

LAKELAND BANCORP INC  
Form 10-Q  
May 09, 2008  
Table of Contents

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark one)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the quarterly period ended March 31, 2008

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 33-27312

LAKELAND BANCORP, INC.

(Exact name of registrant as specified in its charter)

New Jersey

22-2953275

(State or other jurisdiction of

(I.R.S. Employer

incorporation or organization)

Identification No.)

250 Oak Ridge Road, Oak Ridge, New Jersey

07438

(Address of principal executive offices)

(Zip Code)

(973) 697-2000

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed

since last report.)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act:

Edgar Filing: LAKELAND BANCORP INC - Form 10-Q

(Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting Company

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

Yes  No

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

As of April 30, 2008 there were 23,435,355 outstanding shares of Common Stock, no par value.

**Table of Contents**

LAKELAND BANCORP, INC.

Form 10-Q Index

|  | PAGE |
|--|------|
| Part I Financial Information   |      |
| Item 1. Financial Statements:  |      |
| <u>Consolidated Balance Sheets - March 31, 2008 (unaudited) and December 31, 2007</u>                                    | 1    |
| <u>Consolidated Income Statements - Unaudited Three Months ended March 31, 2008 and 2007</u>                             | 2    |
| <u>Consolidated Statements of Changes in Stockholders' Equity - Unaudited Three Months ended March 31, 2008 and 2007</u> | 3    |
| <u>Consolidated Statements of Cash Flows - Unaudited Three Months ended March 31, 2008 and 2007</u>                      | 4    |
| <u>Notes to Consolidated Financial Statements (unaudited)</u>  | 5    |
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                     | 12   |
| Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>  | 20   |
| Item 4. <u>Controls and Procedures</u>   | 20   |
| <u>Part II Other Information</u>   |      |
| Item 1. <u>Legal Proceedings</u>   | 21   |
| Item 1A. <u>Risk Factors</u>   | 21   |
| Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>   | 21   |
| Item 3. <u>Defaults Upon Senior Securities</u>   | 21   |
| Item 4. <u>Submission of Matters to a Vote of Security Holders</u>   | 21   |
| Item 5. <u>Other Information</u>   | 21   |
| Item 6. <u>Exhibits</u>  | 21   |
| <u>Signatures</u>  | 22   |

The Securities and Exchange Commission maintains a web site which contains reports, proxy and information statements and other information relating to registrants that file electronically at the address: <http://www.sec.gov>.

**Table of Contents****Lakeland Bancorp, Inc. and Subsidiaries****CONSOLIDATED BALANCE SHEETS**

|  | March 31, 2008<br>(unaudited) | December 31,<br>2007 |
|--|-------------------------------|----------------------|
|  | (dollars in thousands)        |                      |
| <b>ASSETS</b>  |                               |                      |
| Cash   | \$ 46,309                     | \$ 46,837            |
| Federal funds sold and Interest-bearing deposits due from banks  | 25,600                        | 10,351               |
| Total cash and cash equivalents  | 71,909                        | 57,188               |
| Investment securities available for sale   | 266,161                       | 273,247              |
| Investment securities held to maturity; fair value of \$115,046 in 2008 and \$129,207 in 2007  | 113,584                       | 129,360              |
| Loans and leases, net of deferred costs  | 1,938,472                     | 1,886,535            |
| Less: allowance for loan and lease losses  | 15,460                        | 14,689               |
| Net loans  | 1,923,012                     | 1,871,846            |
| Premises and equipment net   | 29,701                        | 30,093               |
| Accrued interest receivable  | 8,304                         | 8,579                |
| Goodwill   | 87,111                        | 87,111               |
| Other identifiable intangible assets   | 3,497                         | 3,763                |
| Bank owned life insurance  | 38,416                        | 38,112               |
| Other assets   | 13,732                        | 14,472               |
| <b>TOTAL ASSETS</b>  | <b>\$ 2,555,427</b>           | <b>\$ 2,513,771</b>  |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>   |                               |                      |
| <b>LIABILITIES:</b>  |                               |                      |
| <b>Deposits:</b>   |                               |                      |
| Noninterest bearing  | \$ 293,982                    | \$ 292,029           |
| Savings and interest-bearing transaction accounts  | 1,094,147                     | 1,091,205            |
| Time deposits under \$100 thousand   | 355,254                       | 364,477              |
| Time deposits \$100 thousand and over  | 195,389                       | 239,694              |
| Total deposits   | 1,938,772                     | 1,987,405            |
| Federal funds purchased and securities sold under agreements to repurchase   | 96,439                        | 49,294               |
| Long-term debt   | 211,350                       | 171,755              |
| Subordinated debentures  | 77,322                        | 77,322               |
| Other liabilities  | 16,496                        | 16,396               |
| <b>TOTAL LIABILITIES</b>   | <b>2,340,379</b>              | <b>2,302,172</b>     |
| <b>Commitments and contingencies</b>   |                               |                      |
| <b>Stockholders equity:</b>  |                               |                      |
| Common stock, no par value; authorized shares, 40,000,000; issued shares, 24,740,564 at March 31, 2008 and December 31, 2007; outstanding shares, 23,282,587 at March 31, 2008 and 23,281,015 at December 31, 2007 | 258,068                       | 258,037              |
| Accumulated deficit  | (21,799)                      | (24,465)             |
| Treasury stock, at cost, 1,457,977 shares in 2008 and 1,459,549 shares in 2007   | (20,106)                      | (20,140)             |
| Accumulated other comprehensive loss   | (1,115)                       | (1,833)              |
| <b>TOTAL STOCKHOLDERS EQUITY</b>   | <b>215,048</b>                | <b>211,599</b>       |

|  |              |              |
|--|--------------|--------------|
| <b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b> | \$ 2,555,427 | \$ 2,513,771 |
|--|--------------|--------------|

See accompanying notes to consolidated financial statements



Edgar Filing: LAKELAND BANCORP INC - Form 10-Q

|                  |         |         |
|------------------|---------|---------|
| Basic earnings   | \$ 0.24 | \$ 0.19 |
| Diluted earnings | \$ 0.24 | \$ 0.19 |
| Dividends        | \$ 0.10 | \$ 0.10 |

**UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

|   | For the three months ended March 31, |                 |
|---|--------------------------------------|-----------------|
|   | 2008                                 | 2007            |
|   | (in thousands)                       |                 |
| <b>NET INCOME</b>                                       | <b>\$ 5,540</b>                      | <b>\$ 4,370</b> |
| <b>OTHER COMPREHENSIVE INCOME NET OF TAX:</b>           |                                      |                 |
| Unrealized securities gains arising during period       | 773                                  | 487             |
| Less: reclassification for gains included in net income | 6                                    | 0               |
| Change in pension liability, net                        | (49)                                 | 11              |
| Other Comprehensive Income                              | 718                                  | 498             |
| <b>TOTAL COMPREHENSIVE INCOME</b>                       | <b>\$ 6,258</b>                      | <b>\$ 4,868</b> |

See accompanying notes to consolidated financial statements

**Table of Contents****Lakeland Bancorp, Inc. and Subsidiaries**

## UNAUDITED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

**Three Months ended March 31, 2008**

|   | Common stock     |            | Accumulated deficit    | Treasury Stock | Accumulated Other Comprehensive Loss | Total      |
|---|------------------|------------|------------------------|----------------|--------------------------------------|------------|
|   | Number of Shares | Amount     |                        |                |                                      |            |
|   |                  |            | (dollars in thousands) |                |                                      |            |
| BALANCE DECEMBER 31, 2007                             | 24,740,564       | \$ 258,037 | \$ (24,465)            | \$ (20,140)    | \$ (1,833)                           | \$ 211,599 |
| Cumulative adjustment for adoption of EITF 06-04      |                  |            | (546)                  |                |                                      | (546)      |
| BALANCE JANUARY 1, 2008 as revised                    | 24,740,564       | \$ 258,037 | \$ (25,011)            | \$ (20,140)    | \$ (1,833)                           | \$ 211,053 |
| Net Income, first three months 2008                   |                  |            | 5,540                  |                |                                      | 5,540      |
| Other comprehensive income net of tax                 |                  |            |                        |                | 718                                  | 718        |
| Stock based compensation                              |                  | 45         |                        |                |                                      | 45         |
| Exercise of stock options, net of excess tax benefits |                  | (14)       |                        | 34             |                                      | 20         |
| Cash dividends  |                  |            | (2,328)                |                |                                      | (2,328)    |
| BALANCE March 31, 2008 (UNAUDITED)                    | 24,740,564       | \$ 258,068 | \$ (21,799)            | \$ (20,106)    | \$ (1,115)                           | \$ 215,048 |

**Three Months ended March 31, 2007**

|   | Common stock     |            | Accumulated deficit    | Treasury Stock | Accumulated Other Comprehensive Loss | Total      |
|---|------------------|------------|------------------------|----------------|--------------------------------------|------------|
|   | Number of Shares | Amount     |                        |                |                                      |            |
|   |                  |            | (dollars in thousands) |                |                                      |            |
| BALANCE DECEMBER 31, 2006                             | 23,563,463       | \$ 242,661 | \$ (17,526)            | \$ (22,565)    | \$ (3,070)                           | \$ 199,500 |
| Cumulative adjustment for adoption of FIN 48          |                  |            | 509                    |                |                                      | 509        |
| BALANCE JANUARY 1, 2007 as revised                    | 23,563,463       | \$ 242,661 | \$ (17,017)            | \$ (22,565)    | \$ (3,070)                           | \$ 200,009 |
| Net Income, first three months of 2007                |                  |            | 4,370                  |                |                                      | 4,370      |
| Other comprehensive income net of tax                 |                  |            |                        |                | 498                                  | 498        |
| Stock based compensation                              |                  |            |                        | 31             |                                      | 31         |
| Issuance of stock for restricted stock awards         |                  | (566)      |                        | 566            |                                      |            |
| Exercise of stock options, net of excess tax benefits |                  | (204)      |                        | 344            |                                      | 140        |
| Issuance of stock to dividend reinvestment plan       |                  | (94)       | (464)                  | 558            |                                      |            |
| Cash dividends  |                  |            | (1,742)                |                |                                      | (1,742)    |
| BALANCE March 31, 2007 (UNAUDITED)                    | 23,563,463       | \$ 241,797 | \$ (14,853)            | \$ (21,066)    | \$ (2,572)                           | \$ 203,306 |

See accompanying notes to consolidated financial statements



**Table of Contents****Lakeland Bancorp, Inc. and Subsidiaries****CONSOLIDATED STATEMENTS OF CASH FLOWS-(UNAUDITED)**

|  | <b>For the three months ended<br/>March 31,</b> |                 |
|--|---|-----------------|
|  | <b>2008</b>                                     | <b>2007</b>     |
|  | <b>(in thousands)</b>                           |                 |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>  |   |                 |
| Net income   | \$5,540   | \$4,370         |
| Adjustments to reconcile net income to net cash provided by operating activities:      |   |                 |
| Net amortization of premiums, discounts and deferred loan fees and costs               | 186   | 126             |
| Depreciation and amortization  | 1,146   | 1,177           |
| Provision for loan and lease losses  | 1,267   | 602             |
| Gain on securities   | (9)   |                 |
| Gain on sale of branch   |   | (319)           |
| Stock-based compensation   | 45  | 31              |
| (Increase) decrease in other assets  | 487   | (450)           |
| Increase (decrease) in other liabilities   | (695)   | 301             |
| <b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>                                       | <b>7,967</b>                                    | <b>5,838</b>    |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>  |   |                 |
| Proceeds from repayments on and maturity of securities:                                |   |                 |
| Available for sale   | 33,545  | 18,901          |
| Held to maturity   | 16,232  | 5,513           |
| Proceeds from sales of securities:   |   |                 |
| Available for sale   |   |                 |
| Held to maturity   |   |                 |
| Purchase of securities:  |   |                 |
| Available for sale   | (25,368)  | (188)           |
| Held to maturity   | (500)   | (5,649)         |
| Net increase in loans and leases   | (52,466)  | (64,308)        |
| Proceeds from the sale of branch premises and equipment                                |   | 946             |
| Capital expenditures   | (488)   | (844)           |
| <b>NET CASH USED IN INVESTING ACTIVITIES</b>   | <b>(29,045)</b>                                 | <b>(45,629)</b> |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>  |   |                 |
| Net increase (decrease) in deposits  | (48,633)  | 9,322           |
| Increase in federal funds purchased and securities sold under agreements to repurchase | 47,145  | 17,805          |
| Repayments of long-term debt   | (10,405)  | (10,405)        |
| Issuance of long-term debt   | 50,000  |                 |
| Exercise of stock options  | 16  | 140             |
| Excess tax benefits  | 4   | 29              |
| Dividends paid   | (2,328)   | (1,742)         |
| <b>NET CASH PROVIDED BY FINANCING ACTIVITIES</b>                                       | <b>35,799</b>                                   | <b>15,149</b>   |
| Net increase in cash and cash equivalents  | 14,721  | (24,642)        |
| Cash and cash equivalents, beginning of year   | 57,188  | 79,964          |
| <b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>  | <b>\$71,909</b>                                 | <b>\$55,322</b> |

Edgar Filing: LAKELAND BANCORP INC - Form 10-Q

See accompanying notes to consolidated financial statements

**Table of Contents**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**Note 1. Significant Accounting Policies**

*Basis of Presentation.*

This quarterly report presents the consolidated financial statements of Lakeland Bancorp, Inc. (the Company) and its subsidiary, Lakeland Bank (Lakeland).

The Company's financial statements reflect all adjustments and disclosures which management believes are necessary for a fair presentation of interim results. The results of operations for the quarter presented do not necessarily indicate the results that the Company will achieve for all of 2008. You should read these interim financial statements in conjunction with the consolidated financial statements and accompanying notes that are presented in the Lakeland Bancorp, Inc. Annual Report on Form 10-K for the year ended December 31, 2007 (the 10-K).

The financial information in this quarterly report has been prepared in accordance with the Company's customary accounting practices; these financial statements have not been audited. Certain information and footnote disclosures required under generally accepted accounting principles have been condensed or omitted, as permitted by rules and regulations of the Securities and Exchange Commission.

All weighted average, actual shares and per share information set forth in this quarterly report on Form 10-Q have been adjusted retroactively for the effects of stock dividends including the stock dividend declared on October 16, 2007, payable on November 16, 2007 to shareholders of record on October 31, 2007.

**Note 2. Stock-Based Compensation**

The Company established the 2000 Equity Compensation Program which authorizes the granting of incentive stock options and supplemental stock options to employees of the Company, including those employees serving as officers and directors of the Company. The plan authorizes options to purchase up to 2,257,368 shares of common stock of the Company. The Company has no option awards with market or performance conditions attached to them. The Company's stock option program allows for the grant of restricted shares, as well as stock option grants. The Company generally issues shares for option exercises from its treasury stock.

Share-based compensation expense of \$45,000 and \$31,000 and related income tax benefits of \$16,000 and \$11,000 were recognized for the three months ended March 31, 2008 and 2007, respectively. As of March 31, 2008, there was unrecognized compensation cost of \$576,000 related to unvested restricted stock; that cost is expected to be recognized over a weighted average period of less than four years. Unrecognized compensation expense related to unvested stock options was approximately \$50,000 as of March 31, 2008 and is expected to be recognized over a period of less than four years.

There were no grants of stock options or restricted stock in the first quarter of 2008 or 2007.

**Table of Contents**

Option activity under the Company's stock option plans as of March 31, 2008 is as follows:

|                                       | Number<br>of<br>shares | Weighted<br>average<br>exercise<br>price | Weighted<br>average<br>remaining<br>contractual<br>term<br>(in years) | Aggregate<br>intrinsic value |
|---------------------------------------|------------------------|--|---|------------------------------|
| Outstanding, January 1, 2008          | 1,156,240              | \$ 12.71                                 |   |                              |
| Granted                               | 0                      | 0.00                                     |   |                              |
| Exercised                             | (2,491)                | 6.51                                     |   |                              |
| Forfeited                             | (4,473)                | 13.35                                    |   |                              |
| Outstanding, March 31, 2008           | 1,149,276              | \$ 12.72                                 | 5.23  | \$ 1,302,448                 |
| Options exercisable at March 31, 2008 | 1,128,276              | \$ 12.75                                 | 5.15  | \$ 1,270,918                 |

The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value (the difference between the Company's closing stock price on the last trading day of the first quarter of 2008 and the exercise price, multiplied by the number of in the money options).

Stock options outstanding were 1,149,276 and 1,173,293 at March 31, 2008 and 2007, respectively. The aggregate intrinsic value of options exercised during the first three months ended March 31, 2008 and 2007 was \$15,000 and \$129,000, respectively. Exercise of stock options during the first three months of 2008 and 2007 resulted in cash receipts of \$16,000 and \$140,000, respectively.

Information regarding the Company's restricted stock (all unvested) and changes during the three months ended March 31, 2008 is as follows:

|                              | Number of<br>shares | Weighted<br>average<br>price |
|------------------------------|---------------------|------------------------------|
| Outstanding, January 1, 2008 | 48,423              | \$ 12.75                     |
| Forfeited                    | (918)               | 12.79                        |
| Outstanding, March 31, 2008  | 47,505              | \$ 12.75                     |

**Table of Contents****Note 3. Comprehensive Income**

The components of other comprehensive income are as follows:

|  | Before<br>tax<br>amount | Tax<br>Benefit<br>(Expense) | Net of<br>tax<br>amount |
|--|-------------------------|-----------------------------|-------------------------|
| (dollars in thousands)   |                         |                             |                         |
| <b>For the quarter ended March 31, 2008</b>                              |                         |                             |                         |
| Net unrealized gains on available for sale securities                    |                         |                             |                         |
| Net unrealized holding gains arising during period                       | \$ 1,200                | \$ (427)                    | \$ 773                  |
| Less reclassification adjustment for net gains arising during the period | (9)                     | 3                           | (6)                     |
| Net unrealized gains   | 1,191                   | (424)                       | 767                     |
| Change in minimum pension liability                                      | (74)                    | 25                          | (49)                    |
| Other comprehensive income, net  | \$ 1,117                | \$ (399)                    | \$ 718                  |

|  | Before<br>tax<br>amount | Tax<br>Benefit<br>(Expense) | Net of<br>tax<br>amount |
|--|-------------------------|-----------------------------|-------------------------|
| (dollars in thousands)   |                         |                             |                         |
| <b>For the quarter ended March 31, 2007</b>                              |                         |                             |                         |
| Net unrealized gains on available for sale securities                    |                         |                             |                         |
| Net unrealized holding gains arising during period                       | \$ 764                  | \$ (277)                    | \$ 487                  |
| Less reclassification adjustment for net gains arising during the period | 0                       | 0                           | 0                       |
| Net unrealized gains   | 764                     | (277)                       | 487                     |
| Change in minimum pension liability                                      | 17                      | (6)                         | 11                      |
| Other comprehensive income, net  | \$ 781                  | \$ (283)                    | \$ 498                  |

**Note 4. Statement of Cash Flow Information.**

|  | For the three months ended<br>March 31, |        |
|--|---|--------|
|  | 2008                                    | 2007   |
| (in thousands)   |   |        |
| Supplemental schedule of noncash investing and financing activities: |   |        |
| Cash paid during the period for income taxes                         | \$ 885                                  | \$ 190 |
| Cash paid during the period for interest                             | 16,160                                  | 14,936 |

**Note 5. Earnings Per Share.**

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

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

All weighted average, actual shares and per share information set forth in this quarterly report on Form 10-Q have been adjusted retroactively for the effects of stock dividends including the stock dividend declared on October 16, 2007, payable on November 16, 2007 to shareholders of record on October 31, 2007. The following schedule shows the Company's earnings per share for the periods presented:



**Table of Contents**

| (In thousands except per share data)  | For the three months ended<br>March 31, |          |
|---|---|----------|
|   | 2008                                    | 2007     |
| Income applicable to common stock   | \$ 5,540                                | \$ 4,370 |
| Weighted average number of common shares outstanding basic                    | 23,282                                  | 23,183   |
| Share-based plans   | 92                                      | 132      |
| Weighted average number of common shares and common share equivalents diluted | 23,374                                  | 23,315   |
| Basic earnings per share  | \$ 0.24                                 | \$ 0.19  |
| Diluted earnings per share  | \$ 0.24                                 | \$ 0.19  |

Options to purchase 924,530 shares of common stock at a weighted average price of \$14.03 per share and 18,354 shares of restricted stock at a weighted average price of \$13.95 per share were outstanding and were not included in the computation of diluted earnings per share for the three months ended March 31, 2008 because the option exercise price and the grant-date price were greater than the average market price. Options to purchase 558,878 shares of common stock at a weighted average price of \$14.66 per share and 35,424 shares of restricted stock at a weighted average price of \$13.95 per share were outstanding and were not included in the computations of diluted earnings per share for the three months ended March 31, 2007.

**Note 6. Investment Securities****AVAILABLE FOR SALE**

| (in thousands)                                   | March 31, 2008    |                              |                               |            | December 31, 2007 |                              |                               |               |
|--|-------------------|------------------------------|-------------------------------|------------|-------------------|------------------------------|-------------------------------|---------------|
|  | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair Value | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
| U.S. government agencies                         | \$ 42,022         | \$ 597                       | \$                            | \$ 42,619  | \$ 48,314         | \$ 289                       | \$ (151)                      | \$ 48,452     |
| Mortgage-backed securities                       | 159,691           | 847                          | (1,082)                       | 159,456    | 161,520           | 307                          | (1,761)                       | 160,066       |
| Obligations of states and political subdivisions | 24,618            | 459                          | (16)                          | 25,061     | 25,550            | 199                          | (38)                          | 25,711        |
| Other debt securities                            | 16,609            | 34                           | (1,811)                       | 14,832     | 17,124            |                              | (1,523)                       | 15,601        |
| Other equity securities                          | 24,147            | 544                          | (498)                         | 24,193     | 22,856            | 921                          | (360)                         | 23,417        |
|  | \$ 267,087        | \$ 2,481                     | \$ (3,407)                    | \$ 266,161 | \$ 275,364        | \$ 1,716                     | \$ (3,833)                    | \$ 273,247    |

**HELD TO MATURITY**

| (in thousands)                                   | March 31, 2008    |                              |                               |            | December 31, 2007 |                              |                               |               |
|--|-------------------|------------------------------|-------------------------------|------------|-------------------|------------------------------|-------------------------------|---------------|
|  | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair Value | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
| U.S. government agencies                         | \$ 23,050         | \$ 640                       | \$                            | \$ 23,690  | \$ 31,493         | \$ 151                       | \$ (13)                       | \$ 31,631     |
| Mortgage-backed securities                       | 38,905            | 182                          | (64)                          | 39,023     | 40,849            | 73                           | (338)                         | 40,584        |
| Obligations of states and political subdivisions | 50,035            | 791                          | (6)                           | 50,820     | 55,421            | 200                          | (158)                         | 55,463        |
| Other  | 1,594             |                              | (81)                          | 1,513      | 1,597             |                              | (68)                          | 1,529         |
|  | \$ 113,584        | \$ 1,613                     | \$ (151)                      | \$ 115,046 | \$ 129,360        | \$ 424                       | \$ (577)                      | \$ 129,207    |

**Table of Contents**

|  | March 31, 2008     |               |                   |               |
|--|--------------------|---------------|-------------------|---------------|
|  | Available for Sale |               | Held to Maturity  |               |
|  | Amortized<br>Cost  | Fair<br>Value | Amortized<br>Cost | Fair<br>Value |
|  | (in thousands)     |               |                   |               |
| Due in one year or less                | \$ 11,656          | \$ 11,739     | \$ 8,372          | \$ 8,417      |
| Due after one year through five years  | 38,073             | 38,525        | 37,042            | 37,968        |
| Due after five years through ten years | 26,465             | 25,520        | 25,385            | 25,771        |
| Due after ten years                    | 7,055              | 6,728         | 3,880             | 3,867         |
|  | 83,249             | 82,512        | 74,679            | 76,023        |
| Mortgage-backed securities             | 159,691            | 159,456       | 38,905            | 39,023        |
| Other investments                      | 24,147             | 24,193        |                   |               |
| Total securities                       | \$ 267,087         | \$ 266,161    | \$ 113,584        | \$ 115,046    |

**Note 7. Loans and Leases.**

|                             | March 31,<br>2008 | December 31,<br>2007 |
|-----------------------------|-------------------|----------------------|
|                             | (in thousands)    |                      |
| Commercial                  | \$ 824,195        | \$ 821,621           |
| Leases                      | 392,155           | 355,644              |
| Real estate-construction    | 96,348            | 91,706               |
| Real estate-mortgage        | 310,636           | 301,798              |
| Installment                 | 309,764           | 310,359              |
| Total loans                 | 1,933,098         | 1,881,128            |
| Plus: deferred costs        | 5,374             | 5,407                |
| Loans net of deferred costs | \$ 1,938,472      | \$ 1,886,535         |

The Company follows Statement of Financial Accounting Standards No. 114, Accounting by Creditors for Impairment of a Loan (known as SFAS No. 114), and Statement of Financial Accounting Standards No. 118, Accounting by Creditors for Impairment of a Loan, Income Recognition and Disclosures. Impairment is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, except that as a practical expedient, a creditor may measure impairment based on a loan's observable market price, or the fair value of the collateral if the loan is collateral-dependent. Regardless of the measurement method, a creditor must measure impairment based on the fair value of the collateral when the creditor determines that foreclosure is probable.

The following table shows the Company's recorded investment in impaired loans and leases and the related valuation allowance calculated under SFAS No. 114 as of March 31, 2008 and 2007, and the average recorded investment in impaired loans and leases during the three months preceding those dates:

| Date           | Investment      | Valuation Allowance | Average Recorded Investment<br>(over preceding nine months) |
|----------------|-----------------|---------------------|---|
| March 31, 2008 | \$ 10.3 million | \$ 2.7 million      | \$ 10.0 million   |
| March 31, 2007 | \$ 6.0 million  | \$ 2.4 million      | \$ 4.5 million  |

Interest received on impaired loans and leases may be recorded as interest income. However, if management is not reasonably certain that an impaired loan will be repaid in full, or if a specific time frame to resolve full collection cannot yet be reasonably determined, all payments received are recorded as reductions of principal. The Company recognized interest on impaired loans and leases of \$22,000 in the first three



Edgar Filing: LAKELAND BANCORP INC - Form 10-Q

months of 2008. Interest that would have accrued had the loans and leases performed under original terms would have been \$232,000 for the first three months of 2008.

**Table of Contents****Note 8. Employee Benefit Plans**

The components of net periodic pension cost for the Newton defined pension plan are as follows:

|   | For the three months ended<br>March 31, |       |
|---|---|-------|
|   | 2008                                    | 2007  |
|   | (in thousands)                          |       |
| Interest cost                                   | \$ 24                                   | \$ 24 |
| Expected return on plan assets                  | (23)                                    | (21)  |
| Amortization of prior service cost              |   |       |
| Amortization of unrecognized net actuarial loss | 6                                       | 8     |
| Net periodic benefit expense                    | \$ 7                                    | \$ 11 |

**Note 9. Directors Retirement Plan**

The components of net periodic plan costs for the directors retirement plan are as follows:

|   | For the three months ended<br>March 31, |       |
|---|---|-------|
|   | 2008                                    | 2007  |
|   | (in thousands)                          |       |
| Service cost                                    | \$ 6                                    | \$ 5  |
| Interest cost                                   | 15                                      | 13    |
| Amortization of prior service cost              | 8                                       | 9     |
| Amortization of unrecognized net actuarial loss | 2                                       | 0     |
| Net periodic benefit expense                    | \$ 31                                   | \$ 27 |

The Company made contributions of \$99,000 to the plan in the three months ended March 31, 2008 and does not expect to make any more contributions in 2008.

**Note 10. Fair Value Measurements**

In September 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements which is effective for fiscal years beginning after November 15, 2007 and for interim periods within those years. This statement defines fair value, establishes a framework for measuring fair value and expands the related disclosure requirements. SFAS No. 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. SFAS No. 157 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels giving the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest level priority to unobservable inputs (level 3 measurements). The following describes the three levels of fair value hierarchy:

Level 1 unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2 Quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in market that are not active; inputs other than quoted prices that are observable for the asset or liability (such as interest rates, yield curves, volatilities, etc.)

Level 3 unobservable inputs for the asset or liability these shall be used to the extent that observable inputs are not available allowing for situations in which there is little, if any, market activity available.

Edgar Filing: LAKELAND BANCORP INC - Form 10-Q

The following table sets forth the Company's financial assets that were accounted for at fair values as of March 31,

**Table of Contents**

2008 by level within the fair value hierarchy. The Company had no liabilities accounted for at fair value as of March 31, 2008. As required by SFAS No. 157, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement:

| (in thousands)                            | Quoted Prices in<br>Active<br>Markets<br>for Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) | Balance<br>as of<br>March 31,<br>2008 |
|---|---|---|--|---------------------------------------|
| <b>Assets:</b>                            |   |   |  |                                       |
| Investment securities, available for sale | \$ 2,700  | \$ 263,461  |  | \$ 266,161                            |
| Investment securities, held to maturity   |   | 115,046   |  | \$ 115,046                            |
| Impaired Loans                            |   |   | 10,328   | 10,328                                |

Impaired loans and leases are evaluated and valued at the time the loan is identified as impaired at the lower of cost or market value. Market value is measured based on the value of the collateral securing these loans and leases and is classified at a level 3 in the fair value hierarchy. Collateral may be real estate, accounts receivable, equipment and/or other business assets. The value of the real estate is assessed based on appraisals by qualified third party licensed appraisers. The value of the equipment is determined by an appraiser, if significant, or by the value on the borrower's financial statements. Field examiner reviews are conducted based on the loan exposure and reliance on this type of collateral. Appraised and reported values may be discounted based on management's historical knowledge, changes in market conditions from the time of valuation, and/or management's expertise and knowledge of the client and client's business. Impaired loans and leases are reviewed and evaluated on at least a quarterly basis for additional impairment and adjusted accordingly, based on the same factors identified above. Impaired loans and leases were \$10.3 million and \$9.8 million at March 31, 2008 and December 31, 2007, respectively. During the quarter, there were new impaired loans and leases of \$1.3 million, payments of \$508,000 and charge-offs of \$233,000.

**Note 11. Recent Accounting Pronouncements**

In September 2006, the Financial Accounting Standards Board ratified a consensus opinion reached by the Emerging Issues Task Force on Issue 06-4, Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements, ( EITF 06-4 ) which requires employers that enter into endorsement split-dollar life insurance arrangements that provide an employee with a postretirement benefit to recognize a liability for the future benefits promised based on the substantive agreement made with the employee. Whether the accrual is based on a death benefit or on the future cost of maintaining the insurance would depend on what the employer has effectively agreed to provide during the employee's retirement. The purchase of an endorsement-type life insurance policy does not qualify as a settlement of the liability.

The consensus in EITF 06-4 is effective for fiscal years beginning after December 15, 2007. The Company adopted EITF 06-4 effective January 1, 2008. As a result of this adoption, the Company recorded an increase to accumulated deficit of \$546,000.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities-Including an amendment of FASB Statement No. 115. SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. SFAS No. 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The Company did not elect the fair value option for any financial instruments.

**Table of Contents**

**PART I ITEM 2**

**Management's Discussion and Analysis of**

**Financial Condition and Results of Operations**

You should read this section in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations included in the Company's Annual Report on Form 10-K for the year ended December 31, 2007. All weighted average, actual share and per share information set forth in this Quarterly Report on Form 10-Q has been adjusted retroactively for the effects of stock dividends, including the stock dividend declared on October 16, 2007, payable on November 16, 2007 to shareholders of record on October 31, 2007.

**Statements Regarding Forward Looking Information**

The information disclosed in this document includes various forward-looking statements that are made in reliance upon the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 with respect to credit quality (including delinquency trends and the allowance for loan and lease losses), corporate objectives, and other financial and business matters. The words anticipates, projects, intends, estimates, expects, believes, plans, may, will, should, could, and other similar expressions are intended to identify such forward-looking statements. Company cautions that these forward-looking statements are necessarily speculative and speak only as of the date made, and are subject to numerous assumptions, risks and uncertainties, all of which may change over time. Actual results could differ materially from such forward-looking statements.

In addition to the factors disclosed by the Company elsewhere in this document, the following factors, among others, could cause the Company's actual results to differ materially and adversely from such forward-looking statements: pricing pressures on loan and deposit products; competition; changes in economic conditions nationally, regionally and in the Company's markets; the extent and timing of actions of the Federal Reserve Board; changes in levels of market interest rates; clients' acceptance of the Company's products and services; credit risks of lending activities; changes in the conditions of the capital markets in general and in the capital markets for financial institutions in particular and the impact of the war in Iraq or elsewhere on such markets; and the extent and timing of legislative and regulatory actions and reforms.

The above-listed risk factors are not necessarily exhaustive, particularly as to possible future events, and new risk factors may emerge from time to time. Certain events may occur that could cause the Company's actual results to be materially different than those described in the Company's periodic filings with the Securities and Exchange Commission. Any statements made by the Company that are not historical facts should be considered to be forward-looking statements. The Company is not obligated to update and does not undertake to update any of its forward-looking statements made herein.

**Significant Accounting Policies, Judgments and Estimates**

The accounting and reporting policies of the Company and its subsidiaries conform with accounting principles generally accepted in the United States of America and predominant practices within the banking industry. The consolidated financial statements include the accounts of the Company, Lakeland, Lakeland Investment Corp. and Lakeland NJ Investment Corp. All intercompany balances and transactions have been eliminated.

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. These estimates and assumptions also affect reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates. Significant estimates implicit in these financial statements are as follows:

The principal estimates that are particularly susceptible to significant change in the near term relate to the allowance for loan and lease losses, the analysis of goodwill impairment and the Company's deferred tax asset. The evaluation of the adequacy of the allowance for loan and lease losses includes, among other factors, an analysis of historical loss rates, by category, applied to current loan totals. However, actual losses may be higher or lower than historical trends, which vary. Actual losses on specified problem loans and leases, which also are provided for in the evaluation, may vary from estimated loss percentages.

The allowance for loan and lease losses is established through a provision for loan and lease losses charged to expense.



---

## **Table of Contents**

Loan principal considered to be uncollectible by management is charged against the allowance for loan and lease losses. The allowance is an amount that management believes will be adequate to absorb losses on existing loans and leases that may become uncollectible based upon an evaluation of known and inherent risks in the loan portfolio. The evaluation takes into consideration such factors as changes in the nature and size of the loan portfolio, overall portfolio quality, specific problem loans and leases, and current economic conditions which may affect the borrowers' ability to pay. The evaluation also details historical losses by loan category, the resulting loss rates for which are projected at current loan total amounts. Loss estimates for specified problem loans and leases are also detailed. All of the factors considered in the analysis of the adequacy of the allowance for loan and lease losses may be subject to change. To the extent actual outcomes differ from management estimates, additional provisions for loan and lease losses may be required that would adversely impact earnings in future periods.

Interest income is accrued as earned on a simple interest basis. Accrual of interest is discontinued on a loan when management believes, after considering economic and business conditions and collection efforts, that the borrower's financial condition is such that collection of interest is doubtful. When a loan is placed on such non-accrual status, all accumulated accrued interest receivable is reversed out of current period income. Commercial loans and leases 90 days or more past due and still accruing interest must have both principal and accruing interest adequately secured and must be in the process of collection. Residential mortgage loans are placed on non-accrual status at the time when foreclosure proceedings are commenced except where there exists sufficient collateral to cover the defaulted principal and interest payments, and management's knowledge of the specific circumstances warrant continued accrual. Consumer loans are generally charged off when principal and interest payments are four months in arrears unless the obligations are well secured and in the process of collection. Interest thereafter on such charged-off consumer loans is taken into income when received only after full recovery of principal.

The Company accounts for impaired loans and leases in accordance with SFAS No. 114, *Accounting by Creditors for Impairment of a Loan*, as amended by SFAS No. 118, *Accounting by Creditors for Impairment of a Loan - Income Recognition and Disclosures*. Impairment is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, except that as a practical expedient, a creditor may measure impairment based on a loan's observable market price, or the fair value of the collateral if the loan is collateral-dependent. Regardless of the measurement method, a creditor must measure impairment based on the fair value of the collateral when the creditor determines that foreclosure is probable.

The Company accounts for income taxes under the liability method of accounting for income taxes. Deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities as measured by the enacted tax rates that will be in effect when these differences reverse. Deferred tax expense is the result of changes in deferred tax assets and liabilities. The principal types of differences between assets and liabilities for financial statement and tax return purposes are the allowance for loan and lease losses, deferred loan fees, deferred compensation and securities available for sale.

On January 1, 2007, the Company adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes (FIN 48)*, to account for any tax positions that may be uncertain. FIN 48 prescribes a recognition threshold of more-likely-than-not, and a measurement attribute for all tax positions taken or expected to be taken on a tax return, in order for those tax positions to be recognized in the financial statements. Additional information regarding the Company's uncertain tax positions is set forth in Note 9 to the Financial Statements of the Company's Form 10-K for the year ended December 31, 2007.

The Company accounts for goodwill and other identifiable intangible assets in accordance with SFAS No. 142, *Goodwill and Intangible Assets*. SFAS No. 142 includes requirements to test goodwill and indefinite lived intangible assets for impairment rather than amortize them. The Company has tested its goodwill as of December 31, 2007 and determined that it is not impaired.

### **Results of Operations**

#### **(First Quarter 2008 Compared to First Quarter 2007)**

##### **Net Income**

Net income for the first quarter of 2008 was \$5.5 million, compared to \$4.4 million for the same period in 2007, an increase of \$1.2 million or 27%. Diluted earnings per share were \$0.24 for the first quarter of 2008, a \$0.05 or 26% increase over what was reported for the same period last year. Return on Average Assets was 0.88% and Return on Average Equity was 10.47% for the first quarter of 2008.

**Table of Contents**

The factors that influenced first quarter net income in 2008 compared to the same period in 2007 included a \$3.4 million increase in net interest income resulting from a reduction in the cost of interest bearing liabilities and continued loan growth offset by an increase in the provision for loan and lease losses. These factors will be discussed in further detail below.

**Net Interest Income**

Net interest income on a tax equivalent basis for the first quarter of 2008 was \$20.8 million, a \$3.3 million or 19% increase from the \$17.5 million earned in the first quarter of 2007. The increase in net interest income primarily resulted from a more favorable mix of earning assets and a decrease in the cost of interest bearing liabilities. The components of net interest income will be discussed in greater detail below.

The following table reflects the components of the Company's net interest income, setting forth for the periods presented, (1) average assets, liabilities and stockholders' equity, (2) interest income earned on interest-earning assets and interest expense paid on interest-bearing liabilities, (3) average yields earned on interest-earning assets and average rates paid on interest-bearing liabilities, (4) the Company's net interest spread (i.e., the average yield on interest-earning assets less the average cost of interest-bearing liabilities) and (5) the Company's net interest margin. Rates are computed on a tax equivalent basis using a tax rate of 35%.



**Table of Contents**

|  | For the three months ended,<br>March 31, 2008 |                                |   | For the three months ended,<br>March 31, 2007 |                                |                                     |
|--|---|--------------------------------|---|---|--------------------------------|-------------------------------------|
|  | Average<br>Balance                            | Interest<br>Income/<br>Expense | Average<br>rates<br>earned/<br>paid<br>(dollars in thousands) | Average<br>Balance                            | Interest<br>Income/<br>Expense | Average<br>rates<br>earned/<br>paid |
| <b>Assets</b>                                    |   |                                |   |   |                                |                                     |
| Interest-earning assets:                         |   |                                |   |   |                                |                                     |
| Loans and leases (A)                             | \$ 1,893,631                                  | \$ 31,650                      | 6.72%   | \$ 1,602,689                                  | \$ 27,276                      | 6.90%                               |
| Taxable investment securities                    | 320,777                                       | 3,597                          | 4.49%   | 332,765                                       | 3,637                          | 4.37%                               |
| Tax-exempt securities                            | 77,059  | 1,086                          | 5.64%   | 85,560  | 1,209                          | 5.65%                               |
| Federal funds sold (B)                           | 19,727  | 160                            | 3.24%   | 32,213  | 408                            | 5.07%                               |
| <b>Total interest-earning assets</b>             | <b>2,311,194</b>                              | <b>36,493</b>                  | <b>6.35%</b>  | <b>2,053,227</b>                              | <b>32,530</b>                  | <b>6.41%</b>                        |
| Noninterest-earning assets:                      |   |                                |   |   |                                |                                     |
| Allowance for loan and lease losses              | (14,863)                                      |                                |   | (13,508)                                      |                                |                                     |
| Other assets                                     | 234,792                                       |                                |   | 226,801                                       |                                |                                     |
| <b>TOTAL ASSETS</b>                              | <b>\$ 2,531,123</b>                           |                                |   | <b>\$ 2,266,520</b>                           |                                |                                     |
| <b>Liabilities and Stockholders Equity</b>       |   |                                |   |   |                                |                                     |
| Interest-bearing liabilities:                    |   |                                |   |   |                                |                                     |
| Savings accounts                                 | \$ 317,024                                    | \$ 1,264                       | 1.60%   | \$ 325,761                                    | \$ 1,346                       | 1.68%                               |
| Interest-bearing transaction accounts            | 792,477                                       | 4,202                          | 2.13%   | 733,706                                       | 5,446                          | 3.01%                               |
| Time deposits                                    | 579,877                                       | 6,316                          | 4.36%   | 513,383                                       | 5,672                          | 4.42%                               |
| Borrowings                                       | 326,514                                       | 3,881                          | 4.75%   | 190,667                                       | 2,554                          | 5.36%                               |
| <b>Total interest-bearing liabilities</b>        | <b>2,015,892</b>                              | <b>15,663</b>                  | <b>3.12%</b>  | <b>1,763,517</b>                              | <b>15,018</b>                  | <b>3.43%</b>                        |
| Noninterest-bearing liabilities:                 |   |                                |   |   |                                |                                     |
| Demand deposits                                  | 286,695                                       |                                |   | 289,030                                       |                                |                                     |
| Other liabilities                                | 15,633  |                                |   | 14,918  |                                |                                     |
| Stockholders equity                              | 212,903                                       |                                |   | 199,055                                       |                                |                                     |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b> | <b>\$ 2,531,123</b>                           |                                |   | <b>\$ 2,266,520</b>                           |                                |                                     |
| Net interest income/spread                       |   | 20,830                         | 3.23%   |   | 17,512                         | 2.98%                               |
| Tax equivalent basis adjustment                  |   | 380                            |   |   | 423                            |                                     |
| <b>NET INTEREST INCOME</b>                       |   | <b>\$ 20,450</b>               |   |   | <b>\$ 17,089</b>               |                                     |
| Net interest margin (C)                          |   |                                | 3.62%   |   |                                | 3.46%                               |

(A) Includes non-accrual loans, the effect of which is to reduce the yield earned on loans, and deferred loan fees.

(B) Includes interest-bearing cash accounts.

(C) Net interest income divided by interest-earning assets.

Interest income on a tax equivalent basis increased from \$32.5 million in the first quarter of 2007 to \$36.5 million in 2008, an increase of \$4.0 million or 12%. The increase in interest income was due to an increase in average interest-earning assets of \$258.0 million, or 13%, and a change in the mix of interest-earning assets. Loans and leases as a percent of interest-earning assets increased from 78% in the first quarter of 2007 to 82% in 2008 while total investment securities as a percent of interest-earning assets decreased from 20% in the first quarter of 2007 to 17% in the first quarter of 2008. Loans and leases typically earn higher yields than investment securities. The yield on interest earning assets declined six basis points to 6.35% as a result of the declining rate environment.

## Edgar Filing: LAKELAND BANCORP INC - Form 10-Q

Total interest expense increased from \$15.0 million in the first quarter of 2007 to \$15.7 million in the first quarter of 2008, an increase of \$645,000, or 4%. Average interest-bearing liabilities increased \$252.4 million, but the cost of those liabilities decreased from 3.43% in 2007 to 3.12% in 2008. The decrease in liability yields reflects the decrease in short term interest rates, as the Federal Reserve Bank lowered the federal funds target rate from 4.25% at year end 2007 to 2.25% at the end of the first quarter of 2008. Lakeland lowered its deposit rates to reflect this lower interest rate environment. Average deposits increased from \$1.86 billion in the first quarter of 2007 to \$1.98 billion in the first quarter of 2008, an increase of \$114.2 million, or 6%. Average borrowings increased from \$190.7 million in 2007 to \$326.5 million in 2008 to fund loan growth. The average rate paid on these borrowings declined 61 basis points due to the declining rate environment.

---

## **Table of Contents**

### **Provision for Loan and Lease Losses**

In determining the provision for loan and lease losses, management considers historical loan loss experience, changes in composition and volume of the portfolio, the level and composition of non-performing loans and leases, the adequacy of the allowance for loan and lease losses, and prevailing economic conditions.

The provision for loan and lease losses increased to \$1.3 million for the first quarter of 2008 from \$602,000 for the same period last year as a result of management's evaluation of the adequacy of the allowance for loan and lease losses. During the first quarter of 2008, the Company charged off loans of \$587,000 and recovered \$91,000 in previously charged off loans compared to \$391,000 and \$262,000, respectively, during the same period in 2007. The higher provision for loan and lease losses reflects loan growth and a higher level of non-performing loans and leases and net charge-offs in the first quarter of 2008 compared to first quarter 2007. For more information regarding the determination of the provision, see Risk Elements under Financial Condition.

### **Noninterest Income**

Noninterest income increased \$422,000 from the first quarter of 2007 to the first quarter of 2008. The majority of that increase can be attributed to an increase in leasing income of \$470,000 which includes gains on sale of leases of \$452,000. Commissions and fees increased from \$779,000 in the first quarter of 2007 to \$952,000 in the first quarter of 2008 due to an increase in loan fees and investment services income. Other income decreased \$312,000 due to a \$319,000 gain on the sale of a branch office in the first quarter of 2007.

### **Noninterest Expense**

Noninterest expense increased from \$14.3 million in the first quarter of 2007 to \$15.3 million in the first quarter of 2008, an increase of \$1.0 million or 7%. Salaries and employee benefits expense increased \$247,000 or 3% to \$8.4 million in the first quarter of 2008. Savings realized from modifications in our medical benefit plans were used to offset normal salary and benefit increases. Net occupancy expense increased by \$118,000 or 8% to \$1.6 million in the first quarter of 2008 from the first quarter of 2007. Furniture and equipment cost increased by \$126,000 or 11% to \$1.3 million in the same time period. Occupancy and equipment cost increased as a result of two branches that were opened in the second quarter of 2007. Marketing expense increased from \$391,000 in the first quarter of 2007 to \$458,000 in the first quarter of 2008 as a result of increased market research. Stationery, supplies and postage increased from \$400,000 in the first quarter of 2007 to \$464,000 in the first quarter of 2008 because of additional mailings. Other expenses increased by \$415,000 or 17% primarily due to consulting costs and an increased FDIC assessment. The Company's efficiency ratio was 59.2% in the first quarter of 2008, compared to 64.5% for the same period last year. The efficiency ratio expresses the relationship between noninterest expense (excluding other real estate expense and core deposit amortization) to total tax-equivalent revenue (excluding gains (losses) on sales of securities).

### **Income Taxes**

The Company's effective tax rate increased from 31.5% in the first quarter of 2007 to 34.8% in the first quarter of 2008 because the Company's pre-tax income increased \$2.1 million or 33% from the first quarter of 2007 to the first quarter of 2008. Interest income on tax-exempt securities declined \$80,000 or 10% during the same time period.

### **Financial Condition**

The Company's total assets increased \$41.7 million or 2% from \$2.51 billion at December 31, 2007, to \$2.56 billion at March 31, 2008. Total deposits decreased from \$1.99 billion on December 31, 2007 to \$1.94 billion on March 31, 2008, a decrease of \$48.6 million or 2%. Long term debt increased by \$39.6 million from \$171.8 million on December 31, 2007 to \$211.4 million on March 31, 2008.

**Table of Contents****Loans and Leases**

Gross loans and leases increased from \$1.88 billion on December 31, 2007 to \$1.93 billion on March 31, 2008, an increase of \$52.0 million, or 3%. For more information on the loan portfolio, see Note 7 in Notes to the Consolidated Financial Statements in this Quarterly Report on Form 10-Q.

**Risk Elements**

The following schedule sets forth certain information regarding the Company's non-accrual, past due and renegotiated loans and leases and other real estate owned on the dates presented:

| (in thousands)   | March 31,<br>2008 | December 31,<br>2007 | March 31,<br>2007 |
|--|-------------------|----------------------|-------------------|
| Non-performing loans and leases:                             |                   |                      |                   |
| Non-accrual loans and leases                                 | \$ 10,853         | \$ 10,159            | \$ 6,235          |
| Renegotiated loans and leases                                |                   |                      |                   |
| <b>TOTAL NON-PERFORMING LOANS AND LEASES</b>                 | <b>10,853</b>     | <b>10,159</b>        | <b>6,235</b>      |
| Other real estate and other repossessed assets               | 185               | 185                  |                   |
| <b>TOTAL NON-PERFORMING ASSETS</b>                           | <b>\$ 11,038</b>  | <b>\$ 10,344</b>     | <b>\$ 6,235</b>   |
| Loans and leases past due 90 days or more and still accruing | \$ 1,167          | \$ 667               | \$ 211            |

Non-performing assets increased from \$10.3 million on December 31, 2007, or 0.41% of total assets, to \$11.0 million, or 0.43% of total assets, on March 31, 2008. Loans and leases past due ninety days or more and still accruing at March 31, 2008 increased \$500,000 to \$1.2 million from \$667,000 on December 31, 2007. Loans and leases past due 90 days or more and still accruing are those loans and leases that are both well-secured and in process of collection.

On March 31, 2008, the Company had \$10.3 million in impaired loans and leases (consisting primarily of non-accrual loans and leases) compared to \$9.8 million at year-end 2007. For more information on these loans and leases see Note 7 in Notes to the Consolidated Financial Statements of this Quarterly Report on Form 10-Q. The impairment of the loans and leases is measured using the present value of future cash flows on certain impaired loans and leases and is based on the fair value of the underlying collateral for the remaining loans and leases. Based on such evaluation, \$2.7 million has been allocated as a portion of the allowance for loan and lease losses for impairment at March 31, 2008. At March 31, 2008, the Company also had \$9.6 million in loans and leases that were rated substandard that were not classified as non-performing or impaired.

There were no loans and leases at March 31, 2008, other than those designated non-performing, impaired or substandard, where the Company was aware of any credit conditions of any borrowers or obligors that would indicate a strong possibility of the borrowers not complying with present terms and conditions of repayment and which may result in such loans and leases being included as non-accrual, past due or renegotiated at a future date.

**Table of Contents**

The following table sets forth for the periods presented, the historical relationships among the allowance for loan and lease losses, the provision for loan losses, the amount of loans and leases charged-off and the amount of loan recoveries:

| (dollars in thousands)   | Three months ended<br>March 31,<br>2008 | Year ended<br>December 31,<br>2007 | Three months ended<br>March 31,<br>2007 |
|--|---|------------------------------------|---|
| Balance of the allowance at the beginning of the year                                    | \$ 14,689                               | \$ 13,454                          | \$ 13,454                               |
| Loans and leases charged off:  |   |                                    |   |
| Commercial   | 280                                     | 3,601                              | 68                                      |
| Leases   |   | 425                                | 9                                       |
| Home Equity and consumer   | 307                                     | 1,341                              | 314                                     |
| Real estate mortgage   |   |                                    |   |
| <b>Total loans charged off</b>   | <b>587</b>                              | <b>5,367</b>                       | <b>391</b>                              |
| Recoveries:  |   |                                    |   |
| Commercial   | 20                                      | 209                                | 172                                     |
| Leases   |   | 2                                  | 1                                       |
| Home Equity and consumer   | 71                                      | 415                                | 89                                      |
| Real estate mortgage   |   |                                    |   |
| <b>Total Recoveries</b>  | <b>91</b>                               | <b>626</b>                         | <b>262</b>                              |
| Net charge-offs:   | 496                                     | 4,741                              | 129                                     |
| Provision for loan and lease losses  | 1,267                                   | 5,976                              | 602                                     |
| Ending balance   | \$ 15,460                               | \$ 14,689                          | \$ 13,927                               |
| Ratio of annualized net charge-offs to average loans and leases outstanding              | 0.10%                                   | 0.28%                              | 0.03%                                   |
| Ratio of allowance at end of period as a percentage of period end total loans and leases | 0.80%                                   | 0.78%                              | 0.84%                                   |

The ratio of the allowance for loan and lease losses to loans and leases outstanding reflects management's evaluation of the underlying credit risk inherent in the loan portfolio. The determination of the adequacy of the allowance for loan and lease losses and periodic provisioning for estimated losses included in the consolidated financial statements is the responsibility of management and the Board of Directors. The evaluation process is undertaken on a quarterly basis.

Methodology employed for assessing the adequacy of the allowance for loan and lease losses consists of the following criteria:

The establishment of reserve amounts for all specifically identified classified loans and leases that have been designated as requiring attention by the Company or its external loan review consultant.

The establishment of reserves for pools of homogeneous types of loans and leases not subject to specific review, including 1-4 family residential mortgages and consumer loans.

## Edgar Filing: LAKELAND BANCORP INC - Form 10-Q

The establishment of reserve amounts for the non-classified loans and leases in each portfolio based upon the historical average loss experience of these portfolios and management's evaluation of key factors.

Consideration is given to the results of ongoing credit quality monitoring processes, the adequacy and expertise of the Company's lending staff, underwriting policies, loss histories, delinquency trends, and the cyclical nature of economic and business conditions. Since many of the Company's loans depend on the sufficiency of collateral as a secondary means of repayment, any adverse trend in the real estate markets could affect underlying values available to protect the Company against loss.

---

## **Table of Contents**

Based upon the process employed and giving recognition to all accompanying factors related to the loan portfolio, management considers the allowance for loan and lease losses to be adequate at March 31, 2008. The preceding statement constitutes a forward-looking statement under the Private Securities Litigation Reform Act of 1995.

### **Investment Securities**

For detailed information on the composition and maturity distribution of the Company's investment security portfolio, see Note 6 in the Notes to Consolidated Financial Statements contained in this Form 10-Q. Total investment securities decreased from \$402.6 million on December 31, 2007 to \$379.7 million on March 31, 2008, a decrease of \$22.9 million, or 6% which included maturities of securities used to fund loan growth.

### **Deposits**

Total deposits decreased from \$1.99 billion on December 31, 2007 to \$1.94 billion on March 31, 2008, a decrease of \$48.6 million, or 2%. This decrease was due to a \$44.3 million decrease in time deposits \$100,000 and over, primarily in the municipal sector. As an alternative to higher costing, short-term municipal CD's, we elected to borrow long-term in this lower rate environment.

### **Liquidity**

Cash and cash equivalents, totaling \$71.9 million on March 31, 2008, increased \$14.7 million from December 31, 2007. Operating activities, principally the result of the Company's net income, provided \$8.0 million in net cash. Investing activities used \$29.0 million in net cash, primarily reflecting the use of funds for loan originations. Financing activities provided \$35.8 million in net cash, reflecting an increase of \$47.1 million in federal funds purchased and securities sold under agreements to repurchase and an increase of \$50.0 million in long-term debt. The Company anticipates that it will have sufficient funds available to meet its current loan commitments and deposit maturities. This constitutes a forward-looking statement under the Private Securities Litigation Reform Act of 1995. At March 31, 2008, the Company had outstanding loan origination commitments of \$404.8 million. These commitments include \$341.0 million that mature within one year; \$28.9 million that mature after one but within three years; \$1.9 million that mature after three but within five years and \$33.0 million that mature after five years. The Company also had \$9.3 million in letters of credit outstanding at March 31, 2008. This included \$8.1 million that are maturing within one year and \$1.2 million that mature after one but within three years. Time deposits issued in amounts of \$100,000 or more maturing within one year total \$175.8 million.

### **Capital Resources**

Stockholders' equity increased from \$211.6 million on December 31, 2007 to \$215.0 million on March 31, 2008. Book value per common share increased to \$9.24 on March 31, 2008 from \$9.09 on December 31, 2007. The increase in stockholders' equity from December 31, 2007 to March 31, 2008 was primarily due to net income offset by dividends and a cumulative adjustment for adoption of EITF 06-4 of \$546,000. For more information, please see Note 11 in Notes to the Consolidated Financial Statements in this Quarterly Report on Form 10-Q.

The Company and Lakeland are subject to various regulatory capital requirements that are monitored by federal banking agencies. Failure to meet minimum capital requirements can lead to certain supervisory actions by regulators; any supervisory action could have a direct material effect on the Company or Lakeland's financial statements. Management believes, as of March 31, 2008, that the Company and Lakeland meet all capital adequacy requirements to which they are subject.

**Table of Contents**

The capital ratios for the Company and Lakeland at March 31, 2008 and the minimum regulatory guidelines for such capital ratios for qualification as a well-capitalized institution are as follows:

|   | <b>Tier 1 Capital<br/>to Total Average<br/>Assets Ratio</b> | <b>Tier 1 Capital<br/>to Risk-Weighted<br/>Assets Ratio</b> | <b>Total Capital<br/>to Risk-Weighted<br/>Assets Ratio</b> |
|---|---|---|--|
| <b>Capital Ratios:</b>                              | <b>March 31,<br/>2008</b>                                   | <b>March 31,<br/>2008</b>                                   | <b>March 31,<br/>2008</b>                                  |
| The Company   | 8.10%   | 10.11%  | 11.09%   |
| Lakeland Bank                                       | 7.74%   | 9.68%   | 10.50%   |
| Well capitalized institution under FDIC Regulations | 5.00%   | 6.00%   | 10.00%   |

## ITEM 3. Quantitative and Qualitative Disclosures about Market Risk

The Company manages interest rate risk and market risk by identifying and quantifying interest rate risk exposures using simulation analysis, economic value at risk models and gap analysis. At March 31, 2008, the cumulative one-year gap was \$(310.3) million or (12.1%) of total assets.

The Company uses net interest income simulation because the Company's Asset/Liability Management Committee believes that the interest rate sensitivity modeling more accurately reflects the effects and exposure to changes in interest rates. Net interest income simulation considers the relative sensitivities of the balance sheet including the effects of interest rate caps on adjustable rate mortgages and the relatively stable aspects of core deposits. As such, net interest simulation is designed to address the probability of interest rate changes and the behavioral response of the balance sheet to those changes. Market Value of Portfolio Equity represents the fair value of the net present value of assets, liabilities and off-balance-sheet items. The Company's Market Value of Portfolio Equity at March 31, 2008 was \$256.9 million.

Based on its simulation models, the Company estimates that for a 200 basis point rate shock increase, the Company's Market Value of Portfolio Equity would decline (12.9%) and would decrease (4.9%) for a 200 basis point rate shock decrease. The simulation model also shows that for a 200 basis point rate increase, the Company's projected net interest income for the next 12 months would decrease (3.0%), and would increase 2.9% for a 200 basis point rate decrease. The information provided for net interest income over the next 12 months assumes that changes in interest rates of plus 200 basis points and minus 200 basis points change gradually in equal increments over the following 12 month period. The above information is based on significant estimates and assumptions and constitutes a forward-looking statement under the Private Securities Litigation Reform Act of 1995. For more information regarding the Company's market risk and assumptions used in the Company's simulation models, please refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2007.

## ITEM 4. Controls and Procedures

(a) Disclosure controls and procedures. As of the end of the Company's most recently completed fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) covered by this report, the Company carried out an evaluation, with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures pursuant to Securities Exchange Act Rule 13a-15. Based upon that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective in ensuring that information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms.

(b) Changes in internal controls over financial reporting. There have been no changes in the Company's internal control over financial reporting that occurred during the Company's last fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.





**Table of Contents**

SIGNATURES

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

Lakeland Bancorp, Inc.  
(Registrant)

/s/ Thomas J. Shara  
Thomas J. Shara  
President and Chief Executive Officer

/s/ Joseph F. Hurley  
Joseph F. Hurley  
Executive Vice President and  
Chief Financial Officer

May 9, 2008

Date