72)** | **(811)** | **(883)** | 1,561 | (960) | 601 |
| Equity securities | **132** | **(185)** | **(53)** | 579 | (569) | 10 |
| Short-term investments | **3,080** | **1,288** | **4,368** | 650 | 596 | 1,246 |
| *Total interest-earning assets* | **$ 79,147** | **$ (21,035)** | **$ 58,112** | $ 46,742 | $ (80,499) | $ (33,757) |
| Interest expense on: | | | | | | |
| Demand deposits | **$ 1,088** | **$ 102** | **$ 1,190** | $ 1,812 | $ (2,472) | $ (660) |
| Savings deposits | **1,236** | **(78)** | **1,158** | 1,502 | (7,185) | (5,683) |
| Time deposits | **5,796** | **(12,563)** | **(6,767)** | (3,299) | (21,554) | (24,853) |
| Short-term borrowings | **5,839** | **1,970** | **7,809** | 4,619 | (3,844) | 775 |
| Long-term debt | **3,551** | **(2,041)** | **1,510** | 4,956 | (1,660) | 3,296 |
| *Total interest-bearing liabilities* | **$ 17,510** | **$ (12,610)** | **$ 4,900** | $ 9,590 | $ (36,715) | $ (27,125) |

Note: Changes which are partly attributable to rate and volume are allocated based on the proportion of the direct changes attributable to rate and volume.

*2004 vs. 2003*

Net interest income increased $53.2 million, or 17.5%, from $304.4 million in 2003 to $357.6 million in 2004, primarily as a result of earning asset growth as the Corporation's net interest margin for the year was relatively constant at 3.83% for 2004 compared to 3.82% for 2003.

Average earning assets grew 16.5%, from $8.2 billion in 2003 to $9.6 billion in 2004. The Acquisitions contributed approximately $900 million to this increase in average balances. Interest income increased $58.1 million, or 13.3%, mainly as a result of the 16.5% increase in average earning assets, which resulted in a $79.1 million increase in interest income. This increase was partially offset by the $21.0 million decrease in interest income that resulted from the decline in the average yield earned. This reflects the impact of customers favoring floating rate loans which tend to carry lower interest rates than fixed rate products.

The increase in average interest-earning assets was due to loan growth, both internal and through acquisitions, as investment balances remained relatively flat. Average loans increased by $1.3 billion, or 23.5%, to $6.9 billion in 2004. The following table presents the growth in average loans, by type:

| | **2004** | 2003 | Increase (decrease) $ | Increase (decrease) % |
|---|---|---|---|---|
| | (dollars in thousands) | | | |
| Commercial - industrial and financial | **$ 1,769,801** | $ 1,519,609 | $ 250,192 | 16.5% |
| Commercial - agricultural | **330,269** | 197,381 | 132,888 | 67.3 |
| Real estate - commercial mortgage | **2,205,025** | 1,724,635 | 480,390 | 27.9 |
| Real estate - commercial construction | **304,845** | 228,833 | 76,012 | 33.2 |
| Real estate - residential mortgage | **509,593** | 497,095 | 12,498 | 2.5 |
| Real estate - residential construction | **205,581** | 46,692 | 158,889 | 340.3 |
| Real estate - home equity | **988,454** | 772,020 | 216,434 | 28.0 |
| Consumer | **517,138** | 531,384 | (14,246) | (2.7) |
| Leasing and other | **70,746** | 72,014 | (1,268) | (1.8) |
| *Total* | **$ 6,901,452** | $ 5,589,663 | $ 1,311,789 | 23.5% |

The Acquisitions contributed approximately $675.6 million to this increase in average balances. The following table presents the average balance impact of the Acquisitions, by type:

| | **2004** | 2003 | Increase |
|---|---|---|---|
| | (in thousands) | | |
| Commercial - industrial and financial | **$ 139,169** | $ 25,048 | $ 114,121 |
| Commercial - agricultural | **520** | - | 520 |
| Real estate - commercial mortgage | **382,500** | 111,219 | 271,281 |
| Real estate - commercial construction | **63,566** | 4,836 | 58,730 |
| Real estate - residential mortgage | **54,761** | 457 | 54,304 |
| Real estate - residential construction | **155,687** | - | 155,687 |
| Real estate - home equity | **13,042** | 822 | 12,220 |
| Consumer | **2,770** | 271 | 2,499 |
| Leasing and other | **5,864** | (408) | 6,272 |
| *Total* | **$ 817,879** | $ 142,245 | $ 675,634 |

The following table presents the growth in average loans, by type, excluding the average balances contributed by the Acquisitions:

| | **2004** | 2003 | Increase (decrease) $ | Increase (decrease) % |
|---|---|---|---|---|
| | (dollars in thousands) | | | |
| Commercial - industrial and financial | **$ 1,630,632** | $ 1,494,561 | $ 136,071 | 9.1% |
| Commercial - agricultural | **329,749** | 197,381 | 132,368 | 67.1 |
| Real estate - commercial mortgage | **1,822,525** | 1,613,416 | 209,109 | 13.0 |
| Real estate - commercial construction | **241,279** | 223,997 | 17,282 | 7.7 |
| Real estate - residential mortgage | **454,832** | 496,638 | (41,806) | (8.4) |
| Real estate - residential construction | **49,894** | 46,692 | 3,202 | 6.9 |
| Real estate - home equity | **975,412** | 771,198 | 204,214 | 26.5 |
| Consumer | **514,368** | 531,113 | (16,745) | (3.2) |
| Leasing and other | **64,882** | 72,422 | (7,540) | (10.4) |
| *Total* | **$ 6,083,573** | $ 5,447,418 | $ 636,155 | 11.7% |

*MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION*

Loan growth continued to be strong in the commercial and commercial mortgage categories. The growth shown in the commercial – agricultural category reflects the agricultural loan portfolio purchased in December 2003. The reduction in mortgage loan balances was due to customer refinance activity that occurred during 2003. The Corporation generally sells newly originated fixed rate mortgages in the secondary market to promote liquidity and manage interest rate risk. Home equity loans increased significantly due to promotional efforts and customers using home equity loans as a cost-effective refinance alternative and as a preferred type of consumer loan. Consumer loans decreased, reflecting customers' repayment of these loans with tax-advantaged residential mortgage or home equity loans. In addition, the indirect finance market remains extremely competitive with the participation of vehicle manufacturers.

The average yield on loans during 2004 was 5.75%, a 36 basis point, or 5.9%, decline from 2003. Much of the recent loan growth has been experienced in the floating rate categories that tend to carry lower interest rates than fixed-rate products.

Average investments decreased slightly during 2004, however, without the impact of the Acquisitions, the investment balances would have decreased $165.9 million, or 6.6%. The Corporation's investment balances had increased over the last few years due to both significant deposit growth and the use of limited strategies to manage the Corporation's gap position and to take advantage of low short-term borrowing rates. During 2004, the Corporation did not reinvest a significant portion of investment maturities in order to minimize interest rate risk in expectation of a rising rate environment and to help fund loan growth.

The average yield on investment securities declined slightly from 3.58% in 2003 to 3.53% in 2004. Premium amortization, which is accounted for as a reduction of interest income, was $20.0 million in 2003 compared to $10.5 million in 2004. The benefit from the lower premium amortization was offset by the reduction in stated yields experienced throughout 2004.

Interest expense increased $4.9 million, or 3.7%, to $136.0 million in 2004 from $131.1 million in 2003, mainly as a result of $1.2 billion increase in average interest-bearing liabilities, which included approximately $800 million added by the Acquisitions. The increase in average interest-bearing liabilities resulted in an increase in interest expense of $17.5 million during 2004. This increase was partially offset by a $12.6 million decrease due to the 23 basis point decrease in the cost of total interest-bearing liabilities. The cost of interest-bearing deposits declined 25 basis points, or 14.1%, from 1.77% in 2003 to 1.52% in 2004. This reduction was due to both the impact of declining short-term interest rates in the first half of 2003 and the continuing shift in the composition of deposits from higher-rate time deposits to lower-rate demand and savings deposits. Customers continued to exhibit an unwillingness to invest in certificates of deposit at the rates available, instead keeping their funds in demand and savings products.

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

| | | | Increase | |
|---|---|---|---|---|
| | **2004** | 2003 | $ | % |
| | (dollars in thousands) | | | |
| Noninterest-bearing demand | **$ 1,380,264** | $ 1,195,479 | $ 184,785 | 15.5% |
| Interest-bearing demand | **1,364,953** | 1,158,333 | 206,620 | 17.8 |
| Savings/money market | **1,846,503** | 1,655,325 | 191,178 | 11.5 |
| Time deposits | **2,693,414** | 2,496,234 | 197,180 | 7.9 |
| *Total* | **$ 7,285,134** | $ 6,505,371 | $ 779,763 | 12.0% |

The Acquisitions accounted for approximately $595.4 million of the increase in average balances. The following table presents the average balance impact of the Acquisitions, by type:

| | **2004** | 2003 | Increase |
|---|---|---|---|
| | | (in thousands) | |
| Noninterest-bearing demand | **$ 64,683** | $ 14,454 | $ 50,229 |
| Interest-bearing demand | **126,569** | 45,099 | 81,470 |
| Savings/money market | **103,797** | 33,522 | 70,275 |
| Time deposits | **470,733** | 77,337 | 393,396 |
| *Total* | **$ 765,782** | $ 170,412 | $ 595,370 |

The following table presents the growth in average deposits, by type, excluding the contribution of the Acquisitions:

| | | | Increase (decrease) | |
|---|---|---|---|---|
| | **2004** | 2003 | $ | % |
| | | (dollars in thousands) | | |
| Noninterest-bearing demand | **$ 1,315,581** | $ 1,181,025 | $ 134,556 | 11.4% |
| Interest-bearing demand | **1,238,384** | 1,113,234 | 125,150 | 11.2 |
| Savings/money market | **1,742,706** | 1,621,803 | 120,903 | 7.5 |
| Time deposits | **2,222,681** | 2,418,897 | (196,216) | (8.1) |
| *Total* | **$ 6,519,352** | $ 6,334,959 | $ 184,393 | 2.9% |

Average borrowings increased significantly during 2004, with average short-term borrowings increasing $499.5 million, or 67.6%, to $1.2 billion, and average long-term debt increasing $71.2 million, or 12.6%, to $637.7 million. The Acquisitions added $174.6 million to the short-term borrowings increase and $83.6 million to the long-term debt increase. The additional increase in short-term borrowings resulted primarily from certain limited strategies employed during 2003 to manage the Corporation's gap position and to take advantage of low short-term borrowing rates. In addition, customer cash management accounts, which are included in short-term borrowings, grew $54.9 million, or 15.6%, to an average of $406.2 million in 2004.

*2003 vs. 2002*

Net interest income decreased $6.6 million, or 2.1%, from $311.1 million in 2002 to $304.4 million in 2003. While average earning assets grew 11.5%, from $7.4 billion in 2002 to $8.2 billion in 2003, the net interest margin declined 12.2%, or 53 basis points, from 4.35% in 2002 to 3.82% in 2003 as a result of the interest rate environment. During 2003, yields earned on assets decreased further than rates paid on liabilities.

Interest income decreased $33.8 million, or 7.2%, mainly as a result of the 107 basis point decrease in the average yield on earning assets. Average yields decreased during 2003 due both to the general decrease in short-term interest rates as well as the shift in earning assets, on a percentage basis, from higher yielding loans to generally lower yielding investment securities. The decrease of $80.5 million as a result of rates was partially offset by a $46.7 million increase due to average earning asset growth.

Average loans increased $207.7 million, or 3.9%, to $5.6 billion in 2003. Loan growth was particularly strong in the commercial and commercial mortgage categories. Even factoring out the loans acquired in the Premier acquisition, these categories both grew approximately 8.0%. The significant reduction in mortgage loan balances was due to customer refinance activity that continued at a high rate through much of the year. The Corporation generally sells newly originated fixed rate mortgages in the secondary market to promote liquidity and manage interest rate risk. Home equity loans increased significantly due to promotional efforts and customers using home equity loans as a cost-effective refinance alternative. Consumer loans decreased, reflecting customers' repayment of these loans with tax-advantaged residential mortgage or home equity loans. In addition, many vehicle manufacturers continued to offer attractive financing rates, with which the Corporation chose not to compete.

***MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION***

The average yield on loans during 2003 was 6.11%, a 77 basis point, or 11.2%, decline from 2002. This reflects the 55 basis point reduction in the Corporation's average prime lending rate from 4.68% in 2002 to 4.13% in 2003, as well as higher than normal prepayments received on fixed rate commercial and commercial mortgage loans.

Average investment securities increased $618.5 million, or 31.7%, during 2003. The increase was attributable primarily to deposit growth exceeding loan growth. Total average deposit growth of $452.7 million exceeded average loan growth by $245.0 million during 2003. In addition, the Corporation employed certain limited strategies to manage the Corporation's gap position and to take advantage of low short-term borrowing rates. Most of the growth in investment securities was in mortgage-backed securities, which increased by $553.2 million, or 38.1%.

The average yield on investment securities declined significantly from 5.03% in 2002 to 3.58% in 2003. This 28.8% decrease was due to both the relatively short maturity of the portfolio as well as the high prepayment levels experienced on mortgage-backed securities. During 2003 and 2002, most mortgage-backed securities were being purchased at premiums. As longer-term interest rates continued to fall through the first half of 2003, the prepayments on these securities exceeded expected levels. Prepayments negatively impact yields through the acceleration of premium amortization expense, which is accounted for as a reduction of interest income. Premium amortization was $20.0 million in 2003 compared to $5.7 million in 2002. Approximately $17.3 million of premium amortization during 2003 was accelerated amortization.

Interest expense decreased $27.1 million, or 17.1%, to $131.1 million in 2003 from $158.2 million in 2002, mainly as a result of the 69 basis point decrease in the cost of total interest-bearing liabilities. This decrease in cost resulted in a $36.7 million decrease in interest expense, which was partially offset by a $9.6 million increase in interest expense due to average balance growth. The cost of interest-bearing deposits declined 73 basis points, or 29.2%, from 2.50% in 2002 to 1.77% in 2003. This reduction was due to both the impact of declining short-term interest rates and the continuing shift in the composition of deposits from higher-rate time deposits to lower-rate demand and savings deposits. Customers continued to exhibit an unwillingness to invest in certificates of deposit at the rates available, instead keeping their funds in demand and savings products.

The acquisition of Premier added $187.4 million to the total average balance of deposits in 2003. If those balances were factored out, the deposit categories would show the following increases (decreases) – noninterest-bearing demand, 12.9%, interest-bearing demand, 21.6%, savings/money market, 6.7%, and time deposits, (6.5)%.

Average short-term borrowings increased $304.1 million, or 70.0%, to $738.5 million in 2003, while average long-term debt increased $90.0 million, or 18.9%, to $566.4 million in 2003. The increase in short-term borrowings resulted primarily from certain limited strategies to manage the Corporation's gap position and to take advantage of low short-term borrowing rates. In addition, customer cash management accounts, which are included in short-term borrowings, grew $53.8 million, or 18.1%, to reach $351.3 million in 2003.

**Provision and Allowance for Loan Losses**

The Corporation accounts for the credit risk associated with lending activities through its allowance and provision for loan losses. The provision is the expense recognized in the income statement to adjust the allowance to its proper balance, as determined through the application of the Corporation's allowance methodology procedures. These procedures include the evaluation of the risk characteristics of the portfolio and documentation in accordance with the Securities and Exchange Commission's (SEC) Staff Accounting Bulletin No. 102, "Selected Loan Loss Allowance Methodology and Documentation Issues" (SAB 102). See "Critical Accounting Policies" on page 23 for a discussion of the Corporation's allowance for loan loss evaluation methodology.

A summary of the Corporation's loan loss experience follows:

| | Year Ended December 31 | | | | |
|---|---|---|---|---|---|
| | **2004** | 2003 | 2002 | 2001 | 2000 |
| | (dollars in thousands) | | | | |
| Loans outstanding at end of year | **$ 7,584,547** | $6,159,994 | $ 5,317,068 | $ 5,373,020 | $ 5,374,659 |
| Daily average balance of loans and leases | **$ 6,901,452** | $5,589,663 | $ 5,381,950 | $ 5,341,497 | $ 5,131,651 |
| *Balance of allowance for loan losses at beginning of year* | **$ 77,700** | $ 71,920 | $ 71,872 | $ 65,640 | $ 61,538 |
| Loans charged-off: | | | | | |
| Commercial, financial and agricultural | **3,482** | 6,604 | 7,203 | 6,296 | 9,242 |
| Real estate – mortgage | **1,466** | 1,476 | 2,204 | 767 | 1,922 |
| Consumer | **3,476** | 4,497 | 5,587 | 6,683 | 6,911 |
| Leasing and other | **453** | 651 | 676 | 529 | 282 |
| *Total loans charged-off* | **8,877** | 13,228 | 15,670 | 14,275 | 18,357 |
| Recoveries of loans previously charged-off: | | | | | |
| Commercial, financial and agricultural | **2,042** | 1,210 | 842 | 703 | 1,518 |
| Real estate – mortgage | **906** | 711 | 669 | 364 | 541 |
| Consumer | **1,496** | 1,811 | 2,251 | 2,683 | 2,724 |
| Leasing and other | **76** | 97 | 56 | 87 | 19 |
| *Total recoveries* | **4,520** | 3,829 | 3,818 | 3,837 | 4,802 |
| Net loans charged-off | **4,357** | 9,399 | 11,852 | 10,438 | 13,555 |
| Provision for loan losses | **4,717** | 9,705 | 11,900 | 14,585 | 15,024 |
| Allowance purchased | **11,567** | 5,474 | - | 2,085 | 2,633 |
| *Balance at end of year* | **$ 89,627** | $ 77,700 | $ 71,920 | $ 71,872 | $ 65,640 |
| *Selected Asset Quality Ratios:* | | | | | |
| Net charge-offs to average loans | **0.06%** | 0.17% | 0.22% | 0.20% | 0.26% |
| Allowance for loan losses to loans outstanding at end of year | **1.18%** | 1.26% | 1.35% | 1.34% | 1.22% |
| Non-performing assets (1) to total assets | **0.30%** | 0.33% | 0.47% | 0.44% | 0.41% |
| Non-accrual loans to total loans | **0.30%** | 0.36% | 0.45% | 0.42% | 0.41% |

(1) Includes accruing loans past due 90 days or more.

The following table presents the aggregate amount of non-accrual and past due loans and other real estate owned (3):

| | December 31 | | | | |
|---|---|---|---|---|---|
| | **2004** | 2003 | 2002 | 2001 | 2000 |
| | (in thousands) | | | | |
| Non-accrual loans (1) (2) | **$ 22,574** | $ 22,422 | $ 24,090 | $ 22,794 | $ 21,790 |
| Accruing loans past due 90 days or more | **8,318** | 9,609 | 14,095 | 9,368 | 7,135 |
| Other real estate | **2,209** | 585 | 938 | 1,817 | 1,035 |
| *Totals* | **$ 33,101** | $ 32,616 | $ 39,123 | $ 33,979 | $ 29,960 |

(1) As of December 31, 2004, the additional interest income that would have been recorded during 2004 if nonaccrual loans had been current in accordance with their original terms was approximately $1.5 million. The amount of interest income on nonaccrual loans that was included in 2004 income was approximately $2.8 million.

(2) Accrual of interest is generally discontinued when a loan becomes 90 days past due as to principal and interest. When interest accruals are discontinued, interest credited to income is reversed. Nonaccrual loans are restored to accrual status when all delinquent principal and interest becomes current or the loan is considered secured and in the process of collection. Certain loans, primarily residential mortgages, that are determined to be sufficiently collateralized may continue to accrue interest after reaching 90 days past due.

(3) Excluded from the amounts presented at December 31, 2004 are $124.0 million in loans where possible credit problems of borrowers have caused management to have serious doubts as to the ability of such borrowers to comply with the present loan repayment terms. These loans are considered to be impaired under Statement 114, but continue to pay according to their contractual terms and are therefore not included in non-performing loans. Nonaccrual loans include $6.6 million of impaired loans.

The following table summarizes the allocation of the allowance for loan losses by loan type:

| | December 31 | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **2004** | | 2003 | | 2002 | | 2001 | | 2000 | |
| | (dollars in thousands) | | | | | | | | | |
| | **Allowance** | **% of Loans in Each Category** | Allowance | % of Loans in Each Category | Allowance | % of Loans in Each Category | Allowance | % of Loans in Each Category | Allowance | % of Loans in Each Category |
| Comm'l, financial & agriculture | **$ 43,207** | **29.9%** | $ 34,247 | 31.6% | $ 33,130 | 31.6% | $ 22,531 | 27.8% | $ 21,193 | 25.8% |
| Real estate – mortgage | **19,784** | **62.5** | 14,471 | 58.8 | 13,099 | 56.8 | 19,018 | 58.9 | 14,940 | 59.1 |
| Consumer, leasing & other | **16,289** | **7.6** | 16,279 | 9.6 | 14,178 | 11.6 | 10,855 | 13.3 | 10,772 | 15.1 |
| Unallocated | **10,347** | **-** | 12,703 | - | 11,513 | - | 19,468 | - | 18,735 | - |
| *Totals* | **$ 89,627** | **100.0%** | $ 77,700 | 100.0% | $ 71,920 | 100.0% | $ 71,872 | 100.0% | $ 65,640 | 100.0% |

Over the past several years, the procedures used by the banking industry to evaluate the allowance for loan losses have received increased attention from the SEC, regulatory bodies and the accounting industry. These groups have attempted to reconcile the accounting theory of reserving for loan losses, which requires that the allowance represent management's estimate of the losses inherent in the loan portfolio as of the balance sheet date, with the regulatory goals of safety and soundness.

While the resulting guidance provided by these groups has not changed the accounting, it has focused on clarifying the application of existing accounting pronouncements and improving documentation. As with others in the industry, the Corporation has used this guidance

to improve its process and its documentation. The unallocated allowance for loan losses, as shown in the preceding table, decreased from 16% at December 31, 2003 to 12% at December 31, 2004. The Corporation continues to monitor its allowance methodology to ensure compliance with both regulatory and accounting industry policies.

The provision for loan losses decreased $5.0 million from $9.7 million in 2003 to $4.7 million in 2004, after decreasing $2.2 million in 2003. These decreases reflect the continued improvement in the Corporation's asset quality reflected in both lower net charge-offs and lower non-performing assets ratios. Net charge-offs as a percentage of average loans were 0.06% in 2004, an eleven basis point improvement over 0.17% in 2003, which was a five basis point decrease from 2002. Non-performing assets as a percentage of total assets decreased slightly from 0.33% at December 31, 2003 to 0.30% at December 31, 2004, after decreasing 14 basis points in 2003. The declines in both ratios reflect the improving quality of the Corporation's portfolio during the years.

The provision for loan losses in 2004 resulted from the Corporation's allowance allocation procedures. The continued growth of the Corporation's commercial loan and commercial mortgage portfolios, which are inherently more risky than other loan types, is a trend which would indicate the need for a higher allowance balance. Offsetting these trends were the improvements in the quality of the Corporation's portfolio, as evidenced by its improving asset quality measures over the past several years. The net result of the Corporation's allowance allocation procedures was a provision for loan losses that was $5.0 million less than 2003 and was comparable to total net charge-offs for the year. Management believes that the allowance balance of $89.6 million at December 31, 2004 is sufficient to cover losses inherent in the loan portfolio on that date and is appropriate based on applicable accounting standards.

**Other Income**

The following table presents the components of other income for each of the past three years:

| | **2004** | 2003 | 2002 |
|---|---|---|---|
| | | (in thousands) | |
| Investment management and trust services | **$ 34,817** | $ 33,898 | $ 29,114 |
| Service charges on deposit accounts | **39,451** | 38,500 | 37,502 |
| Other service charges and fees | **20,494** | 18,860 | 17,743 |
| Gain on sale of mortgage loans | **19,262** | 18,965 | 13,941 |
| Investment securities gains | **17,712** | 19,853 | 8,992 |
| Other | **7,128** | 4,294 | 6,720 |
| *Total* | **$ 138,864** | $ 134,370 | $ 114,012 |

Total other income increased $4.5 million, or 3.3%, from $134.4 million in 2003 to $138.9 million in 2004, after increasing $20.4 million, or 17.9%, from $114.0 million in 2002. Excluding investment securities gains, other income increased $6.6 million, or 5.8%, in 2004 and $9.5 million, or 9.0%, in 2003. While the acquisition of Premier did not have a significant impact on other income growth during 2003 and 2004, the acquisition of Resource Bank contributed $14.4 million to total other income in 2004.

Investment management and trust services income grew $919,000, or 2.7%, in 2004 and $4.8 million, or 16.4%, in 2003. Trust commission income was relatively flat in 2004 after increasing $1.5 million, or 8.3%, in 2003 as improvements in the equity markets increased values of assets under management. Brokerage revenue increased $974,000, or 8.3%, in 2004 and $3.0 million, or 33.8%, in 2003 as a result of the performance of the equity markets and increased annuity sales.

Total service charges on deposit accounts increased $951,000, or 2.5%, in 2004 and $1.0 million, or 2.7%, in 2003. Overdraft fees increased $1.2 million, or 7.5%, in 2004 (including $175,000 due to the Acquisitions) and $407,000, or 2.7%, in 2003 (including $46,000 due to the Acquisitions). Cash management fees increased $50,000, or 0.7%, in 2004 and $260,000, or 3.6%, in 2003. The low interest rate environment has made cash management services less attractive for smaller business customers.

Other service charges and fees increased $1.6 million, or 8.7%, in 2004 (including $280,000 due to the Acquisitions) and $1.1 million, or 6.3%, in 2003 (including $53,000 due to the Acquisitions). The increase in both years was driven by growth in letter of

credit fees, merchant fees and debit card fees. Letter of credit fees increased $245,000, or 7.2% in 2004 and $889,000, or 35.1%, in 2003, and merchant fees increased $372,000, or 8.2%, in 2004 and $491,000, or 12.2%, in 2003, all as a result of an increased focus on growing these business lines. Debit card fees increased $549,000, or 10.7%, in 2004 (including $55,000 due to the Acquisitions) and $122,000, or 2.4%, in 2003 (including $19,000 due to the Acquisitions). While the earnings rate on debit card transactions has decreased, the Corporation has seen an increase in transaction volume.

Gains on sales of mortgage loans increased $297,000, or 1.6%, in 2004 after increasing $5.0 million, or 36.0%, in 2003 and $4.4 million, or 45.6% in 2002. Resource Bank contributed $11.1 million to the 2004 amount and without that amount, this category would show a $10.8 million, or 57.0%, decrease. The decrease in the current year was expected based on the increase in interest rates from their historic lows and the resulting reduction in the level of mortgage refinancing activity.

Investment securities gains decreased $2.1 million, or 10.8%, in 2004 after increasing $10.9 million, or 120.8%, in 2003. Investment securities gains included realized gains on the sale of equity securities of $14.8 million and $17.3 million in 2004 and 2003, respectively, reflecting the general improvement in the equity markets and bank stocks in particular, and $3.1 million and $5.9 million in 2004 and 2003, respectively, on the sale of debt securities, which were generally sold to take advantage of the interest rate environment. These gains were offset by write-downs of $137,000 in 2004 and $3.3 million in 2003 for specific equity securities deemed to exhibit other than temporary impairment in value. As of December 31, 2004, the impaired securities still being held in the portfolio had recovered approximately $1.4 million of the original write-down amount.

Other income increased $2.8 million, or 66.0%, in 2004 after decreasing $2.4 million, or 36.1%, in 2003. The increase in 2004 is entirely due to the acquisition of Resource Bank, which generated significant fee income from its mortgage-related business. The decrease in 2003 resulted from the reversal of $848,000 of negative goodwill in 2002 and a decrease in mortgage loan servicing income as the amortization of mortgage servicing rights increased.

**Other Expenses**

The following table presents the components of other expenses for each of the past three years:

| | **2004** | 2003 | 2002 |
|---|---|---|---|
| | | (in thousands) | |
| Salaries and employee benefits | **$ 162,126** | $ 136,002 | $ 127,584 |
| Net occupancy expense | **23,813** | 19,896 | 17,705 |
| Equipment expense | **10,769** | 10,505 | 11,295 |
| Data processing | **11,430** | 11,532 | 11,968 |
| Advertising | **6,943** | 6,039 | 6,525 |
| Intangible amortization | **4,726** | 2,059 | 1,838 |
| Other | **53,808** | 45,526 | 46,850 |
| *Total* | **$ 273,615** | $ 231,559 | $ 223,765 |

Total other expenses increased $42.1 million, or 18.2%, in 2004 (including $30.0 million due to the Acquisitions) and $7.8 million, or 3.5% in 2003 (including $4.8 million due to the Acquisitions).

The following table presents the amounts included in the above totals which were contributed by the Acquisitions:

| | **2004** | 2003 |
|---|---|---|
| | (in thousands) | |
| Salaries and employee benefits | **$ 18,523** | $ 2,121 |
| Net occupancy expense | **2,923** | 378 |
| Equipment expense | **1,426** | 138 |
| Data processing | **936** | 387 |
| Advertising | **1,028** | 48 |
| Intangible amortization | **1,504** | 570 |
| Other | **8,549** | 1,183 |
| *Total* | **$ 34,889** | $ 4,825 |

The following table presents the components of other expenses for each of the past three years, excluding the amounts contributed by the Acquisitions:

| | **2004** | 2003 | 2002 |
|---|---|---|---|
| | | (in thousands) | |
| Salaries and employee benefits | **$ 143,603** | $ 133,881 | $ 127,584 |
| Net occupancy expense | **20,890** | 19,518 | 17,705 |
| Equipment expense | **9,343** | 10,367 | 11,295 |
| Data processing | **10,494** | 11,145 | 11,968 |
| Advertising | **5,915** | 5,991 | 6,525 |
| Intangible amortization | **3,222** | 1,489 | 1,838 |
| Other | **45,259** | 44,343 | 46,850 |
| *Total* | **$ 238,726** | $ 226,734 | $ 223,765 |

The discussion that follows addresses changes in other expenses, excluding the Acquisitions.

Salaries and employee benefits increased $9.7 million, or 7.3%, in 2004 and $6.3 million, or 4.9%, in 2003. The salary expense component increased $4.2 million, or 3.9%, in 2004 and $5.3 million, or 5.2%, in 2003, driven by salary increases for existing employees as total average full-time equivalent employees remained relatively consistent at approximately 2,900. In 2003, an increase in commission expense related to brokerage business also contributed to the increase in salary expense. Employee benefits increased $5.1 million, or 21.7%, in 2004 and $1.7 million, or 7.9%, in 2003 driven mainly by continued increases in healthcare costs and retirement plan expenses. See additional discussion of the Corporations defined benefit pension plan in Note L, "Employee Benefit Plans", in the Notes to Consolidated Financial Statements.

Net occupancy expense increased $1.4 million, or 7.0%, to $20.9 million in 2004 after increasing $1.8 million, or 10.2%, in 2003. The increases resulted from the expansion of the branch network and the addition of new office space for existing affiliates. Equipment expense decreased $1.0 million, or 9.9%, in 2004 after decreasing $928,000, or 8.2%, in 2003. The decrease in both years was due to lower depreciation expense as certain equipment became fully depreciated.

Data processing expense decreased $651,000, or 5.8%, in 2004 after decreasing $823,000, or 6.9%, in 2003. The Corporation has been successful over the past few years in renegotiating key processing contracts with certain vendors.

Advertising expense decreased $76,000, or 1.3%, in 2004 after decreasing $534,000, or 8.2%, in 2003. The Corporation had made a conscious decision to control advertising spending in both 2004 and 2003.

Intangible amortization increased $1.7 million, or 116.4%, in 2004 after decreasing $349,000, or 19.0%, in 2003. Intangible amortization consists of the amortization of unidentifiable intangible assets related to branch and loan acquisitions, core deposit

intangible assets, and other identified intangible assets. The increase in 2004 primarily represents the amortization of intangible assets related to the acquisition of an agriculture loan portfolio in December 2003. The decrease in 2003 resulted from an accelerated amortization schedule in connection with a prior branch acquisition.

Other expense increased $916,000, or 2.1%, in 2004 after decreasing $2.5 million, or 5.4%, in 2003. The Corporation's costs increased as a result of complying with the provisions of the Sarbanes-Oxley Act of 2002. These costs were realized in external audit fees, which increased from $363,000 in 2003 to $1.6 million in 2004 as well as an additional $400,000 in consulting expense during 2004. These cost increases were offset by reductions in operating risk loss, other real estate expenses and legal fees. In 2003, many categories of costs decreased including operating risk loss, legal fees and non-income taxes. Additionally, there were amounts accrued for leasing residual value losses and severance in 2002 that did not recur in 2003.

**Income Taxes**

Income taxes increased $5.9 million, or 9.9%, in 2004 and $2.9 million, or 5.1%, in 2003. The Corporation's effective tax rate (income taxes divided by income before income taxes) remained fairly stable at 29.9%, 30.1% and 29.8% in 2004, 2003 and 2002, respectively. In general, the variances from the 35% Federal statutory rate consisted of tax-exempt interest income and investments in low and moderate income housing partnerships, which generate Federal tax credits. Net credits were $4.5 million, $4.0 million and $4.0 million in 2004, 2003 and 2002, respectively.

For additional information regarding income taxes, see Note K, "Income Taxes" in the Notes to Consolidated Financial Statements.

## FINANCIAL CONDITION

Total assets increased $1.4 billion, or 14.2%, to $11.2 billion at December 31, 2004. Excluding the Resource and First Washington acquisitions (the 2004 Acquisitions), total assets decreased $236.4 million, or 2.4%. During 2004, maturing investment securities were not reinvested, instead paying off short-term borrowings and funding loan growth, in expectation of continued increases in short-term interest rates. Total loans increased $1.4 billion, or 23.2% ($552.0 million, or 9.1%, excluding the 2004 Acquisitions), while total investments decreased $477.3 million, or 16.3% ($808.8 million, or 27.6%, excluding the 2004 Acquisitions). Total deposits increased $1.1 billion, or 16.9%, to $7.9 billion at December 31, 2004, with $1.0 billion of the increase attributable to the 2004 Acquisitions.

The table below presents a condensed ending balance sheet for the Corporation, adjusted for the balances recorded for the 2004 Acquisitions, in comparison to 2003 ending balances.

| | 2004 | | | 2003 | Increase (decrease) (3) | |
|---|---|---|---|---|---|---|
| | **Fulton Financial Corporation (As Reported)** | **2004 Acquisitions (1)** | **Fulton Financial Corporation (2)** | Fulton Financial Corporation | $ | % |
| **Assets:** | (dollars in thousands) | | | | | |
| Cash and due from banks | **$ 278,065** | **$ 26,320** | **$ 251,745** | $ 300,966 | $ (49,221) | 16.4% |
| Other earning assets | **195,560** | **117,487** | **78,073** | 37,320 | 40,753 | 109.2 |
| Investment securities | **2,449,859** | **331,541** | **2,118,318** | 2,927,150 | (808,832) | (27.6) |
| Loans, net allowance | **7,494,920** | **860,638** | **6,634,282** | 6,082,294 | 551,988 | 9.1 |
| Premises and equipment | **146,911** | **22,382** | **124,529** | 120,777 | 3,752 | 3.1 |
| Goodwill and intangible assets | **389,322** | **239,112** | **150,210** | 144,796 | 5,414 | 3.7 |
| Other assets | **203,714** | **29,948** | **173,766** | 153,985 | 19,781 | 12.9 |
| *Total Assets* | **$ 11,158,351** | **$ 1,627,428** | **$ 9,530,923** | $ 9,767,288 | $ (236,365) | (2.4)% |
| **Liabilities and Shareholders' Equity:** | | | | | | |
| Deposits | **$ 7,895,524** | **$ 1,024,863** | **$ 6,870,661** | $ 6,751,783 | $ 118,878 | 1.8% |
| Short-term borrowings | **1,194,524** | **127,755** | **1,066,769** | 1,396,711 | (329,942) | (23.6) |
| Long-term debt | **684,236** | **134,015** | **550,221** | 568,730 | (18,509) | (3.3) |
| Other liabilities | **141,777** | **19,268** | **122,509** | 103,128 | 19,381 | 18.8 |
| *Total Liabilities* | **9,916,061** | **1,305,901** | **8,610,160** | 8,820,352 | (210,192) | (2.4) |
| Shareholders' equity | **1,242,290** | **321,527** | **920,763** | 946,936 | (26,173) | (2.8) |
| *Total Liabilities and Shareholders' Equity* | **$ 11,158,351** | **$ 1,627,428** | **$ 9,530,923** | $ 9,767,288 | $ (236,365) | (2.4)% |

(1) Balances recorded on acquisition dates.
(2) Excluding Resource and First Washington.
(3) Fulton Financial Corporation, excluding Resource and First Washington as compared to the prior year.

**Loans**

The following table sets forth the amount of loans outstanding as of the dates shown:

| | December 31 | | | | |
|---|---|---|---|---|---|
| | **2004** | 2003 | 2002 | 2001 | 2000 |
| | | | (in thousands) | | |
| Commercial – industrial and financial | **$ 1,946,962** | $ 1,594,451 | $ 1,489,990 | $ 1,341,280 | $ 1,248,045 |
| Commercial – agricultural | **326,176** | 354,517 | 189,110 | 154,100 | 138,127 |
| Real-estate – commercial mortgage | **2,461,016** | 1,992,650 | 1,527,143 | 1,428,066 | 1,359,715 |
| Real-estate – commercial construction | **348,846** | 264,129 | 201,178 | 208,191 | 202,286 |
| Real-estate – residential mortgage | **543,072** | 434,568 | 534,286 | 793,507 | 965,760 |
| Real-estate – residential construction | **277,940** | 42,979 | 47,387 | 59,436 | 45,096 |
| Real estate – home equity | **1,108,249** | 890,044 | 710,497 | 675,292 | 603,876 |
| Consumer | **506,290** | 516,587 | 543,040 | 626,985 | 738,797 |
| Leasing and other | **77,767** | 84,056 | 89,903 | 107,054 | 97,138 |
| Deferred loan fees, net of costs | **(4,972)** | (6,410) | (5,840) | (8,231) | (9,194) |
| | **7,591,346** | 6,167,571 | 5,326,694 | 5,385,680 | 5,389,646 |
| Unearned income | **(6,799)** | (7,577) | (9,626) | (12,660) | (14,987) |
| *Totals* | **$ 7,584,547** | $ 6,159,994 | $ 5,317,068 | $ 5,373,020 | $ 5,374,659 |

Total loans, net of unearned increased $1.4 billion, or 23.1%, in 2004 ($552.5 million, or 9.0%, excluding the 2004 Acquisitions). The internal growth of $552.5 million included increases in total commercial loans ($148.5 million, or 7.6%), commercial mortgage loans ($183.8 million, or 8.1%), construction loans ($42.7 million, or 13.9%), residential mortgages ($22.6 million, or 5.2%), and home equity loans ($168.3 million, or 18.9%), offset partially by decreases in consumer loans ($16.6 million, or 3.2%) and leasing and other loans ($8.0 million, or 10.3%).

In 2003, total loans increased $842.9 million, or 15.9% ($319.1 million, or 6.0%, excluding the Premier and purchased loan acquisitions). Excluding these acquisitions, increases in total commercial loans ($45.6 million, or 2.7%), commercial mortgage loans ($177.2 million, or 11.6%), construction loans ($50.6 million, or 20.4%) and residential mortgages ($76.2 million, or 6.1%), were offset by decreases in consumer loans ($27.1 million, or 5.0%) and leasing and other ($3.4 million, or 4.6%).

**Investment Securities**

The following table sets forth the carrying amount of investment securities held to maturity (HTM) and available for sale (AFS) as of the dates shown:

| | December 31 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | **2004** | | | 2003 | | | 2002 | | |
| | **HTM** | **AFS** | **Total** | HTM | AFS | Total | HTM | AFS | Total |
| | | | | | (in thousands) | | | | |
| U.S. Government and agency securities | **$ 6,903** | **$ 128,925** | **$ 135,828** | $ 7,728 | $ 82,439 | $ 90,167 | $ 8,568 | $ 97,304 | $ 105,872 |
| State and municipal | **10,658** | **332,455** | **343,113** | 4,462 | 298,030 | 302,492 | 4,679 | 249,866 | 254,545 |
| Equity securities | **-** | **170,065** | **170,065** | - | 212,352 | 212,352 | - | 155,138 | 155,138 |
| Corporate debt securities | **650** | **71,127** | **71,777** | 640 | 28,656 | 29,296 | 50 | 300 | 350 |
| Mortgage-backed securities | **6,790** | **1,722,286** | **1,729,076** | 10,163 | 2,282,680 | 2,292,843 | 19,387 | 1,880,999 | 1,900,386 |
| *Totals* | **$ 25,001** | **$2,424,858** | **$2,449,859** | $ 22,993 | $2,904,157 | $2,927,150 | $ 32,684 | $2,383,607 | $2,416,291 |

Total investment securities decreased $477.3 million, or 16.4%, ($808.8 million, or 27.6%, excluding the 2004 Acquisitions), to a balance of $2.4 billion at December 31, 2004. In 2003, investment securities increased $510.9 million, or 21.1%, to reach a balance of $2.9 billion. As noted above, the decrease in 2004 represented maturities and prepayments that were not reinvested due to the expectation of increasing short-term interest rates.

The Corporation classified virtually its entire investment portfolio as available for sale at December 31, 2004 and, as such, these investments were recorded at their estimated fair values. As short-term interest rates increased in the second half of 2004, the net unrealized gain on non-equity available for sale investment securities decreased $24.8 million from a net unrealized gain of $3.8 million at December 31, 2003 to a net unrealized loss of $21.1 million at December 31, 2004.

At December 31, 2004, equity securities consisted of FHLB and other government agency stock ($63.4 million), stocks of other financial institutions ($69.2 million) and mutual funds and other ($37.4 million). The bank stock portfolio has historically been a source of capital appreciation and realized gains ($14.8 million in 2004, $17.3 million in 2003 and $7.4 million in 2002). Management periodically sells bank stocks when, in its opinion, valuations and market conditions warrant such sales.

**Other Assets**

Cash and due from banks decreased $22.9 million, or 7.6% ($49.2 million, or 16.4%, excluding the 2004 Acquisitions), in 2004, following a $13.9 million, or 4.4%, decrease in 2003. Because of the daily fluctuations that result in the normal course of business, cash is more appropriately analyzed in terms of average balances. On an average balance basis, cash and due from banks increased $36.2 million, or 12.9%, from $280.0 million in 2003 to $316.2 million in 2004, following a $26.5 million, or 10.4%, increase in 2003. The increase in both years resulted from acquisitions and growth in the Corporation's branch network.

Premises and equipment increased $26.1 million, or 21.6%, in 2004 to $146.9 million, which included $22.4 as a result of the 2004 Acquisitions. The remaining increase reflects additions of $16.2 million primarily for the construction of various new branch and office facilities, partially offset by current year depreciation expense.

Goodwill and intangible assets increased $244.5 million, or 168.9%, in 2004, following a $72.5 million, or 100.3%, increase in 2003, as a result of acquisitions. Other assets increased $49.7 million, or 32.3%, in 2004 to $203.7 million, including $29.9 million as a result of the 2004 Acquisitions, an increase in the net deferred tax asset mainly as a result of decreases in unrealized gains on investment securities, and an $11.9 million increase in investments in low-income housing projects. During 2004, equity investments of $17.5 million were made to eight new partnerships. The Corporation made its initial investment of this type during 1989 and is now involved in 58 partnerships, located in the communities served by its subsidiary banks. The carrying value of these investments was approximately $52.0 million at December 31, 2004. With these investments, the Corporation not only improves the quantity and quality of available housing for low income individuals in support of its banks' Community Reinvestment Act compliance efforts, but also becomes eligible for tax credits under Federal and, in some cases state, programs.

**Deposits and Borrowings**

Deposits increased $1.1 billion, or 16.9%, to $7.9 billion at December 31, 2004 ($118.9 million, or 1.8%, excluding the 2004 Acquisitions). This compares to an increase of $506.3 million, or 8.1%, in 2003, ($71.8 million, or 1.1%, excluding the Premier acquisition). The recent trend has been strong growth in core demand and savings accounts, offset by declines in time deposits. Consumers have continued to favor banks over the equity markets, even though market performance has recovered some of its decline from the past few years. In addition, the relatively low interest rate environment resulted in consumers continuing to favor demand and savings products over time deposits. Although short-term rates have increased in 2004, longer-term rate increases have not been as significant. If longer-term rates increase significantly in the future, consumers may shift their deposit funds to higher cost time deposits.

During 2004, demand deposits increased $457.1 million, or 17.9% ($234.6 million, or 10.8%, excluding the 2004 Acquisitions), savings deposits increased $165.7 million, or 9.5% ($58.7 million, or 3.8%, excluding the 2004 Acquisitions) and time deposits increased $521,000 , or 21.3% (decrease of $174.5 million, or 7.2%, excluding the 2004 Acquisitions).

During 2003, demand deposits increased $372.7 million, or 17.1% ($220.8 million, or 10.1%, excluding Premier), savings deposits increased $222.4 million, or 14.5% ($139.0 million, or 9.1%, excluding Premier), while time deposits decreased $88.8 million, or 3.5%, ($287.9 million, or 11.3%, excluding Premier). Many of the trends experienced during 2003 began in 2001 when the FRB started its series of rate cuts.

Short-term borrowings, which consist mainly of Federal funds purchased and customer cash management accounts, decreased $202.2 million, or 14.5% ($329.9 million, or 23.6%, excluding the 2004 Acquisitions), in 2004 after increasing $764.5 million, or 120.9%, in 2003. The decrease in 2004 was due to strategies to reduce overnight Federal funds purchased in the recent rising rate environment. In 2003, the increase resulted from actions taken to manage the gap position and to take advantage of low short-term borrowing rates. Long-term debt increased $115.5 million, or 20.3% (decrease of $18.5 million, or 3.3%, excluding the 2004 Acquisitions). The decrease in 2004 was due to a decrease in Federal Home Loan Bank advances. Long-term debt increased $33.2 million, or 6.2%, during 2003 mainly due to $25.0 million of junior subordinated debentures assumed from Premier.

**Other Liabilities**

Other liabilities increased $38.6 million, or 37.5% ($19.4 million, or 18.8%, excluding the 2004 Acquisitions), following a $2.1 million, or 2.0%, decrease in 2003. The increase in 2004 was primarily attributable to additional equity commitments for low-income housing projects ($9.2 million increase), an increase in accrued retirement benefits ($2.4 million) and an increase in dividends payable to shareholders ($2.5 million).

**Shareholders' Equity**

Total shareholders' equity of $1.2 billion, or 11.1% of ending total assets, increased $295.4 million, or 31.2%, since December 31, 2003. This growth reflected the issuance of stock to effect the 2004 Acquisitions in the amount of $311.1 million, offset by treasury stock purchases of $79.0 million. Shareholders' equity was also increased by retained earnings of $75.7 million.

The Corporation periodically implements stock repurchase plans for various corporate purposes. In addition to evaluating the financial benefits of implementing repurchase plans, management also considers liquidity needs, the current market price per share and regulatory limitations. In 2002, the Board of Directors approved a stock repurchase plan for 5.8 million shares, which was extended through June 30, 2004. During 2004, 1.3 million shares were repurchased under this plan. On June 15, 2004, the Board of Directors approved a stock repurchase plan for 4.0 million shares through December 31, 2004. During 2004, 2.5 million shares were repurchased under this plan, including 1.0 million shares acquired under an accelerated share repurchase program. On December 21, 2004, the Board of Directors extended the stock repurchase plan through June 30, 2005 and increased the total number of shares that could be repurchased to 4.0 million. No shares were purchased under this extended plan in 2004.

The Corporation and its subsidiary banks are subject to regulatory capital requirements administered by various banking regulators. Failure to meet minimum capital requirements can initiate certain actions by regulators that could have a material effect on the Corporation's financial statements. The regulations require that banks maintain minimum amounts and ratios of total and Tier I capital (as defined in the regulations) to risk weighted assets (as defined), and Tier I capital to average assets (as defined). As of December 31, 2004, the Corporation and each of its bank subsidiaries met the minimum capital requirements. In addition, the Corporation and each of its bank subsidiaries' capital ratios exceeded the amounts required to be considered "well-capitalized" as defined in the regulations. See also Note J, "Regulatory Matters", in the Notes to Consolidated Financial Statements.

**Contractual Obligations and Off-Balance Sheet Arrangements**

The Corporation has various financial obligations that may require future cash payments. These obligations include the payment of liabilities recorded on the Corporation's balance sheet as well as contractual obligations for purchased services or for operating leases. The following table summarizes significant contractual obligations to third parties, by type, that are fixed and determinable at December 31, 2004:

| | Payments Due In | | | | |
|---|---|---|---|---|---|
| | One Year or Less | One to Three Years | Three to Five Years | Over Five Years | Total |
| | | | (in thousands) | | |
| Deposits with no stated maturity (a) | $ 4,926,478 | $ - | $ - | $ - | $ 4,926,478 |
| Time deposits (b) | 1,503,631 | 982,014 | 173,822 | 309,579 | 2,969,046 |
| Short-term borrowings (c) | 1,194,524 | - | - | - | 1,194,524 |
| Long-term debt (c) | 126,230 | 104,008 | 281,347 | 172,651 | 684,236 |
| Operating leases (d) | 8,051 | 13,961 | 8,592 | 19,752 | 50,356 |
| Purchase obligations (e) | 11,438 | 6,675 | 3,411 | - | 21,524 |

(a) Includes demand deposits and savings accounts, which can be withdrawn by customers at any time.
(b) See additional information regarding time deposits in Note H, "Deposits" in the Notes to Consolidated Financial Statements.
(c) See additional information regarding borrowings in Note I, "Short-Term Borrowings and Long-Term Debt" in the Notes to Consolidated Financial Statements.
(d) See additional information regarding operating leases in Note N, "Leases" in the Notes to Consolidated Financial Statements.
(e) Includes significant information technology, telecommunication and data processing outsourcing contracts. Variable obligations, such as those based on transaction volumes, are not included.

In addition to the contractual obligations listed in the preceding table, the Corporation is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit, which involve, to varying degrees, elements of credit and interest rate risk that are not recognized in the consolidated balance sheets. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Standby letters of credit are conditional commitments issued to guarantee the financial or performance obligation of a customer to a third party. Commitments and standby letters of credit do not necessarily represent future cash needs as they may expire without being drawn.

The following table presents the Corporation's commitments to extend credit and letters of credit as of December 31, 2004 (in thousands):

| | |
|---|---|
| Commercial mortgage, construction and land development | $ 689,818 |
| Home equity | 412,790 |
| Credit card | 384,504 |
| Commercial and other | 1,851,159 |
| Total commitments to extend credit | $ 3,338,271 |
| | |
| Standby letters of credit | $ 533,094 |
| Commercial letters of credit | 24,312 |
| Total letters of credit | $ 557,406 |

## CRITICAL ACCOUNTING POLICIES

The following is a summary of those accounting policies that the Corporation considers to be most important to the portrayal of its financial condition and results of operations as they require management's most difficult judgments as a result of the need to make estimates about the effects of matters that are inherently uncertain.

Allowance and Provision for Loan Losses – The Corporation accounts for the credit risk associated with its lending activities through the allowance and provision for loan losses. The allowance is an estimate of the losses inherent in the loan portfolio as of the balance sheet date. The provision is the periodic charge to earnings, which is necessary to adjust the allowance to its proper balance. On a quarterly basis, the Corporation assesses the adequacy of its allowance through a methodology that consists of the following:

- Identifying loans for individual review under FASB Statement of Financial Accounting Standards No. 114, "Accounting by Creditors for Impairment of a Loan" (Statement 114). In general, these consist of large balance commercial loans and commercial mortgages, that are rated less than "satisfactory" based upon the Corporation's internal credit-rating process.
- Assessing whether the loans identified for review under Statement 114 are "impaired". That is, whether it is probable that all amounts will not be collected according to the contractual terms of the loan agreement.
- For loans identified as impaired, calculating the estimated fair value, using observable market prices, discounted cash flows or the value of the underlying collateral.
- Classifying all non-impaired large balance loans based on credit risk ratings and allocating an allowance for loan losses based on appropriate factors, including recent loss history for similar loans.
- Identifying all smaller balance homogeneous loans for evaluation collectively under the provisions of Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies" (Statement 5). In general, these loans include residential mortgages, consumer loans, installment loans, smaller balance commercial loans and mortgages and lease receivables.
- Statement 5 loans are segmented into groups with similar characteristics and an allowance for loan losses is allocated to each segment based on recent loss history and other relevant information.
- Reviewing the results to determine the appropriate balance of the allowance for loan losses. This review gives additional consideration to factors such as the mix of loans in the portfolio, the balance of the allowance relative to total loans and non-performing assets, trends in the overall risk profile of the portfolio, trends in delinquencies and non-accrual loans and local and national economic conditions.
- An unallocated allowance is maintained to recognize the imprecision in estimating and measuring loss exposure.
- Documenting the results of its review in accordance with SAB 102.

The allowance review methodology is based on information known at the time of the review. Changes in factors underlying the assessment could have a material impact on the amount of the allowance that is necessary and the amount of provision to be charged against earnings. Such changes could impact future results.

Accounting for Business Combinations – The Corporation accounts for all business acquisitions using the purchase method of accounting as required by Statement of Financial Accounting Standards No. 141, "Business Combinations" (Statement 141). Purchase accounting requires the purchase price to be allocated to the estimated fair values of the assets acquired and liabilities assumed. It also requires assessing the existence of and, if necessary, assigning a value to certain intangible assets. The remaining excess purchase price over the fair value of net assets acquired is recorded as goodwill.

The purchase price is established as the value of securities issued for the acquisition, cash consideration paid and certain acquisition-related expenses. The fair values of assets acquired and liabilities assumed are typically established through appraisals, observable market values or discounted cash flows. Management has engaged independent third-party valuation experts to assist in valuing certain assets, particularly intangibles. Other assets and liabilities are generally valued using the Corporation's internal asset/liability modeling system. The assumptions used and the final valuations, whether prepared internally or by a third party, are reviewed by management. Due to the complexity of purchase accounting, final determinations of values can be time consuming and, occasionally,

amounts included in the Corporation's consolidated balance sheets and consolidated statements of income are based on preliminary estimates of value.

Goodwill and Intangible Assets – Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" (Statement 142) addresses the accounting for goodwill and intangible assets subsequent to acquisition. Intangible assets are amortized over their estimated lives. Some intangible assets have indefinite lives and are, therefore, not amortized. All intangible assets must be evaluated for impairment if certain events occur. Any impairment write-downs are recognized as expense in the consolidated income statement.

Goodwill is not amortized to expense, but is evaluated at least annually for impairment. The Corporation completes its annual goodwill impairment test as of October 31st of each year. The Corporation tests for impairment by first allocating its goodwill and other assets and liabilities, as necessary, to defined reporting units. A fair value is then determined for each reporting unit. If the fair values of the reporting units exceed their book values, no write-down of the recorded goodwill is necessary. If the fair values are less than the book values, an additional test is necessary to assess the proper carrying value of the goodwill. The Corporation determined that no impairment write-offs were necessary during 2004, 2003 and 2002.

Business unit valuation is inherently subjective, with a number of factors based on assumptions and management judgments. Among these are future growth rates for the reporting units, discount rates and earnings capitalization rates. Changes in assumptions and results due to economic conditions, industry factors and reporting unit performance and cash flow projections could result in different assessments of the fair values of reporting units and could result in impairment charges in the future.

Income Taxes – The provision for income taxes is based upon income before income taxes, adjusted for the effect of certain tax-exempt income and non-deductible expenses. In addition, certain items of income and expense are reported in different periods for financial reporting and tax return purposes. The tax effects of these temporary differences are recognized currently in the deferred income tax provision or benefit. Deferred tax assets or liabilities are computed based on the difference between the financial statement and income tax bases of assets and liabilities using the applicable enacted marginal tax rate.

The Corporation must also evaluate the likelihood that deferred tax assets will be recovered from future taxable income. If any such assets are not likely to be recovered, a valuation allowance must be recognized. The Corporation has determined that a valuation allowance is not required for deferred tax assets as of December 31, 2004, except in the case of deferred tax benefits related to state income tax net operating losses. The assessment of the carrying value of deferred tax assets is based on certain assumptions, changes in which could have a material impact on the Corporation's financial statements. See also Note K, "Income Taxes", in the Notes to Consolidated Financial Statements.

**Recent Accounting Pronouncements**

Note A, "Summary of Significant Accounting Policies", in the Notes to Consolidated Financial Statements discusses the expected impact of recently issued accounting standards which have not yet been adopted by the Corporation.

## MARKET RISK

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

*Equity Market Price Risk*

Equity market price risk is the risk that changes in the values of equity investments could have a material impact on the financial position or results of operations of the Corporation. The Corporation's equity investments consist of common stocks of publicly traded financial institutions, U.S. Government and agency stocks and money market mutual funds. The equity investments most susceptible to equity market price risk are the financial institutions stocks, which had a cost basis of approximately $56.9 million and a fair value of $64.3 million at December 31, 2004. Gross unrealized gains in this portfolio were approximately $7.8 million at December 31, 2004.

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

Management continuously monitors the fair value of its equity investments and evaluates current market conditions and operating results of the companies. Periodic sale and purchase decisions are made based on this monitoring process. None of the Corporation's equity securities are classified as trading. Future cash flows from these investments are not provided in the table on page 29 as such investments do not have maturity dates.

The Corporation has evaluated, based on existing accounting guidance, whether any unrealized losses on individual equity investments constituted "other than temporary" impairment, which would require a write-down through a charge to earnings. Based on the results of such evaluations, the Corporation recorded write-downs of $137,000 in 2004 and $3.3 million in 2003 for specific equity securities which were deemed to exhibit other than temporary impairment in value. Through December 31, 2004, gains of approximately $1.7 million had been realized on the sale of investments previously written down and, as of December 31, 2004, the impaired securities still held in the portfolio had recovered approximately $1.4 million of the original write-down amount. Additional impairment charges may be necessary depending upon the performance of the equity markets in general and the performance of the individual investments held by the Corporation. See also Note C, "Investment Securities", in the Notes to Consolidated Financial Statements.

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

*Interest Rate Risk, Asset/Liability Management and Liquidity*

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

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

From a liquidity standpoint, the Corporation must maintain a sufficient level of liquid assets to meet the ongoing cash flow requirements of customers, who, as depositors, may want to withdraw funds or who, as borrowers, need credit availability. Liquidity sources are found on both sides of the balance sheet. Liquidity is provided on a continuous basis through scheduled and unscheduled principal reductions and interest payments on outstanding loans and investments. Liquidity is also provided through the availability of deposits and borrowings.

The Corporation's sources and uses of cash were discussed in general terms in the "Overview" section of Management's Discussion. The consolidated statements of cash flows provide additional information. The Corporation generated $145.9 million in cash from operating activities during 2004, mainly due to net income. Investing activities resulted in a net cash inflow of $215.8 million, compared to a net cash outflow of $825.9 million in 2003. In 2004, proceeds from maturities and sales of investment securities exceeded reinvestments in the portfolio and the net increase in the loan portfolio. In 2003, funds provided by investment maturities and increased borrowings were used to purchase additional investment securities. Financing activities resulted in a net cash outflow of $384.5 million in 2004, compared to a net cash inflow of $623.3 in 2003 as funds provided by maturing investments were used to reduce short-term borrowings.

Liquidity must also be managed at the Fulton Financial Corporation parent company level. For safety and soundness reasons, banking regulations limit the amount of cash that can be transferred from subsidiary banks to the Parent Company in the form of loans and dividends. Generally, these limitations are based on the subsidiary banks' regulatory capital levels and their net income. Until 2004, the Parent Company has been able to meet its cash needs through normal, allowable dividends and loans. However, as a result of increased acquisition activity and stock repurchase plans, the Parent Company's cash needs have increased, requiring additional sources of funds in 2004.

In 2004, the Parent Company entered into a revolving line of credit agreement with an unaffiliated bank. Under the terms of the agreement, the Parent Company can borrow up to $50.0 million (may be increased to $100.0 million upon request) with interest calculated at the one-month London Interbank Offering Rate (LIBOR) plus 0.625%. The credit agreement requires the Corporation to maintain certain financial ratios related to capital strength and earnings. The Corporation was in compliance with all required covenants under the credit agreement as of December 31, 2004.

This borrowing arrangement supplements the liquidity available from subsidiaries through dividends and borrowings and provides some flexibility in Parent Company cash management. As of December 31, 2004, $11.9 million had been borrowed on this line. Management continues to monitor the liquidity and capital needs of the Parent Company and will implement appropriate strategies, as necessary, to remain well-capitalized and to meet its cash needs.

In addition to its normal recurring and operating cash needs, the Parent Company will also pay cash for a portion of the SVB acquisition, which is expected to be completed in the third quarter of 2005. Based on the terms of the merger agreement, the Parent Company will pay a minimum of approximately $17.0 million and a maximum of approximately $34.0 million to consummate the acquisition. See Note Q, "Mergers and Acquisitions" in the Notes to Consolidated Financial Statements for a summary of the terms of this transaction.

At December 31, 2004, liquid assets (defined as cash and due from banks, short-term investments, Federal funds sold, mortgages available for sale, securities available for sale, and non-mortgage-backed securities held to maturity due in one year or less) totaled $2.9 billion, or 26.1% of total assets. This compares to $3.2 billion, or 33.2% of total assets, at December 31, 2003.

*MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION*

The following tables set forth the maturities of investment securities at December 31, 2004 and the weighted average yields of such securities (calculated based on historical cost):

**HELD TO MATURITY** (at amortized cost)

| | MATURING | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Within One Year | | After One But Within Five Years | | After Five But Within Ten Years | | After Ten Years | |
| | Amount | Yield | Amount | Yield | Amount | Yield | Amount | Yield |
| | (dollars in thousands) | | | | | | | |
| U.S. Government and agency securities | $ 862 | 2.25% | $ 3,549 | 4.13% | $ 2,179 | 4.29% | $ 313 | 7.61% |
| State and municipal (1) | 8,893 | 2.98 | 1,110 | 6.32 | 655 | 8.00 | - | - |
| Other securities | 50 | 6.91 | 600 | 4.13 | - | - | - | - |
| *Totals* | $ 9,805 | 2.93% | $ 5,259 | 4.59% | $ 2,834 | 5.15% | $ 313 | 7.61% |
| Mortgage-backed securities (2) | $ 6,790 | 6.04% | | | | | | |

**AVAILABLE FOR SALE** (at estimated fair value)

| | MATURING | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Within One Year | | After One But Within Five Years | | After Five But Within Ten Years | | After Ten Years | |
| | Amount | Yield | Amount | Yield | Amount | Yield | Amount | Yield |
| | (dollars in thousands) | | | | | | | |
| U.S. Government and agency securities | $ 82,954 | 1.97% | $ 29,884 | 3.15% | $ 11,934 | 5.04% | $ 4,153 | 3.39% |
| State and municipal (1) | 30,570 | 4.52 | 161,760 | 5.17 | 98,740 | 5.09 | 41,385 | 8.67 |
| Other securities | 3,327 | 6.28 | 378 | 5.01 | 2,962 | 7.19 | 64,460 | 7.24 |
| *Totals* | $ 116,851 | 2.76% | $192,022 | 4.85% | $113,636 | 5.14% | $109,998 | 7.63% |
| Mortgage-backed securities (2) | $1,722,286 | 3.45% | | | | | | |

(1) Weighted average yields on tax-exempt securities have been computed on a fully tax-equivalent basis assuming a tax rate of 35 percent.

(2) Maturities for mortgage-backed securities are dependent upon the interest rate environment and prepayments on the underlying loans. For the purpose of this table, the entire balance and weighted average rate is shown in one period.

The Corporation's investment portfolio consists mainly of mortgage-backed securities which do not have stated maturities. Cash flows from such investments are dependent upon the performance of the underlying mortgage loans, and are generally influenced by the level of interest rates. As rates increase, cash flows generally decrease as prepayments on the underlying mortgage loans decrease. As rates decrease, cash flows generally increase as prepayments increase. The Corporation invests primarily in five and seven year balloon mortgage-backed securities to limit interest rate risk and promote liquidity.

The following table presents the approximate contractual maturity and sensitivity of certain loan types, excluding consumer loans and leases, to changes in interest rates as of December 31, 2004:

| | One Year or Less | One Through Five Years | More Than Five Years | Total |
|---|---|---|---|---|
| | | (in thousands) | | |
| Commercial, financial and agricultural: | | | | |
| Floating rate | $ 523,570 | $ 518,874 | $ 770,183 | $ 1,812,627 |
| Fixed rate | 139,925 | 243,802 | 76,784 | 460,511 |
| *Total* | $ 663,495 | $ 762,676 | $ 846,967 | $ 2,273,138 |
| Real-estate – mortgage: | | | | |
| Floating rate | $ 480,490 | $ 1,222,487 | $ 882,216 | $ 2,585,193 |
| Fixed rate | 744,984 | 671,297 | 110,863 | 1,527,144 |
| *Total* | $ 1,225,474 | $ 1,893,784 | $ 993,079 | $ 4,112,337 |
| Real-estate – construction: | | | | |
| Floating rate | $ 292,368 | $ 108,896 | $ 72,776 | $ 474,040 |
| Fixed rate | 87,020 | 28,631 | 37,095 | 152,746 |
| *Total* | $ 379,388 | $ 137,527 | $ 109,871 | $ 626,786 |

From a funding standpoint, the Corporation has been able to rely over the years on a stable base of "core" deposits. Even though the Corporation has experienced notable changes in the composition and interest sensitivity of this deposit base, it has been able to rely on this base to provide needed liquidity.

The Corporation also has access to sources of large denomination or jumbo time deposits and repurchase agreements as potential sources of liquidity. However, the Corporation has attempted to minimize its reliance upon these more volatile short-term funding sources and to use them primarily to meet the requirements of its existing customer base or when it is profitable to do so.

Contractual maturities of time deposits of $100,000 or more outstanding at December 31, 2004 are as follows (in thousands):

| | |
|---|---|
| Three months or less | $ 114,859 |
| Over three through six months | 77,021 |
| Over six through twelve months | 95,626 |
| Over twelve months | 248,458 |
| *Total* | $ 535,964 |

Each of the Corporation's subsidiary banks is a member of the FHLB and has access to FHLB overnight and term credit facilities. At December 31, 2004, the Corporation had $645.5 million in term advances from the FHLB with an additional $1.3 billion of borrowing capacity (including both short-term funding on its lines of credit and long-term borrowings). This availability, along with Federal funds lines at various correspondent commercial banks, provides the Corporation with additional liquidity.

*MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION*

The following table provides information about the Corporation's interest rate sensitive financial instruments. The table presents expected cash flows and weighted average rates for each significant interest rate sensitive financial instrument, by expected maturity period (dollars in thousands).

| | Expected Maturity Period | | | | | | | Estimated |
|---|---|---|---|---|---|---|---|---|
| | 2005 | 2006 | 2007 | 2008 | 2009 | Beyond | Total | Fair Value |
| Fixed rate loans (1) | $ 747,825 | $ 486,830 | $ 402,921 | $ 261,533 | $ 161,706 | $ 325,429 | $ 2,386,244 | $ 2,480,958 |
| *Average rate (2)* | 6.07% | 6.15% | 6.08% | 6.05% | 6.31% | 6.38% | 6.14% | |
| Floating rate loans (1) (3) | 1,362,108 | 685,031 | 538,425 | 442,696 | 391,812 | 1,778,231 | 5,198,303 | 5,188,778 |
| *Average rate (2)* | 5.97% | 5.83% | 6.02% | 6.11% | 5.70% | 4.83% | 5.56% | |
| Fixed rate investments (1) | 577,487 | 367,723 | 295,099 | 429,357 | 193,217 | 428,146 | 2,291,029 | 2,270,383 |
| *Average rate (2)* | 3.41% | 3.77% | 4.06% | 3.85% | 4.07% | 4.05% | 3.81% | |
| Floating rate investments (1) | - | - | - | 141 | - | 9,681 | 9,822 | 9,823 |
| *Average rate* | - | - | - | 5.85% | - | 3.40% | 3.44% | |
| Other interest-earning assets | 195,560 | - | - | - | - | - | 195,560 | 195,560 |
| *Average rate* | 6.09% | - | - | - | - | - | 6.09% | |
| **Total** | $ 2,882,980 | $ 1,539,584 | $ 1,236,445 | $ 1,133,727 | $ 746,735 | $ 2,541,487 | $10,080,958 | $10,145,502 |
| ***Average rate*** | 5.40% | 5.44% | 5.57% | 5.24% | 5.41% | 4.90% | 5.29% | |
| Fixed rate deposits (4) | $ 1,521,075 | $ 556,945 | $ 409,100 | $ 96,606 | $ 64,590 | $ 281,729 | $ 2,930,045 | $ 2,935,643 |
| *Average rate* | 2.25% | 2.97% | 3.93% | 3.29% | 3.82% | 4.26% | 2.88% | |
| Floating rate deposits (5) | 1,978,454 | 192,717 | 192,717 | 192,717 | 192,717 | 2,216,157 | 4,965,479 | 4,965,384 |
| *Average rate* | 1.03% | 0.27% | 0.27% | 0.27% | 0.27% | 0.19% | 0.54% | |
| Fixed rate borrowings (6) | 154,728 | 37,874 | 87,487 | 221,671 | 42,405 | 140,071 | 684,236 | 710,215 |
| *Average rate* | 4.37% | 3.36% | 3.80% | 5.01% | 4.80% | 5.38% | 4.68% | |
| Floating rate borrowings (7) | 1,194,524 | - | - | - | - | - | 1,194,524 | 1,194,524 |
| *Average rate* | 1.54% | - | - | - | - | - | 1.54% | |
| **Total** | $ 4,848,781 | $ 787,536 | $ 689,304 | $ 510,994 | $ 299,712 | $ 2,637,957 | $ 9,774,284 | $ 9,805,766 |
| ***Average rate*** | 1.75% | 2.33% | 2.89% | 2.89% | 1.67% | 0.91% | 1.71% | |

***Assumptions:***

(1) Amounts are based on contractual payments and maturities, adjusted for expected prepayments.
(2) Average rates are shown on a fully taxable equivalent basis using an effective tax rate of 35%.
(3) Floating rate loans include adjustable rate commercial loans and mortgages which may not reprice immediately upon a change in interest rates.
(4) Amounts are based on contractual maturities of fixed rate time deposits.
(5) Money market, Super NOW, NOW and savings accounts are placed based on history of deposit flows.
(6) Amounts are based on contractual maturities of Federal Home Loan Bank advances, adjusted for possible calls.
(7) Amounts are Federal funds purchased and securities sold under agreements to repurchase, which mature in less than 90 days.

The preceding table and discussion addressed the liquidity implications of interest rate risk and focused on expected cash flows from financial instruments. Expected maturities, however, do not necessarily reflect the net interest income impact of interest rate changes. Certain financial instruments, such as adjustable rate loans, have repricing periods that differ from expected cash flows.

In addition to the interest rate sensitive instruments included in the preceding table, the Corporation also had interest rate swaps with a notional amount of $220 million as of December 31, 2004. These swaps were used to hedge certain long-term fixed rate certificates of deposit held at one of the Corporation's affiliate banks. The terms of the certificates of deposit and the interest rate swaps mirror each other and were committed to simultaneously. Under the terms of the agreements, the Corporation is the fixed rate receiver and the floating rate payer (generally tied to the three month London Interbank Offering Rate, or LIBOR, a common index used for setting

rates between financial institutions). The combination of the interest rate swaps and the issuance of the certificates of deposit generates long-term floating rate funding for the Corporation.

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

Static gap provides a measurement of repricing risk in the Corporation's balance sheet as of a point in time. This measurement is accomplished through stratification of the Corporation's assets and liabilities into repricing periods. The assets and liabilities in each of these periods are compared for mismatches within that maturity segment. Core deposits not having a contractual maturity are placed into repricing periods based upon historical balance performance. Repricing for mortgage loans and for mortgage-backed securities includes the effect of expected cash flows. Estimated prepayment effects are applied to these balances based upon industry projections for prepayment speeds. The Corporation's policy limits the cumulative 6-month gap to plus or minus 15% of total earning assets. The cumulative 6-month gap as of December 31, 2004 was 1.00. The following is a summary of the interest sensitivity gaps for various time intervals as of December 31, 2004:

| | 0-90 Days | 91-180 Days | 181-365 Days |
|---|---|---|---|
| GAP | 1.00 | 0.97 | 1.08 |
| CUMULATIVE GAP | 1.00 | 1.00 | 1.01 |

Simulation of net interest income is performed for the next twelve-month period. A variety of interest rate scenarios are used to measure the effects of sudden and gradual movements upward and downward in the yield curve. These results are compared to the results obtained in a flat or unchanged interest rate scenario. Simulation of earnings is used primarily to measure the Corporation's short-term earnings exposure to rate movements. The Corporation's policy limits the potential exposure of net interest income to 10% of the base case net interest income for every 100 basis point "shock" in interest rates. A "shock" is an immediate upward or downward movement of short-term interest rates with changes across the yield curve based upon industry projections. The following table summarizes the expected impact of interest rate shocks on net interest income (due to the current low rates, only the 100 basis shock in a downward scenario is shown):

| Rate Shock | Annual change in net interest income | % Change |
|---|---|---|
| +300 bp | + $26.4 million | +6.9% |
| +200 bp | + $17.6 million | +4.6% |
| +100 bp | + $12.6 million | +3.3% |
| -100 bp | - $8.6 million | -2.2% |

***MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION***

Economic value of equity estimates the discounted present value of asset cash flows and liability cash flows. Discount rates are based upon market prices for like assets and liabilities. Upward and downward shocks of interest rates are used to determine the comparative effect of such interest rate movements relative to the unchanged environment. This measurement tool is used primarily to evaluate the longer term repricing risks and options in the Corporation's balance sheet. A policy limit of 10% of economic equity may be at risk for every 100 basis point "shock" movement in interest rates. The following table summarizes the expected impact of interest rate shocks on economic value of equity (due to the current low rates, only the 100 basis shock in a downward scenario is shown):

| Rate Shock | Change in economic value of equity | % Change |
|---|---|---|
| +300 bp | + $36.0 million | +2.3% |
| +200 bp | + $23.0 million | +1.4% |
| +100 bp | + $34.2 million | +2.1% |
| -100 bp | - $52.6 million | -3.3% |

As with any modeling system, the results of the static gap and simulation of net interest income and economic value of equity are a function of the assumptions and projections built into the model. The actual behavior of the financial instruments could differ from these assumptions and projections.

**Common Stock**

As of December 31, 2004, the Corporation had 125.7 million shares of $2.50 par value common stock outstanding held by 45,440 shareholders. The common stock of the Corporation is traded on the national market system of the National Association of Securities Dealers Automated Quotation System (NASDAQ) under the symbol FULT.

The following table presents the quarterly high and low prices of the Corporation's common stock and per-share cash dividends declared for each of the quarterly periods in 2004 and 2003. Per-share amounts have been retroactively adjusted to reflect the effect of stock dividends.

| | Price Range | | Per-Share |
|---|---|---|---|
| | High | Low | Dividend |
| **2004** | | | |
| **First Quarter** | **$ 21.70** | **$ 19.86** | **$ 0.152** |
| **Second Quarter** | **21.64** | **19.14** | **0.165** |
| **Third Quarter** | **21.90** | **20.00** | **0.165** |
| **Fourth Quarter** | **23.60** | **21.05** | **0.165** |
| 2003 | | | |
| First Quarter | $ 17.32 | $ 15.89 | $ 0.136 |
| Second Quarter | 20.00 | 17.01 | 0.152 |
| Third Quarter | 20.48 | 18.33 | 0.152 |
| Fourth Quarter | 20.95 | 18.81 | 0.152 |

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**CONSOLIDATED BALANCE SHEETS**
**(dollars in thousands, except per-share data)**

| | December 31 | |
|---|---|---|
| **Assets** | **2004** | 2003 |
| Cash and due from banks | **$ 278,065** | $ 300,966 |
| Interest-bearing deposits with other banks | **4,688** | 4,559 |
| Federal funds sold | **32,000** | - |
| Mortgage loans held for sale | **158,872** | 32,761 |
| Investment securities: | | |
| Held to maturity (estimated fair value of $25,413 in 2004 and $23,739 in 2003) | **25,001** | 22,993 |
| Available for sale | **2,424,858** | 2,904,157 |
| Loans, net of unearned income | **7,584,547** | 6,159,994 |
| Less: Allowance for loan losses | **(89,627)** | (77,700) |
| *Net Loans* | **7,494,920** | 6,082,294 |
| Premises and equipment | **146,911** | 120,777 |
| Accrued interest receivable | **40,633** | 34,407 |
| Goodwill | **364,019** | 127,202 |
| Intangible assets | **25,303** | 17,594 |
| Other assets | **163,081** | 119,578 |
| *Total Assets* | **$ 11,158,351** | $ 9,767,288 |
| **Liabilities** | | |
| Deposits: | | |
| Noninterest-bearing | **$ 1,507,799** | $ 1,262,214 |
| Interest-bearing | **6,387,725** | 5,489,569 |
| *Total Deposits* | **7,895,524** | 6,751,783 |
| Short-term borrowings: | | |
| Federal funds purchased | **676,922** | 933,000 |
| Other short-term borrowings | **517,602** | 463,711 |
| *Total Short-Term Borrowings* | **1,194,524** | 1,396,711 |
| Accrued interest payable | **27,279** | 24,579 |
| Other liabilities | **114,498** | 78,549 |
| Federal Home Loan Bank advances and long-term debt | **684,236** | 568,730 |
| *Total Liabilities* | **9,916,061** | 8,820,352 |
| **Shareholders' Equity** | | |
| Common stock, $2.50 par value, 400 million shares authorized, 134.2 million shares issued in 2004 and 119.5 million shares issued in 2003 | **335,604** | 284,480 |
| Additional paid-in capital | **1,000,111** | 633,588 |
| Retained earnings | **77,419** | 117,373 |
| Accumulated other comprehensive (loss) income | **(10,133)** | 12,267 |
| Treasury stock (8.5 million shares in 2004 and 5.8 million shares in 2003), at cost | **(160,711)** | (100,772) |
| *Total Shareholders' Equity* | **1,242,290** | 946,936 |
| *Total Liabilities and Shareholders' Equity* | **$ 11,158,351** | $ 9,767,288 |

*See Notes to Consolidated Financial Statements*

**CONSOLIDATED STATEMENTS OF INCOME**
**(dollars in thousands, except per-share data)**

| | Year Ended December 31 | | |
|---|---|---|---|
| **Interest Income** | **2004** | 2003 | 2002 |
| Loans, including fees | **$ 396,731** | $ 341,393 | $ 370,318 |
| Investment securities: | | | |
| Taxable | **76,792** | 77,450 | 84,139 |
| Tax-exempt | **9,553** | 10,436 | 9,835 |
| Dividends | **4,023** | 4,076 | 4,066 |
| Other interest income | **6,544** | 2,176 | 930 |
| *Total Interest Income* | **493,643** | 435,531 | 469,288 |
| **Interest Expense** | | | |
| Deposits | **89,779** | 94,198 | 125,394 |
| Short-term borrowings | **15,182** | 7,373 | 6,598 |
| Long-term debt | **31,033** | 29,523 | 26,227 |
| *Total Interest Expense* | **135,994** | 131,094 | 158,219 |
| *Net Interest Income* | **357,649** | 304,437 | 311,069 |
| **Provision for Loan Losses** | **4,717** | 9,705 | 11,900 |
| *Net Interest Income After Provision for Loan Losses* | **352,932** | 294,732 | 299,169 |
| **Other Income** | | | |
| Investment management and trust services | **34,817** | 33,898 | 29,114 |
| Service charges on deposit accounts | **39,451** | 38,500 | 37,502 |
| Other service charges and fees | **20,494** | 18,860 | 17,743 |
| Gain on sale of mortgage loans | **19,262** | 18,965 | 13,941 |
| Investment securities gains | **17,712** | 19,853 | 8,992 |
| Other | **7,128** | 4,294 | 6,720 |
| *Total Other Income* | **138,864** | 134,370 | 114,012 |
| **Other Expenses** | | | |
| Salaries and employee benefits | **162,126** | 136,002 | 127,584 |
| Net occupancy expense | **23,813** | 19,896 | 17,705 |
| Equipment expense | **10,769** | 10,505 | 11,295 |
| Data processing | **11,430** | 11,532 | 11,968 |
| Advertising | **6,943** | 6,039 | 6,525 |
| Intangible amortization | **4,726** | 2,059 | 1,838 |
| Other | **53,808** | 45,526 | 46,850 |
| *Total Other Expenses* | **273,615** | 231,559 | 223,765 |
| *Income Before Income Taxes* | **218,181** | 197,543 | 189,416 |
| **Income Taxes** | **65,264** | 59,363 | 56,468 |
| *Net Income* | **$ 152,917** | $ 138,180 | $ 132,948 |
| **Per-Share Data:** | | | |
| Net Income (Basic) | **$ 1.28** | $ 1.23 | $ 1.17 |
| Net Income (Diluted) | **1.27** | 1.22 | 1.17 |
| Cash Dividends | **0.647** | 0.593 | 0.531 |

*See Notes to Consolidated Financial Statements*

## CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY AND COMPREHENSIVE INCOME

| | Number of Shares Outstanding | Common Stock | Additional Paid-In Capital | Retained Earnings | Accumulated Other Comprehen-sive (Loss) Income | Treasury Stock | Total |
|---|---|---|---|---|---|---|---|
| | | | | (dollars in thousands) | | | |
| Balance at January 1, 2002 | 113,850,000 | $ 207,962 | $ 536,235 | $ 65,649 | $ 12,970 | $ (11,362) | $ 811,454 |
| Comprehensive income: | | | | | | | |
| Net income | | | | 132,948 | | | 132,948 |
| Unrealized gain on securities (net of $14.9 million tax effect) | | | | | 27,676 | | 27,676 |
| Less – reclassification adjustment for gains included in net income (net of $3.1 million tax expense) | | | | | (5,845) | | (5,845) |
| *Total comprehensive income* | | | | | | | 154,779 |
| 5 for 4 stock split paid in the form of a 25% stock dividend | | 51,981 | (52,050) | | | | (69) |
| Stock issued | 371,000 | | (3,157) | | | 6,964 | 3,807 |
| Acquisition of treasury stock | (2,751,000) | | | | | (46,133) | (46,133) |
| Cash dividends – $0.531 per share | | | | (60,096) | | | (60,096) |
| Balance at December 31, 2002 | 111,470,000 | 259,943 | 481,028 | 138,501 | 34,801 | (50,531) | 863,742 |
| Comprehensive income: | | | | | | | |
| Net income | | | | 138,180 | | | 138,180 |
| Unrealized loss on securities (net of $5.2 million tax effect) | | | | | (9,630) | | (9,630) |
| Less – reclassification adjustment for gains included in net income (net of $6.9 million tax expense) | | | | | (12,904) | | (12,904) |
| *Total comprehensive income* | | | | | | | 115,646 |
| Stock dividend – 5% | | 12,998 | 79,491 | (92,526) | | | (37) |
| Stock issued | 566,000 | | (3,570) | | | 9,458 | 5,888 |
| Stock issued for acquisition of Premier Bancorp, Inc. | 4,846,000 | 11,539 | 76,639 | | | | 88,178 |
| Acquisition of treasury stock | (3,214,000) | | | | | (59,699) | (59,699) |
| Cash dividends – $0.593 per share | | | | (66,782) | | | (66,782) |
| Balance at December 31, 2003 | 113,668,000 | 284,480 | 633,588 | 117,373 | 12,267 | (100,772) | 946,936 |
| Comprehensive income: | | | | | | | |
| Net income | | | | **152,917** | | | **152,917** |
| Unrealized loss on securities (net of $5.6 million tax effect) | | | | | **(10,329)** | | **(10,329)** |
| Less – reclassification adjustment for gains included in net income (net of $6.2 million tax expense) | | | | | **(11,513)** | | **(11,513)** |
| Minimum pension liability adjustment (net of $300,000 tax effect) | | | | | **(558)** | | **(558)** |
| *Total comprehensive income* | | | | | | | **130,517** |
| Stock dividend – 5% | | **15,278** | **100,247** | **(115,615)** | | | **(90)** |
| Stock issued | **1,048,000** | | **(8,966)** | | | **19,027** | **10,061** |
| Stock issued for acquisition of Resource Bankshares Corporation. | **9,030,000** | **21,498** | **164,365** | | | | **185,863** |
| Stock issued for acquisition of First Washington FinancialCorp. | **5,739,000** | **14,348** | **110,877** | | | | **125,225** |
| Acquisition of treasury stock | **(3,765,000)** | | | | | **(78,966)** | **(78,966)** |
| Cash dividends – $0.647 per share | | | | **(77,256)** | | | **(77,256)** |
| Balance at December 31, 2004 | **125,720,000** | **$ 335,604** | **$ 1,000,111** | **$ 77,419** | **$ (10,133)** | **$ (160,711)** | **$1,242,290** |

*See Notes to Consolidated Financial Statements*

**CONSOLIDATED STATEMENTS OF CASH FLOWS**
**(in thousands)**

| | Year Ended December 31 | | |
|---|---|---|---|
| | **2004** | 2003 | 2002 |
| **CASH FLOWS FROM OPERATING ACTIVITIES:** | | | |
| Net Income | **$ 152,917** | $ 138,180 | $ 132,948 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Provision for loan losses | **4,717** | 9,705 | 11,900 |
| Depreciation and amortization of premises and equipment | **12,409** | 12,379 | 12,786 |
| Net amortization of investment security premiums | **9,906** | 19,243 | 3,974 |
| Deferred income tax expense | **1,232** | 4,709 | 1,955 |
| Gain on sale of investment securities | **(17,712)** | (19,853) | (8,992) |
| Gain on sale of mortgage loans | **(19,262)** | (18,965) | (13,941) |
| Proceeds from sales of mortgage loans held for sale | **1,475,000** | 871,447 | 609,726 |
| Originations of mortgage loans held for sale | **(1,487,303)** | (813,476) | (647,886) |
| Amortization of intangible assets | **4,726** | 2,059 | 1,838 |
| Decrease in accrued interest receivable | **22** | 11,333 | 713 |
| Decrease (increase) in other assets | **6,895** | (14,595) | 87 |
| Decrease in accrued interest payable | **(759)** | (6,136) | (8,318) |
| Increase (decrease) in other liabilities | **3,089** | (7,370) | (1,580) |
| Total adjustments | **(7,040)** | 50,480 | (37,738) |
| *Net cash provided by operating activities* | **145,877** | 188,660 | 95,210 |
| **CASH FLOWS FROM INVESTING ACTIVITIES:** | | | |
| Proceeds from sales of securities available for sale | **235,332** | 521,520 | 67,633 |
| Proceeds from maturities of securities held to maturity | **8,870** | 18,146 | 21,247 |
| Proceeds from maturities of securities available for sale | **816,834** | 1,543,992 | 807,980 |
| Purchase of securities held to maturity | **(11,402)** | (8,514) | (5,654) |
| Purchase of securities available for sale | **(269,776)** | (2,445,592) | (1,528,199) |
| (Increase) decrease in short-term investments | **(9,188)** | 19,248 | (931) |
| Net (increase) decrease in loans | **(546,565)** | (487,147) | 44,098 |
| Net cash received from acquisitions | **7,810** | 17,222 | - |
| Net purchase of premises and equipment | **(16,161)** | (4,730) | (10,619) |
| *Net cash provided by (used in) investing activities* | **215,754** | (825,855) | (604,445) |
| **CASH FLOWS FROM FINANCING ACTIVITIES:** | | | |
| Net increase in demand and savings deposits | **293,331** | 347,665 | 366,981 |
| Net decrease in time deposits | **(174,453)** | (295,760) | (108,257) |
| Addition to long-term debt | **45,000** | 90,000 | 100,406 |
| Repayment of long-term debt | **(63,509)** | (157,360) | (21,653) |
| Decrease (increase) in short-term borrowings | **(338,845)** | 757,964 | 231,859 |
| Dividends paid | **(74,802)** | (64,628) | (58,954) |
| Net proceeds from issuance of common stock | **7,712** | 5,122 | 3,304 |
| Acquisition of treasury stock | **(78,966)** | (59,699) | (46,133) |
| *Net cash (used in) provided by financing activities* | **(384,532)** | 623,304 | 467,553 |
| **Net Decrease in Cash and Due From Banks** | **(22,901)** | (13,891) | (41,682) |
| **Cash and Due From Banks at Beginning of Year** | **300,966** | 314,857 | 356,539 |
| **Cash and Due From Banks at End of Year** | **$ 278,065** | $ 300,966 | $ 314,857 |
| **Supplemental Disclosures of Cash Flow Information** | | | |
| Cash paid during period for: | | | |
| Interest | **$ 136,753** | $ 137,230 | $ 166,537 |
| Income taxes | **54,457** | 48,924 | 49,621 |

*See Notes to Consolidated Financial Statements*

***NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***

## NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Business:** Fulton Financial Corporation (Parent Company) is a multi-bank financial holding company which provides a full range of banking and financial services to businesses and consumers through its wholly-owned banking subsidiaries: Fulton Bank, Lebanon Valley Farmers Bank, Swineford National Bank, Lafayette Ambassador Bank, FNB Bank N.A., Hagerstown Trust, Delaware National Bank, The Bank, The Peoples Bank of Elkton, Skylands Community Bank, Premier Bank, Resource Bank and First Washington State Bank as well as its financial services subsidiaries: Fulton Financial Advisors, N.A., and Fulton Insurance Services Group, Inc. In addition, the Parent Company owns the following other non-bank subsidiaries: Fulton Financial Realty Company, Fulton Reinsurance Company, LTD, Central Pennsylvania Financial Corp., FFC Management, Inc. and FFC Penn Square, Inc. Collectively, the Parent Company and its subsidiaries are referred to as the Corporation.

The Corporation's primary sources of revenue are interest income on loans and investment securities and fee income on its products and services. Its expenses consist of interest expense on deposits and borrowed funds, provision for loan losses, other operating expenses and income taxes. The Corporation's primary competition is other financial services providers operating in its region. Competitors also include financial services providers located outside the Corporation's geographical market with the growth in electronic delivery systems. The Corporation is subject to the regulations of certain Federal and state agencies and undergoes periodic examinations by such regulatory authorities.

The Corporation offers, through its banking subsidiaries, a full range of retail and commercial banking services throughout central and eastern Pennsylvania, Maryland, Delaware, New Jersey and Virginia. Industry diversity is the key to the economic well being of these markets and the Corporation is not dependent upon any single customer or industry.

**Basis of Financial Statement Presentation:** The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States and include the accounts of the Parent Company and all wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated. The preparation of financial statements in accordance with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements as well as revenues and expenses during the period. Actual results could differ from those estimates.

**Scope of Management's Report on Internal Control Over Financial Reporting:** Management's report on internal control over financial reporting includes controls at all consolidated entities, except for First Washington FinancialCorp (First Washington) which was acquired on December 31, 2004. Management has not evaluated the internal controls over financial reporting of First Washington and management's conclusion regarding the effectiveness of internal control over financial reporting does not extend to the internal controls of First Washington. See Note Q, "Mergers and Acquisitions", for a summary of the account balances of First Washington included in the consolidated balance sheet of December 31, 2004.

**Investments:** Debt securities are classified as held to maturity at the time of purchase when the Corporation has both the intent and ability to hold these investments until they mature. Such debt securities are carried at cost, adjusted for amortization of premiums and accretion of discounts using the effective yield method. The Corporation does not engage in trading activities, however, since the investment portfolio serves as a source of liquidity, most debt securities and all marketable equity securities are classified as available for sale. Securities available for sale are carried at estimated fair value with the related unrealized holding gains and losses reported in shareholders' equity as a component of other comprehensive income, net of tax. Realized security gains and losses are computed using the specific identification method and are recorded on a trade date basis. Securities are evaluated periodically to determine whether a decline in their value is other than temporary. Declines in value that are determined to be other than temporary are recorded as realized losses.

**Loans and Revenue Recognition:** Loan and lease financing receivables are stated at their principal amount outstanding, except for mortgage loans held for sale which are carried at the lower of aggregate cost or market value. Interest income on loans is accrued as earned. Unearned income on lease financing receivables is recognized on a basis which approximates the effective yield method. Premiums and discounts on purchased loans are amortized as an adjustment to interest income using the effective yield method.

***NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***

Accrual of interest income is generally discontinued when a loan becomes 90 days past due as to principal or interest, except for adequately collateralized residential mortgage loans. When interest accruals are discontinued, unpaid interest credited to income is reversed. Nonaccrual loans are restored to accrual status when all delinquent principal and interest become current or the loan is considered secured and in the process of collection.

**Interest Rate Swaps:** As of December 31, 2004, interest rate swaps with a notional amount of $220 million were used to hedge certain long-term fixed rate certificate of deposit liabilities held at one of the Corporation's affiliate banks. The terms of the certificates of deposit and the interest rate swaps mirror each other and were committed to simultaneously. Under the terms of the swap agreements, the Corporation is the fixed rate receiver and the floating rate payer (generally tied to the three month London Interbank Offering Rate, or LIBOR, a common index used for setting rates between financial institutions). The combination of the interest rate swaps and the issuance of the certificates of deposit generates long-term floating rate funding for the Corporation. Both the interest rate swaps and the certificates of deposit are recorded at fair value, with changes in fair value included in the consolidated statements of income as interest expense. Risk management results indicate that the hedges were 98.3% effective as of December 31, 2004, resulting in a favorable adjustment to interest expense to reflect hedge ineffectiveness of $14,000 for the year ended December 31, 2004.

**Loan Origination Fees and Costs:** Loan origination fees and the related direct origination costs are offset and the net amount is deferred and amortized over the life of the loan using the effective interest method as an adjustment to interest income. For mortgage loans sold, the net amount is included in gain or loss upon the sale of the related mortgage loan.

**Allowance for Loan Losses:** The allowance for loan losses is increased by charges to expense and decreased by charge-offs, net of recoveries. Management's periodic evaluation of the adequacy of the allowance for loan losses is based on the Corporation's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrowers' ability to repay, the estimated fair value of the underlying collateral, and current economic conditions. Management believes that the allowance for loan losses is adequate, however, future changes to the allowance may be necessary based on changes in any of these factors.

The allowance for loan losses consists of two components – specific allowances allocated to individually impaired loans, as defined by Statement of Financial Accounting Standards No. 114, "Accounting by Creditors for Impairment of a Loan" (Statement 114), and allowances calculated for pools of loans under Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies" (Statement 5).

Commercial loans and commercial mortgages are reviewed for impairment under Statement 114 if they are both greater than $100,000 and are rated less than "satisfactory" based upon the Corporation's internal credit-rating process. A satisfactory loan does not present more than a normal credit risk based on the strength of the borrower's management, financial condition and trends, and the type and sufficiency of underlying collateral. It is expected that the borrower will be able to satisfy the terms of the loan agreement.

A loan is considered to be impaired when, based on current information and events, it is probable that the Corporation will be unable to collect all amounts due according to the contractual terms of the loan agreement. Impaired loans are measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, or at the loan's observable market price or fair value of the collateral if the loan is collateral dependent. An allowance is allocated to an impaired loan if the carrying value exceeds the calculated estimated fair value.

All loans not reviewed for impairment are evaluated under Statement 5. In addition to commercial loans and mortgages not meeting the impairment evaluation criteria discussed above, these include residential mortgages, consumer loans, installment loans and lease receivables. These loans are segmented into groups with similar characteristics and an allowance for loan losses is allocated to each segment based on quantitative factors such as recent loss history and qualitative factors such as economic conditions and trends.

Loans and lease financing receivables deemed to be a loss are written off through a charge against the allowance for loan losses. Consumer loans are generally charged off when they become 120 days past due if they are not adequately secured by real estate. All other loans are evaluated for possible charge-off when they reach 90 days past due. Such loans or portions thereof are charged-off when it is probable that the balance will not be collected, based on the ability of the borrower to pay and the value of the underlying collateral. Recoveries of loans previously charged off are recorded as an increase to the allowance for loan losses. Past due status is determined based on contractual due dates for loan payments.

***NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***

Lease financing receivables include both open and closed end leases for the purchase of vehicles and equipment. Residual values are set at the inception of the lease and are reviewed periodically for impairment. If the impairment is considered to be other than temporary, the resulting reduction in the net investment in the lease is recognized as a loss in the period.

**Premises and Equipment:** Premises and equipment are stated at cost, less accumulated depreciation and amortization. The provision for depreciation and amortization is generally computed using the straight-line method over the estimated useful lives of the related assets, which are a maximum of 50 years for buildings and improvements and eight years for furniture and equipment. Leasehold improvements are amortized over the shorter of 15 years or the noncancelable lease term. Interest costs incurred during the construction of major bank premises are capitalized.

**Other Real Estate Owned:** Assets acquired in settlement of mortgage loan indebtedness are recorded as other real estate owned and are included in other assets initially at the lower of the estimated fair value of the asset less estimated selling costs or the carrying amount of the loan. Costs to maintain the assets and subsequent gains and losses on sales are included in other income and other expense.

**Mortgage Servicing Rights:** The estimated fair value of mortgage servicing rights (MSR's) related to loans sold is recorded as an asset upon the sale of such loans. MSR's are amortized as a reduction to servicing income over the estimated lives of the underlying loans. In addition, MSR's are evaluated quarterly for impairment based on prepayment experience and, if necessary, additional amortization is recorded.

**Income Taxes:** The provision for income taxes is based upon income before income taxes, adjusted primarily for the effect of tax-exempt income and net credits received from investments in low income housing partnerships. Certain items of income and expense are reported in different periods for financial reporting and tax return purposes. The tax effects of these temporary differences are recognized currently in the deferred income tax provision or benefit. Deferred tax assets or liabilities are computed based on the difference between the financial statement and income tax bases of assets and liabilities using the applicable enacted marginal tax rate. Deferred income tax expenses or benefits are based on the changes in the deferred tax asset or liability from period to period.

**Stock-Based Compensation:** The Corporation accounts for its stock options in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" (APB 25). As such, no compensation expense has been recognized as stock options are granted with an exercise price equal to the fair market value of the Corporation's stock. Pro-forma disclosures of the impact of stock option grants on the Corporation's net income and net income per share, had compensation expense been recognized, are provided in Note M, "Stock-based Compensation Plans and Shareholders' Equity", as required by Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" (Statement 123).

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 123r, "Share-Based Payment" (Statement 123r). Statement 123r is a revision to the original Statement 123 which disallows the APB 25 method of accounting for stock options and requires public companies to recognize compensation expense related to stock options in their income statements. Companies can adopt Statement 123r using either "modified prospective application" or "modified retrospective application". Modified prospective application requires expense to be recognized for all options granted or vested after June 15, 2005. Modified retrospective application also results in restatement of prior period results, based on the amounts previously disclosed in prior period financial statements. Management is in the process of evaluating the adoption alternatives. The impact of adopting Statement 123r on the Corporation's results of operations and financial condition is illustrated in the pro-forma information presented in Note M.

**Net Income Per Share:** The Corporation's basic net income per share is calculated as net income divided by the weighted average number of shares outstanding. For diluted net income per share, net income is divided by the weighted average number of shares outstanding plus the incremental number of shares added as a result of converting common stock equivalents, calculated using the treasury stock method. The Corporation's common stock equivalents consist solely of outstanding stock options. Excluded from the calculation were anti-dilutive options totaling 479,000 in 2002.

***NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***

A reconciliation of the weighted average shares outstanding used to calculate basic net income per share and diluted net income per share follows. There were no adjustments to net income to arrive at diluted net income per share.

| | **2004** | 2003 | 2002 |
|---|---|---|---|
| | | (in thousands) | |
| Weighted average shares outstanding (basic) | **119,435** | 112,268 | 113,156 |
| Impact of common stock equivalents | **1,206** | 867 | 742 |
| Weighted average shares outstanding (diluted) | **120,641** | 113,135 | 113,898 |

**Disclosures about Segments of an Enterprise and Related Information**: The Corporation does not have any operating segments which require disclosure of additional information. While the Corporation owns thirteen separate banks, each engages in similar activities, provides similar products and services, and operates in the same general geographical area. The Corporation's non-banking activities are immaterial and, therefore, separate information has not been disclosed.

**Financial Guarantees**: Financial guarantees, which consist primarily of standby and commercial letters of credit, are accounted for by recognizing a liability equal to the fair value of the guarantees and crediting the liability to income over the term of the guarantee. Fair value is estimated using the fees currently charged to enter into similar agreements with similar terms.

**Business Combinations and Intangible Assets**: The Corporation accounts for its acquisitions using the purchase accounting method as required by Statement of Financial Accounting Standards No. 141, "Business Combinations". Purchase accounting requires the total purchase price to be allocated to the estimated fair values of assets and liabilities acquired, including certain intangible assets that must be recognized. Typically, this results in a residual amount in excess of the net fair values, which is recorded as goodwill.

As required by Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" (Statement 142), goodwill is not amortized to expense, but is tested for impairment at least annually. Write-downs of the balance, if necessary as a result of the impairment test, are to be charged to the results of operations in the period in which the impairment is determined. The Corporation performed its annual tests of goodwill impairment on October 31 of each year. Based on the results of these tests the Corporation concluded that there was no impairment and no write-downs were recorded. If certain events occur which might indicate goodwill has been impaired, the goodwill is tested when such events occur.

In October 2002, the FASB issued Statement of Financial Accounting Standards No. 147, "Acquisitions of Certain Financial Institutions" (Statement 147) which allowed the excess purchase price recorded in qualifying branch acquisitions to be treated in the same manner as Statement 142 goodwill. Upon adoption of Statement 147, its provisions were applied retroactively to the January 1, 2002 adoption date for Statement 142. As a result of adopting Statement 147, the Corporation was not required to recognize $1.0 million of goodwill amortization in 2002 ($677,000, net of taxes), for a net benefit of $0.01 per share (basic and diluted). See Note F, "Goodwill and Intangible Assets" for additional disclosures.

**Variable Interest Entities**: FASB Interpretation No. 46, "Consolidation of Variable Interest Entities – An Interpretation of ARB No. 51" (FIN 46), provides guidance on when to consolidate certain Variable Interest Entities (VIE's) in the financial statements of the Corporation. VIE's are entities in which equity investors do not have a controlling financial interest or do not have sufficient equity at risk for the entity to finance activities without additional financial support from other parties. Under FIN 46, a company must consolidate a VIE if the company has a variable interest that will absorb a majority of the VIE's losses, if they occur, and/or receive a majority of the VIE's residual returns, if they occur. For the Corporation, FIN 46 affects corporation-obligated mandatorily redeemable capital securities of subsidiary trust (Trust Preferred Securities) and its investments in low and moderate income housing partnerships.

Trust Preferred Securities had historically been presented as minority interests in the Corporation's consolidated balance sheet. With the adoption of the related FIN 46 provisions, as interpreted by the Securities and Exchange Commission, Trust Preferred Securities were deconsolidated from the consolidated balance sheet as of December 31, 2004 and 2003. The impact of this deconsolidation was to increase long-term debt and reduce corporation-obligated mandatorily redeemable capital securities of subsidiary trust by $34.0

million. There was no impact of the deconsolidation on net income or net income per share. Prospectively, expense related to these issuances will be recorded as interest expense on long-term debt rather than minority interest expense.

Current regulatory capital rules allow Trust Preferred Securities to be included as a component of regulatory capital. This treatment has continued despite the deconsolidation of these instruments for financial reporting purposes. If banking regulators make a determination that Trust Preferred Securities can no longer be considered in regulatory capital, the securities become callable and the Corporation may redeem them. See additional disclosures in Note I, “Short-Term Borrowings and Long-term Debt”.

Investments in low and moderate income partnerships (LIH Investments) are amortized under the effective interest method over the life of the Federal income tax credits generated as a result of such investments, generally ten years. At December 31, 2004 and 2003, the Corporation’s LIH Investments totaled $52.0 million and $40.0 million, respectively. The net income tax benefit associated with these investments was $4.5 million in 2004, $4.0 million in 2003 and 2002. Based on its review of FIN 46, the Corporation did not consolidate any of its LIH Investments as of December 31, 2004 or 2003.

**Accounting for Certain Loans or Debt Securities Acquired in a Transfer**: In December 2003, the Accounting Standards Executive Committee issued Statement of Position 03-3 (SOP 03-3), “Accounting for Certain Loans or Debt Securities Acquired in a Transfer”. SOP 03-3 addresses accounting for differences between contractual cash flows and cash flows expected to be collected from an investor’s initial investment in loans or debt securities acquired in a transfer, including business combinations, if those differences are attributable, at least in part, to credit quality.

SOP 03-3 is effective for loans or debt securities acquired in fiscal years beginning after December 15, 2004. The Corporation intends to adopt the provisions of SOP 03-3 effective January 1, 2005, and does not expect the initial implementation to have a material effect on the Corporation’s financial condition or results of operations.

**Other-Than-Temporary Impairment**: In the second quarter of 2004, the Emerging Issues Task Force (EITF) released EITF Issue 03-01, “The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments” (EITF 03-01), which provides guidance for evaluating whether an investment is other-than-temporarily impaired and requires certain disclosures with respect to these investments.

In September 2004, the FASB delayed the effective date of the measurement and recognition guidance of EITF 03-01 from the third calendar quarter of 2004 to a date to be determined upon the issuance of a final FASB Staff Position. The Corporation continues to apply the measurement and recognition criteria of existing authoritative literature in evaluating its investments for other than temporary impairment. Management does not expect EITF 03-01 to have a material impact on its financial condition or results of operations.

**Reclassifications and Restatements:** Certain amounts in the 2003 and 2002 consolidated financial statements and notes have been reclassified to conform to the 2004 presentation. All share and per-share data have been restated to reflect the impact of the 5% stock dividend paid in June 2004.

## NOTE B – RESTRICTIONS ON CASH AND DUE FROM BANKS

The Corporation's subsidiary banks are required to maintain reserves, in the form of cash and balances with the Federal Reserve Bank, against their deposit liabilities. The average amount of such reserves during 2004 and 2003 was approximately $100.8 million and $94.4 million, respectively.

*NOTES TO CONSOLIDATED FINANCIAL STATEMENTS*

**NOTE C – INVESTMENT SECURITIES**

The following tables present the amortized cost and estimated fair values of investment securities as of December 31:

| **2004 Held to Maturity** | **Amortized Cost** | **Gross Unrealized Gains** | **Gross Unrealized Losses** | **Estimated Fair Value** |
|---|---|---|---|---|
| | | (in thousands) | | |
| U.S. Government and agency securities | **$ 6,903** | **$ 78** | **$ (55)** | **$ 6,926** |
| State and municipal securities | **10,658** | **65** | **-** | **10,723** |
| Corporate debt securities | **650** | **1** | **-** | **651** |
| Mortgage-backed securities | **6,790** | **323** | **-** | **7,113** |
| | **$ 25,001** | **$ 467** | **$ (55)** | **$ 25,413** |
| **2004 Available for Sale** | | | | |
| Equity securities | **$ 163,249** | **$ 7,822** | **$ (1,006)** | **$ 170,065** |
| U.S. Government and agency securities | **128,829** | **144** | **(48)** | **128,925** |
| State and municipal securities | **328,726** | **4,350** | **(621)** | **332,455** |
| Corporate debt securities | **68,215** | **3,053** | **(141)** | **71,127** |
| Mortgage-backed securities | **1,750,080** | **1,427** | **(29,221)** | **1,722,286** |
| | **$ 2,439,099** | **$ 16,796** | **$ (31,037)** | **$ 2,424,858** |
| **2003 Held to Maturity** | | | | |
| U.S. Government and agency securities | $ 7,728 | $ 158 | $ (41) | $ 7,845 |
| State and municipal securities | 4,462 | 87 | - | 4,549 |
| Corporate debt securities | 640 | 1 | - | 641 |
| Mortgage-backed securities | 10,163 | 541 | - | 10,704 |
| | $ 22,993 | $ 787 | $ (41) | $ 23,739 |
| **2003 Available for Sale** | | | | |
| Equity securities | $ 197,262 | $ 15,597 | $ (507) | $ 212,352 |
| U.S. Government and agency securities | 82,178 | 261 | - | 82,439 |
| State and municipal securities | 291,244 | 7,115 | (329) | 298,030 |
| Corporate debt securities | 28,772 | 292 | (408) | 28,656 |
| Mortgage-backed securities | 2,285,845 | 9,109 | (12,274) | 2,282,680 |
| | $ 2,885,301 | $ 32,374 | $ (13,518) | $ 2,904,157 |

***NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***

The amortized cost and estimated fair value of debt securities at December 31, 2004 by contractual maturity are shown in the following table. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

| | Held to Maturity | | Available for Sale | |
|---|---|---|---|---|
| | Amortized Cost | Estimated Fair Value | Amortized Cost | Estimated Fair Value |
| | (in thousands) | | | |
| Due in one year or less | $ 9,805 | $ 9,804 | $ 116,720 | $ 116,851 |
| Due from one year to five years | 5,259 | 5,308 | 190,051 | 192,022 |
| Due from five years to ten years | 2,834 | 2,798 | 112,882 | 113,636 |
| Due after ten years | 313 | 390 | 106,117 | 109,998 |
| | 18,211 | 18,300 | 525,770 | 532,507 |
| Mortgage-backed securities | 6,790 | 7,113 | 1,750,080 | 1,722,286 |
| | $ 25,001 | $ 25,413 | $2,275,850 | $2,254,793 |

Gains totaling $14.8 million, $17.3 million and $7.4 million were realized on the sale of equity securities during 2004, 2003 and 2002, respectively. Gains totaling $3.1 million, $5.9 million and $1.6 million were realized on the sale of available for sale debt securities during 2004, 2003 and 2002, respectively. Losses of $137,000, and $3.3 million were recognized in 2004 and 2003 respectively, for equity investments exhibiting other than temporary impairment.

Securities carried at $1.2 billion at December 31, 2004 and 2003 were pledged as collateral to secure public and trust deposits and customer and brokered repurchase agreements.

The following table presents the gross unrealized losses and fair values of investments, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2004:

| | Less Than 12 months | | 12 Months or Longer | | Total | |
|---|---|---|---|---|---|---|
| | Estimated Fair Value | Unrealized Losses | Estimated Fair Value | Unrealized Losses | Estimated Fair Value | Unrealized Losses |
| | (in thousands) | | | | | |
| U.S. Government and agency securities | $ 67,763 | $ (103) | $ - | $ - | $ 67,763 | $ (103) |
| State and municipal securities | 66,794 | (554) | 2,392 | (67) | 69,186 | (621) |
| Corporate debt securities | 2,296 | (15) | 8,118 | (126) | 10,414 | (141) |
| Mortgage-backed securities | 896,845 | (13,498) | 632,216 | (15,723) | 1,529,061 | (29,221) |
| Total debt securities | 1,033,698 | (14,170) | 642,726 | (15,916) | 1,676,424 | (30,086) |
| Equity securities | 13,063 | (810) | 10,469 | (196) | 23,532 | (1,006) |
| Total | $1,046,761 | $ (14,980) | $ 653,195 | $ (16,112) | $1,699,956 | $ (31,092) |

Mortgage-backed securities consist of five and seven-year balloon pools issued by the Federal Home Loan Mortgage Corporation (FHLMC) and the Federal National Mortgage Association (FNMA). The majority of the securities shown in the above table were purchased during 2003 when mortgage rates were at historical lows. Unrealized losses on these securities at December 31, 2004 resulted from an increase in market rates since the securities were purchased. Because FHLMC and FNMA guarantee the payment of principal, the credit risk for these securities is minimal and, as such, no impairment write-offs were considered to be necessary.

*NOTES TO CONSOLIDATED FINANCIAL STATEMENTS*

## NOTE D – LOANS AND ALLOWANCE FOR LOAN LOSSES

Gross loans are summarized as follows as of December 31:

| | **2004** | 2003 |
|---|---|---|
| | (in thousands) | |
| Commercial - industrial and financial | **$ 1,946,962** | $ 1,594,451 |
| Commercial - agricultural | **326,176** | 354,517 |
| Real-estate - commercial mortgage | **2,461,016** | 1,992,650 |
| Real-estate - commercial construction | **348,846** | 264,129 |
| Real-estate - residential mortgage | **543,072** | 434,568 |
| Real-estate - residential construction | **277,940** | 42,979 |
| Real estate - home equity | **1,108,249** | 890,044 |
| Consumer | **506,290** | 516,587 |
| Leasing and other | **77,767** | 84,056 |
| Deferred loan fees, net of costs | **(4,972)** | (6,410) |
| | **7,591,346** | 6,167,571 |
| Unearned income | **(6,799)** | (7,577) |
| | **$ 7,584,547** | $ 6,159,994 |

Changes in the allowance for loan losses were as follows for the years ended December 31:

| | **2004** | 2003 | 2002 |
|---|---|---|---|
| | | (in thousands) | |
| Balance at beginning of year | **$ 77,700** | $ 71,920 | $ 71,872 |
| Loans charged off | **(8,877)** | (13,228) | (15,670) |
| Recoveries of loans previously charged off | **4,520** | 3,829 | 3,818 |
| Net loans charged off | **(4,357)** | (9,399) | (11,852) |
| Provision for loan losses | **4,717** | 9,705 | 11,900 |
| Allowance purchased | **11,567** | 5,474 | - |
| Balance at end of year | **$ 89,627** | $ 77,700 | $ 71,920 |

The following table presents non-performing assets as of December 31:

| | **2004** | 2003 |
|---|---|---|
| | (in thousands) | |
| Nonaccrual loans | **$ 22,574** | $ 22,422 |
| Accruing loans greater than 90 days past due | **8,318** | 9,609 |
| Other real estate owned | **2,209** | 585 |
| | **$ 33,101** | $ 32,616 |

Interest of approximately $1.5 million, $1.8 million and $1.7 million was not recognized as interest income due to the non-accrual status of loans during 2004, 2003 and 2002, respectively.

*NOTES TO CONSOLIDATED FINANCIAL STATEMENTS*

The recorded investment in loans that were considered to be impaired as defined by Statement 114 was $130.6 million and $78.2 million at December 31, 2004 and 2003, respectively. At December 31, 2004 and 2003, $6.6 million and $8.9 million of impaired loans were included in non-accrual loans, respectively. At December 31, 2004 and 2003, impaired loans had related allowances for loan losses of $41.6 million and $25.8 million, respectively. There were no impaired loans in 2004 and 2003 that did not have a related allowance for loan losses. The average recorded investment in impaired loans during the years ended December 31, 2004, 2003 and 2002 was approximately $108.0 million, $78.4 million, and $40.2 million, respectively.

The Corporation applies all payments received on non-accruing impaired loans to principal until such time as the principal is paid off, after which time any additional payments received are recognized as interest income. Payments received on accruing impaired loans are applied to principal and interest according to the original terms of the loan. The Corporation recognized interest income of approximately $5.6 million, $3.9 million and $1.7 million on impaired loans in 2004, 2003 and 2002, respectively.

The Corporation has extended credit to the officers and directors of the Corporation and to their associates. Related-party loans are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated persons and do not involve more than the normal risk of collectibility. The aggregate dollar amount of these loans, including unadvanced commitments, was $209.8 million and $170.1 million at December 31, 2004 and 2003, respectively. During 2004, $48.4 million of new advances were made and repayments totaled $18.7 million. First Washington and Resource added $10.0 million to related party loans.

The total portfolio of mortgage loans serviced by the Corporation for unrelated third parties was $1.1 billion at December 31, 2004 and 2003.

## NOTE E – PREMISES AND EQUIPMENT

The following is a summary of premises and equipment as of December 31:

| | **2004** | 2003 |
|---|---|---|
| | (in thousands) | |
| Land | **$ 25,253** | $ 18,626 |
| Buildings and improvements | **149,700** | 131,971 |
| Furniture and equipment | **105,406** | 92,468 |
| Construction in progress | **10,967** | 1,909 |
| | **291,326** | 244,974 |
| Less: Accumulated depreciation and amortization | **(144,415)** | (124,197) |
| | **$ 146,911** | $ 120,777 |

## NOTE F – GOODWILL AND INTANGIBLE ASSETS

The following table summarizes the changes in goodwill:

| | **2004** | 2003 | 2002 |
|---|---|---|---|
| | | (in thousands) | |
| Balance at beginning of year | **$ 127,202** | $ 61,048 | $ 38,900 |
| Goodwill acquired | **236,817** | 66,154 | - |
| Reclassified goodwill | **-** | - | 21,300 |
| Reversal of negative goodwill | **-** | - | 848 |
| Balance at end of year | **$ 364,019** | $ 127,202 | $ 61,048 |

## *NOTES TO CONSOLIDATED FINANCIAL STATEMENTS*

Reclassified goodwill consists of certain branch acquisition unidentifiable intangible assets that were accounted for as unidentifiable intangible assets prior to the adoption of Statement 147. Upon adoption of Statement 147, previous acquisitions giving rise to unidentifiable intangible assets were reviewed to determine if they constituted the acquisition of a business. Upon adoption of Statement 147 retroactively to January 1, 2002, certain of these assets were reclassified to goodwill. See Note Q, "Mergers and Acquisitions" for information regarding goodwill acquired in 2004 and 2003.

The cumulative effect of adopting Statement 142 was $848,000, representing the reversal of negative goodwill balances existing at January 1, 2002. This has been presented as other income in the consolidated statement of income. The following table adjusts net income and net income per share for this amount (in thousands, except per-share amounts):

| | **2004** | 2003 | 2002 |
|---|---|---|---|
| Net income, as reported | **$ 152,917** | $ 138,180 | $ 132,948 |
| Reversal of negative goodwill | **-** | - | (848) |
| Net income, as adjusted | **$ 152,917** | $ 138,180 | $ 132,100 |
| Basic net income per share, as reported | **$ 1.28** | $ 1.23 | $ 1.17 |
| Reversal of negative goodwill | **-** | - | (0.01) |
| Basic net income per share, as adjusted | **$ 1.28** | $ 1.23 | $ 1.17 |
| Diluted net income per share, as reported | **$ 1.27** | $ 1.22 | $ 1.17 |
| Reversal of negative goodwill | **-** | - | (0.01) |
| Diluted net income per share, as adjusted | **$ 1.27** | $ 1.22 | $ 1.16 |

Note: Adjusted per share amounts do not sum in all cases due to rounding.

The following table summarizes intangible assets at December 31:

| | **2004** | | | 2003 | | |
|---|---|---|---|---|---|---|
| | **Gross** | **Accumulated Amortization** | **Net** | Gross | Accumulated Amortization | Net |
| | | | (in thousands) | | | |
| Amortizing: | | | | | | |
| Core deposit | **$ 27,678** | **$ (7,418)** | **$ 20,260** | $ 19,540 | $ (4,320) | $ 15,220 |
| Non-compete | **475** | **(40)** | **435** | - | - | - |
| Unidentifiable | **7,706** | **(3,998)** | **3,708** | 4,784 | (2,410) | 2,374 |
| Total amortizing | **35,859** | **(11,456)** | **24,403** | 24,324 | (6,730) | 17,594 |
| Non-amortizing - Trade name | **900** | **-** | **900** | - | - | - |
| | **$ 36,759** | **$ (11,456)** | **$ 25,303** | $ 24,324 | $ (6,730) | $ 17,594 |

Core deposit intangible assets are amortized using an accelerated method over the estimated remaining life of the acquired core deposits. As of December 31, 2004, these assets had a weighted average remaining life of approximately eight years. Unidentifiable intangible assets related to branch acquisitions are amortized on a straight-line basis over ten years. Non-compete intangible assets are being amortized on a straight-line basis over five years, which is the term of the underlying contracts. Amortization expense related to intangible assets totaled $4.7 million, $2.1 million and $1.8 million in 2004, 2003 and 2002, respectively.

Amortization expense for the next five years is expected to be as follows (in thousands):

| Year | |
|---|---|
| 2005 | $ 4,639 |
| 2006 | 4,266 |
| 2007 | 3,663 |
| 2008 | 3,081 |
| 2009 | 2,791 |

**NOTE G – MORTGAGE SERVICING RIGHTS**

The following table summarizes the changes in mortgage servicing rights (MSR's), which are included in other assets in the consolidated balance sheets:

| | **2004** | 2003 | 2002 |
|---|---|---|---|
| | | (in thousands) | |
| Balance at beginning of year | **$ 8,396** | $ 6,233 | $ 3,271 |
| Originations of mortgage servicing rights | **2,138** | 4,992 | 3,839 |
| Amortization expense | **(2,377)** | (2,829) | (877) |
| Balance at end of year | **$ 8,157** | $ 8,396 | $ 6,233 |

MSR's represent the economic value to be derived by the Corporation based upon its existing contractual rights to service mortgage loans that have been sold. Accordingly, to the extent mortgage loan prepayments occur the value of MSR's can be impacted.

The Corporation estimates the fair value of its MSR's by discounting the estimated cash flows of servicing revenue, net of costs, over the expected life of the underlying loans at a discount rate commensurate with the risk associated with these assets. Expected life is based on industry prepayment projections for mortgage-backed securities with rates and terms comparable to the loans underlying the Corporation's MSR's. The estimated fair value of the Corporation's MSR's was approximately $8.5 million and $8.4 million at December 31, 2004 and 2003, respectively.

Estimated MSR's amortization expense for the next five years, based on balances at December 31, 2004 and the expected remaining lives of the underlying loans follows (in thousands):

| Year | |
|---|---|
| 2005 | $ 1,931 |
| 2006 | 1,730 |
| 2007 | 1,499 |
| 2008 | 1,236 |
| 2009 | 938 |

***NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***

**NOTE H – DEPOSITS**

Deposits consisted of the following as of December 31:

| | **2004** | 2003 |
|---|---|---|
| | (in thousands) | |
| Noninterest-bearing demand | **$ 1,507,799** | $ 1,262,214 |
| Interest-bearing demand | **1,501,476** | 1,289,946 |
| Savings and money market accounts | **1,917,203** | 1,751,475 |
| Time deposits | **2,969,046** | 2,448,148 |
| | **$ 7,895,524** | $ 6,751,783 |

Included in time deposits were certificates of deposit equal to or greater than $100,000 of $536.0 million and $451.0 million at December 31, 2004 and 2003, respectively. The scheduled maturities of time deposits as of December 31, 2004 were as follows (in thousands):

| Year | |
|---|---|
| 2005 | $ 1,503,631 |
| 2006 | 555,230 |
| 2007 | 426,784 |
| 2008 | 103,273 |
| 2009 | 70,549 |
| Thereafter | 309,579 |
| | $ 2,969,046 |

**NOTE I – SHORT-TERM BORROWINGS AND LONG-TERM DEBT**

Short-term borrowings at December 31, 2004, 2003, and 2002 and the related maximum amounts outstanding at the end of any month in each of the three years are presented below. The securities underlying the repurchase agreements remain in available for sale investment securities.

| | December 31 | | | Maximum Outstanding | | |
|---|---|---|---|---|---|---|
| | **2004** | 2003 | 2002 | **2004** | 2003 | 2002 |
| | (in thousands) | | | | | |
| Federal funds purchased | **$ 676,922** | $ 933,000 | $ 330,000 | **$ 849,200** | $ 933,000 | $ 330,000 |
| Securities sold under agreements to repurchase | **500,206** | 408,697 | 297,556 | **708,830** | 429,819 | 347,248 |
| FHLB overnight repurchase agreements | - | 50,000 | - | - | 50,000 | - |
| Revolving line of credit | **11,930** | - | - | **26,000** | - | - |
| Other | **5,466** | 5,014 | 4,638 | **5,807** | 6,387 | 5,640 |
| | **$ 1,194,524** | $ 1,396,711 | $ 632,194 | | | |

In 2004, the Corporation entered into a $50.0 million revolving line of credit agreement with an unaffiliated bank that provides for interest to be paid on outstanding balances at the one-month London Interbank Offering Rate (LIBOR) plus 0.625%. The credit agreement requires the Corporation to maintain certain financial ratios related to capital strength and earnings. The Corporation was in compliance with all required covenants under the credit agreement as of December 31, 2004.

*NOTES TO CONSOLIDATED FINANCIAL STATEMENTS*

The following table presents information related to securities sold under agreements to repurchase:

| | December 31 | | |
|---|---|---|---|
| | **2004** | 2003 | 2002 |
| | (dollars in thousands) | | |
| Amount outstanding at December 31 | **$ 500,206** | $ 408,697 | $ 297,556 |
| Weighted average interest rate at year end | **1.03%** | 0.72% | 1.43% |
| Average amount outstanding during the year | **$ 531,196** | $ 351,302 | $ 297,453 |
| Weighted average interest rate during the year | **0.97%** | 0.83% | 1.43% |

Federal Home Loan Bank advances and long-term debt included the following as of December 31:

| | **2004** | 2003 |
|---|---|---|
| | (in thousands) | |
| Federal Home Loan Bank advances | **$ 645,461** | $ 532,344 |
| Junior subordinated deferrable interest debentures | **34,022** | 33,509 |
| Other long-term debt | **4,753** | 2,877 |
| | **$ 684,236** | $ 568,730 |

The Parent Company owns all of the common stock of four Delaware business trusts, which have issued Trust Preferred Securities in conjunction with the Parent Company issuing junior subordinated deferrable interest debentures to the trusts. The terms of the junior subordinated deferrable interest debentures are the same as the terms of the Trust Preferred Securities. The Parent Company's obligations under the debentures constitute a full and unconditional guarantee by the Parent Company of the obligations of the trusts. Trust Preferred securities are redeemable on specified dates, or earlier if the deduction of interest for Federal income taxes is prohibited, the Trust Preferred Securities no longer qualify as Tier I capital, or if certain other contingencies arise. The Trust Preferred Securities must be redeemed upon maturity. The following table details the terms of the debentures (dollars in thousands):

| **Debentures Issued to** | **Fixed/ Variable** | **Rate at December 31, 2004** | **Amount** | **Maturity** | **Callable** |
|---|---|---|---|---|---|
| Premier Capital Trust | Fixed | 8.57 % | $ 10,310 | 8/15/28 | 8/15/08 |
| PBI Capital Trust II | Variable | 5.73 % | 15,464 | 11/7/32 | 11/7/07 |
| Resource Capital Trust II | Variable | 5.61 % | 5,155 | 12/8/31 | 12/8/06 |
| Resource Capital Trust III | Variable | 5.73 % | 3,093 | 11/7/32 | 11/7/07 |
| | | | $ 34,022 | | |

Federal Home Loan Bank advances mature through May 2014 and carry a weighted average interest rate of 4.61%. As of December 31, 2004, the Corporation had an additional borrowing capacity of approximately $1.3 billion with the Federal Home Loan Bank. Advances from the Federal Home Loan Bank are secured by Federal Home Loan Bank stock, qualifying residential mortgages, investments and other assets.

***NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***

The following table summarizes the scheduled maturities of Federal Home Loan Bank advances and long-term debt as of December 31, 2004 (in thousands):

| Year | |
|---|---|
| 2005 | $ 126,230 |
| 2006 | 33,706 |
| 2007 | 70,302 |
| 2008 | 212,359 |
| 2009 | 68,988 |
| Thereafter | 172,651 |
| | $ 684,236 |

**NOTE J – REGULATORY MATTERS**

*Dividend and Loan Limitations*

The dividends that may be paid by subsidiary banks to the Parent Company are subject to certain legal and regulatory limitations. Under such limitations, the total amount available for payment of dividends by subsidiary banks was approximately $230 million at December 31, 2004.

Under current Federal Reserve regulations, the subsidiary banks are limited in the amount they may loan to their affiliates, including the Parent Company. Loans to a single affiliate may not exceed 10%, and the aggregate of loans to all affiliates may not exceed 20% of each bank subsidiary's regulatory capital. At December 31, 2004, the maximum amount available for transfer from the subsidiary banks to the Parent Company in the form of loans and dividends was approximately $310 million.

*Regulatory Capital Requirements*

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

Quantitative measures established by regulation to ensure capital adequacy require the subsidiary banks to maintain minimum amounts and ratios of total and Tier I capital to risk-weighted assets, and of Tier I capital to average assets (as defined in the regulations). Management believes, as of December 31, 2004, that all of its bank subsidiaries meet the capital adequacy requirements to which they are subject.

As of December 31, 2004 and 2003, the Corporation's seven significant subsidiaries, Fulton Bank, Lebanon Valley Farmers Bank, Lafayette Ambassador Bank, The Bank, Premier Bank, Resource Bank and First Washington State Bank were well capitalized under the regulatory framework for prompt corrective action based on their capital ratio calculations. To be categorized as well-capitalized, these banks must maintain minimum total risk-based, Tier I risk-based, and Tier I leverage ratios as set forth in the following table. There are no conditions or events since December 31, 2004 that management believes have changed the institutions' categories.

***NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***

The following tables present the total risk-based, Tier I risk-based and Tier I leverage requirements for the Corporation and its significant subsidiaries.

| | Actual | | For Capital Adequacy Purposes | | Well-Capitalized | |
|---|---|---|---|---|---|---|
| **As of December 31, 2004** | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| | | | (dollars in thousands) | | | |
| Total Capital (to Risk Weighted Assets): | | | | | | |
| Corporation | **$ 979,203** | **11.7%** | **$ 667,377** | **8.0%** | **$ 834,222** | **10.0%** |
| Fulton Bank | **401,961** | **11.2** | **286,697** | **8.0** | **358,372** | **10.0** |
| Lebanon Valley Farmers Bank | **59,860** | **11.6** | **41,254** | **8.0** | **51,567** | **10.0** |
| Lafayette Ambassador Bank | **95,631** | **11.4** | **67,124** | **8.0** | **83,905** | **10.0** |
| The Bank | **89,891** | **11.1** | **64,969** | **8.0** | **81,211** | **10.0** |
| Premier Bank | **45,770** | **13.0** | **28,218** | **8.0** | **35,272** | **10.0** |
| Resource Bank | **83,274** | **11.1** | **60,241** | **8.0** | **75,302** | **10.0** |
| First Washington State Bank | **38,183** | **12.7** | **24,142** | **8.0** | **30,177** | **10.0** |
| Tier I Capital (to Risk Weighted Assets): | | | | | | |
| Corporation | **$ 886,729** | **10.6%** | **$ 333,689** | **4.0%** | **$ 500,533** | **6.0%** |
| Fulton Bank | **366,633** | **10.2** | **143,349** | **4.0** | **215,023** | **6.0** |
| Lebanon Valley Farmers Bank | **55,051** | **10.7** | **20,627** | **4.0** | **30,940** | **6.0** |
| Lafayette Ambassador Bank | **86,456** | **10.3** | **33,562** | **4.0** | **50,343** | **6.0** |
| The Bank | **81,252** | **10.0** | **32,485** | **4.0** | **48,727** | **6.0** |
| Premier Bank | **39,858** | **11.3** | **14,109** | **4.0** | **21,163** | **6.0** |
| Resource Bank | **75,503** | **10.0** | **30,121** | **4.0** | **45,181** | **6.0** |
| First Washington State Bank | **34,729** | **11.5** | **12,071** | **4.0** | **18,106** | **6.0** |
| Tier I Capital (to Average Assets): | | | | | | |
| Corporation | **$ 886,729** | **8.7%** | **$ 304,337** | **3.0%** | **$ 507,228** | **5.0%** |
| Fulton Bank | **366,633** | **8.4** | **130,290** | **3.0** | **217,150** | **5.0** |
| Lebanon Valley Farmers Bank | **55,051** | **7.2** | **23,048** | **3.0** | **38,413** | **5.0** |
| Lafayette Ambassador Bank | **86,456** | **7.4** | **35,166** | **3.0** | **58,609** | **5.0** |
| The Bank | **81,252** | **7.7** | **31,762** | **3.0** | **52,937** | **5.0** |
| Premier Bank | **39,858** | **8.6** | **13,903** | **3.0** | **23,172** | **5.0** |
| Resource Bank | **75,503** | **7.7** | **29,304** | **3.0** | **48,839** | **5.0** |
| First Washington State Bank | **34,729** | **7.2** | **14,564** | **3.0** | **24,273** | **5.0** |

***NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***

| **As of December 31, 2003** | Actual | | For Capital Adequacy Purposes | | Well-Capitalized | |
|---|---|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| | | | (dollars in thousands) | | | |
| Total Capital (to Risk Weighted Assets): | | | | | | |
| Corporation | $ 899,512 | 12.7% | $ 564,986 | 8.0% | $ 706,233 | 10.0% |
| Fulton Bank | 363,827 | 10.4 | 278,843 | 8.0 | 348,553 | 10.0 |
| Lebanon Valley Farmers Bank | 60,714 | 11.4 | 42,428 | 8.0 | 53,035 | 10.0 |
| Lafayette Ambassador Bank | 89,046 | 10.7 | 66,405 | 8.0 | 83,007 | 10.0 |
| The Bank | 78,769 | 11.1 | 56,583 | 8.0 | 70,729 | 10.0 |
| Premier Bank | 40,582 | 11.4 | 29,223 | 8.0 | 36,529 | 10.0 |
| Tier I Capital (to Risk Weighted Assets): | | | | | | |
| Corporation | $ 815,021 | 11.5% | $ 282,493 | 4.0% | $ 423,740 | 6.0% |
| Fulton Bank | 328,868 | 9.4 | 139,421 | 4.0 | 209,132 | 6.0 |
| Lebanon Valley Farmers Bank | 55,142 | 10.4 | 21,214 | 4.0 | 31,821 | 6.0 |
| Lafayette Ambassador Bank | 79,810 | 9.6 | 33,203 | 4.0 | 49,804 | 6.0 |
| The Bank | 71,506 | 10.1 | 28,292 | 4.0 | 42,437 | 6.0 |
| Premier Bank | 34,515 | 9.7 | 14,612 | 4.0 | 21,917 | 6.0 |
| Tier I Capital (to Average Assets): | | | | | | |
| Corporation | $ 815,021 | 8.8% | $ 279,565 | 3.0% | $ 465,941 | 5.0% |
| Fulton Bank | 328,868 | 8.3 | 119,252 | 3.0 | 198,753 | 5.0 |
| Lebanon Valley Farmers Bank | 55,142 | 6.9 | 24,058 | 3.0 | 40,096 | 5.0 |
| Lafayette Ambassador Bank | 79,810 | 6.6 | 36,102 | 3.0 | 60,171 | 5.0 |
| The Bank | 71,506 | 6.9 | 30,931 | 3.0 | 51,551 | 5.0 |
| Premier Bank | 34,515 | 6.6 | 15,589 | 3.0 | 25,981 | 5.0 |

## NOTE K – INCOME TAXES

The components of the provision for income taxes are as follows:

| | Year ended December 31 | | |
|---|---|---|---|
| | **2004** | 2003 | 2002 |
| | | (in thousands) | |
| Current tax expense: | | | |
| Federal | **$ 63,615** | $ 53,377 | $ 52,749 |
| State | **417** | 1,277 | 1,764 |
| | **64,032** | 54,654 | 54,513 |
| Deferred tax expense | **1,232** | 4,709 | 1,955 |
| | **$ 65,264** | $ 59,363 | $ 56,468 |

***NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***

The differences between the effective income tax rate and the Federal statutory income tax rate are as follows:

| | Year ended December 31 | | |
|---|---|---|---|
| | **2004** | 2003 | 2002 |
| Statutory tax rate | **35.0%** | 35.0% | 35.0% |
| Effect of tax-exempt income | **(2.8)** | (3.2) | (3.2) |
| Effect of low income housing investments | **(2.1)** | (2.0) | (2.1) |
| State income taxes, net of Federal benefit | **0.1** | 0.4 | 0.6 |
| Other | **(0.3)** | (0.1) | (0.5) |
| Effective income tax rate | **29.9%** | 30.1% | 29.8% |

The net deferred tax asset recorded by the Corporation is included in other assets and consists of the following tax effects of temporary differences at December 31:

| | **2004** | 2003 |
|---|---|---|
| | (in thousands) | |
| Deferred tax assets: | | |
| Allowance for loan losses | **$ 31,370** | $ 27,195 |
| Deferred compensation | **6,072** | 3,776 |
| Investments in low income housing | **2,724** | 2,951 |
| Post-retirement benefits | **3,403** | 3,318 |
| Other accrued expenses | **1,549** | 1,406 |
| Unrealized holding losses on securities available for sale | **5,155** | - |
| Other than temporary impairment of investments | **1,022** | 1,285 |
| Other | **1,541** | 767 |
| Total gross deferred tax assets | **52,836** | 40,698 |
| Deferred tax liabilities: | | |
| Direct leasing | **10,038** | 9,877 |
| Unrealized holding gains on securities available for sale | - | 6,620 |
| Mortgage servicing rights | **2,855** | 2,939 |
| Premises and equipment | **2,003** | 1,304 |
| Intangible assets | **5,014** | 2,723 |
| Other | **2,522** | 328 |
| Total gross deferred tax liabilities | **22,432** | 23,791 |
| Net deferred tax asset | **$ 30,404** | $ 16,907 |

The Corporation has net operating losses (NOL's) for income taxes in certain states that are eligible for carryforward credit against future taxable income for a specific number of years. The Corporation does not anticipate generating taxable income in these states during the carryforward years and, as such, deferred tax assets have not been recognized for these NOL's.

As of December 31, 2004 and 2003, the Corporation had not established any valuation allowance against net Federal deferred tax assets since these tax benefits are realizable either through carryback availability against prior years' taxable income or the reversal of existing deferred tax liabilities. Income tax benefits arising from the exercise of non-qualified stock options totaling $2.3 million in 2004, $730,000 in 2003 and $434,000 in 2002 are included in shareholders' equity.

***NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***

**NOTE L – EMPLOYEE BENEFIT PLANS**

Substantially all eligible employees of the Corporation are covered by one of the following plans or combination of plans:

*Profit Sharing Plan* – A noncontributory defined contribution plan where employer contributions are based on a formula providing for an amount not to exceed 15% of each eligible employee's annual salary (10% for employees hired subsequent to January 1, 1996). Participants are 100% vested in balances after five years of eligible service. In addition, the profit sharing plan includes a 401(k) feature which allows employees to defer a portion of their pre-tax salary on an annual basis, with no employer match. Contributions under this feature are 100% vested.

*Defined Benefit Pension Plans and 401(k) Plans* – Contributions to the Corporation's defined benefit pension plan (Pension Plan) are actuarially determined and funded annually. Pension Plan assets are invested in money markets, fixed income securities, including corporate bonds, U.S. Treasury securities and common trust funds, and equity securities, including common stocks and common stock mutual funds. The Pension Plan has been closed to new participants, but existing participants continue to accrue benefits according to the terms of the plan.

Employees covered under the Pension Plan are also eligible to participate in the Fulton Financial Affiliates 401(k) Savings Plan, which allows employees to defer a portion of their pre-tax salary on an annual basis. At its discretion, the Corporation may also make a matching contribution up to 3%. Participants are 100% vested in the Corporation's matching contributions after three years of eligible service.

The following summarizes the Corporation's expense under the above plans for the years ended December 31:

| | **2004** | 2003 | 2002 |
|---|---|---|---|
| | | (in thousands) | |
| Profit Sharing Plan | **$ 8,251** | $ 6,606 | $ 6,220 |
| Pension Plan | **3,072** | 3,025 | 1,812 |
| 401(k) Plan | **967** | 596 | 667 |
| | **$ 12,290** | $ 10,227 | $ 8,699 |

The net periodic pension cost for the Corporation's Pension Plan, as determined by consulting actuaries, consisted of the following components for the years ended December 31:

| | **2004** | 2003 | 2002 |
|---|---|---|---|
| | | (in thousands) | |
| Service cost | **$ 2,307** | $ 2,178 | $ 1,954 |
| Interest cost | **3,102** | 2,952 | 2,653 |
| Expected return on assets | **(3,001)** | (2,631) | (2,835) |
| Net amortization and deferral | **664** | 526 | 40 |
| Net periodic pension cost | **$ 3,072** | $ 3,025 | $ 1,812 |

***NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***

The measurement date for the Pension Plan is September 30. The following table summarizes the changes in the projected benefit obligation and fair value of plan assets for the indicated periods:

| | Plan Year Ended September 30 | |
|---|---|---|
| | **2004** | 2003 |
| | (in thousands) | |
| Projected benefit obligation, beginning | **$ 52,282** | $ 43,886 |
| Service cost | **2,307** | 2,178 |
| Interest cost | **3,102** | 2,952 |
| Benefit payments | **(1,270)** | (1,666) |
| Actuarial loss | **2,552** | 5,309 |
| Experience loss (gain) | **292** | (377) |
| Projected benefit obligation, ending | **$ 59,265** | $ 52,282 |
| Fair value of plan assets, beginning | **$ 37,980** | $ 33,288 |
| Employer contributions | **2,622** | 2,021 |
| Actual return on assets | **2,136** | 4,337 |
| Benefit payments | **(1,270)** | (1,666) |
| Fair value of plan assets, ending | **$ 41,468** | $ 37,980 |

The funded status of the Pension Plan and the amounts included in other liabilities as of December 31 follows:

| | **2004** | 2003 |
|---|---|---|
| | (in thousands) | |
| Projected benefit obligation | **$ (59,265)** | $ (52,282) |
| Fair value of plan assets | **41,468** | 37,980 |
| Funded status | **(17,797)** | (14,302) |
| Unrecognized net transition asset | **(51)** | (64) |
| Unrecognized prior service cost | **82** | 93 |
| Unrecognized net loss | **15,687** | 12,645 |
| Intangible asset | **(82)** | - |
| Accumulated other comprehensive loss | **(858)** | - |
| Pension liability recognized in the consolidated balance sheets | **$ (3,019)** | $ (1,628) |
| Accumulated benefit obligation | **$ 44,487** | $ 39,124 |

Accumulated other comprehensive income was reduced by $858,000 ($558,000, net of tax) as of December 31, 2004 to increase the pension liability to an amount equal to the difference between the accumulated benefit obligation and the fair value of plan assets.

***NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***

The following rates were used to calculate net periodic pension cost and the present value of benefit obligations:

| | **2004** | 2003 | 2002 |
|---|---|---|---|
| Discount rate-projected benefit obligation | **5.75%** | 6.00% | 6.75% |
| Rate of increase in compensation level | **4.50** | 4.50 | 5.00 |
| Expected long-term rate of return on plan assets | **8.00** | 8.00 | 8.00 |

The 8.0% long-term rate of return on plan assets used to calculate the net periodic pension cost and present value of benefit obligations is based on historical returns. Although plan assets generated a negative return in 2002, total returns for 2004 and 2003 approximated this rate. The expected long-term return is considered to be appropriate based on the asset mix and the historical returns realized.

The following table summarizes the weighted average asset allocations as of September 30:

| | **2004** | 2003 |
|---|---|---|
| Cash and equivalents | **6.0%** | 9.0% |
| Equity securities | **50.0** | 51.0 |
| Fixed income securities | **44.0** | 40.0 |
| Total | **100.0%** | 100.0% |

Equity securities consist mainly of equity common trust and mutual funds. Fixed income securities consist mainly of fixed income common trust funds. Defined benefit plan assets are invested with a balanced growth objective, with target asset allocations between 40 and 70 percent for equity securities and 30 to 60 percent for fixed income securities. The Corporation expects to contribute $2.3 million to the pension plan in 2005. Estimated future benefit payments are as follows (in thousands):

| Year | |
|---|---|
| 2005 | $ 1,217 |
| 2006 | 1,370 |
| 2007 | 1,411 |
| 2008 | 1,583 |
| 2009 | 1,761 |
| 2010 - 2014 | 13,376 |
| | $ 20,718 |

*Post-retirement Benefits*

The Corporation currently provides medical benefits and a death benefit to retired full-time employees who were employees of the Corporation prior to January 1, 1998. Full-time employees may become eligible for these discretionary benefits if they reach retirement while working for the Corporation. Benefits are based on a graduated scale for years of service after attaining the age of 40.

The components of the expense for post-retirement benefits other than pensions are as follows:

| | **2004** | 2003 | 2002 |
|---|---|---|---|
| | | (in thousands) | |
| Service cost | **$ 364** | $ 281 | $ 260 |
| Interest cost | **474** | 446 | 444 |
| Expected return on plan assets | **(2)** | (2) | (3) |
| Net amortization and deferral | **(230)** | (287) | (298) |
| Net post-retirement benefit cost | **$ 606** | $ 438 | $ 403 |

***NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***

The following table summarizes the changes in the accumulated post-retirement benefit obligation and fair value of plan assets for the years ended December 31:

| | 2004 | 2003 |
|---|---|---|
| | (in thousands) | |
| Accumulated post-retirement benefit obligation, beginning | **$ 7,815** | $ 7,104 |
| Service cost | **364** | 281 |
| Interest cost | **474** | 446 |
| Benefit payments | **(268)** | (324) |
| Change due to change in experience | **296** | (301) |
| Change due to change in assumptions | **248** | 609 |
| Accumulated post-retirement benefit obligation, ending | **$ 8,929** | $ 7,815 |
| Fair value of plan assets, beginning | **$ 165** | $ 171 |
| Employer contributions | **251** | 316 |
| Actual return on assets | **2** | 2 |
| Benefit payments | **(268)** | (324) |
| Fair value of plan assets, ending | **$ 150** | $ 165 |

The funded status of the plan and the amounts included in other liabilities as of December 31 follows:

| | 2004 | 2003 |
|---|---|---|
| | (in thousands) | |
| Accumulated post-retirement benefit obligation | **$ (8,929)** | $ (7,815) |
| Fair value of plan assets | **150** | 165 |
| Funded status | **(8,779)** | (7,650) |
| Unrecognized prior service cost | **(679)** | (905) |
| Unrecognized net gain | **(39)** | (586) |
| Post-retirement benefits liability recognized in the consolidated balance sheets | **$ (9,497)** | $ (9,141) |

For measuring the post-retirement benefit obligation, the annual increase in the per capita cost of health care benefits was assumed to be 8.5% in year one, declining to an ultimate rate of 4.5% by year nine. This health care cost trend rate has a significant impact on the amounts reported. Assuming a 1.0% increase in the health care cost trend rate above the assumed annual increase, the accumulated post-retirement benefit obligation would increase by approximately $1.1 million and the current period expense would increase by approximately $123,000. Conversely, a 1% decrease in the health care cost trend rate would decrease the accumulated post-retirement benefit obligation by approximately $904,000 and the current period expense by approximately $100,000.

The discount rate used in determining the accumulated post-retirement benefit obligation was 5.75% at December 31, 2004 and 6.00% at December 31, 2003. The expected long-term rate of return on plan assets was 3.00% at December 31, 2004 and 2003.

In December 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (Medicare Bill) was signed into law. The Medicare Bill expands Medicare benefits, primarily by adding a prescription drug benefit for Medicare-eligible retirees beginning in 2006. The impact of this benefit on the Corporation's post-retirement benefit obligation was a reduction of $143,000 at December 31, 2004.

***NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***

**NOTE M – STOCK-BASED COMPENSATION PLANS AND SHAREHOLDERS' EQUITY**

*Stock Option and Compensation Plan and Employee Stock Purchase Plan*
The Corporation has a Stock Option and Compensation Plan (Option Plan) and an Employee Stock Purchase Plan (ESPP). Under the Option Plan, options are granted to key personnel for terms of up to 10 years at option prices equal to the fair market value of the Corporation's stock on the date of grant. Options have been 100% vested immediately upon grant. The Plan has reserved 12.8 million additional shares for future grant through 2013. The number of options granted in any year is dependent upon the Corporation's performance relative to that of a self-defined peer group. A summary of stock option activity under the current and prior plans follows:

| | | Option Price Per Share | |
|---|---|---|---|
| | Stock Options | Range | Weighted Average |
| Balance at January 1, 2002 | 3,069,606 | $ 2.29 - $ 14.85 | $11.24 |
| Granted | 477,989 | 17.53 | 17.53 |
| Exercised | (394,244) | 5.12 - 14.86 | 8.73 |
| Canceled | (6,777) | 9.49 - 14.86 | 11.93 |
| Balance at December 31, 2002 | 3,146,574 | 2.29 - 17.53 | 12.51 |
| Granted | 481,793 | 18.95 - 19.20 | 18.95 |
| Exercised | (424,006) | 2.29 - 18.95 | 7.43 |
| Canceled | (33,802) | 12.99 - 17.52 | 14.16 |
| Assumed from Premier | 327,334 | 2.37 - 8.30 | 4.26 |
| Balance at December 31, 2003 | 3,497,893 | 2.37 - 19.20 | 13.22 |
| **Granted** | **1,043,800** | **20.19** | **20.19** |
| **Exercised** | **(1,110,991)** | **2.37 - 20.19** | **8.39** |
| **Canceled** | **(2,544)** | **4.23 - 18.95** | **15.62** |
| **Assumed from Resource** | **941,183** | **2.70 - 18.23** | **6.08** |
| **Assumed from First Washington** | **903,350** | **3.52 - 21.46** | **7.87** |
| **Balance at December 31, 2004** | **5,272,691** | **2.37 - 21.46** | **13.43** |
| **Exercisable at December 31, 2004** | **5,244,437** | **$2.37 - $21.46** | **$13.46** |

***NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***

The following table summarizes information concerning options outstanding at December 31, 2004:

| Range of Exercise Prices | Total Unexercised Stock Options | Weighted Average Remaining Life (Years) | Weighted Average Exercise Price | Exercisable Stock Options |
|---|---|---|---|---|
| $ 0.00 - $ 5.00 | 520,661 | 2.77 | $ 3.39 | 520,661 |
| $ 5.00 - $10.00 | 1,245,227 | 4.54 | 7.74 | 1,216,973 |
| $10.00 - $15.00 | 1,581,091 | 5.37 | 14.08 | 1,581,091 |
| $15.00 - $20.00 | 894,911 | 8.11 | 18.25 | 894,911 |
| $20.00 - $25.00 | 1,030,801 | 9.58 | 20.19 | 1,030,801 |
| | 5,272,691 | 6.21 | $ 13.43 | 5,244,437 |

The ESPP allows eligible employees to purchase stock of the Corporation at 85% of the fair market value of the stock on the date of exercise. Under the terms of the ESPP, 84,000 shares, 85,000 shares and 92,000 shares were issued in 2004, 2003 and 2002, respectively. A total of 1.6 million shares have been issued since the inception of the ESPP in 1986. As of December 31, 2004, 318,000 shares have been reserved for future issuances under the ESPP.

The Corporation accounts for both the Option Plan and the ESPP under APB 25 and, accordingly, no compensation expense is reflected in net income. Had compensation cost for these plans been recorded consistent with the fair value provisions of Statement 123, the Corporation's net income and net income per share would have been reduced to the following pro-forma amounts:

| | **2004** | 2003 | 2002 |
|---|---|---|---|
| | (in thousands, except per-share data) | | |
| Net income as reported | **$ 152,917** | $ 138,180 | $ 132,948 |
| Stock-based employee compensation expense under the fair value method, net of tax | **(3,309)** | (1,813) | (1,993) |
| Pro-forma net income | **$ 149,608** | $ 136,367 | $ 130,955 |
| Net income per share (basic) | **$ 1.28** | $ 1.23 | $ 1.17 |
| Pro-forma net income per share (basic) | **1.25** | 1.21 | 1.16 |
| Net income per share (diluted) | **$ 1.27** | $ 1.22 | $ 1.17 |
| Pro-forma net income per share (diluted) | **1.24** | 1.21 | 1.15 |
| Weighted average fair value of options granted | **$ 3.48** | $ 3.84 | $ 4.26 |

The fair value of each option grant was estimated on the date of grant using the Black-Scholes option pricing model and the following assumptions:

| | **2004** | 2003 | 2002 |
|---|---|---|---|
| Risk-free interest rate | **4.22%** | 3.55% | 4.78% |
| Volatility of Corporation's stock | **18.12** | 22.75 | 23.64 |
| Expected dividend yield | **3.22** | 3.22 | 3.10 |
| Expected life of options | **7 Years** | 8 Years | 8 Years |

***NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***

*Shareholder Rights*
On June 20, 1989, the Board of Directors of the Corporation declared a dividend of one common share purchase right (Original Rights) for each outstanding share of common stock, par value $2.50 per share, of the Corporation. The dividend was paid to the shareholders of record as of the close of business on July 6, 1989. On April 27, 1999, the Board of Directors approved an amendment to the Original Rights and the rights agreement. The significant terms of the amendment included extending the expiration date from June 20, 1999 to April 27, 2009 and resetting the purchase price to $90.00 per share. As of December 31, 2004, the purchase price had adjusted to $53.85 per share as a result of stock dividends.

The Rights are not exercisable or transferable apart from the common stock prior to distribution. Distribution of the Rights will occur ten business days following (1) a public announcement that a person or group of persons ("Acquiring Person") has acquired or obtained the right to acquire beneficial ownership of 20% or more of the outstanding shares of common stock (the "Stock Acquisition Date") or (2) the commencement of a tender offer or exchange offer that would result in a person or group beneficially owning 25% or more of such outstanding shares of common stock. The Rights are redeemable in full, but not in part, by the Corporation at any time until ten business days following the Stock Acquisition Date, at a price of $0.01 per Right.

*Treasury Stock*
The Corporation periodically repurchases shares of its common stock under repurchase plans approved by the Board of Directors. These repurchases have typically been through open market transactions and have complied with all regulatory restrictions on the timing and amount of such repurchases. Shares repurchased have been added to treasury stock and are accounted for at cost. These shares are periodically reissued for stock option exercises, ESPP purchases, acquisitions or other corporate needs.

On November 19, 2004, the Corporation purchased 1.0 million shares of its common stock from an investment bank at a total cost of $22.0 million under an “Accelerated Share Repurchase” program (ASR), which allowed the shares to be purchased immediately rather than over time. The investment bank, in turn, is repurchasing shares on the open market over a period that is determined by the average daily trading volume of our shares, among other factors. The Corporation periodically settles its position with the investment bank by paying or receiving cash in an amount representing the difference between the initial price and the actual price of the shares repurchased. The Corporation expects the ASR to be completed during 2005.

Total treasury stock purchases, including both open market purchases and the ASR, totaled approximately 3.8 million shares in 2004, 3.2 million shares in 2003 and 2.8 million shares in 2002.

## NOTE N – LEASES

Certain branch offices and equipment are leased under agreements that expire at varying dates through 2025. Most leases contain renewal provisions at the Corporation's option. Total rental expense was approximately $9.4 million in 2004, $6.4 million in 2003 and $5.9 million in 2002. Future minimum payments as of December 31, 2004 under noncancelable operating leases are as follows (in thousands):

| Year | |
|---|---|
| 2005 | $ 8,051 |
| 2006 | 7,453 |
| 2007 | 6,508 |
| 2008 | 4,867 |
| 2009 | 3,725 |
| Thereafter | 19,752 |
| | $ 50,356 |

## NOTE O – COMMITMENTS AND CONTINGENCIES

The Corporation is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit, which involve, to varying degrees, elements of credit and interest rate risk that are not recognized in the consolidated balance sheets.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since a portion of the commitments is expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Corporation evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained upon extension of credit is based on management's credit evaluation of the customer. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment and income producing commercial properties.

Standby letters of credit are conditional commitments issued to guarantee the financial or performance obligation of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Corporation underwrites these obligations using the same criteria as its commercial lending underwriting. The Corporation’s maximum exposure to loss for standby letters of credit is equal to the contractual (or notional) amount of the instruments.

From time to time, the Corporation and its subsidiary banks may be defendants in legal proceedings relating to the conduct of their banking business. Most of such legal proceedings are a normal part of the banking business, and in management's opinion, the financial position and results of operations and cash flows of the Corporation would not be affected materially by the outcome of such legal proceedings.

The following table presents the Corporation’s commitments to extend credit and letters of credit:

| | **2004** | 2003 |
|---|---|---|
| | (in thousands) | |
| Commercial mortgage, construction and land development | **$ 689,818** | $ 297,156 |
| Home equity | **412,790** | 333,139 |
| Credit card | **384,504** | 314,532 |
| Commercial and other | **1,851,159** | 1,617,108 |
| Total commitments to extend credit | **$ 3,338,271** | $ 2,561,935 |
| | | |
| Standby letters of credit | **$ 533,094** | $ 483,522 |
| Commercial letters of credit | **24,312** | 16,992 |
| Total letters of credit | **$ 557,406** | $ 500,514 |

*NOTES TO CONSOLIDATED FINANCIAL STATEMENTS*

**NOTE P – FAIR VALUE OF FINANCIAL INSTRUMENTS**

The following are the estimated fair values of the Corporation's financial instruments as of December 31, 2004 and 2003, followed by a general description of the methods and assumptions used to estimate such fair values. These fair values are significantly affected by assumptions used, principally the timing of future cash flows and the discount rate. Because assumptions are inherently subjective in nature, the estimated fair values cannot be substantiated by comparison to independent market quotes and, in many cases, the estimated fair values could not necessarily be realized in an immediate sale or settlement of the instrument. Further, certain financial instruments and all non-financial instruments are excluded. Accordingly, the aggregate fair value amounts presented do not necessarily represent management's estimation of the underlying value of the Corporation.

| | **2004** | | 2003 | |
|---|---|---|---|---|
| **FINANCIAL ASSETS** | **Book Value** | **Estimated Fair Value** | Book Value | Estimated Fair Value |
| | (in thousands) | | | |
| Cash and due from banks | **$ 278,065** | **$ 278,065** | $ 300,966 | $ 300,966 |
| Interest-bearing deposits with other banks | **4,688** | **4,688** | 4,559 | 4,559 |
| Federal funds sold | **32,000** | **32,000** | - | - |
| Mortgage loans held for sale | **158,872** | **158,872** | 32,761 | 32,761 |
| Securities held to maturity | **25,001** | **25,413** | 22,993 | 23,739 |
| Securities available for sale | **2,424,858** | **2,424,858** | 2,904,157 | 2,904,157 |
| Net loans | **7,584,547** | **7,669,736** | 6,082,294 | 6,187,091 |
| Accrued interest receivable | **40,633** | **40,633** | 34,407 | 34,407 |
| **FINANCIAL LIABILITIES** | | | | |
| Demand and savings deposits | **$ 4,926,476** | **$ 4,926,476** | $ 4,303,635 | $ 4,303,635 |
| Time deposits | **2,969,048** | **2,974,551** | 2,448,148 | 2,480,789 |
| Short-term borrowings | **1,194,524** | **1,194,524** | 1,396,711 | 1,396,711 |
| Accrued interest payable | **27,279** | **27,279** | 24,579 | 24,579 |
| Other financial liabilities | **29,640** | **29,640** | 26,769 | 26,769 |
| Federal Home Loan Bank advances and long-term debt | **684,236** | **710,215** | 568,730 | 560,699 |

For short-term financial instruments, defined as those with remaining maturities of 90 days or less, the carrying amount was considered to be a reasonable estimate of fair value. The following instruments are predominantly short-term:

| **Assets** | **Liabilities** |
|---|---|
| Cash and due from banks | Demand and savings deposits |
| Interest bearing deposits | Short-term borrowings |
| Federal funds sold | Accrued interest payable |
| Accrued interest receivable | Other financial liabilities |
| Mortgage loans held for sale | |

For those components of the above-listed financial instruments with remaining maturities greater than 90 days, fair values were determined by discounting contractual cash flows using rates which could be earned for assets with similar remaining maturities and, in the case of liabilities, rates at which the liabilities with similar remaining maturities could be issued as of the balance sheet date.

As indicated in Note A, "Summary of Significant Accounting Policies", securities available for sale are carried at their estimated fair values. The estimated fair values of securities held to maturity as of December 31, 2004 and 2003 were generally based on quoted market prices, broker quotes or dealer quotes.

For short-term loans and variable rate loans that reprice within 90 days, the carrying value was considered to be a reasonable estimate of fair value. For other types of loans, fair value was estimated by discounting future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. In addition, for loans secured by real estate, appraisal values for the collateral were considered in the fair value determination.

The fair value of long-term debt was estimated by discounting the remaining contractual cash flows using a rate at which the Corporation could issue debt with a similar remaining maturity as of the balance sheet date. The fair value of commitments to extend credit and standby letters of credit is estimated to equal their carrying amounts.

## NOTE Q – MERGERS AND ACQUISITIONS

*Completed Acquisitions*

On December 31, 2004, the Corporation acquired all of the outstanding common stock of First Washington FinancialCorp (First Washington), of Windsor, New Jersey. First Washington was a $490 million bank holding company whose primary subsidiary was First Washington State Bank, which operates sixteen community-banking offices in Mercer, Monmouth, and Ocean Counties in New Jersey. This acquisition enabled the Corporation to expand and enhance its existing New Jersey franchise.

The total purchase price was $125.8 million including $125.2 million in stock issued and options assumed and $610,000 in First Washington stock purchased for cash and other direct acquisition costs. The Corporation issued 1.35 shares of its stock for each of the 4.3 million shares of First Washington outstanding on the acquisition date. The purchase price was determined based on the value of the Corporation's stock on the date when the final terms of the acquisition were agreed to and announced.

The acquisition was accounted for as a purchase and the Corporation's consolidated balance sheet includes First Washington balances as of December 31, 2004. Since this acquisition occurred on the last day of the year, the Corporation's results of operations do not include First Washington. The following is a summary of the preliminary purchase price allocation based on estimated fair values on the acquisition date (in thousands):

| | |
|---|---|
| Cash and due from banks | $ 14,823 |
| Other earning assets | 17,719 |
| Investment securities available for sale | 206,068 |
| Loans, net of allowance | 241,520 |
| Premises and equipment | 12,110 |
| Core deposit intangible asset | 6,685 |
| Trade name intangible asset | 417 |
| Goodwill | 84,183 |
| Other assets | 1,089 |
| Total assets acquired | 584,614 |
| Deposits | 426,474 |
| Short-term borrowings | 16,560 |
| Long-term debt | 13,483 |
| Other liabilities | 2,262 |
| Total liabilities assumed | 458,779 |
| Net assets acquired | $ 125,835 |

In August 2004, the Corporation acquired Penn Business Credit, Inc. (PBC), a finance company with approximately $10.0 million of commercial loans located in Bala Cynwyd, PA. The Corporation paid approximately $6.1 million in cash and recorded $4.4 million in

***NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***

goodwill, representing the excess of the purchase price over the fair value of the net assets acquired. The goodwill recorded for this acquisition is being deducted for Federal income tax purposes on a straight-line basis over 15 years. PBC became a wholly owned subsidiary of Fulton Bank.

On April 1, 2004, the Corporation acquired all of the outstanding common stock of Resource Bankshares Corporation (Resource), an $889 million financial holding company, and its primary subsidiary, Resource Bank. The total purchase price was $195.7 million, including $185.9 million in stock issued and options assumed, and $9.8 million in Resource stock purchased for cash and other direct acquisition costs. The Corporation issued 1.54 shares of its stock for each of the 5.9 million shares of Resource outstanding on the acquisition date. The purchase price was determined based on the value of the Corporation's stock on the date when the final terms of the acquisition were agreed to and announced.

Resource Bank is located in Virginia Beach, Virginia, and operates six community-banking offices in Newport News, Chesapeake, Herndon, Virginia Beach, and Richmond, Virginia and 14 loan production and residential mortgage offices in Virginia, North Carolina, Maryland and Florida. This acquisition allowed the Corporation to enter a new geographic market.

The acquisition was accounted for as a purchase and the Corporation's results of operations include Resource from the date of acquisition. The following is a summary of the purchase price allocation based on estimated fair values on the acquisition date (in thousands):

| | |
|---|---|
| Cash and due from banks | $ 11,497 |
| Other earning assets | 5,222 |
| Mortgage loans held for sale | 94,546 |
| Investment securities available for sale | 125,473 |
| Loans, net of allowance | 619,118 |
| Premises and equipment | 10,272 |
| Core deposit intangible asset | 1,450 |
| Trade name intangible asset | 484 |
| Goodwill | 146,062 |
| Other assets | 28,690 |
| Total assets acquired | 1,042,814 |
| Deposits | 598,389 |
| Short-term borrowings | 111,195 |
| Long-term debt | 120,532 |
| Other liabilities | 17,006 |
| Total liabilities assumed | 847,122 |
| Net assets acquired | $ 195,692 |

On August 1, 2003, the Corporation acquired all of the outstanding common stock of Premier Bancorp, Inc. (Premier), a $600 million financial holding company, and its wholly-owned subsidiary, Premier Bank. The total purchase price was $92.0 million, including $2.1 million of direct acquisition costs. The Corporation issued 1.477 shares of its stock for each of the 3.4 million shares of Premier outstanding on the acquisition date. The purchase price was determined based on the value of the Corporation's stock on the date when the final terms of the acquisition were agreed to and announced.

Premier Bank is located in Doylestown, Pennsylvania and the eight community banking offices in Bucks, Northampton and Montgomery Counties, Pennsylvania acquired by the Corporation in this transaction complement its existing retail banking network. The acquisition was accounted for as a purchase and the Corporation's results of operations include Premier from the date of the acquisition.

***NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***

The following table summarizes unaudited pro-forma information assuming the acquisitions of First Washington, Resource and Premier had occurred on January 1, 2003. This pro-forma information includes certain adjustments, including amortization related to fair value adjustments recorded in purchase accounting (in thousands, except per-share information):

| | **2004** | 2003 |
|---|---|---|
| Net interest income | **$ 381,251** | $ 354,424 |
| Other income | **147,764** | 163,352 |
| Net income | **159,378** | 153,851 |
| Per Share: | | |
| Net income (basic) | **$ 1.25** | $ 1.18 |
| Net income (diluted) | **1.23** | 1.16 |

*Pending Acquisition*
On January 11, 2005, the Corporation entered into a merger agreement to acquire SVB Financial Services (SVB), of Somerville, New Jersey. SVB is a $475 million bank holding company whose primary subsidiary is Somerset Valley Bank, which operates eleven community-banking offices in Somerset, Hunterdon and Middlesex Counties in New Jersey.

Under the terms of the merger agreement, each of the approximately 4.1 million shares of SVB's common stock will be acquired based on a "cash election merger" structure. Each SVB shareholder will have the ability to elect to receive 100% of the merger consideration in stock, 100% in cash, or a combination of FFC stock and cash. Their elections will be subject to prorating to achieve a result where a minimum of 20% and a maximum of 40% of SVB's outstanding shares will receive cash consideration. Those shares that will be converted into FFC stock would be exchanged based on a fixed exchange ratio of 0.9519 shares of FFC stock for each share of SVB stock. Those shares of SVB stock that will be converted into cash will be converted into a per share amount of cash based on a fixed price of $21.00 per share of SVB stock. In addition, each of the options to acquire SVB's stock will be converted to options to purchase the Corporation's stock.

The acquisition is subject to approval by both the SVB shareholders and applicable bank regulatory authorities. The acquisition is expected to be completed during the third quarter of 2005. As a result of the acquisition, SVB will be merged into the Corporation and Somerset Valley Bank will become a wholly owned subsidiary.

The acquisition will be accounted for as a purchase. Purchase accounting requires the Corporation to allocate the total purchase price of the acquisition to the assets acquired and liabilities assumed, based on their respective fair values at the acquisition date, with any remaining acquisition cost being recorded as goodwill. Resulting goodwill balances are then subject to an impairment review on at least an annual basis. The results of SVB's operations will be included in the Corporation's financial statements prospectively from the date of the acquisition.

The total purchase price is estimated to be approximately $89.0 million, which includes cash paid, the value of the Corporation's stock to be issued, SVB's options to be converted and certain acquisition related costs. The net assets of SVB as of December 31, 2004 were $29.4 million and accordingly, the purchase price exceeds the carrying value of the net assets by $59.6 million as of this date. The total purchase price will be allocated to the net assets acquired as of the merger effective date, based on fair market values at that date. The Corporation expects to record a core deposit intangible asset and goodwill as a result of the acquisition accounting.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## NOTE R – CONDENSED FINANCIAL INFORMATION - PARENT COMPANY ONLY

### CONDENSED BALANCE SHEETS

(in thousands)

| | December 31 | |
|---|---|---|
| | **2004** | 2003 |
| **ASSETS** | | |
| Cash, securities, and other assets | **$ 4,943** | $ 8,186 |
| Receivable from subsidiaries | **777** | 96 |
| Investment in: | | |
| Bank subsidiaries | **1,183,856** | 775,074 |
| Non-bank subsidiaries | **250,901** | 235,431 |
| *Total Assets* | **$ 1,440,477** | $ 1,018,787 |

| | December 31 | |
|---|---|---|
| | **2004** | 2003 |
| **LIABILITIES AND EQUITY** | | |
| Line of credit with bank subsidiaries | **$ 70,500** | $ 2,878 |
| Revolving line of credit | **11,930** | - |
| Long-term debt | **34,955** | 34,717 |
| Payable to non-bank subsidiaries | **48,117** | 5,662 |
| Other liabilities | **32,685** | 28,594 |
| *Total Liabilities* | **198,187** | 71,851 |
| Shareholders' equity | **1,242,290** | 946,936 |
| *Total Liabilities and Shareholders' Equity* | **$ 1,440,477** | $ 1,018,787 |

### CONDENSED STATEMENTS OF INCOME

| | Year ended December 31 | | |
|---|---|---|---|
| | **2004** | 2003 | 2002 |
| | | (in thousands) | |
| Income: | | | |
| Dividends from bank subsidiaries | **$ 62,131** | $ 149,596 | $ 100,161 |
| Other | **40,227** | 38,206 | 32,531 |
| | **102,358** | 187,802 | 132,692 |
| Expenses | **54,663** | 48,180 | 43,883 |
| *Income before income taxes and equity in undistributed net income of subsidiaries* | **47,695** | 139,622 | 88,809 |
| Income tax benefit | **(5,829)** | (3,898) | (4,171) |
| | **53,524** | 143,520 | 92,980 |
| Equity in undistributed net income (loss) of: | | | |
| Bank subsidiaries | **84,525** | (20,879) | 29,694 |
| Non-bank subsidiaries | **14,868** | 15,539 | 10,274 |
| *Net Income* | **$ 152,917** | $ 138,180 | $ 132,948 |

***NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***

**CONDENSED STATEMENTS OF CASH FLOWS**

| | Year Ended December 31 | | |
|---|---|---|---|
| | **2004** | 2003 | 2002 |
| | | (in thousands) | |
| Cash Flows From Operating Activities: | | | |
| Net Income | **$ 152,917** | $ 138,180 | $ 132,948 |
| Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities: | | | |
| (Increase) decrease in other assets | **(12,588)** | 1,499 | (2,107) |
| (Increase) decrease in investment in subsidiaries | **(99,393)** | 5,340 | (39,968) |
| Increase (decrease) in other liabilities and payable to non-bank subsidiaries | **36,859** | (4,098) | 5,249 |
| *Total adjustments* | **(75,122)** | 2,741 | (36,826) |
| *Net cash provided by operating activities* | **77,795** | 140,921 | 96,122 |
| Cash Flows From Investing Activities: | | | |
| Investment in bank subsidiaries | **(6,000)** | (3,500) | (3,500) |
| Net cash paid for acquisitions | **(5,283)** | (1,544) | - |
| *Net cash used in investing activities* | **(11,283)** | (5,044) | (3,500) |
| Cash Flows From Financing Activities: | | | |
| Net increase (decrease) in borrowings | **79,552** | (16,678) | 9,056 |
| Dividends paid | **(74,802)** | (64,628) | (58,954) |
| Net proceeds from issuance of common stock | **7,712** | 5,122 | 3,304 |
| Acquisition of treasury stock | **(78,966)** | (59,699) | (46,133) |
| *Net cash used in financing activities* | **(66,504)** | (135,883) | (92,727) |
| Net Increase (Decrease) in Cash and Cash Equivalents | **8** | (6) | (105) |
| Cash and Cash Equivalents at Beginning of Year | **-** | 6 | 111 |
| Cash and Cash Equivalents at End of Year | **$ 8** | $ - | $ 6 |
| Cash paid during the year for: | | | |
| Interest | **$ 2,889** | $ 2,469 | $ 1,791 |
| Income taxes | **54,457** | 48,924 | 49,621 |

**Management Report on Internal Control Over Financial Reporting**

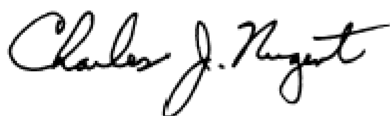
The management of Fulton Financial Corporation is responsible for establishing and maintaining adequate internal control over financial reporting. Fulton Financial Corporation's internal control system is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2004, using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control – Integrated Framework. A discussion of the scope of management's assessment is included in Note A in the accompanying financial statements. Based on this assessment, management concluded that, as of December 31, 2004, the company's internal control over financial reporting is effective based on those criteria.

Management's assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2004 has been audited by KPMG LLP, an independent registered public accounting firm, as stated in their report which is included herein.

Rufus A. Fulton, Jr.
Chairman and Chief Executive Officer



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

**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Stockholders
Fulton Financial Corporation:

We have audited management's assessment, included in the accompanying Management Report on Internal Control Over Financial Reporting, that Fulton Financial Corporation maintained effective internal control over financial reporting as of December 31, 2004, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Fulton Financial Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Fulton Financial Corporation maintained effective internal control over financial reporting as of December 31, 2004, is fairly stated, in all material respects, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also, in our opinion, Fulton Financial Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2004, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Fulton Financial Corporation acquired First Washington FinancialCorp. on December 31, 2004, and management excluded from its assessment of the effectiveness of Fulton Financial Corporation's internal control over financial reporting as of December 31, 2004, First Washington FinancialCorp.'s internal control over financial reporting associated with total assets of approximately $585 million and total revenues of $0 included in the consolidated financial statements of Fulton Financial Corporation as of and for the year ended December 31, 2004. Our audit of internal control over financial reporting of Fulton Financial Corporation also excluded an evaluation of the internal control over financial reporting of First Washington FinancialCorp.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Fulton Financial Corporation and subsidiaries as of December 31, 2004 and 2003, and the related consolidated statements of income, shareholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2004, and our report dated February 22, 2005 expressed an unqualified opinion on those consolidated financial statements.

KPMG LLP

Harrisburg, Pennsylvania
February 22, 2005

## Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Fulton Financial Corporation:

We have audited the accompanying consolidated balance sheets of Fulton Financial Corporation and subsidiaries as of December 31, 2004 and 2003, and the related consolidated statements of income, shareholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2004. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Fulton Financial Corporation and subsidiaries as of December 31, 2004 and 2003, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2004, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Fulton Financial Corporation's internal control over financial reporting as of December 31, 2004, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 22, 2005 expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

KPMG LLP

Harrisburg, Pennsylvania
February 22, 2005

**QUARTERLY CONSOLIDATED RESULTS OF OPERATIONS (UNAUDITED)**
**(in thousands, except per-share data)**

| | Three Months Ended | | | |
|---|---|---|---|---|
| | March 31 | June 30 | Sept. 30 | Dec. 31 |
| **FOR THE YEAR 2004** | | | | |
| Interest income | **$ 113,936** | **$ 122,024** | **$ 126,947** | **$ 130,736** |
| Interest expense | **30,969** | **33,318** | **34,446** | **37,261** |
| Net interest income | **82,967** | **88,706** | **92,501** | **93,475** |
| Provision for loan losses | **1,740** | **800** | **1,125** | **1,052** |
| Other income | **32,038** | **36,663** | **34,994** | **35,169** |
| Other expenses | **62,272** | **70,538** | **70,335** | **70,470** |
| Income before income taxes | **50,993** | **54,031** | **56,035** | **57,122** |
| Income taxes | **15,147** | **16,167** | **16,915** | **17,035** |
| Net income | **$ 35,846** | **$ 37,864** | **$ 39,120** | **$ 40,087** |
| Per-share data: | | | | |
| Net income (basic) | **$ 0.32** | **$ 0.31** | **$ 0.32** | **$ 0.33** |
| Net income (diluted) | **0.31** | **0.31** | **0.32** | **0.33** |
| Cash dividends | **0.152** | **0.165** | **0.165** | **0.165** |
| | | | | |
| **FOR THE YEAR 2003** | | | | |
| Interest income | $ 110,184 | $ 107,166 | $ 105,907 | $ 112,274 |
| Interest expense | 34,546 | 32,796 | 32,128 | 31,624 |
| Net interest income | 75,638 | 74,370 | 73,779 | 80,650 |
| Provision for loan losses | 2,835 | 2,490 | 2,190 | 2,190 |
| Other income | 31,048 | 33,862 | 36,629 | 32,831 |
| Other expenses | 55,265 | 57,393 | 58,666 | 60,235 |
| Income before income taxes | 48,586 | 48,349 | 49,552 | 51,056 |
| Income taxes | 14,543 | 14,287 | 15,170 | 15,363 |
| Net income | $ 34,043 | $ 34,062 | $ 34,382 | $ 35,693 |
| Per-share data: | | | | |
| Net income (basic) | $ 0.30 | $ 0.30 | $ 0.30 | $ 0.31 |
| Net income (diluted) | 0.30 | 0.30 | 0.30 | 0.31 |
| Cash dividends | 0.136 | 0.152 | 0.152 | 0.152 |