PEAPACK GLADSTONE FINANCIAL CORP
Form 10-Q
May 08, 2008

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

FORM 10-Q

(MARK ONE)

ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarter Ended March 31, 2008

OR

o 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. 001-16197

PEAPACK-GLADSTONE FINANCIAL CORPORATION
(Exact name of registrant as specified in its charter)

New Jersey (State or other jurisdiction of incorporation or organization)	22-3537895 (I.R.S. Employer Identification No.)

158 Route 206 North
Gladstone, New Jersey 07934
(Address of principal executive offices, including zip code)

(908) 234-0700
(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 ý No o.

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 definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act (check one):

Large accelerated filer o	Accelerated filer ý
Non-accelerated filer (do not check if a smaller reporting company) o	Smaller reporting company o

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

Number of shares of Common Stock outstanding as of May 1, 2008:
8,300,124

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PEAPACK-GLADSTONE FINANCIAL CORPORATION
PART 1 FINANCIAL INFORMATION

PART 2 OTHER INFORMATION

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Item 1. Financial Statements (Unaudited)

PEAPACK-GLADSTONE FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CONDITION
(Dollars in thousands)
(Unaudited)

	March 31, 2008	December 31, 2007
ASSETS		
Cash and due from banks	$ 25,205	$ 25,443
Federal funds sold	1,690	1,771
Interest-earning deposits	50,441	973
Total cash and cash equivalents	77,336	28,187
Investment securities held to maturity (approximate market value $43,305 in 2008 and $45,070 in 2007)	42,819	45,139
Securities available for sale	228,885	236,944
FHLB and FRB Stock, at cost	4,112	4,293
Loans	983,358	981,180
Less: Allowance for loan losses	7,777	7,500
Net Loans	975,581	973,680
Premises and equipment	26,364	26,236
Other real estate owned	965	-
Accrued interest receivable	4,998	5,122
Cash surrender value of life insurance	24,709	19,474
Other assets	10,067	7,901
TOTAL ASSETS	$ 1,395,836	$ 1,346,976
LIABILITIES		
Deposits:		
Noninterest-bearing demand deposits	$ 197,403	$ 199,266
Interest-bearing deposits:		
Checking	135,948	145,490
Savings	65,919	64,772
Money market accounts	412,890	377,544
Certificates of deposit over $100,000	182,764	155,410
Certificates of deposit less than $100,000	235,550	237,785
Total deposits	1,230,474	1,180,267
Overnight borrowings	-	15,650
Long-term debt	40,658	29,169
Accrued expenses and other liabilities	19,011	14,461
TOTAL LIABILITIES	1,290,143	1,239,547

SHAREHOLDERS' EQUITY		
Common stock (no par value; $0.83 per share;		
authorized 20,000,000 shares; issued shares, 8,599,512 at		
March 31, 2008 and 8,577,446 at December 31, 2007;		
outstanding shares, 8,289,125 at March 31, 2008 and		
8,304,486 at December 31, 2007)	7,166	7,148
Surplus	91,308	90,677
Treasury stock at cost, 310,987 shares at March 31, 2008		
and 272,960 shares at December 31, 2007	(7,196)	(6,255)
Retained earnings	23,437	21,750
Accumulated other comprehensive loss, net of income tax	(9,022)	(5,891)
TOTAL SHAREHOLDERS' EQUITY	105,693	107,429
TOTAL LIABILITIES & SHAREHOLDERS' EQUITY	$ 1,395,836	$ 1,346,976

See accompanying notes to consolidated financial statements.

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PEAPACK-GLADSTONE FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
(Dollars in thousands, except share data)
(Unaudited)

	Three Months Ended March 31, 2008	Three Months Ended March 31, 2007
INTEREST INCOME		
Interest and fees on loans	$ 14,683	$ 13,179
Interest on investment securities:		
Taxable	174	234
Tax-exempt	241	271
Interest on securities available for sale:		
Taxable	2,809	3,275
Tax-exempt	283	245
Interest-earning deposits	48	11
Interest on federal funds sold	107	79
Total interest income	18,345	17,294
INTEREST EXPENSE		
Interest on savings and interest-bearing deposit accounts	2,958	4,243
Interest on certificates of deposit over $100,000	1,842	1,606
Interest on other time deposits	2,661	2,858
Interest on borrowed funds	370	263
Total interest expense	7,831	8,970
NET INTEREST INCOME BEFORE PROVISION FOR LOAN LOSSES	10,514	8,324
Provision for loan losses	430	125
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	10,084	8,199
OTHER INCOME		
Trust department income	2,485	2,142
Service charges and fees	489	490
Bank owned life insurance	269	216
Securities gains	310	162
Other income	176	178
Total other income	3,729	3,188
OTHER EXPENSES		
Salaries and employee benefits	4,911	4,254
Premises and equipment	2,040	1,854
Other expenses	1,658	1,450
Total other expenses	8,609	7,558

INCOME BEFORE INCOME TAX EXPENSE		5,204		3,829
Income tax expense		1,741		1,137
NET INCOME	$	3,463	$	2,692
EARNINGS PER SHARE				
Basic	$	0.42	$	0.33
Diluted	$	0.41	$	0.32
Average basic shares outstanding		8,296,494		8,273,250
Average diluted shares outstanding		8,397,751		8,400,599

See accompanying notes to consolidated financial statements.

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EAPACK-GLADSTONE FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(Dollars in thousands)
(Unaudited)

	Three Months Ended March 31, 2008	2007
Balance, beginning of period	$ 107,429	$ 103,763
Cumulative effect adjustment resulting from the adoption of EITF 06-04	(449)	-
Balance, beginning of period, as adjusted	106,980	103,763
Comprehensive income:		
Net income	3,463	2,692
Unrealized holding (losses)/gains/ on securities arising during the period, net of tax	(2,930)	376
Less: reclassification adjustment for gains included in net income, net of tax	201	105
	(3,131)	271
Total comprehensive income	332	2,963
Common stock options exercised	386	219
Purchase of treasury stock	(941)	(181)
Cash dividends declared	(1,328)	(1,241)
Stock-based compensation expense	101	45
Tax benefit on disqualifying and nonqualifying exercise of stock options	163	-
Balance, March 31,	$ 105,693	$ 105,568

See accompanying notes to consolidated financial statements.

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PEAPACK-GLADSTONE FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in thousands)
(Unaudited)

	Three Months Ended March 31, 2008	Three Months Ended March 31, 2007
OPERATING ACTIVITIES:		
Net income:	$ 3,463	$ 2,692
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	574	530
Amortization of premium and accretion of discount on securities, net	75	80
Provision for loan losses	430	125
Gains on security sales	(310)	(162)
Gain on loans sold	-	(1)
Loss/(Gain) on disposal of fixed assets	71	(3)
Gain on sale of other real estate owned	(24)	-
Stock-based compensation	101	45
Increase in cash surrender value of life insurance, net	(235)	(188)
Decrease/(increase) in accrued interest receivable	124	281
(Increase)/Decrease in other assets	(91)	198
Increase/(Decrease) in accrued expenses and other liabilities	4,102	(3,946)
NET CASH PROVIDED BY OPERATING ACTIVITIES	8,280	(349)
INVESTING ACTIVITIES:		
Proceeds from maturities of investment securities	2,002	2,002
Proceeds from maturities of securities available for sale	11,792	14,313
Proceeds from calls of investment securities	300	150
Proceeds from calls and sales of securities available for sale	19,419	810
Purchase of securities available for sale	(27,924)	(4,596)
Purchase of life insurance	(5,000)	-
Proceeds from sales of loans	6,658	858
Net increase in loans	(10,216)	(13,277)
Proceeds from sales of other real estate owned	286	-
Purchases of premises and equipment	(804)	(1,128)
Disposal of premises and equipment	31	30
NET CASH USED IN INVESTING ACTIVITIES	(3,456)	(838)
FINANCING ACTIVITIES:		
Net increase in deposits	50,207	21,291
Net decrease in other borrowings	(15,650)	-
Proceeds from Federal Home Loan Bank advances	12,000	-
Repayments of Federal Home Loan Bank advances	(511)	(444)
Cash dividends paid	(1,329)	(1,241)
Tax benefit on stock option exercises	163	-
Exercise of stock options	386	219
Purchase of treasury stock	(941)	(181)
NET CASH PROVIDED BY FINANCING ACTIVITIES	44,325	19,644

Net increase in cash and cash equivalents		49,149		18,457
Cash and cash equivalents at beginning of period		28,187		30,258
Cash and cash equivalents at end of period	$	77,336	$	48,715
Supplemental disclosures of cash flow information:				
Cash paid during the period for:				
Interest	$	7,309	$	8,067
Income taxes		-		750

See accompanying notes to consolidated financial statements.

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PEAPACK-GLADSTONE FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Certain information and footnote disclosures normally included in the unaudited consolidated financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Annual Report on Form 10-K for the period ended December 31, 2007 for Peapack-Gladstone Financial Corporation (the "Corporation").

Principles of Consolidation: The Corporation considers that all adjustments necessary for a fair presentation of the statement of the financial position and results of operations in accordance with U.S. generally accepted accounting principles for these periods have been made. Results for such interim periods are not necessarily indicative of results for a full year.

The consolidated financial statements of Peapack-Gladstone Financial Corporation are prepared on the accrual basis and include the accounts of the Corporation and its wholly owned subsidiary, Peapack-Gladstone Bank. All significant intercompany balances and transactions have been eliminated from the accompanying consolidated financial statements.

Allowance for Loan Losses: The allowance for loan losses is maintained at a level considered adequate to provide for probable incurred loan losses in the Corporation's loan portfolio. The allowance is based on management's evaluation of the loan portfolio considering, among other things, current economic conditions, the volume and nature of the loan portfolio, historical loan loss experience, and individual credit situations. The allowance is increased by provisions charged to expense and reduced by charge-offs net of recoveries.

Stock Option Plans: The Corporation has stock option plans that allow the granting of shares of the Corporation's common stock as incentive stock options, nonqualified stock options, restricted stock awards and stock appreciation rights to directors, officers, employees and independent contractors of the Corporation and its subsidiaries. The options granted under these plans are exercisable at a price equal to the fair market value of common stock on the date of grant and expire not more than ten years after the date of grant. Stock options may vest during a period of up to five years after the date of grant.

For the three months ended March 31, 2008 and 2007, the Corporation recorded total compensation cost for share-based payment arrangements of $101 thousand and $45 thousand, respectively, with a recognized tax benefit of $6 thousand and $4 thousand for the three months ended March 31, 2008 and 2007, respectively.

As of March 31, 2008, there was approximately $1.2 million of unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the Corporation's stock incentive plans. That cost is expected to be recognized over a weighted average period of 1.9 years.

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For the Corporation's stock option plans, changes in options outstanding during the three months ended March 31, 2008 were as follows:

(Dollars in thousands except share data)	Number of Shares	Exercise Price Per Share	Weighted Average Exercise Price	Aggregate Intrinsic Value
Balance, December 31, 2007	583,812	$ 13.62-$32.14	$ 24.77	
Granted	64,860	24.57-27.04	24.59	
Exercised	(22,066)	16.86-18.23	17.50	
Forfeited	(100)	27.90	27.90	
Balance, March 31, 2008	626,506	$ 13.62-$32.14	$ 25.01	$ 1,931
Options exercisable, March 31, 2008	496,757			$ 1,764

The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value (the difference between the Corporation'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).

The aggregate intrinsic value of options exercised during the three months ended March 31, 2008 and 2007 was $172 thousand and $211 thousand, respectively.

The per share weighted-average fair value of stock options granted during the first three months of 2008 and 2007 for all plans was $10.79 and $10.24, respectively, on the date of grant using the Black Scholes option-pricing model with the following weighted average assumptions:

	2008	2007
Dividend yield	2.37%	1.99%
Expected volatility	50%	42%
Expected life	7 years	5 years
Risk-free interest rate	3.86%	4.56%

Earnings per Common Share – Basic and Diluted: The following is a reconciliation of the calculation of basic and diluted earnings per share. Basic net income per common share is calculated by dividing net income to common shareholders by the weighted average common shares outstanding during the reporting period. Diluted net income per common share is computed similarly to that of basic net income per common share, except that the denominator is increased to include the number of additional common shares that would have been outstanding if all potentially dilutive common shares, principally stock options, were issued during the reporting period utilizing the Treasury stock method.

(In Thousands, except per share data)	Three Months Ended March 31, 2008	2007
Net Income to Common Shareholders	$ 3,463	$ 2,692
Basic Weighted-Average Common Shares Outstanding	8,296,494	8,273,250
Plus: Common Stock Equivalents	101,257	127,349
Diluted Weighted-Average Common Shares Outstanding	8,397,751	8,400,599
Net Income Per Common Share		

Basic	$	0.42	$	0.33
Diluted		0.41		0.32

Stock options with an exercise price below the Corporation's market price equal to 380,252 and 373,264 shares were not included in the computation of diluted earnings per share in the first quarters of 2008 and 2007, respectively because they were antidilutive.

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Income Taxes: The Corporation files a consolidated Federal income tax return and separate state income tax returns for each subsidiary based on current laws and regulations.

The Corporation is no longer subject to examination by the U.S. Federal tax authorities for years prior to 2004 or by New Jersey tax authorities for years prior to 2003. The Corporation does not expect the total amount of unrecognized tax benefits to significantly increase in the next 12 months.

The Corporation recognizes interest related to income tax matters as interest expense and penalties related to income tax matters as other expense. The Corporation did not have any amounts accrued for interest and penalties at January 1, 2008.

Comprehensive Income: Comprehensive income consists of net income and the change during the period in the Corporation's pension benefit obligation and the net unrealized gains and losses on securities available for sale during the applicable period of time less adjustments for realized gains and losses. Total comprehensive income for the three months ended March 31, 2008 and 2007 was $332 thousand and $3.0 million, respectively.

Reclassification: Certain reclassifications have been made in the prior periods' financial statements in order to conform to the 2008 presentation.

2. LOANS

Loans outstanding as of March 31, 2008, and December 31, 2007, consisted of the following:

(In thousands)	March 31, 2008	December 31, 2007
Residential real estate	$ 494,806	$ 497,016
Commercial real estate	249,654	237,316
Commercial loans	132,478	129,747
Construction loans	51,928	60,589
Consumer loans	34,353	37,264
Other loans	20,139	19,248
Total loans	$ 983,358	$ 981,180

Non-performing assets, which are loans past due in excess of 90 days and still accruing, non-accrual loans and other real estate owned totaled $5.5 million at March 31, 2008 and $2.1 million at December 31, 2007. Management believes that the value of the real estate exceeds the balance due on the loans and expects no loss.

3. FEDERAL HOME LOAN BANK ADVANCES AND OTHER BORROWINGS

Advances from the Federal Home Loan Bank of New York (FHLB) totaled $40.7 million and $29.2 million at March 31, 2008 and December 31, 2007, respectively, with a weighted average interest rate of 3.59 percent and 3.69 percent, respectively. Advances totaling $13.0 million at March 31, 2008, have fixed maturity dates, while advances totaling $4.7 million were amortizing advances with monthly payments of principal and interest. These advances are secured by blanket pledges of certain 1-4 family residential mortgages totaling $227.5 million at March 31, 2008.

At March 31, 2008, the Corporation had $23.0 million in fixed rates advances that are noncallable for one, two or three years and then callable quarterly within final maturities of three, five or ten years. These advances are secured by pledges of investment securities totaling $24.4 million at March 31, 2008.

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There were no overnight borrowings at March 31, 2008, while overnight borrowings at December 31, 2007 totaled $15.7 million. For the three months ended March 31, 2008 and 2007, overnight borrowings from the FHLB averaged $1.8 million with a weighted average interest rate of 3.98 percent and $4.3 million with a weighted average interest rate of 5.37 percent, respectively.

The final maturity dates of the advances and other borrowings are scheduled as follows:

(In thousands)		
2008	$	-
2009		2,000
2010		13,390
2011		3,000
2012		5,000
Over 5 years		17,268
Total	$	40,658

4. BENEFIT PLANS

The Corporation has a defined benefit pension plan covering substantially all of its salaried employees.

The net periodic expense for the periods indicated included the following components:

	Three Months Ended March 31,			
(In thousands)	2008		2007	
Service cost	$	434	$	438
Interest cost		229		195
Expected return on plan assets		(289)		(252)
Amortization of:				
Net loss		9		9
Unrecognized prior service cost		-		-
Unrecognized remaining net assets		(2)		(2)
Net periodic benefit cost	$	381	$	388

The Corporation expects to contribute $1.1 million to its pension plan in 2008. As of March 31, 2008, contributions of $270 thousand had been made for the current year.

5. BUSINESS SEGMENTS

Late in 2007, the Corporation changed internal accounting and reporting processes in order to segregate and assess its results among two operating segments, Banking and Trust and adopted the new processes as of January 1, 2008. Management uses certain methodologies to allocate income and expense to the business segments. A funds transfer pricing methodology is used to assign interest income and interest expense to each interest-earning asset and interest-bearing liability on a matched maturity funding basis. Certain indirect expenses are allocated to segments. These include support unit expenses such as technology and operations and other support functions. Taxes are allocated to each segment based on the effective rate for the period shown.

Banking

The Banking segment includes commercial, commercial real estate, residential and consumer lending activities; deposit generation; operation of ATMs; telephone and internet banking services; merchant credit card services and customer support and sales.

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PGB Trust & Investments

PGB Trust & Investments includes asset management services provided for individuals and institutions; personal trust services, including services as executor, trustee, administrator, custodian and guardian; corporate trust services including services as trustee for pension and profit sharing plans; and other financial planning and advisory services.

The following table presents the statements of income and total assets for the Corporation's reportable segments for the three months ended March 31, 2008.

(In thousands)	Banking 2008	PGB Trust & Investments 2008	Total 2008
Net interest income	$ 9,803	$ 711	$ 10,514
Noninterest income	1,175	2,554	3,729
Total income	10,978	3,265	14,243
Provision for loan losses	430	-	430
Premises and equipment expense	1,828	212	2,040
Other noninterest expense	4,893	1,676	6,569
Total noninterest expense	7,151	1,888	9,039
Income before income tax expense	3,827	1,377	5,204
Income tax expense	1,280	461	1,741
Net income	$ 2,547	$ 916	$ 3,463
Total assets at period end	$ 1,395,184	$ 652	$ 1,395,836

6. FAIR VALUE

Statement 157 establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) or identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The fair values of securities available for sale are determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1 inputs) or matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs).

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Assets Measured on a Recurring Basis

		Fair Value Measurements at March 31, 2008 Using		
	March 31, 2008	Quoted Prices in Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Available for Sale Securities	$ 228,885	$ 2,711	$ 226,174	$ -

Item 2

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

GENERAL: The following discussion and analysis contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements are not historical facts and include expressions about management's view of future interest income and net loans, management's confidence and strategies and management's expectations about new and existing programs and products, relationships, opportunities and market conditions. These statements may be identified by such forward-looking terminology as "expect", "look", "believe", "anticipate", "may", "will", or similar statements or variations of such terms. Actual results may differ materially from such forward-looking statements. Factors that may cause actual results to differ materially from those contemplated by such forward-looking statements include, among others, the following possibilities:

Ÿ Effectiveness of the Corporation's balance sheet restructuring initiative.
Ÿ The uncertain credit environment in which the Corporation operates.
Ÿ Unexpected decline in the direction of the economy in New Jersey.
Ÿ Unexpected changes in interest rates.
Ÿ Failure to grow business.
Ÿ Inability to manage growth in commercial loans.
Ÿ Unexpected loan prepayment volume.
Ÿ Unanticipated exposure to credit risks.
Ÿ Insufficient allowance for loan losses.
Ÿ Competition from other financial institutions.
Ÿ Adverse effects of government regulation or different than anticipated effects from existing regulations.
Ÿ Decline in the levels of loan quality and origination volume.
Ÿ Decline in trust assets or deposits.
Ÿ Unexpected classification of securities to other-than-temporary impaired status.

The Corporation assumes no responsibility to update such forward-looking statements in the future.

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CRITICAL ACCOUNTING POLICIES AND ESTIMATES: "Management's Discussion and Analysis of Financial Condition and Results of Operations" is based upon the Corporation's consolidated financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles. The preparation of these financial statements requires the Corporation to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. Note 1 to the Corporation's Audited Consolidated Financial Statements included in the December 31, 2007 Annual Report on Form 10-K, contains a summary of the Corporation's significant accounting policies. Management believes the Corporation's policy with respect to the methodology for the determination of the allowance for loan losses involves a higher degree of complexity and requires management to make difficult and subjective judgments, which often require assumptions or estimates about highly uncertain matters. Changes in these judgments, assumptions or estimates could materially impact results of operations. This critical policy and its application are periodically reviewed with the Audit Committee and the Board of Directors.

The provision for loan losses is based upon management's evaluation of the adequacy of the allowance, including an assessment of known and inherent risks in the portfolio, giving consideration to the size and composition of the loan portfolio, actual loan loss experience, level of delinquencies, detailed analysis of individual loans for which full collectibility may not be assured, the existence and estimated net realizable value of any underlying collateral and guarantees securing the loans, and current economic and market conditions. Although management uses the best information available, the level of the allowance for loan losses remains an estimate, which is subject to significant judgment and short-term change. Various regulatory agencies, as an integral part of their examination process, periodically review the Corporation's provision for loan losses. Such agencies may require the Corporation to make additional provisions for loan losses based upon information available to them at the time of their examination. Furthermore, the majority of the Corporation's loans are secured by real estate in the State of New Jersey. Accordingly, the collectibility of a substantial portion of the carrying value of the Corporation's loan portfolio is susceptible to changes in local market conditions and may be adversely affected should real estate values decline or should New Jersey experience adverse economic conditions. Future adjustments to the provision for loan losses may be necessary due to economic, operating, regulatory and other conditions beyond the Corporation's control.

EXECUTIVE SUMMARY: For the first quarter of 2008, the Corporation's net income was $3.5 million as compared to $2.7 million for the first quarter of 2007, an increase of $771 thousand, or 28.6 percent. Earnings per share were $0.41 per diluted share in the first quarter of 2008 as compared to $0.32 per diluted share for the first quarter of 2007. The primary factor contributing to the increase in net income is the improvement in net interest income and the net interest margin, which is explained below. Annualized return on average assets for the quarter was 1.02 percent and annualized return on average equity was 12.81 percent for the first quarter of 2008.

On a fully tax-equivalent basis, net interest income was $10.8 million in the first quarter of 2008 as compared to $8.6 million in the first quarter of 2007, an increase of $2.2 million or 26.2 percent from the same quarter last year. The net interest margin was 3.34 percent for the first quarter of 2008 as compared to 2.82 percent for the same quarter of 2007 and 3.21 percent in the fourth quarter of 2007.

Average loans increased $111.7 million or 12.8 percent to $982.6 million for the first quarter of 2008. The Corporation's long-term plan calls for a substantial shift in the asset mix, with less emphasis on residential mortgages and more emphasis on higher yielding commercial loans and commercial mortgages. As a result of this strategy, the average commercial loan portfolios grew $112.2 million or 35.2 percent, while the average mortgage loan portfolio declined by $3.0 million or 0.6 percent. Loan rates declined seven basis points from the first quarter of 2007 to 5.99 percent for the same quarter of 2008.

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Deposits averaged $1.2 billion in the first quarter of 2008, growing $56.9 million, or 5.0 percent, over the levels of the first quarter of 2007. Deposit gathering remains highly competitive as short-term market rates have declined in the past few months. In the first quarter of 2008, rates paid for interest-bearing deposits were 2.95 percent as compared to 3.63 percent for the first quarter of 2007, a decline of 68 basis points.

EARNINGS ANALYSIS

NET INTEREST INCOME: On a tax-equivalent basis on interest-earning assets and before the provision for loan losses, net interest income was $10.8 million for the first quarter of 2008 as compared to $8.6 million for the same quarter of 2007, an increase of $2.2 million or 26.2 percent. The net interest margin, on a fully tax-equivalent basis, was 3.34 percent and 2.82 percent in the first quarters of 2008 and 2007, respectively, an increase of 52 basis points. When compared to the fourth quarter of 2007, net interest income for the first quarter of 2008, rose $553 thousand, or 5.4 percent, from $10.2 million on a tax-equivalent basis. On a fully tax equivalent basis, the net interest margin, increased from 3.21 percent in the fourth quarter of 2007, to 3.34 percent in the first quarter of 2008.

Average loans for the first quarter of 2008 increased $111.7 million or 12.8 percent to $982.6 million from $870.9 million for the first quarter of 2007. The average mortgage loan portfolio declined by $3.0 million or 0.6 percent, during this period, while the average commercial loan portfolios grew $112.2 million or 35.2 percent. Our long-term plan calls for a substantial shift in our asset mix, with less emphasis on residential mortgages and more emphasis on higher yielding commercial loans and commercial mortgages. We believe this material shift in our asset mix will deliver substantially superior earnings performance over the coming years and improvement has already been seen in our net interest margin since last year.

Average deposits were $1.2 billion the first quarter of 2008, growing $56.9 million, or 5.0 percent from the averages reported for the same quarter of 2007. For the first quarters of 2008 and 2007, certificates of deposit averaged $403.9 million and $372.3 million, increasing $31.6 million or 8.5 percent. In the first quarter of 2008, money market accounts averaged $406.1 million, an increase of $28.0 million, or 7.4 percent, over the same quarter in 2007. Certificates of deposit and money market accounts remain the Corporation’s fastest growing categories of deposits and pay the highest rates, averaging 4.46 percent and 2.61 percent, respectively, in the first quarter. The high yield money market account has experienced the largest growth, $97.8 million, or 52.0 percent, and has remained popular with the Bank’s customers. Average demand deposits were $185.8 million for the first quarter of 2008, an increase of $5.6 million or 3.1 percent, from the year ago period. Average overnight borrowings declined $2.5 million from $4.3 million in the first quarter of 2007 to $1.8 million for the first quarter of 2008, as other borrowings increased to $15.6 million, or 65.7 percent.

On a tax-equivalent basis, average interest rates remained relatively flat, 5.76 percent for the first quarter of 2008 as compared to 5.77 percent for the same quarter last year. Average interest rates earned on investment securities increased 19 basis points to 5.21 percent for the first quarter of 2008; however, average balances had declined $50.1 million causing interest income from investments to decline $490 thousand. Average interest rates earned on loans declined 7 basis points to 5.99 percent from 6.06 percent for the same period in 2007.

The average interest rates paid on interest-bearing liabilities in the first quarters of 2008 and 2007 was 2.98 percent and 3.63 percent, respectively, a 65 basis point decrease. While the average rate paid on money market accounts declined 145 basis points to 2.61 percent for the first quarter of 2008, average rates paid on certificates of deposit declined only 34 basis points. The average rates paid on borrowings declined to 3.61 percent in the first quarter of 2008 from 3.77 percent in the first quarter of 2007 due in part to the reduction in short-term market rates.

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The cost of funds decreased to 2.53 percent for the first quarter of 2008 as compared to 3.07 percent for the same period in 2007. The net interest income and net interest margin has benefited from the Federal Reserve Board's decisions to reduce the fed funds target rate 200 basis points in the first quarter of 2008. We expect that further interest rate reductions are possible and anticipate that these rate cuts will further lower the cost of funds.

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The following tables reflect the components of net interest income for the periods indicated:

Average Balance Sheet
Unaudited
Quarters Ended
(Tax-Equivalent Basis, Dollars in Thousands)

	March 31, 2008			March 31, 2007		
	Average Balance	Income/ Expense	Yield	Average Balance	Income/ Expense	Yield
ASSETS:						
Interest-earnings assets:						
Investments:						
Taxable (1)	$ 231,715	$ 2,983	5.15%	$ 282,137	$ 3,509	4.97%
Tax-exempt (1) (2)	56,821	776	5.46	56,502	740	5.24
Loans (2) (3)	982,625	14,704	5.99	870,905	13,193	6.06
Federal funds sold	13,153	107	3.26	5,884	79	5.38
Interest-earning deposits	7,819	48	2.45	898	11	5.02
Total interest-earning assets	1,292,133	$ 18,618	5.76%	1,216,326	$ 17,532	5.77%
Noninterest -earning assets:						
Cash and due from banks	20,809			23,127		
Allowance for loan losses	(7,463)			(6,770)		
Premises and equipment	26,473			24,406		
Other assets	28,436			26,642		
Total noninterest-earning assets	68,255			67,405		
Total assets	$ 1,360,388			$ 1,283,731		