

1ST SOURCE CORP

FORM 10-Q (Quarterly Report)

Filed 7/28/2006 For Period Ending 6/30/2006

Address	100 NORTH MICHIGAN STREET SOUTH BEND, Indiana 46601
Telephone	574-235-2702
CIK	0000034782
Industry	Regional Banks
Sector	Financial
Fiscal Year	12/31

Powered By **EDGAR**Online

<http://www.edgar-online.com/>

© Copyright 2006. All Rights Reserved.

Distribution and use of this document restricted under EDGAR Online's Terms of Use.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2006 OR

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

For the transition period from _____ to _____

Commission file number 0-6233

1st SOURCE CORPORATION

(Exact name of registrant as specified in its charter)

INDIANA

(State or other jurisdiction of
incorporation or organization)

35-1068133

(I.R.S. Employer
Identification No.)

100 North Michigan Street South Bend, Indiana 46601
(Address of principal executive offices) (Zip Code)

(574) 235-2000
(Registrant's telephone number, including area code)

Not Applicable
(Former name, former address and former fiscal year,
if changed since last report.)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes **[X]** No _____

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

Large accelerated filer ____ Accelerated filer **[X]** Non-accelerated filer ____

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes _____ No **[X]**

Number of shares of common stock outstanding as of July 24, 2006 - 20,448,581 shares

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION	
Item 1. Financial Statements (Unaudited)	Page
Consolidated statements of financial condition -- June 30, 2006, and December 31, 2005	3
Consolidated statements of income -- three months and six months ended June 30, 2006 and 2005	4
Consolidated statements of changes in shareholders' equity six months ended June 30, 2006 and 2005	5
Consolidated statements of cash flows -- six months ended June 30, 2006 and 2005	6
Notes to the Consolidated Financial Statements	7
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	12
Item 3. Quantitative and Qualitative Disclosures About Market Risk	22
Item 4. Controls and Procedures	22
PART II. OTHER INFORMATION	
Item 1. Legal Proceedings	22
Item 1A. Risk Factors	22
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	23
Item 3. Defaults Upon Senior Securities	23
Item 4. Submission of Matters to a Vote of Security Holders	23
Item 5. Other Information	24
Item 6. Exhibits	24
SIGNATURES	25

1st SOURCE CORPORATION
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(Unaudited - Dollars in thousands)

	June 30, 2006	December 31, 2005
ASSETS		
Cash and due from banks	\$ 118,884	\$ 124,817
Federal funds sold and interest bearing deposits with other banks	2,320	68,578
Investment securities available-for-sale (amortized cost of \$635,176 and \$637,878 at June 30, 2006 and December 31, 2005, respectively)	628,366	632,625
Trading account securities	300	-
Mortgages held for sale	82,018	67,224
Loans and leases - net of unearned discount:		
Commercial and agricultural loans	491,334	453,197
Auto, light truck and environmental equipment	337,497	310,786
Medium and heavy duty truck	319,845	302,137
Aircraft financing	453,470	459,645
Construction equipment financing	273,621	224,230
Loans secured by real estate	618,204	601,077
Consumer loans	121,181	112,359
Total loans and leases	2,615,152	2,463,431
Reserve for loan and lease losses	(59,197)	(58,697)
Net loans and leases	2,555,955	2,404,734
Equipment owned under operating leases, net	67,647	58,250
Net premises and equipment	37,414	37,710
Accrued income and other assets	115,622	117,339
Total assets	\$ 3,608,526	\$ 3,511,277
LIABILITIES		
Deposits:		
Noninterest bearing	\$ 379,230	\$ 393,494
Interest bearing	2,435,379	2,352,093
Total deposits	2,814,609	2,745,587
Federal funds purchased and securities sold under agreements to repurchase	217,923	230,756
Other short-term borrowings	67,799	46,713
Long-term debt and mandatorily redeemable securities	33,554	23,237
Subordinated notes	59,022	59,022
Accrued expenses and other liabilities	63,307	60,386
Total liabilities	3,256,214	3,165,701
SHAREHOLDERS' EQUITY		
Preferred stock; no par value	-	-
Authorized 10,000,000 shares; none issued or outstanding		
Common stock; no par value		
Authorized 40,000,000 shares; issued 23,781,901 at June 30, 2006 and 23,778,780 at December 31, 2005, less unearned shares (263,369 at June 30, 2006 and 260,248 at December 31, 2005)*	7,578	7,578
Capital surplus	214,001	214,001
Retained earnings	154,339	139,601
Cost of common stock in treasury (1,030,812 shares at June 30, 2006, and 782,428 shares at December 31, 2005)*	(19,405)	(12,364)
Accumulated other comprehensive loss	(4,201)	(3,240)
Total shareholders' equity	352,312	345,576
Total liabilities and shareholders' equity	\$ 3,608,526	\$ 3,511,277

*Per share data gives retroactive recognition to a 10% stock dividend declared on July 27, 2006.

The accompanying notes are a part of the consolidated financial statements.

1st SOURCE CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited - Dollars in thousands, except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Interest income:				
Loans and leases	\$ 44,421	\$ 35,465	\$ 85,309	\$ 69,102
Investment securities, taxable	4,797	3,915	8,722	7,733
Investment securities, tax-exempt	1,292	1,336	2,559	2,600
Other	271	127	587	204
Total interest income	50,781	40,843	97,177	79,639
Interest expense:				
Deposits	19,283	13,330	36,316	25,646
Short-term borrowings	2,822	2,006	5,582	3,708
Subordinated notes	1,080	1,000	2,130	1,964
Long-term debt and mandatorily redeemable securities	451	305	905	515
Total interest expense	23,636	16,641	44,933	31,833
Net interest income	27,145	24,202	52,244	47,806
Recovery of provision for loan and lease losses	(1,671)	(3,411)	(1,971)	(3,832)
Net interest income after recovery of provision for loan and lease losses	28,816	27,613	54,215	51,638
Noninterest income:				
Trust fees	3,658	3,285	7,049	6,531
Service charges on deposit accounts	4,917	4,251	9,303	8,214
Mortgage banking income	3,105	1,551	4,862	4,318
Insurance commissions	932	833	2,614	1,997
Equipment rental income	4,658	3,927	8,878	7,942
Other income	1,647	1,546	3,133	3,182
Investment securities and other investment gains	150	5	2,233	909
Total noninterest income	19,067	15,398	38,072	33,093
Noninterest expense:				
Salaries and employee benefits	16,873	17,090	32,387	35,634
Net occupancy expense	1,860	1,732	3,727	3,834
Furniture and equipment expense	2,959	2,844	6,093	5,486
Depreciation - leased equipment	3,547	3,194	6,929	6,517
Supplies and communication	1,307	1,321	2,670	2,664
Other expense	5,840	4,445	9,986	8,165
Total noninterest expense	32,386	30,626	61,792	62,300
Income before income taxes	15,497	12,385	30,495	22,431
Income tax expense	5,220	4,158	10,285	7,260
Net income	\$ 10,277	\$ 8,227	\$ 20,210	\$ 15,171
Other comprehensive (loss) income, net of tax:				
Change in unrealized (depreciation) appreciation of available-for-sale securities	(1,151)	2,305	(961)	(1,639)
Total comprehensive income	\$ 9,126	\$ 10,532	\$ 19,249	\$ 13,532
Per common share*:				
Basic net income per common share	\$ 0.46	\$ 0.36	\$ 0.90	\$ 0.67
Diluted net income per common share	\$ 0.45	\$ 0.36	\$ 0.88	\$ 0.66
Dividends	\$ 0.127	\$ 0.109	\$ 0.255	\$ 0.218
Basic weighted average common shares outstanding*	22,505,875	22,754,331	22,576,338	22,772,502
Diluted weighted average common shares outstanding*	22,810,923	23,047,293	22,876,839	23,069,981

* The computation of per share data and shares outstanding gives retroactive recognition to a 10% stock dividend declared on July 27, 2006.

The accompanying notes are a part of the consolidated financial statements.

1st SOURCE CORPORATION
STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
(Unaudited - Dollars in thousands)

	Total	Common Stock	Capital Surplus	Retained Earnings	Cost of Common Stock in Treasury	Net Unrealized Appreciation (Depreciation) of Securities Available- For-Sale
Balance at January 1, 2005	\$326,600	\$7,578	\$214,001	\$115,830	(\$10,512)	(\$ 297)
Comprehensive Income, net of tax:						
Net Income	15,171	-	-	15,171	-	-
Change in unrealized appreciation of available-for-sale securities, net of tax	(1,639)	-	-	-	-	(1,639)
Total Comprehensive Income	13,532	-	-	-	-	-
Issuance of 40,237 common shares under stock based compensation plans, including related tax effects	499	-	-	154	345	-
Cost of 99,256 shares of common stock acquired for treasury	(2,046)	-	-	-	(2,046)	-
Cash dividend (\$0.218 per share)*	(4,972)	-	-	(4,972)	-	-
Balance at June 30, 2005	\$333,613	\$7,578	\$214,001	\$126,183	(\$12,213)	(\$1,936)
Balance at January 1, 2006	\$345,576	\$7,578	\$214,001	\$139,601	(\$12,364)	(\$3,240)
Comprehensive Income, net of tax:						
Net Income	20,210	-	-	20,210	-	-
Change in unrealized appreciation of available-for-sale securities, net of tax	(961)	-	-	-	-	(961)
Total Comprehensive Income	19,249	-	-	-	-	-
Issuance of 66,296 common shares under stock based compensation plans, including related tax effects	636	-	-	292	344	-
Cost of 292,099 shares of common stock acquired for treasury	(7,385)	-	-	-	(7,385)	-
Cash dividend (\$0.255 per share)*	(5,764)	-	-	(5,764)	-	-
Balance at June 30, 2006	\$352,312	\$7,578	\$214,001	\$154,339	(\$19,405)	(\$4,201)

*Per share data gives retroactive recognition to a 10% stock dividend declared on July 27, 2006.

The accompanying notes are a part of the consolidated financial statements.

1st SOURCE CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited - Dollars in thousands)

	Six Months Ended June 30,	
	2006	2005
Operating activities:		
Net income	\$ 20,210	\$ 15,171
Adjustments to reconcile net income to net cash (used in)/from by operating activities:		
Provision for loan and lease recoveries	(1,971)	(3,832)
Depreciation of premises and equipment	2,527	2,548
Depreciation of equipment owned and leased to others	6,929	6,517
Amortization of investment security premiums and accretion of discounts, net	392	2,513
Amortization of mortgage servicing rights	2,972	3,588
Mortgage servicing asset impairment recoveries	(30)	(613)
Change in deferred income taxes	(3,917)	4,292
Realized investment securities gains	(2,233)	(909)
Change in mortgages held for sale	(14,794)	(48,826)
Change in trading account securities	(300)	-
Change in interest receivable	309	(313)
Change in interest payable	1,918	74
Change in other assets	(1,534)	(2,286)
Change in other liabilities	5,517	2,797
Other	(152)	136
Net change in operating activities	15,843	(19,143)
Investing activities:		
Proceeds from sales of investment securities	61,650	24,573
Proceeds from maturities of investment securities	138,658	153,226
Purchases of investment securities	(195,764)	(99,631)
Net change in short-term investments	66,258	201,009
Loans sold or participated to others	-	(18)
Net change in loans and leases	(149,251)	(100,720)
Net change in equipment owned under operating leases	(16,326)	(6,492)
Purchases of premises and equipment	(2,312)	(3,529)
Net change in investing activities	(97,087)	168,418
Financing activities:		
Net change in demand deposits, NOW accounts and savings accounts	(210,773)	(100,686)
Net change in certificates of deposit	279,795	31,013
Net change in short-term borrowings	8,253	(56,223)
Proceeds from issuance of long-term debt	10,859	355
Payments on long-term debt	(206)	(163)
Net proceeds from issuance of treasury stock	635	498
Acquisition of treasury stock	(7,385)	(2,046)
Cash dividends	(5,867)	(5,063)
Net change in financing activities	75,311	(132,315)
Net change in cash and cash equivalents	(5,933)	16,960
Cash and cash equivalents, beginning of year	124,817	78,255
Cash and cash equivalents, end of period	\$ 118,884	\$ 95,215

The accompanying notes are a part of the consolidated financial statements.

1ST SOURCE CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1. Basis of Presentation

The accompanying unaudited consolidated financial statements reflect all adjustments (all of which are normal and recurring in nature) that are, in the opinion of management, necessary for a fair presentation of the consolidated financial position, the results of operations, changes in shareholders' equity, and cash flows for the periods presented. These unaudited consolidated financial statements have been prepared according to the rules and regulations of the Securities and Exchange Commission (SEC) and, therefore, certain information and footnote disclosures normally included in financial statements prepared in accordance with U. S. generally accepted accounting principles have been omitted. The Notes to the Consolidated Financial Statements appearing in 1st Source Corporation's Annual Report on Form 10-K for 2005 (2005 Annual Report), which include descriptions of significant accounting policies, should be read in conjunction with these interim financial statements. The balance sheet at December 31, 2005, has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by U. S. generally accepted accounting principles for complete financial statements. Certain amounts in the prior period consolidated financial statements have been reclassified to conform with the current year presentation.

Note 2. Recent Accounting Pronouncements

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

SHARE-BASED PAYMENT: Effective January 1, 2006, we adopted the fair value recognition provisions of Statement of Financial Accounting Standards (SFAS) No.

123 (revised 2004), "Share-Based Payment" (SFAS No.123(R)), using the modified prospective transition method and, therefore, have not restated results for prior periods. Under this transition method, stock-based compensation expense for the first quarter of 2006 included compensation expense for all stock-based compensation awards granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provision of SFAS No. 123, "Accounting for Stock-Based Compensation" ("SFAS No.123"). Stock-based compensation expense for all stock-based compensation awards granted after January 1, 2006 is based on the grant-date fair value estimated in accordance with the provisions of SFAS No.123(R). We recognize these compensation costs on a straight-line basis over the requisite service period of the award. Prior to the January 1, 2006 adoption of SFAS No.123(R), we recognized stock-based compensation expense in accordance with Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees" (APB No. 25). In March 2005, the Securities and Exchange Commission (the SEC) issued Staff Accounting Bulletin No. 107 (SAB No. 107) regarding the SEC's interpretation of SFAS No.123(R) and the valuation of share-based payments for public companies. We have applied the provisions of SAB No. 107 in its adoption of SFAS No. 123(R). See Note 5 to the Unaudited Consolidated Financial Statements for a further discussion on stock-based compensation.

ACCOUNTING FOR SERVICING OF FINANCIAL ASSETS: In March 2006, the FASB issued SFAS No. 156, "Accounting for Servicing of Financial Assets- an amendment of FASB Statement No. 140." SFAS No.156 requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in specific situations. Additionally, the servicing asset or servicing liability shall be initially measured at fair value; however, an entity may elect the "amortization method" or "fair value method" for subsequent balance sheet reporting periods. SFAS No.156 is effective as of an entity's first fiscal year beginning after September 15, 2006. Early adoption is permitted as of the beginning of an entity's fiscal year, provided the entity has not yet issued financial statements, including interim financial statements, for any period of that fiscal year. We do not expect the adoption of this statement to have a material impact on our financial condition, results of operations or cash flows.

ACCOUNTING FOR CERTAIN HYBRID FINANCIAL INSTRUMENTS: In February 2006, the FASB issued SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments - an amendment of FASB Statements No. 133 and 140." SFAS No. 155 simplifies accounting for certain hybrid instruments currently governed by SFAS No. 133 , "Accounting for Derivative Instruments and Hedging Activities," by allowing fair value remeasurement of hybrid instruments that contain an embedded derivative that otherwise would require bifurcation. SFAS No. 155 also eliminates the guidance in SFAS No.133 Implementation Issue No. D1, "Application of Statement 133 to Beneficial Interests in Securitized Financial Assets," which provides such beneficial interests are not subject to SFAS No.133. SFAS No. 155 amends SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities - a Replacement of FASB Statement No. 125," by eliminating the restriction on passive derivative instruments that a qualifying special-purpose entity may hold. This statement is effective for financial instruments acquired or issued after the beginning of our fiscal year 2007. We do not expect the adoption of this statement to have a material impact on our financial condition, results of operations or cash flows.

MEANING OF OTHER-THAN-TEMPORARY IMPAIRMENT: In November 2005, the FASB issued Staff Position (FSP) SFAS No. 115-1 and 124-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments." The FSP addresses the determination of when an investment is considered impaired, whether that impairment is other-than-temporary, and the measurement of an impairment loss. The FSP also includes accounting considerations subsequent to the recognition of an other-than-temporary impairment and requires certain disclosures about unrealized losses that have not been recognized as other-than-temporary impairments. The FSP amends SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities," and SFAS No. 124, "Accounting for Certain Investments Held by Not-for-Profit Organizations," and APB Opinion No. 18, "The Equity Method of Accounting for Investments in Common Stock." The FSP nullifies certain requirements of EITF Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments," and supercedes Emerging Issues Task Force (EITF) Abstracts, Topic D-44, "Recognition of Other-Than-Temporary Impairment upon the Planned Sale of a Security Whose Cost Exceeds Fair Value." The FSP was required to be applied to reporting periods beginning after December 15, 2005. The issuance of this FSP did not have a material impact on the financial condition, the results of operations, or liquidity of 1st Source.

ACCOUNTING CHANGES AND ERROR CORRECTIONS: In May 2005, the FASB issued SFAS No. 154, "Accounting for Changes and Error Corrections," which changes the accounting for and reporting of a change in accounting principle. This statement also applies to all voluntary changes in accounting principle and changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. This statement requires retrospective application to prior period financial statements of changes in accounting principle, unless it is impractical to determine either the period - specific or cumulative effects of the change. SFAS No. 154 was

effective for accounting changes made in fiscal years beginning after December 15, 2005. The adoption of this standard did not have a material effect on the financial condition, the results of operations or liquidity of 1st Source.

Note 3. Reserve for Loan and Lease Losses

The reserve for loan and lease losses is maintained at a level believed to be adequate by management to absorb probable losses inherent in the loan and lease portfolio. The determination of the reserve requires significant judgment reflecting management's best estimate of probable loan and lease losses related to specifically identified loans and leases as well as probable losses in the remainder of the various loan and lease portfolios. The methodology for assessing the appropriateness of the reserve consists of several key elements, which include: specific reserves for identified special attention loans and leases (classified loans and leases and internal watch list credits), percentage allocations for special attention loans and leases without specific reserves, formula reserves for each business lending division portfolio, including a higher percentage reserve allocation for special attention loans and leases without a specific reserve, and reserves for pooled homogeneous loans and leases. Management's evaluation is based upon a continuing review of these portfolios, estimates of future customer performance, collateral values and dispositions and forecasts of future economic and geopolitical events, all of which are subject to judgment and will change.

Note 4. Financial Instruments with Off-Balance-Sheet Risk

To meet the financing needs of our customers, 1st Source Corporation and its subsidiaries are parties to financial instruments with off-balance-sheet risk in the normal course of business. These off-balance-sheet financial instruments include commitments to originate, purchase and sell loans and standby letters of credit. The instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated statements of financial condition. Our exposure to credit loss in the event of nonperformance by the other party to the financial instruments for loan commitments and standby letters of credit is represented by the dollar amount of those instruments. We use the same credit policies and collateral requirements in making commitments and conditional obligations as we do for on-balance-sheet instruments.

Trustcorp Mortgage Company and 1st Source Bank (Bank), subsidiaries of 1st Source Corporation, grant mortgage loan commitments to borrowers, subject to normal loan underwriting standards. The interest rate risk associated with these loan commitments is managed by entering into contracts for future deliveries of loans. Loan commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

We issue letters of credit that are conditional commitments that guarantee the performance of a customer to a third party. The credit risk involved and collateral obtained in issuing letters of credit is essentially the same as that involved in extending loan commitments to customers.

As of June 30, 2006 and December 31, 2005, 1st Source had commitments outstanding to originate and purchase mortgage loans aggregating \$219.37 million and \$130.73 million, respectively. Outstanding commitments to sell mortgage loans aggregated \$126.13 million at June 30, 2006, and \$98.39 million at December 31, 2005. Standby letters of credit totaled \$80.54 million and \$76.43 million at June 30, 2006, and December 31, 2005, respectively. Standby letters of credit have terms ranging from six months to one year.

Note 5. Stock-Based Compensation

As of June 30, 2006, we had five stock-based employee compensation plans, which are more fully described in Note K of the Consolidated Financial Statements in 1st Source's Annual Report on Form 10-K for the year ended December 31, 2005. These plans include two stock option plans, the Employee Stock Purchase Plan, the Executive Incentive Plan, and the Restricted Stock Award Plan. The Employee Stock Purchase Plan is non-compensatory.

Effective January 1, 2006, we adopted the fair value recognition provisions of SFAS No. 123(R), using the modified prospective transition method and, therefore, have not restated results for prior periods. Under this transition method, stock-based compensation expense for the first quarter of 2006 included compensation expense for all stock-based compensation awards granted prior to, but that remained unvested as of, January 1, 2006. Compensation expense was based on the grant date fair value estimated in accordance with the original provision of SFAS No. 123.

Prior to January 1, 2006, we accounted for stock-based compensation under the recognition, measurement and pro forma disclosure provisions of APB No. 25, the original provisions of SFAS No. 123, and SFAS No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure" (SFAS 148). In accordance with APB No. 25, we generally would have recognized compensation expense for stock awards on the grant date and we generally would have recognized compensation expense for stock options only when we granted options with a discounted exercise price or modified the terms of previously issued options, and would have recognized the related compensation expense ratably over the associated service period, which was generally the option vesting term.

Stock-based compensation expense for all stock-based compensation awards granted after January 1, 2006, is based on the grant-date fair value. For all awards except stock option awards, the grant date fair value is either the fair market value per share or book value per share (corresponding to the type of stock awarded) as of the grant date. For stock option awards, the grant date fair value is estimated using the Black-Scholes option pricing model. For all awards we recognize these compensation costs only for those shares expected to vest on a straight-line basis over the requisite service period of the award, for which we use the related vesting term. We estimate forfeiture rates based on historical employee option exercise and employee termination experience. We have identified separate groups of awardees that exhibit similar option exercise behavior and employee termination experience and have considered them as separate groups in the valuation models and expense estimates.

As a result of our January 1, 2006, adoption of SFAS No.123(R), the impact to the Consolidated Financial Statements for the three month period ended June 30, 2006 on income before income taxes and on net income were additions of \$0.67 million and \$0.41 million, respectively; and for the six month period ended June 30, 2006 on income before income taxes and on net income were additions of \$1.82 million and \$1.12 million, respectively. The cumulative effect of the change in accounting was \$0.66 million before income taxes and \$0.40 million, after income taxes. The impact on both basic and diluted earnings per share for the three months ended June 30, 2006 was \$0.02 per share. The impact on both basic and diluted earnings per share for the six months ended June 30, 2006 was \$0.05 per share. In addition, prior to the adoption of SFAS No. 123(R), we presented the tax benefit of stock option exercises as operating cash flows. Upon the adoption of SFAS No. 123(R), tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options are classified as financing cash flows.

Pro Forma Information under SFAS No. 123

Pro forma information regarding the effect on the net income and basic and diluted income per share for the three and six month periods ended June 30, 2005, had we applied the fair value recognition provisions of SFAS No. 123, are as follows:

	THREE MONTHS ENDED JUNE 30	SIX MONTHS ENDED JUNE 30
	2005	2005
Net income, as reported (000's)	\$ 8,227	\$15,171
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	626	1,542
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(695)	(1,632)
Pro forma net income	\$ 8,158	\$15,081
Earnings per share:		
Basic--as reported	\$0.36	\$0.67
Basic--pro forma	\$0.36	\$0.66
Diluted--as reported	\$0.36	\$0.66
Diluted--pro forma	\$0.35	\$0.65

The stock-based compensation expense recognized in the condensed consolidated statement of operations for the three and six months ended June 30, 2006 is based on awards ultimately expected to vest, and accordingly has been adjusted by the amount of estimated forfeitures. SFAS No. 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Forfeitures were estimated based partially on historical experience.

The aggregate intrinsic value in the table below represents the total pretax intrinsic value (the difference between 1st Source's closing stock price on the last trading day of the second quarter of 2006 (June 30, 2006) and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on June 30, 2006, this amount changes based on the fair market value of 1st Source's stock. Total intrinsic value of options exercised for the six months ended June 30, 2006 was \$637 thousand. Total fair value of options vested and expensed was \$12 thousand and \$25 thousand, net of tax, for the three and six month periods ended June 30, 2006, respectively. No options were granted during the three and six month periods ended June 30, 2006 or 2005.

	June 30, 2006			
	Number of Shares	Weighted Average Grant-date Fair Value	Average Remaining Contractual Term (in years)	Total Intrinsic Value (in 000's)
Options outstanding, beginning of year	580,848	\$24.61		
Granted	-	-		
Exercised	(49,494)	12.14		
Forfeited	-	-		
Options outstanding, June 30, 2006	531,354	\$25.31	2.5	\$2,891
Vested and expected to vest at June 30, 2006	531,354	\$25.31	2.6	\$2,891
Exercisable at June 30, 2006	508,438	\$25.75	2.5	\$2,543

As of June 30, 2006, there was \$301,413 of total unrecognized compensation cost related to nonvested share-based compensation arrangements. That cost is expected to be recognized over a weighted-average period of 5.82 years.

The following table summarizes information about stock options outstanding at June 30, 2006:

Range of Exercise Prices	Number of shares Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number of shares Exercisable	Weighted Average Exercise Price
\$11.31 to \$17.99	76,887	4.04	\$14.23	63,137	\$14.70
\$18.00 to \$26.99	66,930	4.42	20.82	57,764	20.81
\$27.00 to \$28.30	387,537	2.06	28.29	387,537	28.29

The fair value of each stock option was estimated on the date of grant using the Black-Scholes option-pricing model with the weighed average assumptions included on the table above, under the header "Stock Based Option Valuation and Expense Information under SFAS No.123(R)."

ITEM 2.

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

Except for historical information contained herein, the matters discussed in this document express "forward-looking statements." Generally, the words "believe," "expect," "intend," "estimate," "anticipate," "project," "will," "should," and similar expressions indicate forward-looking statements. Those statements, including statements, projections, estimates or assumptions concerning future events or performance, and other statements that are other than statements of historical fact, are subject to material risks and uncertainties. We caution readers not to place undue reliance on any forward-looking statements, which speak only as of the date made. We may make other written or oral forward-looking statements from time to time. Readers are advised that various important factors could cause our actual results or circumstances for future periods to differ materially from those anticipated or projected in such forward-looking statements. Such factors include, but are not limited to, changes in law, regulations or U. S. generally accepted accounting

principles; our competitive position within the markets we serve; increasing consolidation within the banking industry; unforeseen changes in interest rates; unforeseen changes in loan prepayment assumptions; unforeseen downturns in or major events affecting the local, regional or national economies or the industries in which we have credit concentrations; and other matters discussed in our filings with the SEC, including our Annual Report on Form 10-K for 2005, which filings are available from the SEC. We undertake no obligation to publicly update or revise any forward-looking statements.

The following management's discussion and analysis is presented to provide information concerning our financial condition as of June 30, 2006, as compared to December 31, 2005, and the results of operations for the three and six month periods ended June 30, 2006 and 2005. This discussion and analysis should be read in conjunction with our consolidated financial statements and the financial and statistical data appearing elsewhere in this report and our 2005 Annual Report.

FINANCIAL CONDITION

Our total assets at June 30, 2006, were \$3.61 billion, up 2.77% from December 31, 2005. Total loans and leases increased 6.16% and total deposits increased 2.51% over the comparable figures at the end of 2005.

Nonperforming assets at June 30, 2006, were \$15.43 million compared to \$22.04 million at December 31, 2005, an improvement of 29.99%. Nonperforming assets decreased across our entire loan and lease portfolios with the exception of loans secured by real estate. The most significant decreases were primarily in the commercial and agricultural loans, aircraft financing, and construction equipment financing categories. At June 30, 2006, nonperforming assets were 0.57% of net loans and leases compared to 0.87% at December 31, 2005.

Accrued income and other assets were as follows:

(Dollars in Thousands)	June 30, 2006	December 31, 2005
	-----	-----
Accrued income and other assets:		
Bank owned life insurance cash surrender value	\$ 35,444	\$ 34,772
Accrued interest receivable	14,071	14,381
Mortgage servicing assets	14,281	19,363
Other real estate	819	959
Repossessions	1,083	4,284
Intangible assets	20,056	21,381
All other assets	29,868	22,199
	-----	-----
Total accrued income and other assets	\$ 115,622	\$ 117,339
	=====	=====

CAPITAL

As of June 30, 2006, total shareholders' equity was \$352.31 million, up 1.95% from the \$345.58 million at December 31, 2005. In addition to net income of \$20.21 million, other significant changes in shareholders' equity during the first six months of 2006 included \$7.39 million in treasury stock purchases, and \$5.76 million of dividends paid. The accumulated other comprehensive loss component of shareholders' equity totaled \$4.20 million at June 30, 2006,

compared to \$3.24 million at December 31, 2005. The increase in accumulated other comprehensive loss was a result of changes in unrealized gain or loss on securities in the available-for-sale portfolio. Our equity-to-assets ratio was 9.76% as of June 30, 2006, compared to 9.84% at December 31, 2005. Book value per common share rose to \$15.67 at June 30, 2006, up from \$15.20 at December 31, 2005 (per share data gives retroactive recognition to a 10% stock dividend declared on July 27, 2006).

We declared and paid dividends per common share of \$0.127 during the second quarter of 2006. The trailing four quarters dividend payout ratio, representing dividends per share divided by diluted earnings per share, was 28.63% (per share data gives retroactive recognition to a 10% stock dividend declared on July 27, 2006). The dividend payout is continually reviewed by management and the Board of Directors.

The banking regulators have established guidelines for leverage capital requirements, expressed in terms of Tier 1 or core capital as a percentage of average assets, to measure the soundness of a financial institution. In addition, banking regulators have established risk-based capital guidelines for U. S. banking organizations. The actual and required capital amounts and ratios of 1st Source and our largest subsidiary, the Bank, as of June 30, 2006, are presented in the table below:

(Dollars in thousands)	Actual		Minimum Capital Adequacy		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Capital (To Risk-Weighted Assets):						
1st Source	\$433,349	14.42 %	\$240,422	8.00 %	\$300,527	10.00 %
Bank	413,465	14.04	235,549	8.00	294,436	10.00
Tier 1 Capital (to Risk-Weighted Assets):						
1st Source	393,707	13.10	120,211	4.00	180,316	6.00
Bank	375,810	12.76	117,774	4.00	176,662	6.00
Tier 1 Capital (to Average Assets):						
1st Source	393,707	11.37	138,495	4.00	173,119	5.00
Bank	375,810	11.13	135,094	4.00	168,868	5.00

LIQUIDITY AND INTEREST RATE SENSITIVITY

The Bank's liquidity is monitored and closely managed by the Asset/Liability Committee (ALCO), which is comprised of the Bank's senior management. Asset and liability management includes the management of interest rate sensitivity and the maintenance of an adequate liquidity position. The purpose of interest rate sensitivity management is to stabilize net interest income during periods of changing interest rates.

Liquidity management is the process by which the Bank ensures that adequate liquid funds are available to meet financial commitments on a timely basis. Financial institutions must maintain liquidity to meet day-to-day requirements of depositors and borrowers, take advantage of market opportunities and provide a cushion against unforeseen needs.

Liquidity of the Bank is derived primarily from core deposits, principal payments received on loans, the sale and maturity of investment securities, net cash provided by operating activities, and access to other funding sources. The most stable source of liability funded liquidity is deposit growth and retention of the core deposit base. The principal sources of asset funded liquidity are available-for-sale investment securities, cash and due from banks, Federal funds sold, securities purchased under agreements to resell, and loans and interest bearing deposits with other banks maturing within one year. Additionally, liquidity is provided by bank lines of credit, repurchase agreements, and the ability to borrow from the Federal Reserve Bank and Federal Home Loan Bank.

The ALCO monitors and manages the relationship of earning assets to interest bearing liabilities and the responsiveness of asset yields, interest expense, and interest margins to changes in market interest rates. At June 30, 2006, the consolidated statement of financial condition was rate sensitive by \$320.28 million more liabilities than assets scheduled to reprice within one year, or approximately 0.86%.

RESULTS OF OPERATIONS

Net income for the three and six month periods ended June 30, 2006, was \$10.28 million and \$20.21 million respectively, compared to \$8.23 million and \$15.17 million for the same periods in 2005. Diluted net income per common share was \$0.45 and \$0.88 respectively, for the three and six month periods ended June 30, 2006, compared to \$0.36 and \$0.66 for the same periods in 2005 (per share data gives retroactive recognition to a 10% stock dividend declared on July 27, 2006). Return on average common shareholders' equity was 11.62% for the six months ended June 30, 2006, compared to 9.33% in 2005. The return on total average assets was 1.18% for the six months ended June 30, 2006, compared to 0.91% in 2005.

The increase in net income for the six months ended June 30, 2006, over the first six months of 2005, was primarily the result of a 9.28% improvement in net interest income and a 15.05% improvement in noninterest income. Total interest income increased primarily due to increase in the volume and yields on loans. Total interest expense increased primarily due to increased volumes and higher cost of funds, reflecting the interest rate environment. Details of the changes in the various components of net income are further discussed below.

NET INTEREST INCOME

The taxable equivalent net interest income for the three months ended June 30, 2006, was \$27.81 million, an increase of 11.76% over the same period in 2005. The net interest margin on a fully taxable equivalent basis was 3.44% for the three months ended June 30, 2006, compared to 3.18% for the three months ended June 30, 2005. The taxable equivalent net interest income for the six month period ended June 30, 2006, was \$53.53 million, an increase of 8.94% over 2005, resulting in a net yield of 3.36%, compared to a net yield of 3.16% for the same period in 2005.

Total average earning assets increased 3.31% and 2.42%, respectively, for the three and six month periods ended June 30, 2006, over the comparative periods in 2005. Average loans and leases outstanding increased 9.33% and 8.60% for the three and six month periods, compared to the same periods in 2005; the increase was due primarily to increased loan outstandings in aircraft financing, commercial and agricultural loans, auto and light truck financings, construction equipment financing, medium and heavy duty truck financings, and loans secured by real estate. These increases were offset slightly by decreases in consumer loans and environmental equipment loans and leases. Total average investment securities decreased 13.25% and 15.95% for the three and six month periods ended June 30, 2006, as compared to one year ago, as availability of excess funds used for investment purposes decreased due to loan growth. These decreases were due primarily to decreases in U. S. Treasury securities and Federal agency securities. For the six month period, average mortgages held for sale decreased 18.98%, due to timing differences in loan sales for the first six months of 2006 as compared to the first six months of 2005. Other investments, which include federal funds sold, time deposits with other banks and trading account securities, decreased for the three and six month periods ended June 30, 2006 over the same periods of 2005. The taxable equivalent yields on total average earning assets were 6.36% and 5.30% for the three month periods ended June 30, 2006 and 2005, respectively, and 6.19% and 5.21% for the six month periods ended June 30, 2006 and 2005, respectively.

Average interest bearing deposits increased 5.78% and 3.80% for the three and six month periods ended June 30, 2006, respectively, over the same periods in 2005. The rates on average interest-bearing deposits were 3.31% and 2.42% for the three months ended June 30, 2006 and 2005, and 3.19% and 2.34% for the six month periods ended June 30, 2006 and 2005, respectively. The increase in the average cost of interest-bearing deposits during the first six months of 2006 as compared to the first six months of 2005 was primarily the result of increases in interest rates offered on deposit products due to increases in market interest rates and increased competition for deposits across all markets. These higher cost deposits were pursued due to increased funding needs. The rates on average interest-bearing liabilities were 3.51% and 2.59% for the three month periods ended June 30, 2006 and 2005, respectively, and 3.40% and 2.49% for the six month periods ended June 30, 2006 and 2005, respectively.

The following table provides an analysis of net interest income and illustrates the interest earned and interest expense charged for each major component of interest earning assets and interest bearing liabilities. Yields/rates are computed on a tax-equivalent basis, using a 35% rate. Nonaccrual loans and leases are included in the average loan and lease balance outstanding.

DISTRIBUTION OF ASSETS, LIABILITIES AND SHAREHOLDERS' EQUITY
INTEREST RATES AND INTEREST DIFFERENTIAL
(Dollars in thousands)

	Three months ended June 30,					
	2006			2005		
	Average Balance	Interest Income/ Expense	Yield/ Rate	Average Balance	Interest Income/ Expense	Yield/ Rate
ASSETS:						
Investment securities:						
Taxable	\$ 453,246	\$ 4,797	4.25%	\$ 534,446	\$ 3,915	2.94%
Tax exempt	174,071	1,855	4.27%	188,716	1,951	4.15%
Mortgages - held for sale	54,654	916	6.72%	76,839	1,151	6.01%
Net loans and leases	2,542,118	43,604	6.88%	2,325,183	34,379	5.93%
Other investments	22,240	271	4.89%	17,064	127	2.98%
Total Earning Assets	3,246,329	51,443	6.36%	3,142,248	41,523	5.30%
Cash and due from banks	80,058			85,701		
Reserve for loan and lease losses	(59,428)			(62,613)		
Other assets	215,573			194,544		
Total	\$ 3,482,532			\$ 3,359,880		
LIABILITIES AND SHAREHOLDERS' EQUITY:						
Interest-bearing deposits	\$ 2,334,683	\$19,283	3.31%	\$ 2,206,994	\$13,330	2.42%
Short-term borrowings	270,896	2,822	4.18%	296,979	2,006	2.71%
Subordinated notes	59,022	1,080	7.34%	59,022	1,000	6.80%
Long-term debt and mandatorily redeemable securities	33,496	451	5.40%	18,026	305	6.79%
Total Interest-Bearing Liabilities	2,698,097	23,636	3.51%	2,581,021	16,641	2.59%
Noninterest-bearing deposits	372,024			396,596		
Other liabilities	60,262			53,916		
Shareholders' equity	352,149			328,347		
Total	\$ 3,482,532			\$ 3,359,880		
Net Interest Income						
		\$27,807			\$24,882	
Net Yield on Earning Assets on a Taxable Equivalent Basis						
			3.44%			3.18%

DISTRIBUTION OF ASSETS, LIABILITIES AND SHAREHOLDERS' EQUITY
INTEREST RATES AND INTEREST DIFFERENTIAL
(Dollars in thousands)

	Six months ended June 30,					
	2006			2005		
	Average Balance	Interest Income/ Expense	Yield/ Rate	Average Balance	Interest Income/ Expense	Yield/ Rate
ASSETS:						
Investment securities:						
Taxable	\$ 456,013	\$ 8,722	3.86%	\$ 565,088	\$ 7,733	2.76%
Tax exempt	174,547	3,682	4.25%	185,114	3,802	4.14%
Mortgages - held for sale	53,545	1,743	6.56%	66,086	1,934	5.90%
Net loans and leases	2,499,834	83,729	6.75%	2,301,846	67,295	5.90%
Other investments	25,380	587	4.66%	15,413	204	2.67%
Total Earning Assets	3,209,319	98,463	6.19%	3,133,547	80,968	5.21%
Cash and due from banks	80,001			83,080		
Reserve for loan and lease losses	(59,067)			(63,134)		
Other assets	213,753			195,839		
Total	\$ 3,444,006			\$ 3,349,332		
LIABILITIES AND SHAREHOLDERS' EQUITY:						
Interest-bearing deposits	\$ 2,293,114	\$36,316	3.19%	\$ 2,209,069	\$25,646	2.34%
Short-term borrowings	281,386	5,582	4.00%	294,904	3,708	2.54%
Subordinated notes	59,022	2,130	7.28%	59,022	1,964	6.71%
Long-term debt and						

mandatorily redeemable securities	32,250	905	5.66%	17,975	515	5.78%

Total Interest-Bearing Liabilities	2,665,772	44,933	3.40%	2,580,970	31,833	2.49%
Noninterest-bearing deposits	367,637			387,312		
Other liabilities	59,863			53,107		
Shareholders' equity	350,734			327,943		

Total	\$ 3,444,006			\$ 3,349,332		
=====						
Net Interest Income		-----			-----	
		\$53,530			\$49,135	
		=====			=====	
Net Yield on Earning Assets on a Taxable						
Equivalent Basis			-----			-----
			3.36%			3.16%
			=====			=====

PROVISION AND RESERVE FOR LOAN AND LEASE LOSSES

The recovery of provision for loan and lease losses for the three month periods ended June 30, 2006 and 2005 was \$1.67 million and \$3.41 million, respectively, and \$1.97 million and \$3.83 million for the six month periods ended June 30, 2006 and 2005, respectively. Net recoveries of \$1.77 million were recorded for the second quarter 2006, compared to net recoveries of \$0.31 million for the same quarter a year ago. Year-to-date net recoveries of \$2.47 million have been recorded in 2006, compared to net charge-offs of \$0.29 million through June 2005.

In the second quarter 2006, loan and lease delinquencies were 0.23%, as compared to 0.53% for the second quarter 2005, and 0.38% at the end of 2005. The reserve for loan and lease losses as a percentage of loans and leases outstanding at the end of the period was 2.26% as compared to 2.50% for the same period one year ago and 2.38% at December 31, 2005. A summary of loan and lease loss experienced during the three and six month periods ended June 30, 2006 and 2005 is provided below.

Summary of Reserve for Loan and Lease Losses

	(Dollars in Thousands)			
	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Reserve for loan and lease losses - beginning balance	\$ 59,097	\$ 62,647	\$ 58,697	\$ 63,672
Charge-offs	(591)	(853)	(1,371)	(3,056)
Recoveries	2,362	1,164	3,842	2,763
Net recoveries/(charge-offs)	1,771	311	2,471	(293)
Recovery of provision for loan and lease losses	(1,671)	(3,411)	(1,971)	(3,832)
Reserve for loan and lease losses - ending balance	\$ 59,197	\$ 59,547	\$ 59,197	\$ 59,547
Loans and leases outstanding at end of period	\$2,615,152	\$2,380,614	\$2,615,152	\$2,380,614
Average loans and leases outstanding during period	2,542,118	2,325,183	2,499,834	2,301,846
Reserve for loan and lease losses as a percentage of loans and leases outstanding at end of period	2.26%	2.50%	2.26%	2.50%
Ratio of net (recoveries)/charge-offs during period to average loans and leases outstanding	(0.28)%	(0.05)%	(0.20)%	0.03%

NONPERFORMING ASSETS

Nonperforming assets were as follows:

(Dollars in thousands)

	June 30, 2006	December 31, 2005	June 30, 2005
Loans and leases past due 90 days or more	\$ 278	\$ 245	\$ 52
Nonaccrual and restructured loans and leases	13,252	16,552	19,447
Other real estate	819	960	1,067
Repossessions	1,082	4,284	411
Equipment owned under operating leases	-	-	1,088
Total nonperforming assets	\$ 15,431	\$ 22,041	\$ 22,065

Nonperforming assets totaled \$15.43 million at June 30, 2006, reflecting an improvement of 29.99% from \$22.04 million at December 31, 2005 and an improvement of 30.07% from \$22.07 million at June 30, 2005. The improvement during the first six months of 2006 was primarily related to a decrease in nonaccrual loans and leases in all areas, with the exception of loans secured by real estate, and a decline in aircraft repossessions. Nonperforming assets as a percentage of total loans and leases improved to 0.57% at June 30, 2006, from 0.87% at December 31, 2005 and 0.91% at June 30, 2005.

As of June 30, 2006, the Bank had a \$3.32 million standby letter of credit outstanding that supported bond indebtedness of a customer. Due to the current financial condition of the customer, if this standby letter of credit is funded, the Bank likely will foreclose on the real estate securing the customer's reimbursement obligation. This likely will result in an increase in other real estate for approximately the same amount as the funding.

As of June 30, 2006, repossessions consisted of aircraft, automobiles, light trucks, and environmental equipment. At the time of repossession, unless the equipment is in the process of immediate sale, the recorded amount of the loan or lease is written down, if necessary, to the estimated value of the equipment or vehicle by a charge to the reserve for loan and lease losses. Any subsequent write-downs are included in noninterest expense.

SUPPLEMENTAL LOAN INFORMATION AS OF JUNE 30, 2006

(Dollars in thousands)	Loans and leases outstanding	Nonaccrual and restructured loans	Other real estate owned and repossessions	Year-to-date net credit losses/ (recoveries)
Commercial and agricultural loans	\$ 491,334	\$ 1,214	\$ -	\$ (391)
Auto, light truck and environmental equipment	337,497	712	58	(233)
Medium and heavy duty truck	319,845	-	-	(16)
Aircraft financing	453,470	6,143	958	(1,463)
Construction equipment financing	273,621	1,385	-	(719)
Loans secured by real estate	618,204	3,704	819	15
Consumer loans	121,181	94	66	261
Total	\$ 2,615,152	\$ 13,252	\$ 1,901	\$ (2,546)

NONINTEREST INCOME

Noninterest income for the three month periods ended June 30, 2006 and 2005 was \$19.07 million and \$15.40 million, respectively, and \$38.07 million and \$33.09 million for the six month periods ended June 30, 2006 and 2005, respectively. Details of noninterest income follow:

(Dollars in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Noninterest income:				
Trust fees	\$ 3,658	\$ 3,285	\$ 7,049	\$ 6,531
Service charges on deposit accounts	4,917	4,251	9,303	8,214
Mortgage banking income	3,105	1,551	4,862	4,318
Insurance commissions	932	833	2,614	1,997
Equipment rental income	4,658	3,927	8,878	7,942
Other income	1,647	1,546	3,133	3,182
Investment securities and other investment gains	150	5	2,233	909
Total noninterest income	\$19,067	\$15,398	\$38,072	\$33,093

During the second quarter of 2006, mortgage banking income increased primarily due to a gain on a bulk sale of mortgage servicing rights of \$1.25 million. Equipment rental income increased during the second quarter of 2006 mainly due to an increase in the operating lease portfolio and rental recoveries. Service charges on deposit accounts, which include overdraft and NSF fees, increased as a result of growth in the number of retail deposit accounts and increased incidence rates.

Trust fees and insurance commissions increased in both the three and six month periods ended June 30, 2006, over the same periods in 2005. Trust fees increased due to growth in assets under management and an increase in IRA custodian revenue. Insurance commissions increased due to growth in commercial lines and higher premiums and higher contingent commissions in the first quarter.

Gains on venture partnership investment totaled \$2.07 million for the first six months of 2006 compared to gains of \$0.74 million for the first six months of 2005.

NONINTEREST EXPENSE

Noninterest expense for the three month periods ended June 30, 2006 and 2005 was \$32.39 million and \$30.63 million, respectively, and \$61.79 million and \$62.30 million for the six month periods ended June 30, 2006 and 2005, respectively. Details of noninterest expense follow:

(Dollars in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Noninterest expense:				
Salaries and employee benefits	\$ 16,873	\$ 17,090	\$ 32,387	\$ 35,634
Net occupancy expense	1,860	1,732	3,727	3,834
Furniture and equipment expense	2,959	2,844	6,093	5,486
Depreciation - leased equipment	3,547	3,194	6,929	6,517
Professional fees	1,104	685	1,989	1,484
Supplies and communication	1,307	1,321	2,670	2,664
Business development and marketing expense	1,048	910	1,690	1,520
Intangible asset amortization	659	670	1,325	1,328
Loan and lease collection and repossession expense	185	318	275	184
Other expense	2,844	1,862	4,707	3,649
	-----	-----	-----	-----
Total noninterest expense	\$ 32,386	\$ 30,626	\$ 61,792	\$ 62,300
	=====	=====	=====	=====

The overall decrease in noninterest expense was mainly reflected in salaries and employee benefits on a year-over-year basis. This decrease was primarily due to the first quarter 2006 reversal of previously recognized stock-based compensation expense under historical accounting methods related to the estimated forfeiture of stock awards. This one-time expense reversal, combined with the adoption of SFAS No. 123(R) estimated forfeiture accounting requirements, resulted in a reduction in stock-based compensation of \$2.07 million, pre-tax. Stock-based compensation is discussed further in Note 5 of the Unaudited Notes to Consolidated Financial Statements.

As of June 30, 2006, leased equipment depreciation increased on a year-over-year basis, primarily due to the increase in the operating lease portfolio. Professional fees increased mostly due to higher audit and regulatory examination fees. Other expenses were higher at June 30, 2006, as compared to one year ago as a result of higher legal contingency expenses and losses related to an employee defalcation, which contributed equally to the increase. Furniture and equipment expense increased on a year-over-year basis due to increased software costs, expenses related to the core system conversion project and other processing charges. Loan and lease collection and repossession expense increased slightly on a year-over-year basis as gains on disposition of repossessed assets decreased and valuation adjustments related to repossessed assets increased. Supplies and communication and business development and marketing expense remained comparable to 2005 levels.

INCOME TAXES

The provision for income taxes for the three and six month periods ended June 30, 2006, was \$5.22 million and \$10.29 million, respectively, compared to \$4.16 million and \$7.26 million, respectively, for the same period in 2005. The effective tax rates were 33.68% for the quarter ended June 30, 2006 and 33.73% for the six month period ended June 30, 2006, compared to 33.57% and 32.37% for the three and six month periods ended June 30, 2005, respectively. The effective tax rate increased due to an increase in pre-tax income. The provision for income taxes for the three and six month periods ended June 30, 2006 and 2005, are at a rate which management believes approximates the effective rate for the year.

ITEM 3.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes in market risks faced by 1st Source since December 31, 2005. For information regarding 1st Source's market risk, refer to 1st Source's Annual Report on Form 10-K for the year ended December 31, 2005.

ITEM 4.

CONTROLS AND PROCEDURES

As of the end of the period covered by this report an evaluation was carried out, under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934) pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, at June 30, 2006, our disclosure controls and procedures were effective in accumulating and communicating to management (including such officers) the information relating to 1st Source (including its consolidated subsidiaries) required to be included in our periodic SEC filings.

In addition, there were no changes in our internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f)) during the second fiscal quarter of 2006 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings.

1st Source and its subsidiaries are involved in various legal proceedings incidental to the conduct of their businesses. Management does not expect that the outcome of any such proceedings will have a material adverse effect on 1st Source's consolidated financial position or results of operations.

ITEM 1A. Risk Factors.

There have been no material changes in risks faced by 1st Source since the filing of our Annual Report on Form 10-K for the year ended December 31, 2005. For information regarding our risk factors, refer to 1st Source's Annual Report on Form 10-K for the year ended December 31, 2005.

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

ISSUER PURCHASES OF EQUITY SECURITIES

Period	(a) Total number of shares purchased	(b) Average price paid per share	(c) Total number of shares purchased as part of publicly announced plans or programs	(d) Maximum number (or approximate dollar value) of shares that may yet be purchased under the plans or programs*
April 01 - 30, 2006	0	0	0	1,025,248
May 01 - 31, 2006	62,710	28.40	62,710	962,538
June 01 - 30, 2006	120	28.30	120	962,418

- (1) 1st Source maintains a stock repurchase plan that was authorized by the Board of Directors on April 27, (2006.) Under the terms of the plan, 1st Source may repurchase up to 1,025,248* shares of its common stock when favorable conditions exist on the open market or through private transactions at various prices from time to time. Since the inception of the plan, 1st Source has repurchased a total of 62,830* shares.

*Unadjusted for 10% stock dividend declared on July 27, 2006.

ITEM 3. Defaults Upon Senior Securities.

None

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

The following actions were taken by the shareholders of 1st Source at the annual shareholders' meeting held April 27, 2006:

1. Election of Directors

The directors named below were elected to the board of directors for terms expiring in April 2009, as follows:

Nominee	Votes For	Votes Withheld
-----	-----	-----
Terry L. Gerber	20,156,933	316,799
William P. Johnson	20,163,184	573,549
Craig A. Kapson	20,137,994	295,118
John T. Phair	20,163,184	176,077
Mark D. Schwabero	20,163,184	309,373

In addition, the following directors continued in office after the 2006 annual meeting:

Terms Expiring in April 2007:

David C. Bowers
Daniel B. Fitzpatrick
Wellington D. Jones III
Dane A. Miller
Toby S. Wilt

Terms Expiring in April 2008:

Lawrence E. Hiler
Rex Martin
Christopher J. Murphy III
Timothy K. Ozark

ITEM 5. Other Information.

None

ITEM 6. Exhibits

The following exhibits are filed with this report:

1. Exhibit 31.1 Certification of Chief Executive Officer required by Rule 13a-14(a).
2. Exhibit 31.2 Certification of Chief Financial Officer required by Rule 13a-14(a).
3. Exhibit 32.1 Certification pursuant to 18 U.S.C. Section 1350 of Chief Executive Officer.
4. Exhibit 32.2 Certification pursuant to 18 U.S.C. Section 1350 of Chief Financial Officer.

SIGNATURES

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

1st Source Corporation

DATE July 27, 2006

/s/CHRISTOPHER J. MURPHY III

Christopher J. Murphy III
Chairman of the Board, President and CEO

DATE July 27, 2006

/s/LARRY E. LENTYCH

Larry E. Lentych
Treasurer and Chief Financial Officer
Principal Accounting Officer

CERTIFICATIONS

I, Christopher J. Murphy III, Chief Executive Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of 1st Source Corporation;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: July 27, 2006

/s/CHRISTOPHER J. MURPHY III

Christopher J. Murphy III
Chief Executive Officer

CERTIFICATION

I, Larry E. Lentych, Chief Financial Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of 1st Source Corporation;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: July 27, 2006

/s/LARRY E. LENTYCH

Larry E. Lentych
Chief Financial Officer

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO**

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of 1st Source Corporation (1st Source) on Form 10-Q for the quarterly period ended June 30, 2006, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Christopher J. Murphy III, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

- (1) The Report fully complies with the requirements of sections 13(a) or 15(d) of the Securities and Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of 1st Source.

By:

/s/CHRISTOPHER J. MURPHY III

Christopher J. Murphy III
Chief Executive Officer
July 27, 2006

EXHIBIT 32.2

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO**

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of 1st Source Corporation (1st Source) on Form 10-Q for the quarterly period ended June 30, 2006, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Larry E. Lentych, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

(1) The Report fully complies with the requirements of sections 13(a) or 15(d) of the Securities and Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of 1st Source.

By:

/s/LARRY E. LENTYCH

Larry E. Lentych

Chief Financial Officer

July 27, 2006