BOK FINANCIAL CORP ET AL
Form 10-Q
August 09, 2006

As filed with the Securities and Exchange Commission on August 9, 2006

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

FORM 10-Q

(Mark One)

|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 No. 0-19341

BOK FINANCIAL CORPORATION
(Exact name of registrant as specified in its charter)

Oklahoma (State or other jurisdiction of Incorporation or Organization)	73-1373454 (IRS Employer Identification No.)
Bank of Oklahoma Tower P.O. Box 2300 Tulsa, Oklahoma (Address of Principal Executive Offices)	74192 (Zip Code)

(918) 588-6000
(Registrant's telephone number, including area code)

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 |X| Accelerated filer |_| Non-accelerated filer |_|

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 66,850,046 shares of common stock ($.00006 par value) as of July 31, 2006.

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Management's Discussion and Analysis of Financial Condition and Results of Operations

Performance Summary

BOK Financial Corporation ("BOK Financial" or the "Company") reported net income of $55.0 million, or $0.82 per diluted share for the second quarter of 2006, compared with $50.5 million, or $0.75 per diluted share for the second quarter of 2005. The annualized returns on average assets and shareholders' equity were 1.33% and 14.03%, respectively for 2006, compared with returns of 1.31% and 14.05%, respectively for 2005. Net income for the second quarter of 2005 included gains of $3.8 million or $0.06 per diluted share from sales of the Company's interest in an Oklahoma City office building and on the sale of certain mortgage loans which were not part of the Company's ongoing mortgage banking business.

Highlights of the quarter included:

- Outstanding loans at June 30, 2006 grew $1.3 billion or 15% since June 30, 2005, including $593 million since March 31, 2006

- Average deposits increased 14% from the second quarter of 2005, exceeding average loan growth by $284 million

- Stable net interest margin

- Fee revenues increased 8% compared with the second quarter of 2005

- Operating expense increase managed at a 6% level compared with the second quarter of 2005

- Near historical low non-performing loans; strong allowance for loan losses

Net interest revenue grew $8.6 million or 8% over 2005. Average outstanding loan balances increased $1.1 billion or 14% and average deposits increased $1.4 billion or 14%. Fees and commission revenue increased $6.9 million, or 8% over the second quarter of 2005. Transaction card revenue and trust revenue grew $2.0 million and $1.5 million, respectively. Other revenue increased $2.8 million, including $1.6 million from fees earned on margin assets.

Operating expenses increased $6.8 million or 6% over the second quarter of 2005, excluding changes in the value of mortgage servicing rights. Personnel costs increased $7.0 million due largely to a $4.5 million increase in salaries and wages and a $2.7 million increase in incentive compensation. The fair value of mortgage servicing rights increased $3.6 million during the second quarter of 2006 due to rising interest rates. At the same time, rising interest rates decreased the value of securities held as an economic hedge of mortgage servicing rights $2.5 million for a net gain of $1.1 million.

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Non-performing loans totaled $31 million or 0.32% of outstanding loans at June 30, 2006 compared with $41 million or 0.48 % of outstanding loans at June 30, 2005. The combined allowance for loan losses and reserve for off-balance sheet credit losses totaled $126 million or 1.30% of outstanding loans, excluding mortgage loans held for sale, at June 30, 2006 and $127 million or 1.50% of outstanding loans at June 30, 2005. The provision for credit losses was $3.8 million for the second quarter of 2006 and $2.0 million for the same period last year.

Net income for the first half of 2006 totaled $109.7 million, up $7.2 million or 7% over 2005. Net interest revenue grew $18.3 million or 8% due primarily to a $1.2 billion increase in average loans. Fee income increased $17.9 million or 11%. All categories of fee income increased over 2005 except mortgage banking revenue which decreased $144 thousand or 1%. Other revenue grew $6.2 million or 40% due primarily to a $3.5 million increase in fees on margin assets. Operating expenses increased $23.5 million or 10%, excluding changes in the value of mortgage servicing rights due to a $19.8 million increase in personnel costs. Appreciation in the value of mortgage servicing rights, net of losses on economic hedges, provided $4.0 million of net income in the first half of 2006.

The Company is establishing a new regional bank in Kansas City. Initial operations are expected to begin in the fourth quarter of 2006, subject to regulatory approval.

Results of Operations

Net Interest Revenue

Tax-equivalent net interest revenue increased to $122.7 million for the second quarter of 2006 from $113.8 million for 2005, due primarily to a $1.1 billion or 14% increase in average outstanding loan principal. Average loan growth was funded by a $1.4 billion or 14% increase in average deposits. The excess of average deposits over average loans of $284 million reduced other borrowings, generally a higher-costing source of funds. Table 1 shows the effects on net interest revenue of changes in average balances and interest rates for the various types of earning assets and interest-bearing liabilities.

Net interest margin, the ratio of tax-equivalent net interest revenue to average earning assets was 3.40% for the second quarter of 2006, compared with 3.45% for the second quarter of 2005 and 3.39% for the first quarter of 2006. Yields on average earning assets continued to trend upwards due to rising market interest rates. The yield on average earning assets was 6.71%, up 103 basis points compared with the second quarter of 2005 and 29 basis points over the preceding quarter. The yield on average outstanding loans was 7.68%, up 128 basis points over the second quarter of 2005 and 33 basis points over the first quarter of 2006. The tax-equivalent yield on securities was 4.77% for the second quarter of 2006, compared with 4.36% for the second quarter of 2005 and 4.64% for the first quarter of 2006.

Rates paid on average interest-bearing liabilities during the second quarter of 2006 increased 115 basis points over the second quarter of 2005 and 30 basis points over the preceding quarter. Rates paid on interest-bearing deposit accounts, which increased 96 basis points over 2005, continued to lag behind the increases in loan yields. The cost of other interest-bearing funds increased 187 basis points compared with the same period last year and 47 basis points from the preceding quarter. Increased non-interest bearing funds and changes in the mix of funding sources added 42 basis points to the net interest margin in second quarter of 2006 compared with 35 basis points for 2005 and 40 basis points for the first quarter of 2006.

Our overall objective is to manage the Company's balance sheet to be essentially neutral to changes in interest rates. Approximately 71% of our commercial loan portfolio is either variable rate or fixed rate that will reprice within one year. These loans are funded primarily by deposit accounts that are either non-interest bearing, or that reprice more slowly than the loans. The result is a balance sheet that would be asset sensitive, which means that assets generally reprice more quickly than liabilities. Among the strategies that we use to achieve a rate-neutral position, we purchase fixed-rate, mortgage-backed securities to offset the short-term nature of the majority of the Company's funding sources. The expected duration of these securities is approximately 3.1 years based on a range of interest rate and prepayment assumptions. The liability-sensitive nature of this strategy provides an offset to the asset-sensitive characteristics of our loan portfolio.

We also use derivative instruments to manage our interest rate risk. We have interest rate swaps with a combined notional amount of $807 million that convert fixed rate liabilities to floating rate based on LIBOR. The purpose of these derivatives, which generally have been designated as fair value hedges, is to position our balance sheet to be neutral to changes in interest rates. We also have interest rate swaps with a notional amount of $100 million that convert prime-based loans to fixed rate. The purpose of these derivatives, which have been designated as cash flow hedges, also

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is to position our balance sheet to be neutral to changes in interest rates.

The effectiveness of these strategies is reflected in the overall change in net interest revenue due to changes in interest rates as shown in Table 1 and in the interest rate sensitivity projections as shown in the Market Risk section of this report.

Table 1 - Volume / Rate Analysis
(In thousands)

	Three Months Ended June 30, 2006 / 2005			Six Mont[hs Ended] June 30, 2[006 / 2005]	
	Change Due To (1)			C[hange Due To (1)]	
	Change	Volume	Yield / Rate	Change	V[olume]
Tax-equivalent interest revenue:					

Securities	$ 6,032	$ 898	$ 5,134	$ 12,344	$
Trading securities	122	158	(36)	140	
Loans	48,096	19,847	28,249	95,238	
Funds sold and resell agreements	251	109	142	326	
Total	54,501	21,012	33,489	108,048	
Interest expense:					
Transaction deposits	18,826	5,266	13,560	36,326	
Savings deposits	68	(27)	95	149	
Time deposits	13,299	4,870	8,429	24,958	
Federal funds purchased and repurchase agreements	9,932	(407)	10,339	18,225	
Other borrowings	1,458	(2,371)	3,829	4,786	
Subordinated debentures	1,950	1,468	482	4,638	
Total	45,533	8,799	36,734	89,082	
Tax-equivalent net interest revenue	8,968	12,213	(3,245)	18,966	
Change in tax-equivalent adjustment	(395)			(661)	
Net interest revenue	$ 8,573			$ 18,305	

(1) Changes attributable to both volume and yield/rate are allocated to both volume and yield/rate on an equal basis.

Other Operating Revenue

Other operating revenue decreased $3.7 million compared with the second quarter of last year. Fees and commission revenue increased $6.9 million or 8%. Growth in fees and commissions revenue was offset by a $4.8 million net increase in losses on securities sales and a $5.9 million decrease in gains on sales of other assets.

Diversified sources of fees and commission revenue are a significant part of our business strategy and represented 44% of total revenue, excluding gains and losses on asset sales, securities and derivatives, for the second quarter of 2006. We believe that a variety of fee revenue sources provide an offset to changes in interest rates, values in the equity markets, commodity prices and consumer spending, all of which can be volatile. We expect continued growth in other operating revenue through offering new products and services and by expanding into new markets. However, increased competition and saturation in our existing markets could affect the rate of future increases.

Fees and commissions revenue

Transaction card revenue increased $2.0 million or 11%. Check card revenue increased $1.1 million or 27% while merchant discount fees increased $227 thousand or 4%. Transaction volumes provided the increased revenue. Growth in check card revenue was distributed among Oklahoma, New Mexico and Texas markets. Increased merchant discount fees were centered primarily in Oklahoma. ATM network revenue also increased $680 thousand or 9% over the second quarter of 2005.

Trust fees and commissions increased $1.5 million or 9% for the second quarter of 2006. The fair value of all trust assets, which is the basis for a significant portion of trust fees, increased to $28.7 billion at June 30, 2006 compared with $26.0 billion at June 30, 2005. Personal trust management fees increased $890 thousand or 18% while revenue from the management of oil and gas properties and other real estate increased $254 thousand or 16%. In addition, net fees from mutual fund advisory and administrative services were up $397 thousand or 12%. Trust activities in the Oklahoma and Colorado markets provided $13.0 million and $2.4 million, respectively, of total trust fees and commissions during the second quarter of 2006. Trust revenue grew $920 thousand or 8% in the Oklahoma market and $382 thousand or 19% in the Colorado market.

Brokerage and trading revenue increased $1.0 million or 10%. Customer hedging revenue increased $967 thousand or 51% to $2.9 million. Volatility in the energy markets prompted our energy customers to more actively hedge their gas and oil production. Revenue from securities trading activities decreased $279 thousand, or 5%. Most of the decrease in trading revenue is attributed to increased competition in the broker dealer or securities brokerage market and lower demand caused by the flattening yield curve in the securities market. Revenue from retail brokerage activities increased $336 thousand, or 10% over the same period of 2005.

Service charges on deposit accounts increased $1.0 million or 4% over the second quarter of 2005. Overdraft fees grew $1.4 million or 8% due to increased volume. Account service charge revenue decreased $213 thousand or 3%. This decrease reflected the change in earnings credit available to commercial deposit customers. The earnings credit, which provides a non-cash method for commercial customers to avoid incurring charges for deposit services, increases when interest rates rise.

Mortgage banking revenue, which is discussed more fully in the Line of Business - Mortgage Banking section of this report decreased $1.4 million, or 16% compared with 2005. Net gains on mortgage loans sold totaled $3.0 million, down $1.5 million from the second quarter of 2005. Servicing revenue totaled $4.2 million for the second quarter of 2006, a 3% increase over the same period last year.

Other operating revenue included $2.9 million of fees earned on margin assets in the second quarter of 2006 and $1.3 million in the second quarter of 2005. Margin assets, which are held primarily as part of the Company's customer derivatives programs, averaged $260 million for the second quarter of 2006, compared with $204 million for the second quarter of 2005. The increase in average margin assets reflected growth in the fair value of liability derivative contracts due primarily to increased volatility in energy markets. Fees earned on average margin assets increased to 4.44% in the second quarter of 2006 from 2.55% in the second quarter of 2005. Fee rates earned on margin assets are generally consistent with short-term interest rates.

Fees and commissions revenue for the first half of 2006 totaled $183.6 million, a $17.9 million or 11% increase over 2005. Transaction card revenue increased $3.9 million or 11% due to volume increases in merchant discounts and debit card transactions. Trust fees and commissions increased $3.4 million or 11% due to increase in asset values and business growth. Other revenue increased $6.2 million or 40%, including $3.5 million from margin account fees.

Securities and derivatives

BOK Financial recognized net losses of $2.6 million on securities for the second quarter of 2006, including net losses of $2.5 million on securities held as an economic hedge of mortgage servicing rights. Securities held as an economic hedge of the mortgage servicing rights are separately identified on the balance sheet as "mortgage trading securities." Mortgage trading securities are carried at fair value; changes in fair value are recognized in earnings as they occur. The Company's use of securities as an economic hedge of mortgage servicing rights is more-fully discussed in the Line of Business - Mortgage Banking section of this report. During the second quarter of 2005, BOK Financial recognized net gains on securities of $2.3 million, including $3.2 million of gains on sales of securities held as an economic hedge of mortgage servicing rights.

Net losses on derivatives totaled $172 thousand for the second quarter of 2006, compared with net losses of $311 thousand in 2005. Net losses in 2006 consisted of fair value adjustments of derivatives used to manage interest rate risk and related hedged liabilities. Net losses on derivatives in the second quarter of 2005 included $498 thousand of net losses from fair value adjustments of derivatives used to manage interest rate risk and related hedged liabilities, partially offset by a gain of $186 thousand from fair value adjustments of derivative contracts held as economic hedges of mortgage servicing rights.

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Table 2 - Other Operating Revenue
(In thousands)

	Three Months Ended			
	June 30, 2006	March 31, 2006	Dec. 31, 2005	Se
Brokerage and trading revenue	$ 11,427	$ 12,010	$ 11,116	$ 1
Transaction card revenue	19,951	18,508	18,988	1
Trust fees and commissions	17,751	17,945	16,536	1
Deposit service charges and fees	26,341	23,986	25,222	2
Mortgage banking revenue	7,195	6,789	7,018	
Other revenue	10,931	10,811	10,067	
Total fees and commissions	93,596	90,049	88,947	9
Gain on sales of assets	39	918	71	
Gain (loss) on securities, net	(2,583)	(1,221)	(1,780)	(
Gain (loss) on derivatives, net	(172)	(309)	106	
Total other operating revenue	$ 90,880	$ 89,437	$ 87,344	$ 8

Other Operating Expense

Other operating expense for the second quarter of 2006 totaled $122.1 million, a $3.9 million, or 3% decrease from 2005. The decrease in other operating expenses resulted from changes in the value of mortgage servicing rights. Appreciation of mortgage servicing rights during the second quarter of 2006 reduced operating expenses $3.6 million. Depreciation in the value of mortgage servicing rights required an impairment charge of $7.1 million in the second quarter of 2005. Operating expenses increased $6.8 million or 6% over the second quarter or 2005, excluding changes in the value of mortgage servicing due to higher personnel expense.

Personnel expense

Personnel expense totaled $72.4 million for the second quarter of 2006 compared with $65.3 million for the second quarter of 2005.

Regular compensation expense which consists primarily of salaries and wages totaled $45.5 million for the second quarter of 2006, up $4.4 million or 11% over 2005. The increase in regular compensation expense was due to a 7% increase in average regular compensation per full-time equivalent employee and a 4% increase in average staffing. Growth in average compensation per full-time equivalent employee reflects the cost of hiring top talent as we expand in various markets.

Incentive compensation expense includes the recognized costs of cash-based commissions, bonus and incentive programs, stock-based compensation plans and deferred compensation plans. Stock-based compensation plans include both equity and liability awards.

Incentive compensation expense totaled $15.5 million for the second quarter of 2006, an increase of $2.7 million or 21% over 2005. Second quarter 2006 expense for the Company's various cash-based incentive programs totaled $12.7 million, up $2.6 million over last year. These programs consist primarily of formula-based plans that determine incentive amounts based on pre-established growth criteria. Compensation expense for stock-based compensation plans totaled $2.8 million for both the second quarters of 2006 and 2005. Compensation expense for stock-based compensation plans accounted for as equity awards totaled $1.6 million in the second quarter of 2006, compared with $1.4 million in the second quarter of 2005. Expense for these awards is determined by the awards' grant-date fair value and is not affected by subsequent changes in the market value of BOK Financial common stock. Compensation expense for stock-based compensation plans accounted for as liability awards totaled $1.2 million in the second quarter of 2006, compared with $1.4 million in 2005. Expense for these liability awards is based on current fair value, including current period changes due to the market value of BOK Financial common stock.

Employee benefit expenses totaled $11.4 million for both the second quarters of 2006 and 2005. Pension expense decreased $1.8 million due to the curtailment of pension plan benefits as of April 1, 2006. The reduction in pension expense was largely offset by a $1.3 million increase in the cost of enhanced employee thrift plan benefits.

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Data processing and communications expense

Data processing and communication expenses decreased $224 thousand, or 1% compared to 2005. This expense consists of two broad categories, data processing systems and transaction card processing. Data processing systems costs decreased $517 thousand, or 5% compared with the first quarter of 2005. The Company negotiated cost reductions on its primary data processing contract during the quarter in exchange for a three-year contract extension. The benefit of these cost reductions will be recognized over the remaining contract term. Transaction card processing costs increased $293 thousand or 5% due to volume growth in check card and merchant discount revenue.

Other operating expenses

Business promotion expenses totaled $4.8 million for the second quarter of 2006, a $932 thousand or 24% increase over 2005. Promotional activities focused on consumer banking growth in Oklahoma and in the regional banking markets. Mortgage banking expense decreased $548 thousand or 16%. Costs associated with loan origination and sales activities totaled $384 thousand in the second quarter of 2006 and $423 thousand in the second quarter of 2005. Mortgage banking expense also included changes in the fair value of mortgage servicing rights due to runoff of the underlying loans. Fair value of mortgage servicing rights decreased $2.5 million in the second quarter of 2006 due to loan runoff. Amortization expense, which also considers the runoff of underlying loans, totaled $3.0 million in the second quarter of 2005.

Year to date operating expenses totaled $239.5 million, up 5% over 2005. Changes in the fair value of mortgage servicing rights decreased operating expenses $10.7 million in 2006 and increased operating expenses $1.5 million in 2005. Excluding changes in the value of mortgage servicing rights, operating expenses were $23.5 million or 10% higher for the first half of 2006. Personnel costs were up $19.8 million or 16%. Salaries and wages increased $10.0 million or 13% due to a 7% increase in average salaries per employee and a 5% increase in the average number of employees. Incentive compensation expense was up $9.1 million or 42%. Cash-based incentive programs increased $5.0 million based on performance measured against pre-established criteria. Stock-based incentive compensation increased $4.1 million.

Table 3 - Other Operating Expense
(In thousands)

	Three Months Ended			
	June 30, 2006	March 31, 2006	Dec. 31, 2005	Sept. 30, 2005
Personnel	$ 72,369	$ 71,232	$ 68,666	$ 66,533
Business promotion	4,802	4,803	5,170	4,494
Professional fees and services	4,362	3,914	4,534	3,951
Net occupancy and equipment	13,199	13,026	12,864	12,587
Data processing & communications	16,157	16,995	18,054	17,492
Printing, postage and supplies	4,001	3,905	3,976	3,846
Net (gains) losses and operating expenses of repossessed assets	54	219	335	(387)
Amortization of intangible assets	1,359	1,370	1,797	1,801
Mortgage banking costs	2,839	3,087	3,294	4,268
Change in fair value of mortgage servicing rights	(3,613)	(7,081)	-	-
Provision (recovery) for impairment of mortgage servicing rights	-	-	(708)	(4,671)
Other expense	6,598	5,909	5,921	7,120
Total other operating expense	$ 122,127	$ 117,379	$ 123,903	$ 117,034

Income Taxes

Income tax expense was $31.1 million, compared with $28.6 million for the second quarter of 2005. This represented 36% of book taxable income for both periods.

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Lines of Business

BOK Financial operates five principal lines of business: Oklahoma corporate banking, Oklahoma consumer banking, mortgage banking, wealth management, and regional banking. Mortgage banking activities include loan origination and servicing across all markets served by the Company. Wealth management provides brokerage and trading, private financial services and investment advisory services in all markets. It also provides fiduciary services in all markets except Colorado. Fiduciary services in Colorado are included in regional banking. Regional banking consists primarily of corporate and consumer banking activities in the respective local markets. In addition to its lines of business, BOK Financial has a funds management unit. The primary purpose of this unit is to manage the Company's overall liquidity needs and interest rate risk. Each line of business borrows funds from and provides funds to the funds management unit as needed to support their operations.

BOK Financial allocates resources and evaluates performance of its lines of business after allocation of funds, certain indirect expenses, taxes and capital costs. The cost of funds borrowed from the funds management unit by the operating lines of business is transfer priced at rates that approximate market for funds with similar duration. Market is generally based on the applicable LIBOR or interest rate swap rates, adjusted for prepayment risk. This method of transfer-pricing funds that support assets of the operating lines of business tends to insulate them from interest rate risk.

The value of funds provided by the operating lines of business to the funds management unit is based on applicable Federal Home Loan Bank advance rates. Deposit accounts with indeterminate maturities, such as demand deposit accounts and interest-bearing transaction accounts, are transfer-priced at a rolling average based on expected duration of the accounts. The expected duration ranges from 90 days for certain rate-sensitive deposits to five years.

Economic capital is assigned to the business units by a capital allocation model that reflects management's assessment of risk. This model assigns capital based upon credit, operating, interest rate and market risk inherent in our business lines and recognizes the diversification benefits among the units. The level of assigned economic capital is a combination of the risk taken by each business line, based on its actual exposures and calibrated to its own loss history where possible. Additional capital is assigned to the regional banking line of business based on our investment in those entities.

Consolidated net income provided by the Regional Banking Division continued to increase due largely to asset growth. Also, performance by business units that generate deposits for the Company, such as the Oklahoma consumer banking unit continued to improve due primarily to internal funds pricing credits. The increased value of deposits when short-term interest rates are rising is reflected in the internal transfer pricing credit. The increase in internal transfer pricing credit is offset through the funds management unit.

Table 4 - Net Income by Line of Business
(In thousands)

	Three months ended June 30, 2006	2005	Six months ended 2006
Regional banking	$ 22,731	$ 20,172	$ 45,505
Oklahoma corporate banking	20,267	23,081	38,425
Mortgage banking	1,341	(473)	4,485
Oklahoma consumer banking	8,545	6,314	17,012
Wealth management	6,128	5,476	13,377
Funds management and other	(4,028)	(4,105)	(9,072)
Total	$ 54,984	$ 50,465	$109,732

Oklahoma Corporate Banking

The Oklahoma Corporate Banking Division provides loan and lease financing and treasury and cash management services to businesses throughout Oklahoma and certain relationships in surrounding states. In addition to serving the banking needs of small businesses, middle market and larger customers, the Oklahoma Corporate Banking Division has specialized groups that serve customers in the energy, agriculture, healthcare and banking/finance industries, and includes TransFund, our electronic funds transfer network. The Oklahoma Corporate Banking Division contributed $20.3 million or 37% to consolidated net income for the second quarter of 2006. This compares to $23.1 million or 46% of consolidated net income for 2005. Net income provided by the Oklahoma Corporate Banking Division in the second quarter of 2005 included $2.9 million from the after-tax gain on the sale of the Company's interest in an Oklahoma City office building. Growth in net income provided by this division, excluding the prior year's gain on asset sale, came primarily from loan and deposit growth. Average loans attributed to the Oklahoma Corporate Banking Division were

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$4.3 billion for the second quarter of 2006, compared with $3.9 billion for the second quarter of 2005. Deposits attributed to Oklahoma Corporate Banking averaged $1.6 billion for the second quarter of 2006, up 10% over last year. Increased average loans and deposits combined to increase net interest revenue $2.9 million or 8%. In addition, other operating revenue increased $1.8 million or 8% due to growth in merchant discount and ATM processing fees. Operating expenses increased $4.0 million or 16%. Personnel expense increased $1.3 million or 16% due to growth in both regular salaries and incentive compensation. In addition, allocations for shared services increased $2.0 million.

Table 5 - Oklahoma Corporate Banking
(Dollars in Thousands)

	Three months ended June 30,		Six months ended Ju	
	2006	2005	2006	
NIR (expense) from external sources	$ 63,647	$ 50,588	$ 123,509	$
NIR (expense) from internal sources	(25,740)	(15,534)	(48,589)	(
Net interest revenue	37,907	35,054	74,920	
Other operating revenue	23,507	21,682	45,275	
Gain on sale of assets	-	4,708	-	
Operating expense	28,105	24,126	56,333	
Net loans charged off / (recovered)	252	(458)	1,087	
Net income	20,267	23,081	38,425	
Average assets	$5,173,904	$ 4,592,757	$5,170,713	$4,5
Average economic capital	401,170	320,170	384,780	3
Return on assets	1.57%	2.02%	1.50%	
Return on economic capital	20.26%	28.92%	20.14%	
Efficiency ratio	45.76%	42.52%	46.87%	

Oklahoma Consumer Banking

The Oklahoma Consumer Banking Division provides a full line of deposit, loan and fee-based services to customers throughout Oklahoma through four major distribution channels: traditional branches, supermarket branches, the 24-hour ExpressBank call center and the Internet. Additionally, the division is a significant referral source for the Bank of Oklahoma Mortgage Division ("BOk Mortgage") and the retail brokerage division of BOSC, Inc., a registered broker / dealer. Consumer banking activities outside of Oklahoma are included in the Regional Banking division. The Oklahoma Consumer Banking Division contributed $8.5 million or 16% to consolidated net income for the second quarter of 2006. This compares to $6.3 million or 13% of consolidated net income for 2005. Net interest revenue, which consisted primarily of credits for funds provided to the funds management unit increased $3.9 million or 29%. Average deposits attributed to this Division increased $193 million, or 7% compared with last year. The value to the Company of these lower-costing retail deposits continues to increase as short-term interest rates rise. Operating revenue increased $1.4 million or 8% over last year. Overdraft charges increased $755 thousand or 6% and check card fees increased $721 thousand or 26%. Operating expenses increased $1.8 million or 10% due primarily to growth in personnel and business promotion expenses.

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Table 6 - Oklahoma Consumer Banking
(Dollars in Thousands)

	Three months ended June 30,		Six months ended	
	2006	2005	2006	
NIR (expense) from external sources	$ (14,853)	$ (10,089)	$ (28,291)	
NIR (expense) from internal sources	31,978	23,340	61,437	
Net interest revenue	17,125	13,251	33,146	
Other operating revenue	18,139	16,736	35,393	
Operating expense	20,511	18,667	39,844	
Net loans charged off	775	913	907	
Net income	8,545	6,314	17,012	
Average assets	$ 2,818,034	$ 2,621,189	$ 2,793,626	$
Average economic capital	61,430	55,400	57,730	
Return on assets	1.22%	0.97%	1.23%	
Return on economic capital	55.79%	45.71%	59.42%	
Efficiency ratio	58.16%	62.25%	58.13%	

Mortgage Banking

BOK Financial engages in mortgage banking activities through the BOk Mortgage Division of Bank of Oklahoma. These activities include the origination, marketing and servicing of conventional and government-sponsored mortgage loans. Mortgage banking activities contributed $1.3 million or 2% to consolidated net income in the second quarter of 2006, compared with a net loss of $473 thousand in 2005.

Mortgage banking activities consisted of two sectors, loan production and loan servicing. The loan production sector generally performs best when mortgage rates are relatively low and loan origination volumes are high. Conversely, the loan servicing sector generally performs best when mortgage rates are relatively high and prepayments are low. The general trend has been toward higher mortgage loan commitment rates, especially in the first half of 2006.

Loan Production Sector

Loan production revenue totaled $3.4 million for the second quarter of 2006, including $3.3 million of capitalized mortgage servicing rights and a $174 thousand net gain on loans sold. Loan production revenue totaled $5.1 million for the second quarter of 2005, including $4.6 million of capitalized mortgage servicing rights. Mortgage loans funded in the second quarter of 2006 totaled $243 million, including $215 million of loans funded for resale and $28 million of loans funded for retention by affiliates. Mortgage loans funded in the same period of 2005 totaled $247 million, including $185 million of loans funded for resale and $62 million of loans funded for retention by affiliates. Approximately 70% of the loans funded during the second quarter of 2006 were to borrowers in Oklahoma. Loan production activities resulted in net pre-tax income of $696 thousand for the second quarter of 2006 and pre-tax income of $1.8 million for the second quarter of 2005. The pipeline of mortgage loan applications totaled $276 million at June 30, 2006, compared to $268 million at March 31, 2006 and $292 million at June 30, 2005.

Loan Servicing Sector

The loan servicing sector had net pre-tax income of $1.3 million for the second quarter of 2006 compared to a pre-tax loss of $3.9 million for the same period of 2005. The fair value of mortgage servicing rights increased in 2006 but decreased during 2005 due to changes in mortgage commitment rates.

A 36 basis point increase in average mortgage commitment rates since March 31, 2006 resulted in a $3.6 million increase in the value of mortgage servicing rights. Rising mortgage commitment rates, along with other market factors, reduced anticipated prepayment speeds and increased the discount rate used to value the servicing rights. At the same time, losses of $2.5 million were recognized from decreases in the fair value of financial instruments held as an economic hedge of the value of the servicing rights.

During the second quarter of 2005, an impairment provision of $7.1 million was recognized. A 50 basis point decrease in mortgage interest rates during this period reduced the fair value of the servicing rights. The impairment provision was partially offset by net gains of $3.4 million on financial instruments designated as economic hedges.

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Servicing revenue, which is included in mortgage banking revenue on the Consolidated Statements of Earnings, totaled $4.2 million in the second quarter of 2006 compared with $4.1 million in 2005. The average outstanding balance of loans serviced for others was $4.5 billion during 2006 compared to $3.8 billion during 2005. On March 31, 2006, the Company paid $6.8 million to acquire the rights to service approximately $480 million of mortgage loans. Substantially all of these loans are to borrowers in our primary market areas. Annualized servicing revenue per outstanding loan principal decreased to 37 basis points for the second quarter of 2006, compared with 43 basis points last year.

In addition to changes in the fair value of mortgage servicing rights due to anticipated prepayments and other factors, the fair value of mortgage servicing rights decreased $2.5 million during the second quarter of 2006 due to runoff of the underlying loans serviced. This reduction in fair value is included in mortgage banking costs in the Consolidated Statements of Earnings. Prior to adoption of FAS 156 in the first quarter of 2006, mortgage servicing rights were amortized in proportion to projected cash flows over the estimated life of the loans serviced. Projected cash flows considered both actual and estimated runoff of the underlying loans serviced. Amortization expense recognized in mortgage banking costs during the second quarter of 2005 totaled $3.0 million. The decrease in expense related to the runoff of loans serviced primarily reflects lower loan prepayment speeds.

Table 7 - Mortgage Banking
(Dollars in Thousands)

	Three months ended June 30,		Six mont
	2006	2005	2006

NIR (expense) from external sources	$ 5,624	$ 5,098	$ 10,4
NIR (expense) from internal sources	(4,683)	(3,585)	(8,9
Net interest revenue	941	1,513	1,4
Capitalized mortgage servicing rights	3,333	4,556	6,1
Other operating revenue	4,391	4,851	8,7
Gain on sale of assets	-	1,232	
Operating expense	7,328	9,160	14,9
Change in fair value of mortgage servicing rights	3,613	-	10,6
Provision for impairment of mortgage servicing rights	-	7,088	
Gains (losses) on financial instruments, net	(2,533)	3,404	(4,3
Net income (loss)	1,341	(473)	4,4
Average assets	$ 498,495	$ 542,797	$ 472,6
Average economic capital	23,410	21,390	23,8
Return on assets	1.08%	(0.35)%	1.
Return on economic capital	22.98%	(8.87)%	37.
Efficiency ratio	84.57%	75.38%	91.

BOK Financial designates a portion of its securities portfolio as an economic hedge against the risk of loss on its mortgage servicing rights. Mortgage-backed securities and U.S. government agency debentures are designated as "mortgage trading securities" when prepayment risks exceed certain levels. Additionally, interest rate derivative contracts may also be designated as an economic hedge of the risk of loss on mortgage servicing rights. Because the fair values of these instruments are expected to vary inversely to the fair value of the servicing rights, they are expected to partially offset risk. These financial instruments are carried at fair value. Changes in fair value are recognized in current period income. No special hedge accounting treatment is applicable to either the mortgage servicing rights or the financial instruments designated as an economic hedge.

This hedging strategy presents certain risks. A well-developed market determines the fair value for the securities and derivatives, however there is no comparable market for mortgage servicing rights. Therefore, the computed change in value of the servicing rights for a specified change in interest rates may not correlate to the change in value of the securities.

At June 30, 2006, financial instruments with a fair value of $83 million were held for the economic hedge program. The interest rate sensitivity of the mortgage servicing rights and securities held as a hedge is modeled over a range of +/- 50 basis points. At June 30, 2006, the pre-tax results of this modeling on reported earnings were:

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Table 8 - Interest Rate Sensitivity - Mortgage Servicing
(Dollars in Thousands)

	50 bp increase	50 bp decrease
Anticipated change in:		
Fair value of mortgage servicing rights	$ 2,796	$ (3,744)
Fair value of hedging instruments	(2,823)	3,085
Net	$ (27)	$ (659)

Table 8 shows the non-linear effect of changes in mortgage commitment rates on the value of mortgage servicing rights. A 50 basis point increase in rates is expected to increase value by $2.8 million while a 50 basis point decrease is expected to reduce value by $3.7 million. This considers that there is an upper limit to appreciation in the value of servicing rights as rates rise due to the contractual repayment terms of the loans and other factors. There is much less of a limit on the speed at which mortgage loans may prepay in a declining rate environment.

Wealth Management

BOK Financial provides a wide range of financial services through its wealth management line of business, including trust and private financial services, and brokerage and trading activities. This line of business includes the activities of BOSC, Inc., a registered broker / dealer. Trust and private financial services includes sales of institutional, investment and retirement products, loans and other services to affluent individuals, businesses, not-for-profit organizations, and governmental agencies. Wealth management services are provided primarily to clients throughout Oklahoma, Texas and New Mexico. Additionally, trust services include a nationally competitive, self-directed 401-(k) program and administrative and advisory services to the American Performance family of mutual funds. Brokerage and trading activities within the wealth management line of business consist of retail sales of mutual funds, securities, and annuities, institutional sales of securities and derivatives, bond underwriting and other financial advisory services. Customer hedging programs are included in the Wealth Management Division.

Wealth Management contributed $6.1 million or 11% to consolidated net income for the second quarter of 2006. This compared to $5.5 million or 11% of consolidated net income for 2005.

Trust and private financial services provided $5.6 million of net income in 2006, an 18% increase over 2005. At June 30, 2006 and 2005, the wealth management line of business was responsible for trust assets with aggregate market values of $26.2 billion and $23.8 billion, respectively, under various fiduciary arrangements. The growth in trust assets reflected increased market value of assets managed in addition to new business generated during the year. We have sole or joint discretionary authority over $9.7 billion of trust assets at June 30, 2006, compared with $8.6 billion at June 30, 2005.

Brokerage and trading activities provided $567 thousand of total net income in the second quarter of 2006 compared to $872 thousand provided in same period of 2005. A reduction in income from trading activities was partially offset by growth in net income from our customer hedging programs.

Table 9 - Wealth Management
(Dollars in Thousands)

	Three months ended June 30,		Six months ended J
	2006	2005	2006
NIR (expense) from external sources	$ 3,012	$ 3,010	$ 5,476
NIR (expense) from internal sources	3,660	2,711	7,698
Net interest revenue	6,672	5,721	13,174
Other operating revenue	29,555	26,554	60,105
Operating expense	26,045	23,149	51,236
Net income	6,128	5,476	13,377
Average assets	$ 1,913,243	$ 1,709,268	$ 1,894,992

Average economic capital	126,720	119,870	122,890
Return on assets	1.28%	1.29%	1.42%
Return on economic capital	19.40%	18.32%	21.95%
Efficiency ratio	71.89%	71.72%	69.92%

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Regional Banking

Regional Banking consists primarily of the corporate and commercial banking services provided by Bank of Texas, Bank of Albuquerque, Bank of Arkansas, Colorado State Bank and Trust, and Bank of Arizona in their respective markets. They also include fiduciary services provided by Colorado State Bank and Trust. Small businesses and middle-market corporations are Regional Banking's primary customer focus. Regional Banking contributed $22.7 million or 41% to consolidated net income during the second quarter of 2006. This compares with $20.2 million or 40% of consolidated net income for the same period in 2005. Growth in net income contributed by the regional banks came primarily from operations in Colorado. Net income from Colorado operations increased $1.1 million or 50% compared with the same period of 2005. In addition, net income for 2006 in Texas and Arizona increased $559 thousand and $444 thousand, respectively.

Net income from operations in Colorado was $3.4 million for the second quarter of 2006, compared with $2.3 million for the second quarter of 2005. Net interest revenue increased $2.2 million or 33% due primarily to a $422 million increase in average earning assets. Average loans increased $105 million while average funds sold to the funds management unit increased $282 million. The growth in earning assets was funded primarily by a $281 million increase in interest-bearing deposits and $101 million of borrowings from the funds management unit. Other operating revenue grew $400 thousand or 15% due primarily to trust fees and commissions. At June 30, 2006 and 2005, Colorado regional banking was responsible for trust assets with aggregate fair values of $2.5 billion and $2.2 billion, respectively under various fiduciary arrangements. We have sole or joint discretionary authority over $955 million of trust assets at June 30, 2006, compared with $860 million at June 30, 2005. Operating expenses also increased 15% due to personnel costs and allocations of shared support services.

Net income from Texas operations totaled $12.8 million for the second quarter of 2006, up $559 thousand over last year. Net interest revenue grew $3.6 million or 11%. Average earning assets increased $513 million, or 19% from the second quarter of 2005. This increase resulted from a $438 million increase in average loans and a $113 million increase in securities. The growth in average earning assets was funded primarily by a $396 million increase in average deposits and a $114 million increase in funds borrowed from the funds management unit. Operating revenue increased $330 thousand due to deposit service charges and check card revenue. Operating expenses increased $2.2 million or 12% due to a $1.0 million or 10% increase in personnel costs and higher allocations for shared services.

The increase in net income from New Mexico operations was also based largely on a $671 thousand increase in net interest revenue. Average earning assets decreased $93 million. Average loans increased $8 million while funds sold to the funds management unit decreased $100 million. Average deposits in the New Mexico market increased $133 million, including $110 million of consumer banking deposits. Average funds borrowed from external sources decreased $201 million as the Company centralized borrowings from external sources in the funds management unit. Other operating income increased $264 thousand or 7% due primarily to growth in transaction card revenue.

We continue to expand operations in the Arizona market since the acquisition of Bank of Arizona in the second quarter of 2005. Outstanding loans attributed to the Arizona market averaged $270 million for the second quarter of 2006, up $131 million from the second quarter of 2005's average of $139 million. Loan growth included $47 million in our recently-opened Tucson loan production office. Average deposits increased $7 million to $121 million. Loan growth was funded by borrowings from the funds management unit.

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Table 10 - Bank of Texas
(Dollars in Thousands)

	Three months ended June 30,		Six mont
	2006	2005	2006
NIR (expense) from external sources	$ 41,190	$ 34,841	$ 80,2
NIR (expense) from internal sources	(5,345)	(2,590)	(9,5
Net interest revenue	35,845	32,251	70,6
Other operating revenue	6,529	6,199	12,6
Operating expense	20,819	18,661	41,1
Net loans charged off	1,789	1,255	2,1
Net income	12,848	12,289	26,0
Average assets	$ 3,610,316	$ 3,099,892	$ 3,578,2
Average economic capital	247,010	166,940	229,2
Average invested capital	414,090	334,020	396,3
Return on assets	1.43%	1.59%	1.
Return on economic capital	20.86%	29.53%	22.
Return on average invested capital	12.44%	14.76%	13.
Efficiency ratio	49.13%	48.53%	49.

Table 11 - Bank of Albuquerque
(Dollars in Thousands)

	Three months ended June 30,		Six mont
	2006	2005	2006
NIR (expense) from external sources	$ 15,992	$ 13,945	$ 31,66
NIR (expense) from internal sources	(4,126)	(2,750)	(8,01
Net interest revenue	11,866	11,195	23,65
Other operating revenue	4,149	3,885	8,07
Operating expense	6,609	6,608	13,68
Net loans charged off	692	275	75
Net income	5,341	5,009	10,58
Average assets	$ 1,446,500	$ 1,536,954	$ 1,459,37
Average economic capital	75,080	84,630	75,41
Average invested capital	94,170	103,720	94,50
Return on assets	1.48%	1.31%	1.4

Return on economic capital	28.53%	23.74%	28.3
Return on average invested capital	22.75%	19.37%	22.5
Efficiency ratio	41.27%	43.82%	43.1

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Table 12 - Bank of Arkansas
(Dollars in Thousands)

	Three months ended June 30,		Six mont
	2006	2005	2006
NIR (expense) from external sources	$ 2,616	$ 2,510	$ 4,905
NIR (expense) from internal sources	(819)	(842)	(1,538
Net interest revenue	1,797	1,668	3,367
Other operating revenue	275	292	529
Operating expense	870	843	1,727
Net loans charged off / (recovered)	(70)	13	(28
Net income	776	686	1,341
Average assets	$ 188,922	$ 248,209	$ 192,477
Average economic capital	15,680	10,460	14,650
Average invested capital	15,680	10,460	14,650
Return on assets	1.65%	1.11%	1.40
Return on economic capital	19.85%	26.31%	18.46
Return on average invested capital	19.85%	26.31%	18.46
Efficiency ratio	41.99%	43.01%	44.33

Table 13 - Colorado State Bank and Trust
(Dollars in Thousands)

	Three months ended June 30,		Six mont
	2006	2005	2006
NIR (expense) from external sources	$ 12,870	$ 8,330	$ 24,42
NIR (expense) from internal sources	(3,929)	(1,629)	(6,95
Net interest revenue	8,941	6,701	17,46
Other operating revenue	3,007	2,607	6,04
Operating expense	6,401	5,589	12,36
Net loans charged off	(5)	23	(5
Net income	3,392	2,258	6,84
Average assets	$ 1,151,708	$ 726,730	$ 1,095,05
Average economic capital	69,080	46,870	65,42
Average invested capital	111,060	88,860	107,41
Return on assets	1.18%	1.25%	1.2
Return on economic capital	19.69%	19.32%	21.0
Return on average invested capital	12.25%	10.19%	12.8
Efficiency ratio	53.57%	60.05%	52.5

Table 14 - Bank of Arizona
(Dollars in Thousands)

	Three months ended June 30,		Six mont
	2006	2005	2006
NIR (expense) from external sources	$ 6,076	$ 2,464	$ 10,76
NIR (expense) from internal sources	(2,441)	(401)	(4,03
Net interest revenue	3,635	2,063	6,73
Other operating revenue	122	375	28
Operating expense	3,206	2,530	5,75
Net loans charged off / (recovered)	(2)	21	
Net income	374	(70)	70
Average assets	$ 366,609	$ 209,947	$ 331,08
Average economic capital	23,560	16,127	20,28
Average invested capital	40,210	32,777	36,93
Return on assets	0.41%	(0.13)%	0.4
Return on economic capital	6.37%	(1.74)%	7.0
Return on average invested capital	3.73%	(0.86)%	3.8
Efficiency ratio	85.33%	103.77%	82.0

*** Data not applicable due to acquisition of Bank of Arizona in April 2005.

Financial Condition

Securities

Securities are classified as either held for investment, available for sale or trading based upon asset/liability management strategies, liquidity and profitability objectives and regulatory requirements. Investment securities, which consist primarily of Oklahoma municipal bonds, are carried at cost and adjusted for amortization of premiums or accretion of discounts. Management has the ability and intent to hold these securities until they mature. Available for sale securities, which may be sold prior to maturity, are carried at fair value. Unrealized gains or losses, less deferred taxes, are recorded as accumulated other comprehensive income in shareholders' equity. Certain mortgage-backed securities, identified as mortgage trading securities, have been designated as economic hedges of mortgage servicing rights. These securities are carried at fair value with changes in fair value recognized in current period income. These securities are held with the intent that gains or losses will offset changes in the fair value of mortgage servicing rights. The Company also maintains a separate trading securities portfolio. Trading portfolio securities, which are also carried at fair value with changes in fair value recognized in current period income, are acquired and held with the intent to sell at a profit.

The amortized cost of available for sale securities totaled $4.9 billion at both June 30, 2006 and March 31, 2006. Mortgage-backed securities continued to represent substantially all available for sale securities. As previously discussed in the Net Interest Revenue section of this report, we hold mortgage backed securities as part of our overall interest rate risk management strategy. Management restricted growth in the securities portfolio during the second quarter of 2006 in anticipation of an investment of up to $200 million in bank-owned life insurance in the third quarter of 2006.

The primary risk of holding mortgage-backed securities comes from extension during periods of rising interest rates or prepayment during periods of falling interest rates. We evaluate this risk through extensive modeling of risk both before making an investment and throughout the life of the security. The effective duration of the mortgage-backed securities portfolio was approximately 3.1 years at June 30, 2006 and 2.8 years at March 31, 2006. Management estimates that the effective duration of the mortgage-backed securities portfolio would extend to 3.3 years assuming a 300 basis point immediate rate shock.

Net unrealized losses on available for sale securities totaled $187 million at June 30, 2006 compared with net unrealized losses of $148 million at March 31, 2006. The increase in net unrealized losses during the quarter was due primarily to rising interest rates. The aggregate gross amount of unrealized losses at June 30, 2006 totaled $201 million. We evaluated the securities with unrealized losses to determine if the losses were temporary. This evaluation considered factors such as causes of the unrealized losses and prospects for recovery over various interest rate scenarios and time periods. Management does not believe that any of the unrealized losses are due to credit quality concerns. We also considered our intent and ability to either hold or sell the securities. It is our belief, based on currently available

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information and our evaluation, that the unrealized losses in these securities are temporary.

Loans

The aggregate loan portfolio at June 30, 2006 totaled $9.8 billion, a $593 million increase since March 31, 2006. Net loan growth accelerated to a 26% annualized rate during the second quarter of 2006. Commercial loans increased $300 million and commercial real estate loans grew $218 million.

Table 15 - Loans
(In thousands)

	June 30, 2006	March 31, 2006	Dec. 31, 2005	Sept. 3 2005
Commercial:				
Energy	$ 1,514,353	$ 1,367,400	$ 1,399,417	$ 1,350,8
Services	1,405,060	1,358,194	1,425,821	1,419,3
Wholesale/retail	879,203	850,013	793,032	804,6
Manufacturing	541,592	519,100	514,792	484,6
Healthcare	546,595	534,091	520,309	476,6
Agriculture	292,022	284,277	291,858	238,9
Other commercial and industrial	360,493	325,746	354,706	292,6
Total commercial	5,539,318	5,238,821	5,299,935	5,067,69
Commercial real estate:				
Construction and land development	789,991	686,400	638,366	605,4
Multifamily	228,781	205,755	204,620	225,0
Other real estate loans	1,304,164	1,212,805	1,146,916	1,142,0
Total commercial real estate	2,322,936	2,104,960	1,989,902	1,972,6

Residential mortgage:				
Secured by 1-4 family residential properties	1,211,448	1,177,337	1,169,331	1,166,5
Residential mortgages held for sale	54,026	40,299	51,666	46,3
Total residential mortgage	1,265,474	1,217,636	1,220,997	1,212,8
Consumer	666,740	640,542	629,144	630,3
Total	$ 9,794,468	$ 9,201,959	$ 9,139,978	$ 8,883,5

The commercial loan portfolio totaled $5.5 billion at June 30, 2006, up $300 million during the second quarter of 2006. Energy loans totaled $1.5 billion or 15% of total loans. Outstanding energy loans increased $147 million, or 43% annualized, during the second quarter of 2006 after decreasing $32 million during the preceding quarter. Growth in energy loans during the second quarter reflected an expectation that the range of energy prices will remain near or exceed current levels. Approximately $1.2 billion of loans in the energy portfolio was to oil and gas producers. The amount of credit available to these customers generally depends on a percentage of the value of their proven energy reserves based on anticipated prices. The energy category also included loans to borrowers involved in the transportation and sale of oil and gas and to borrowers that manufacture equipment or provide other services to the energy industry.

The services sector of the portfolio totaled $1.4 billion, or 14% of the Company's total outstanding loans. Loans in this sector of the portfolio increased $47 million or 14% annualized since March 31, 2006. The services sector consists of a large number of loans to a variety of businesses, including communications, gaming and transportation services. Approximately $960 million of the services sector is made up of loans with balances of less than $10 million.

Other notable loan concentrations by primary industry of the borrowers are presented in Table 15.

BOK Financial participates in shared national credits when appropriate to obtain or maintain business relationships with local customers. Shared national credits are defined by banking regulators as credits of more than $20 million and with three or more non-affiliated banks as participants. The outstanding principal balances of these loans totaled $1.2 billion at both June 30, 2006 and March 31, 2006. Substantially all of these loans were to borrowers with local market

relationships. BOK Financial serves as the agent lender in approximately 31% of the shared national credits, based on dollars committed. Our lending policies generally avoid loans in which we do not have the opportunity to maintain or achieve other business relationships with the customer.

Commercial real estate loans totaled $2.3 billion or 24% of the loan portfolio at June 30, 2006. The outstanding balance of commercial real estate loans increased $218 million, or 41% annualized since March 31, 2006. Construction and land development loans totaled $790 million, up $104 million over March 31, 2006. Construction and land development included $608 million of loans secured by single family residential lots and premises. The major components of other commercial real estate loans were office buildings - $464 million and retail facilities - $352 million.

Residential mortgage loans, excluding mortgage loans held for sale, included $360 million of home equity loans, $406 million of loans held for business relationship purposes, $236 million of adjustable rate mortgages and $178 million of loans held for community development. Consumer loans included $396 million of indirect automobile loans, up $25 million since March 31, 2006. Approximately $350 million of these loans were purchased from dealers in Oklahoma. Growth during the quarter included $16 million from indirect lending activities in Arkansas and $13 million in Oklahoma.

Table 16 presents the distribution of the major loan categories among our primary market areas.

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Table 16 - Loans by Principal Market Area
(In thousands)

	June 30, 2006	March 31, 2006	Dec. 31, 2005	Sept. 3 2005
Oklahoma:				
Commercial	$ 3,212,851	$ 3,074,406	$ 3,159,683	$ 3,101,2
Commercial real estate	1,019,815	936,030	862,700	890,7
Residential mortgage	855,087	847,848	842,757	839,3
Residential mortgage held for sale	54,026	40,299	51,666	46,3
Consumer	479,508	468,920	466,180	472,8
Total Oklahoma	$ 5,621,287	$ 5,367,503	$ 5,382,986	$ 5,350,4
Texas:				
Commercial	$ 1,548,545	$ 1,420,860	$ 1,356,611	$ 1,294,6
Commercial real estate	669,698	604,413	569,921	537,5
Residential mortgage	212,987	200,957	199,726	196,5
Consumer	84,212	87,669	89,017	89,3
Total Texas	$ 2,515,442	$ 2,313,899	$ 2,215,275	$ 2,118,1
New Mexico:				
Commercial	$ 334,984	$ 348,930	$ 383,325	$ 354,0
Commercial real estate	237,020	228,955	232,564	223,2
Residential mortgage	73,281	68,810	65,784	65,2
Consumer	13,404	13,820	15,137	15,1
Total Albuquerque	$ 658,689	$ 660,515	$ 696,810	$ 657,7
Arkansas:				
Commercial	$ 80,539	$ 74,423	$ 79,719	$ 54,7
Commercial real estate	87,080	80,529	75,483	85,6
Residential mortgage	15,067	13,069	13,044	12,0
Consumer	51,166	33,548	25,659	20,3
Total Northwest Arkansas	$ 233,852	$ 201,569	$ 193,905	$ 172,7

Colorado:				
Commercial	$ 299,380	$ 267,928	$ 270,108	$ 219,2
Commercial real estate	155,453	134,771	133,537	132,7
Residential mortgage	21,113	20,383	21,918	26,1
Consumer	31,939	31,487	27,871	26,1
Total Colorado	$ 507,885	$ 454,569	$ 453,434	$ 404,2
Arizona:				
Commercial	$ 63,019	$ 52,274	$ 50,489	$ 43,8
Commercial real estate	153,870	120,262	115,697	102,7
Residential mortgage	33,913	26,270	26,102	27,1
Consumer	6,511	5,098	5,280	6,4
Total Arizona	$ 257,313	$ 203,904	$ 197,568	$ 180,1
Total BOK Financial loans	$ 9,794,468	$ 9,201,959	$ 9,139,978	$ 8,883,5

Loan Commitments

BOK Financial enters into certain off-balance sheet arrangements in the normal course of business. These arrangements included loan commitments which totaled $4.9 billion and standby letters of credit which totaled $481 million at June 30, 2006. Loan commitments may be unconditional obligations to provide financing or conditional obligations that depend on the borrower's financial condition, collateral value or other factors. Standby letters of credit are unconditional commitments to guarantee the performance of our customer to a third party. Since some of these commitments are expected to expire before being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

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Derivatives with Credit Risk

BOK Financial offers programs that permit its customers to hedge various risks, including fluctuations in energy and cattle prices, interest rates and foreign exchange rates, or to take positions in derivative contracts. Each of these programs work essentially the same way. Derivative contracts are executed between the customers and BOK Financial. Offsetting contracts are executed between the Company and selected counterparties to minimize the risk to us of changes in commodity prices, interest rates, or foreign exchange rates. The counterparty contracts are identical to the customer contracts, except for a fixed pricing spread or a fee paid to us as compensation for administrative costs, credit risk and profit.

These programs create credit risk for potential amounts due from customers and from the counterparties. Customer credit risk is monitored through existing credit policies and procedures. The effects of changes in commodity prices, interest rates or foreign exchange rates are evaluated across a range of possible options to determine the maximum exposure we are willing to have individually to any customer. Customers may also be required to provide margin collateral to further limit our credit risk.

Counterparty credit risk is evaluated through existing policies and procedures. This evaluation considers the total relationship between BOK Financial and each of the counterparties. Individual limits are established by management, approved by Credit Administration and reviewed by the Asset / Liability Committee. Margin collateral is required if the exposure between the Company and any counterparty exceeds established limits. Based on declines in the counterparties' credit rating, these limits are reduced and additional margin collateral is required.

A deterioration of the credit standing of one or more of the customers or counterparties to these contracts may result in BOK Financial recognizing a loss as the fair value of the affected contracts may no longer move in tandem with the offsetting contracts. This could occur if the credit standing of the customer or counterparty deteriorated such that either the fair value of underlying collateral no longer supported the contract or the counterparty's ability to provide margin collateral was impaired.

Derivative contracts are carried at fair value. At June 30, 2006, the fair value of derivative contracts reported as assets under these programs totaled $414 million. This included energy contracts with fair values of $365 million, interest rate contracts with fair values of $29 million and foreign exchange contracts with fair values of $17 million. The aggregate fair values of derivative contracts reported as liabilities under these programs totaled $416 million. At March 31, 2006, the fair values of assets and liabilities reported under these programs totaled $401 million and $402 million, respectively. Approximately 96% of the fair value of asset contracts was with customers. The credit risk of these contracts is generally backed by energy production. The remaining 4% was with counterparties. The maximum net exposure to any single customer or counterparty totaled $89 million.

Summary of Loan Loss Experience

The reserve for loan losses, which is available to absorb losses inherent in the loan portfolio, totaled $105 million at June 30, 2006, compared with $104 million at March 31, 2006 and $109 million at June 30, 2005. These amounts represented 1.07%, 1.14% and 1.29% of outstanding loans, excluding loans held for sale, at June 30, 2006, March 31, 2006 and June 30, 2005, respectively. Losses on loans held for sale, principally mortgage loans accumulated for placement into security pools, are charged to earnings through adjustment in the carrying value. The reserve for loan losses also represented 337% of the outstanding balance of nonperforming loans at June 30, 2006, compared with 323% at March 31, 2006 and 269% at June 30, 2005. Nonperforming loans totaled $31 million at June 30, 2006, compared with $32 million at March 31, 2006 and $41 million at June 30, 2005. Net loans charged off during the second quarter of 2006 totaled $3.8 million, up from $1.6 million in the first quarter of 2006 and $2.3 million for the second quarter of 2005.

The Company considers credit risk from loan commitments and letters of credit in its evaluation of the adequacy of the reserve for loan losses. A separate reserve for off-balance sheet credit risk is maintained. Table 17 presents the trend of reserves for off-balance sheet credit losses and the relationship between the reserve and loan commitments. The relationship between the combined reserve for credit losses and outstanding loans is also presented to facilitate comparison with peer banks and others who have not adopted this preferred presentation. The provision for credit losses included the combined charge to expense for both the reserve for loan losses and the reserve for off-balance sheet credit losses. All losses incurred from lending activities will ultimately be reflected in charge-offs against the reserve for loan

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losses following funds advanced against outstanding commitments and after the exhaustion of collection efforts. The reserve for off-balance sheet credit losses would decrease and the reserve for loan losses would increase as outstanding commitments are funded.

Table 17 - Summary of Loan Loss Experience

(In thousands)

	Three Months Ended			
	June 30, 2006	March 31, 2006	Dec. 31, 2005	
Reserve for loan losses:				
Beginning balance	$ 104,143	$ 103,876	$ 109,621	$
Loans charged off:				
Commercial	2,523	1,242	5,772	
Commercial real estate	-	-	84	
Residential mortgage	363	207	226	
Consumer	2,995	2,700	3,497	
Total	5,881	4,149	9,579	
Recoveries of loans previously charged off:				
Commercial	720	847	826	
Commercial real estate	6	40	8	
Residential mortgage	20	97	133	
Consumer	1,339	1,580	1,197	
Total	2,085	2,564	2,164	
Net loans charged off	3,796	1,585	7,415	
Provision for loan losses	4,178	1,852	1,670	
Additions due to acquisitions	-	-	-	
Ending balance	$ 104,525	$ 104,143	$ 103,876	$
Reserve for off-balance sheet credit losses:				
Beginning balance	$ 22,122	$ 20,574	$ 17,794	$
Provision for off-balance sheet credit losses	(383)	1,548	2,780	
Additions due to acquisitions	-	-	-	
Ending balance	$ 21,739	$ 22,122	$ 20,574	$
Total provision for credit losses	$ 3,795	$ 3,400	$ 4,450	$
Reserve for loan losses to loans outstanding at period-end (1)	1. 07%	1.14%	1.14%	
Net charge-offs (annualized) to average loans (1)	0.16	0.07	0.33	
Total provision for credit losses (annualized) to average loans (1)	0.16	0.15	0.20	
Recoveries to gross charge-offs	35.45	61.80	22.59	
Reserve for loan losses as a multiple of net charge-offs (annualized)	6.88x	16.43x	3.50x	
Reserve for off-balance sheet credit losses to off-balance sheet credit commitments	0.41%	0.36%	0.42%	
Combined reserves for credit losses to loans outstanding at period-end (1)	1.30	1.38	1.37	

(1) Excludes residential mortgage loans held for sale.

Specific impairment reserves are determined through evaluation of estimated future cash flows and collateral value. At June 30, 2006, specific impairment reserves totaled $3.3 million on total impaired loans of $27 million. Required specific impairment reserves decreased $1.7 million from March 31, 2006.

Nonspecific reserves are maintained for risks beyond factors specific to an individual loan or those identified through migration analysis. A range of potential losses is determined for each risk factor identified. At June 30, 2006, the ranges of potential losses for the more significant factors were:

General economic conditions - $4.6 million to $8.0 million
Concentration in large loans - $1.0 million to $2.0 million

The provision for credit losses totaled $3.8 million for the second quarter of 2006, compared with $3.4 million for the first quarter of 2006 and $2.0 for the second quarter of 2005. Factors considered in determining the provision for credit

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losses included an increase in net losses during the quarter, partially offset by decreases in the outstanding balances of classified, criticized and non-performing loans.

Nonperforming Assets

Information regarding nonperforming assets, which totaled $39 million at June 30, 2006 and $40 million at March 31, 2006, is presented in Table 18. Nonperforming assets included non-accrual loans and excluded loans 90 days or more past due but still accruing interest. Non-accrual loans totaled $31 million at June 30, 2006 and $32 million at March 31, 2006. Newly identified non-accruing loans totaled $5 million during the second quarter of 2006. Non-accruing loans decreased $3 million for loans charged off or foreclosed, and $3 million for cash payments received. The increase in non-accruing consumer loans during the second quarter of 2006 included a single $3.6 million loan that was originated for personal investment purposes. Management does not believe the increase indicates a change in the trend of level of non-accruing consumer loans.

Table 18 - Nonperforming Assets
(In thousands)

	June 30, 2006	March 31, 2006	Dec. 31, 2005	Sept 20
Nonaccrual loans:				
Commercial	$ 15,087	$ 17,073	$ 11,673	$ 17
Commercial real estate	4,369	6,444	5,370	10
Residential mortgage	7,604	8,057	7,347	8
Consumer	3,916	655	772	
Total nonaccrual loans	30,976	32,229	25,162	37
Other nonperforming assets	8,257	8,196	8,476	5
Total nonperforming assets	$ 39,233	$ 40,425	$ 33,638	$ 42
Ratios:				
Reserve for loan losses to nonaccrual loans	337.44%	323.13%	412.83%	293
Combined reserves for credit losses to nonaccrual loans	407.62	391.77	494.60	34
Nonaccrual loans to period-end loans (2)	0.32	0.35	0.28	0
Loans past due (90 days) (1)	$ 9,630	$ 3,919	$ 8,708	$ 10,

(1) Includes residential mortgages guaranteed by agencies of the U.S.Government.	$ 2,310	$ 1,595	$ 2,021	$ 3,

(2) Excludes residential mortgage loans held for sale.

The loan review process also identifies loans that possess more than the normal amount of risk due to deterioration in the financial condition of the borrower or the value of the collateral. Because the borrowers are still performing in accordance with the original terms of the loan agreements, and no loss of principal or interest is anticipated, these loans were not included in Nonperforming Assets. Known information does, however, cause management concerns as to the borrowers' ability to comply with current repayment terms. These potential problem loans totaled $23 million at both June 30, 2006 and March 31, 2006. The current composition of potential problem loans by primary industry included healthcare - $12 million, services - $7 million and real estate - $2 million.

Deposits

Deposit accounts represent our primary funding source. We compete for retail and commercial deposits by offering a broad range of products and services and focusing on customer convenience. Retail deposit growth is supported through our Perfect Banking program, free checking and on-line Billpay services, an extensive network of branch locations and ATMs and a 24-hour Express Bank call center. Commercial deposit growth is supported by offering treasury management and lockbox services.

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Total deposits averaged $11.2 billion for the second quarter of 2006, up $71 million, or 3% annualized compared with average deposits in the first quarter of 2006. Average deposits attributed to consumer banking increased $91 million, including $49 million in Oklahoma, $26 million in New Mexico and $15 million in Texas, and average deposits attributed to wealth management increased $56 million, including $43 million in Colorado. The growth in consumer and wealth management deposits resulted from promotional and incentive programs across the Company. In addition, average deposits attributed to mortgage banking, which consisted primarily of escrow funds, increased $24 million. Growth in average consumer, wealth management and mortgage banking deposits was partially offset by a $62 million decrease in average commercial banking deposits, including $35 million in Oklahoma and $32 million in Texas. Average deposits attributed to the Company's funds management activities decreased $29 million due to lower public funds and brokered deposits.

Core deposits, which we define as deposits of less than $100,000, excluding public funds and brokered deposits, averaged $5.5 billion for the second quarter of 2006, an annualized increase of 5%. Average core deposits comprised 49% of total deposits for the second quarter of 2006. Deposit accounts with balances in excess of $100,000 increased at a 3% annualized rate to $4.6 billion or 41% of total average deposits for both the second and the first quarters of 2006.

The distribution of deposit accounts among our principal markets is shown in Table 19.

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Table 19 - Deposits by Principal Market Area

(In thousands)

	June 30, 2006	March 31, 2006	Dec. 31, 2005	Sept. 3 2005
Oklahoma:				
Demand	$ 908,034	$ 950,582	$ 1,003,284	$ 959,1
Interest-bearing:				
Transaction	2,732,312	2,937,228	3,002,610	2,411,1
Savings	88,218	93,093	85,837	86,2
Time	2,662,770	2,623,352	2,564,337	2,728,2
Total interest-bearing	5,483,300	5,653,673	5,652,784	5,225,6
Total Oklahoma	$ 6,391,334	$ 6,604,255	$ 6,656,068	$ 6,184,7
Texas:				
Demand	$ 638,157	$ 551,411	$ 615,732	$ 533,4
Interest-bearing:				
Transaction	1,530,491	1,455,856	1,535,570	1,299,2
Savings	26,370	27,827	27,398	29,6
Time	717,027	726,530	735,731	633,7
Total interest-bearing	2,273,888	2,210,213	2,298,699	1,962,6
Total Texas	$ 2,912,045	$ 2,761,624	$ 2,914,431	$ 2,496,1
New Mexico:				
Demand	$ 147,307	$ 159,125	$ 129,289	$ 155,5
Interest-bearing:				
Transaction	410,166	408,160	381,099	338,7
Savings	16,860	17,805	17,839	17,6
Time	494,426	483,428	453,314	454,5
Total interest-bearing	921,452	909,393	852,252	810,8
Total New Mexico	$ 1,068,759	$ 1,068,518	$ 981,541	$ 966,3
Arkansas:				
Demand	$ 11,521	$ 11,629	$ 10,429	$ 13,7
Interest-bearing:				
Transaction	20,577	26,675	22,354	23,3
Savings	1,072	1,051	1,058	1,2
Time	69,418	73,082	75,034	81,5
Total interest-bearing	91,067	100,808	98,446	106,1
Total Arkansas	$ 102,588	$ 112,437	$ 108,875	$ 119,8
Colorado:				
Demand	$ 45,214	$ 56,419	$ 61,647	$ 51,9
Interest-bearing:				
Transaction	245,504	258,801	258,668	216,7
Savings	13,786	16,315	17,772	16,5
Time	379,239	309,068	264,020	221,7
Total interest-bearing	638,529	584,184	540,460	455,0
Total Colorado	$ 683,743	$ 640,603	$ 602,107	$ 507,0
Arizona:				

Demand	$ 73,696	$ 55,421	$ 45,567	$ 42,7
Interest-bearing:				
Transaction	67,841	57,400	56,994	71,5
Savings	2,702	3,380	4,111	3,8
Time	4,077	4,608	5,624	6,8
Total interest-bearing	74,620	65,388	66,729	82,1
Total Arizona	$ 148,316	$ 120,809	$ 112,296	$ 124,9
Total BOK Financial deposits	$ 11,306,785	$ 11,308,246	$ 11,375,318	$ 10,399,2

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Borrowings and Capital

BOK Financial (parent company) has a $100 million unsecured revolving line of credit with certain banks that expires in December 2010. There was no outstanding principal balance on this credit agreement at June 30, 2006. Interest is based on LIBOR plus a defined margin that is determined by the Company's credit rating or a base rate. This margin ranges from 0.375% to 1.125%. The margin currently applicable to borrowings against this line is 0.500%. The base rate is defined as the greater of the daily federal funds rate plus 0.500% or the SunTrust Bank prime rate. Interest is generally paid monthly. Facility fees are paid quarterly on the unused portion of the commitment at rates that range from 0.100% to 0.250% based on the Company's credit rating.

This credit agreement includes certain restrictive covenants that limit the Company's ability to borrow additional funds, to make investments and to pay cash dividends on common stock. These covenants also require BOK Financial and subsidiary banks to maintain minimum capital levels and to exceed minimum net worth ratios. BOK Financial met all of the restrictive covenants at June 30, 2006.

The primary source of liquidity for BOK Financial is dividends from subsidiary banks, which are limited by various banking regulations to net profits, as defined, for the preceding two years. Dividends are further restricted by minimum capital requirements. Based on the most restrictive limitations, the subsidiary banks could declare up to $233 million of dividends without regulatory approval. Management has developed and the Board of Directors has approved an internal capital policy that is more restrictive than the regulatory capital standards. The subsidiary banks could declare dividends of up to $166 million under this policy.

Equity capital for BOK Financial totaled $1.6 billion at June 30, 2006, up $18 million during the quarter. Retained earnings, net income less cash dividends, provided $45 million of the increase. Growth in capital from retained earnings was partially offset by a $25 million increase in accumulated other comprehensive losses due primarily to net unrealized losses on available for sale securities and $5 million of treasury stock purchases. The remaining increase in capital during the second quarter of 2006 resulted primarily from activity in employee stock options.

Capital is managed to maximize long-term value to the shareholders. Factors considered in managing capital include projections of future earnings, asset growth and acquisition strategies, and regulatory and debt covenant requirements. Capital management may include subordinated debt issuance, share repurchase and stock and cash dividends.

On April 26, 2005, the Board of Directors authorized a share repurchase program, which replaced a previously authorized program. The maximum of two million common shares may be repurchased. The specific timing and amount of shares repurchased will vary based on market conditions, securities law limitations and other factors. Repurchases may be made over time in open market or privately negotiated transactions. The repurchase programs may be suspended or discontinued at any time without prior notice. During the second quarter of 2006, the Company repurchased 108,322 common shares at an average price of $48.56 per share. The Company may repurchase 1.8 million common shares in the future under this program.

Cash dividends of $10.0 million or $0.15 per common share were paid during the second quarter of 2006. On July 25, 2006 the Board of Directors approved a quarterly cash dividend of $0.15 per common share. The dividend will be payable on or about August 31, 2006 to shareholders of record on August 14, 2006.

BOK Financial and its subsidiary banks are subject to various capital requirements administered by federal agencies. Failure to meet minimum capital requirements can result in certain mandatory and possibly additional discretionary actions by regulators that could have material impact on operations. These capital requirements include quantitative measures of assets, liabilities, and off-balance sheet items. The capital standards are also subject to qualitative judgments by the regulators.

For a banking institution to qualify as well capitalized, its Tier 1, Total and Leverage capital ratios must be at least 6%, 10% and 5%, respectively. All of the Company's banking subsidiaries exceeded the regulatory definition of well capitalized. The capital ratios for BOK Financial on a consolidated basis are presented in Table 20.

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Table 20 - Capital Ratios	June 30, 2006	March 31, 2006	Dec. 31, 2005	Sept. 3 2005
Average shareholders' equity				
to average assets	9.49%	9.51%	9.30%	9.54
Risk-based capital:				
Tier 1 capital	10.00	10.16	9.84	9.71
Total capital	12.14	12.41	12.10	12.04
Leverage	8.74	8.60	8.30	8.01

Off-Balance Sheet Arrangements

During 2002, BOK Financial agreed to a limited price guarantee on a portion of the common shares issued to purchase Bank of Tanglewood. Any holder of BOK Financial common shares issued in this acquisition may annually make a claim for the excess of the guaranteed price over the actual sales price of any shares sold during a 60-day period after each of the first five anniversary dates after October 25, 2002. The maximum annual number of shares subject to this guarantee is 210,069. The price guarantee is non-transferable and non-cumulative. BOK Financial may elect, in its sole discretion, to issue additional shares of common stock or to pay cash to satisfy any obligation under the price guaranty.

The Company will have no obligation to issue additional common shares or pay cash to satisfy any benchmark price protection obligation if the market value per share of BOK Financial common stock remains above the highest benchmark price of $42.53. The closing price of BOK Financial common stock on June 30, 2006 was $49.67 per share.

Market Risk

Market risk is a broad term for the risk of economic loss due to adverse changes in the fair value of a financial instrument. These changes may be the result of various factors, including interest rates, foreign exchange prices, commodity prices or equity prices. Financial instruments that are subject to market risk can be classified either as held for trading or held for purposes other than trading.

BOK Financial is subject to market risk primarily through the effect of changes in interest rates on both its assets held for purposes other than trading and trading assets. The effects of other changes, such as foreign exchange rates, commodity prices or equity prices do not pose significant market risk to BOK Financial. BOK Financial has no material investments in assets that are affected by changes in foreign exchange rates or equity prices. Energy derivative contracts, which are affected by changes it; TEXT-INDENT: 0pt; MARGIN-RIGHT: 0pt" align="left"
where substantially all the rewards and risks of ownership of assets remain with the leasing company are accounted for as operating leases. Payments made under operating leases are charged to the consolidated statements of operations on a straight-line basis over the lease period.

(R) Foreign Currency Translation

The assets and liabilities of the Company’s subsidiaries denominated in currencies other than United States (“U.S.”) dollars are translated into U.S. dollars using the applicable exchange rates at the balance sheet date. For statement of operations’ items, amounts denominated in currencies other than U.S. dollars were translated into U.S. dollars using the average exchange rate during the period. Equity accounts were translated at their historical exchange rates. Net gains and losses resulting from translation of foreign currency financial statements are included in the statements of stockholders’ equity as accumulated other comprehensive income (loss). Foreign currency transaction gains and losses are reflected in the statements of operations.

(S) Fair Value of Financial Instruments

The carrying value of the Company’s financial instruments, which consist of cash, accounts receivables, prepaid expenses and other current assets, accounts payable, accrued expenses and other payables, approximates fair value due to the short-term maturities.

The carrying value of the Company’s financial instruments related to warrants associated with convertible promissory notes issued in 2007 is stated at a value being equal to the allocated proceeds of convertible promissory notes based on the relative fair value of notes and warrants. In the measurement of the fair value of these instruments, the Black-Scholes option pricing model is utilized, which is consistent with the Company’s historical valuation techniques. These derived fair value estimates are significantly affected by the assumptions used. The allocated value of the financial instruments related to warrants associated with convertible promissory notes is recorded as an equity, which does not require to mark-to-market as of each subsequent reporting period ,

(T) Concentration of Credit Risk

The Company places its cash with various financial institutions. The Company believes that no significant credit risk exists as these cash investments are made with high-credit-qualify financial institutions.

All the revenue of the Company and a significant portion of the Company’s assets are generated and located in China. The Company’s business activities and accounts receivables are mainly from tour services and advertising services.

Deposits are usually collected from customers in advance and the Company performs ongoing credit evaluation of its customers. The Company believes that no significant credit risk exists as credit loss.

(U) Segmental Reporting

SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information" establishes standards for reporting information about operating segments on a basis consistent with the Company's internal organization structure as well as information about geographical areas, business segments and major customers in financial statements. The Company's operating segments are organized internally primarily by the type of services rendered. In 2007, the Company changed their operating segments as a result of change of internal organization structure by management. It is the management's view that the services rendered by the Company are of three operating segments: Media Network, Travel Network and Investment Holding in 2007.

(V) Recent Accounting Pronouncements

In September 2006, FASB issued SFAS 157, "Fair Value Measurements". This statement defines fair value and establishes a framework for measuring fair value in generally accepted accounting principles. More precisely, this statement sets forth a standard definition of fair value as it applies to assets or liabilities, the principal market (or most advantageous market) for determining fair value (price), the market participants, inputs and the application of the derived fair value to those assets and liabilities. The effective date of this pronouncement is for all full fiscal and interim periods beginning after November 15, 2007. The Company is currently evaluating the impact of adopting SFAS 157 on its financial statements and related disclosures.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" which permit entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. SFAS 159 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of adopting SFAS 159 on its financial statements and related disclosures.

In December 2007, the FASB issued SFAS No. 141 (Revised), "Business Combinations" ("SFAS No. 141 (R)"), replacing SFAS No. 141, "Business Combinations" ("SFAS No. 141"), and SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements — an Amendment of ARB No. 51" . SFAS No. 141(R) retains the fundamental requirements of SFAS No. 141, broadens its scope by applying the acquisition method to all transactions and other events in which one entity obtains control over one or more other businesses, and requires, among other things, that assets acquired and liabilities assumed be measured at fair value as of the acquisition date, that liabilities related to contingent consideration be recognized at the acquisition date and re-measured at fair value in each subsequent reporting period, that acquisition-related costs be expensed as incurred, and that income be recognized if the fair value of the net assets acquired exceeds the fair value of the consideration transferred. SFAS No. 160 establishes accounting and reporting standards for non controlling interests (i.e. minority interests) in a subsidiary, including changes in a parent's ownership interest in a subsidiary and requires, among other things, that noncontrolling interests in subsidiaries be classified as a separate component of equity. Except for the presentation and disclosure requirements of SFAS No. 160, which are to be applied retrospectively for all periods presented, SFAS No. 141 (R) and SFAS No. 160 are to be applied prospectively in financial statements issued for fiscal years beginning after December 15, 2008. The Company is currently assessing the impact of adopting

SFAS No. 141 (R) and SFAS No. 160 on its financial statements and related disclosures.

NOTE 10 CONVERTIBLE PROMISSORY NOTES AND WARRANTS

(a) 12% Convertible Promissory Note and Warrants

On November 12, 2007, the Company entered into a 12% Note and Warrant Purchase Agreement with Wei An Developments Limited (“Wei An”) with respect to the purchase by Wei An a convertible promissory note in the principal account of $5,000,000 at interest rate of 12% per annum (the “12% Convertible Promissory Note”). The 12% Convertible Promissory Note is convertible into the Company’s common stock at the conversion price of $2.40 per share. Pursuant to the agreement, the Company is subject to a commitment fee of 2% of the principal amount of the 12% Convertible Promissory Note. The term of the 12% Convertible Promissory Note is six months and the Company has the option to extend the 12% Convertible Promissory Note by an additional six-month period at an interest rate of 14% per annum and be subject to an additional commitment fee of 2% of the principal amount of the note. However, the Company has the right to prepay all or any portion of the amounts due under the note at any time without penalty or premium.

In addition, pursuant to the Warrant Purchase Agreement, the Company issued warrants to purchase up to 250,000 shares of the Company’s common stock at the exercise price of $2.30 per share, which are exercisable for a period of two years.

(b) 3% Convertible Promissory Notes and warrants

On November 19, 2007, the Company, Quo Advertising and the Designated Holders (as defined in the Purchase Agreement), entered into a 3% Note and Warrant Purchase Agreement (the “Purchase Agreement”) with affiliated investment funds of Och-Ziff Capital Management Group (the “Investors”). Pursuant to the Purchase Agreement, the Company agreed to issue 3% Senior Secured Convertible Notes due June 30, 2011 in the aggregate principal amount of up to $50,000,000 (the “3% Convertible Promissory Notes”) and warrants to acquire an aggregate amount of 34,285,715 shares of common stock of the Company (the “Warrants”). The 3% Convertible Promissory Notes and Warrants are issued and issuable in three tranches, with Convertible Notes in the aggregate principal amount of $6,000,000, Warrants exercisable for 2,400,000 shares at $2.50 per share and Warrants exercisable for 1,714,285 shares at $3.50 per share, issued on 19 November, 2007, Convertible Notes in the aggregate principal amount of $9,000,000, Warrants exercisable for 3,600,000 shares at $2.50 per share and Warrants exercisable for 2,571,430 shares at $3.50 per share issued on 28 November 2007, and Convertible Notes in the aggregate principal amount of $35,000,000, Warrants exercisable for 14,000,000 shares at $2.50 per share and Warrants exercisable for 10,000,000 shares at $3.50 per share to be issued in the third tranche, which was completed in January 2008. Please refer to Note 18 - Subsequent Events for details. The warrants shall expire on June 30, 2011, pursuant to the Purchase Agreement.

The 3% Convertible Promissory Notes bear interest at 3% per annum payable semi-annually in arrears and mature on June 30, 2011. The 3% Convertible Promissory Notes are convertible into shares of common stock at an initial conversion price of $1.65 per share, subject to customary anti-dilution adjustments. In addition, the conversion price will be adjusted downward on an annual basis if the Company should fail to meet certain annual earnings per share (“EPS”) targets described in the Purchase Agreement. In the event of a default, or if the Company’s actual EPS for any fiscal year is less than 80% of the respective EPS target, certain of the investors may require the Company to redeem the 3% Convertible

Promissory Notes at 100% of the principal amount, plus any accrued and unpaid interest, plus an amount representing a 20% internal rate of return on the then outstanding principal amount. The Warrants grant the holders the right to acquire shares of common stock at $2.50 and $3.50 per share, subject to customary anti-dilution adjustments. The exercise price of the Warrants will also be adjusted downward whenever the conversion price of the 3% Convertible Promissory Notes is adjusted downward in accordance with the provisions of the Purchase Agreement.

As of December 31, 2007, none of the conversion options and warrants associated with the above convertible promissory notes was exercised.

The following table details the accounting treatment of the convertible promissory notes:

	12% Convertible Promissory Note	3% Convertible Promissory Notes	Total
Proceeds of convertible promissory notes	$ 5,000,000	$ 15,000,000	$ 20,000,000
Allocation of proceeds:			
Allocated relative fair value of warrants	(333,670)	(2,490,000)	(2,823,670)
Allocated intrinsic value of beneficial conversion feature	-	(4,727,272)	(4,727,272)
Total net proceeds of the convertible promissory notes as of December 31, 2007	4,666,330	7,782,728	12,449,058
Amortization of debt discount for the year ended December 31, 2007	74,466	4,762,728	4,837,194
Net carrying value of convertible promissory notes	$ 4,740,796	$ 12,545,456	$ 17,286,252

Warrant and Beneficial Conversion Features

The fair value of the financial instruments associated with warrants of both 12% convertible promissory note and 3% convertible promissory notes was determined utilizing Black-Scholes option pricing model, which is consistent with the Company’s historical valuation methods. The following assumptions and estimates were used in the Black-Scholes option pricing model: (1) 12% convertible promissory note: volatility of 182%; an average risk-free interest rate of 3.52%; dividend yield of 0%; and an expected life of 2 years, (2) 3% convertible promissory notes: volatility of 47%; an average risk-free interest rate of 3.30%; dividend yield of 0%; and an expected life of 3.5 years.

Both the warrants and embedded conversion features issued in connection with 12% convertible promissory note and 3% convertible promissory notes meet the criteria of EITF 00-19, “Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock” for equity classification and also met the other criteria in paragraph 11(a) of SFAS 133, “Accounting for Derivative Instruments and Hedging Activities” as of December 31, 2007. Accordingly, the conversion features do not require derivative accounting. The intrinsic value of beneficial conversion feature is calculated in according to EITF Issue No. 98-5, “Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratio” and EITF Issue No. 00-27, “Application of Issue No. 98-5 to Certain Convertible Instruments” . For 3% convertible promissory note, as the effective conversion price after allocating a portion of the proceeds to the warrants was less than the Company’s market price of common stock at commitment date, it was considered to have a beneficial conversion feature while for 12% convertible promissory note, no beneficial conversion feature existed. The value of beneficial conversion feature is recorded as a reduction in the carrying value of the convertible promissory notes against additional paid-in capital. As 3% convertible promissory notes are convertible at the date of issuance, the respective debt discount being equal to the value of beneficial conversion feature of $4,727,272 is fully amortized through interest expense as of the date of issuance.

Amortization of Deferred Charges and Debt Discount

The amortization of deferred charges and debt discount for the year ended December 31, 2007 were as follows:

	Warrants	Conversion Features	Deferred Charges	Total
12% convertible promissory note	$ 74,466	$ -	$ 19,301	$ 93,767
3% convertible promissory notes	35,456	4,727,272	9,856	4,772,584
Total	$ 109,922	$ 4,727,272	$ 29,157	$ 4,866,351

PART III

ITEM 13. EXHIBITS

The following Exhibits are filed as part of this Amendment No.1 to Annual Report on Form 10-KSB:

23.1	Consent of independent auditors Webb & Company, P.A. *
23.2	Consent of independent auditors Jimmy C.H. Cheung & Co. *
24.1	Power of Attorney (included in the Signatures section of this report).
31.1	Rule 13a-15(e)/15d-15(e) Certification by the Chief Executive Officer. *
31.2	Rule 13a-15(e)/15d-15(e) Certification by the Chief Financial Officer. *
32.1	Certification by the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. *
32.2	Certification by the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. *

* Filed herewith.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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

Date: August 11, 2008

NETWORK CN INC.
By: /s/ Godfrey Hui
Godfrey Hui
Chief Executive Officer

POWER OF ATTORNEY

Each person whose signature appears below appoints Godfrey Hui his or her attorney-in-fact, with full power of substitution and re-substitution, to sign any and all amendments to this report on Form 10-KSB/A of Network CN Inc., and to file them, with all their exhibits and other related documents, with the Securities and Exchange Commission, ratifying and confirming all that their attorney-in-fact and agent or his or her substitute or substitutes may lawfully do or cause to be done by virtue of this appointment. In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated:

Name	Title	Date
/s/ Godfrey Hui Godfrey Hui	Director and Chief Executive Officer	August 11, 2008
/s/ Daley Mok Daley Mok	Director and Chief Financial Officer	August 11, 2008
/s/ Daniel So Daniel So	Managing Director	August 11, 2008
/s/ Stanley Chu Stanley Chu	Director	August 11, 2008
/s/ Peter Mak Peter Mak	Director	August 11, 2008