

LAKELAND BANCORP INC  
Form 10-Q  
November 10, 2014  
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 September 30, 2014**

**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 000-17820**

**LAKELAND BANCORP, INC.**

**(Exact name of registrant as specified in its charter)**

**New Jersey**  
**(State or other jurisdiction of**  
**incorporation or organization)**

**22-2953275**  
**(I.R.S. Employer**  
**Identification No.)**

**250 Oak Ridge Road, Oak Ridge, New Jersey**  
**(Address of principal executive offices)**  
**(973) 697-2000**

**07438**  
**(Zip Code)**

**(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 has submitted electronically and posted on its corporate Web site, if any, any Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or such shorter period that the registrant was required to submit and post such files). Yes  No

Edgar Filing: LAKELAND BANCORP INC - Form 10-Q

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: (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 October 31, 2014, there were 37,910,617 outstanding shares of Common Stock, no par value.

**Table of Contents**

LAKELAND BANCORP, INC.

Form 10-Q Index

	PAGE
<b>Part I Financial Information</b>	
Item 1. Financial Statements:	
<u>Consolidated Balance Sheets - September 30, 2014 (unaudited) and December 31, 2013</u>	3
<u>Consolidated Statements of Income - Unaudited Three and Nine Months Ended September 30, 2014 and 2013</u>	4
<u>Consolidated Statements of Comprehensive Income (Loss) - Unaudited Three and Nine Months Ended September 30, 2014 and 2013</u>	5
<u>Consolidated Statements of Changes in Stockholders' Equity - Unaudited Nine Months Ended September 30, 2014</u>	6
<u>Consolidated Statements of Cash Flows - Unaudited Nine Months Ended September 30, 2014 and 2013</u>	7
<u>Notes to Consolidated Financial Statements (unaudited)</u>	8
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	37
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	52
<u>Item 4. Controls and Procedures</u>	53
<b><u>Part II Other Information</u></b>	
<u>Item 1. Legal Proceedings</u>	54
<u>Item 1A. Risk Factors</u>	54
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	54
<u>Item 3. Defaults Upon Senior Securities</u>	54
<u>Item 4. Mine Safety Disclosures</u>	54
<u>Item 5. Other Information</u>	54
<u>Item 6. Exhibits</u>	54
<u>Signatures</u>	55
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: <a href="http://www.sec.gov">http:// www.sec.gov</a> .	

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

	September 30, 2014 (unaudited)	December 31, 2013
	(dollars in thousands except share and per share amounts)	
<b>ASSETS:</b>		
Cash	\$ 122,989	\$ 94,205
Interest-bearing deposits due from banks	4,177	8,516
Total cash and cash equivalents	127,166	102,721
Investment securities available for sale, at fair value	444,292	431,106
Investment securities held to maturity; fair value of \$105,127 at September 30, 2014 and \$100,394 at December 31, 2013	104,909	101,744
Federal Home Loan Bank and other membership bank stock, at cost	8,831	7,938
Loans held for sale	1,519	1,206
Loans, net of deferred costs (fees)	2,611,765	2,469,016
Less: allowance for loan and lease losses	30,047	29,821
Net loans	2,581,718	2,439,195
Premises and equipment, net	36,049	37,148
Accrued interest receivable	8,512	8,603
Goodwill	109,974	109,974
Other identifiable intangible assets	2,071	2,424
Bank owned life insurance	57,058	55,968
Other assets	16,806	19,764
<b>TOTAL ASSETS</b>	<b>\$ 3,498,905</b>	<b>\$ 3,317,791</b>
<b>LIABILITIES</b>		
Deposits:		
Noninterest bearing	\$ 674,933	\$ 600,652
Savings and interest-bearing transaction accounts	1,820,657	1,812,467
Time deposits under \$100 thousand	168,391	180,859
Time deposits \$100 thousand and over	112,950	115,227
Total deposits	2,776,931	2,709,205
Federal funds purchased and securities sold under agreements to repurchase	112,796	81,991
Other borrowings	179,700	119,000
Subordinated debentures	41,238	41,238
Other liabilities	15,701	14,933
<b>TOTAL LIABILITIES</b>	<b>3,126,366</b>	<b>2,966,367</b>

**STOCKHOLDERS EQUITY**

Common stock, no par value; authorized shares, 70,000,000; issued 37,910,372 shares at September 30, 2014 and 37,873,800 shares at December 31, 2013	383,819	364,637
Accumulated deficit	(11,267)	(8,538)
Accumulated other comprehensive loss	(13)	(4,675)
<b>TOTAL STOCKHOLDERS EQUITY</b>	<b>372,539</b>	<b>351,424</b>
<b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b>	<b>\$ 3,498,905</b>	<b>\$ 3,317,791</b>

The accompanying notes are an integral part of these consolidated financial statements.

**Table of Contents****Lakeland Bancorp, Inc. and Subsidiaries****CONSOLIDATED STATEMENTS OF INCOME - UNAUDITED**

For the Three Months Ended For the Nine Months Ended  
 September 30, September 30,  
 2014 2013 2014 2013  
 (In thousands, except per share data)

**INTEREST INCOME**

Loans, leases and fees	\$ 27,949	\$ 27,350	\$ 82,405	\$ 77,122
Federal funds sold and interest-bearing deposits with banks	24	27	46	57
Taxable investment securities and other	2,387	2,017	7,448	5,544
Tax-exempt investment securities	436	461	1,376	1,331
<b>TOTAL INTEREST INCOME</b>	<b>30,796</b>	<b>29,855</b>	<b>91,275</b>	<b>84,054</b>

**INTEREST EXPENSE**

Deposits	1,256	1,518	3,762	4,740
Federal funds purchased and securities sold under agreements to repurchase	19	14	69	36
Other borrowings	1,069	836	2,728	2,709
<b>TOTAL INTEREST EXPENSE</b>	<b>2,344</b>	<b>2,368</b>	<b>6,559</b>	<b>7,485</b>

**NET INTEREST INCOME**

Provision for loan and lease losses	1,194	1,879	4,276	7,656
-------------------------------------	-------	-------	-------	-------

**NET INTEREST INCOME AFTER**

<b>PROVISION FOR LOAN AND LEASE LOSSES</b>	<b>27,258</b>	<b>25,608</b>	<b>80,440</b>	<b>68,913</b>
--	---------------	---------------	---------------	---------------

**NONINTEREST INCOME**

Service charges on deposit accounts	2,689	2,838	7,911	8,052
Commissions and fees	1,371	1,139	3,466	3,495
Gains on sales and calls of investment securities			2	506
Gain on debt extinguishment				1,197
Income on bank owned life insurance	365	383	1,090	1,036
Other income	384	285	784	1,203
<b>TOTAL NONINTEREST INCOME</b>	<b>4,809</b>	<b>4,645</b>	<b>13,253</b>	<b>15,489</b>

**NONINTEREST EXPENSE**

Salaries and employee benefits	11,327	11,019	33,340	31,105
Net occupancy expense	2,017	2,060	6,675	5,921
Furniture and equipment	1,605	1,582	4,958	4,492
Stationery, supplies and postage	368	348	1,056	1,086
Marketing expense	629	715	1,491	1,438
FDIC insurance expense	489	436	1,501	1,505

Edgar Filing: LAKELAND BANCORP INC - Form 10-Q

Legal expense	144	406	636	934
Expenses on other real estate owned and other repossessed assets	50	(2)	165	15
Long term debt prepayment fee				526
Merger related expenses		744		2,827
Core deposit intangible amortization	111	123	353	164
Other expenses	2,945	2,976	8,782	8,014
<b>TOTAL NONINTEREST EXPENSE</b>	<b>19,685</b>	<b>20,407</b>	<b>58,957</b>	<b>58,027</b>
Income before provision for income taxes	12,382	9,846	34,736	26,375
Income tax expense	4,136	3,229	11,546	8,747
<b>NET INCOME</b>	<b>\$ 8,246</b>	<b>\$ 6,617</b>	<b>\$ 23,190</b>	<b>\$ 17,628</b>
<b>PER SHARE OF COMMON STOCK</b>				
Basic earnings	\$ 0.22	\$ 0.18	\$ 0.61	\$ 0.52
Diluted earnings	\$ 0.22	\$ 0.18	\$ 0.61	\$ 0.52
Dividends	\$ 0.075	\$ 0.067	\$ 0.218	\$ 0.200

The accompanying notes are an integral part of these consolidated financial statements.



Table of Contents**Lakeland Bancorp, Inc. and Subsidiaries****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)-UNAUDITED**

	For the Three Months Ended		For the Nine Months Ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
	(in thousands)		(in thousands)	
<b>NET INCOME</b>	\$ 8,246	\$ 6,617	\$ 23,190	\$ 17,628
<b>OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX:</b>				
Unrealized securities gains (losses) during period	(1,136)	1,118	4,649	(5,454)
Reclassification for gains included in net income			(2)	(329)
Change in pension liability, net	5	5	15	15
Other Comprehensive Income (Loss)	(1,131)	1,123	4,662	(5,768)
<b>TOTAL COMPREHENSIVE INCOME</b>	\$ 7,115	\$ 7,740	\$ 27,852	\$ 11,860

The accompanying notes are an integral part of these consolidated financial statements.

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

## CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY - UNAUDITED

**Nine Months Ended September 30, 2014**

	Common Stock	Accumulated deficit (dollars in thousands)	Accumulated Other Comprehensive Income (Loss)	Total
BALANCE January 1, 2014	\$ 364,637	(\$8,538)	(\$4,675)	\$ 351,424
Net Income		23,190		23,190
Other comprehensive income, net of tax			4,662	4,662
Stock based compensation	1,121			1,121
Stock dividend	17,630	(17,630)		
Issuance of stock to dividend reinvestment and stock purchase plan	379	(305)		74
Exercise of stock options, net of excess tax benefits	52			52
Cash dividends, common stock		(7,984)		(7,984)
<b>BALANCE September 30, 2014 (UNAUDITED)</b>	<b>\$ 383,819</b>	<b>(\$11,267)</b>	<b>(\$13)</b>	<b>\$ 372,539</b>

The accompanying notes are an integral part of these consolidated financial statements.

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

## CONSOLIDATED STATEMENTS OF CASH FLOWS - UNAUDITED

	For the Nine Months Ended September 30,	
	2014	2013
	(dollars in thousands)	
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$ 23,190	\$ 17,628
Adjustments to reconcile net income to net cash provided by operating activities:		
Net amortization of premiums, discounts and deferred loan fees and costs	2,553	3,695
Depreciation and amortization	2,634	2,606
Amortization of intangible assets	353	164
Provision for loan and lease losses	4,276	7,656
Loans originated for sale	(15,504)	(27,125)
Proceeds from sales of loans	15,569	29,368
Gains on securities	(2)	(506)
Gain on early debt extinguishment		(1,197)
Gains on sales of loans held for sale	(378)	(612)
Gains on other real estate and other repossessed assets	(143)	(277)
(Gains) losses on sales of premises and equipment	(50)	(68)
Stock-based compensation	1,121	669
Deferred tax provision		
(Increase) decrease in other assets	(188)	7,837
Increase in other liabilities	790	468
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>34,221</b>	<b>40,306</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Net cash acquired in acquisition		74,316
Proceeds from repayments on and maturity of securities:		
Available for sale	41,704	55,913
Held to maturity	18,064	20,397
Proceeds from sales of securities		
Available for sale	15,646	53,670
Held to maturity	1,374	
Purchase of securities:		
Available for sale	(65,174)	(144,004)
Held to maturity	(22,901)	(11,768)
Net increase in Federal Home Loan Bank Stock	(893)	(90)
Net increase in loans and leases	(148,397)	(47,537)
Proceeds from sales of other real estate and repossessed assets	1,098	1,751
Capital expenditures	(1,904)	(1,986)
Proceeds from sales of bank premises and equipment	102	462

<b>NET CASH (USED IN) PROVIDED BY INVESTING ACTIVITIES</b>	(161,281)	1,124
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Net increase in deposits	67,858	25,739
Increase (decrease) in federal funds purchased and securities sold under agreements to repurchase	30,805	(6,764)
Proceeds from other borrowings	135,700	
Repayments of other borrowings	(75,000)	(10,000)
Early extinguishment of subordinated debentures		(7,803)
Excess tax benefits	70	27
Exercise of stock options	86	709
Retirement of restricted stock	(104)	
Issuance of stock to dividend reinvestment and stock purchase plan	74	145
Dividends paid	(7,984)	(5,774)
<b>NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES</b>	151,505	(3,721)
Net increase in cash and cash equivalents	24,445	37,709
Cash and cash equivalents, beginning of period	102,721	107,545
<b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>	<b>\$ 127,166</b>	<b>\$ 145,254</b>

The accompanying notes are an integral part of these 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 accounting and reporting policies of the Company conform with accounting principles generally accepted in the United States of America (U.S. GAAP) and predominant practices within the banking industry.

The Company's unaudited interim financial statements reflect all adjustments, such as normal recurring accruals that are, in the opinion of management, necessary for the fair presentation of the results of the interim periods. The results of operations for the quarter and nine months ended September 30, 2014 do not necessarily indicate the results that the Company will achieve for all of 2014. You should read these interim financial statements in conjunction with the audited 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, 2013.

On May 31, 2013, the Company completed its acquisition of Somerset Hills Bancorp (Somerset Hills). For more information, see Note 2 below.

On May 21, 2014, the Company's Board of Directors authorized a 5% stock dividend which was distributed on June 17, 2014 to holders of record as of June 3, 2014. All weighted average, actual share and per share information set forth in this Quarterly Report on Form 10-Q have been adjusted retroactively for the effects of the stock dividend.

The financial information in this quarterly report has been prepared in accordance with the Company's customary accounting practices. Certain information and footnote disclosures required under U.S. GAAP have been condensed or omitted, as permitted by rules and regulations of the Securities and Exchange Commission.

**Note 2. Acquisitions**

On May 31, 2013, the Company completed its acquisition of Somerset Hills Bancorp, a bank holding company headquartered in Bernardsville, New Jersey. This acquisition enables the Company to expand into Somerset and Union counties, and broaden its presence in Morris County. Effective at the close of business on May 31, 2013, Somerset Hills Bancorp merged into the Company, and Somerset Hills Bank merged into Lakeland Bank. The Merger Agreement provided that the shareholders of Somerset Hills Bancorp would receive, at their election, for each outstanding share of Somerset Hills Bancorp common stock that they own at the effective time of the merger, either 1.1962 shares of Lakeland Bancorp common stock or \$11.43 in cash (adjusted for the 5% stock dividend referred to above), subject to proration as described in the Merger Agreement, so that 90% of the aggregate merger consideration was shares of Lakeland Bancorp common stock and 10% was cash. Lakeland Bancorp issued an aggregate of 6,083,783 shares of its common stock in the merger, and also assumed outstanding Somerset Hills Bancorp stock options (which were converted into options to purchase Lakeland Bancorp common stock). Lakeland Bancorp paid \$6.5 million in cash in the transaction.

The acquisition was accounted for under the acquisition method of accounting and accordingly, assets acquired, liabilities assumed and consideration exchanged were recorded at their estimated fair values as of the acquisition date. Somerset Hills' assets were recorded at their preliminary estimated fair values as of May 31, 2013 and Somerset Hills results of operations have been included in the Company's Consolidated Statements of Income since that date.

The assets acquired and liabilities assumed in the acquisition were recorded at their estimated fair values based on management's best estimates using information available at the date of the acquisition, including the use of a third party valuation specialist. The fair values are preliminary estimates and subject to adjustment for up to one year after the closing date of the acquisition. The following table summarizes the estimated fair value of the acquired assets and liabilities (in thousands).

**Table of Contents**

<b>Consideration Paid</b>	
Lakeland Bancorp stock issued	\$ 57,419
Cash Payment	6,460
Fair value of Somerset Hills stock options converted to Lakeland Bancorp stock options	1,500
<b>Total Consideration Paid</b>	<b>\$ 65,379</b>
<b>Recognized amounts of identifiable assets and liabilities assumed at fair value</b>	
Cash and cash equivalents	\$ 80,776
Securities available for sale	1,777
Securities held to maturity	8,686
Federal Home Loan Bank stock	493
Loans and leases	243,927
Loans held for sale	2,532
Premises and equipment	5,214
Identifiable intangible assets	2,712
Accrued interest receivable and other assets	9,946
Deposits	(311,801)
Other liabilities	(1,745)
<b>Total identifiable assets</b>	<b>\$ 42,517</b>
<b>Goodwill</b>	<b>\$ 22,862</b>

Loans acquired in the Somerset Hills acquisition were recorded at fair value and subsequently accounted for in accordance with ASC Topic 310, and there was no carryover related allowance for loan and lease losses. The fair values of loans acquired from Somerset Hills were estimated using cash flow projections based on the remaining maturity and repricing terms. Cash flows were adjusted for estimated future credit losses and the rate of prepayments. Projected cash flows were then discounted to present value using a risk-adjusted market rate for similar loans.

The following is a summary of the loans acquired in the Somerset Hills acquisition as of the closing date.

**Table of Contents**

<u>(in thousands)</u>	Acquired Credit Impaired Loans	Acquired Non-Credit Impaired Loans	Total Acquired Loans
Contractually required principal and interest at acquisition	\$ 4,507	\$ 352,148	\$ 356,655
Contractual cash flows not expected to be collected (non-accretable difference)	2,541		2,541
Expected cash flows at acquisition	\$ 1,966	\$ 352,148	\$ 354,114
Interest component of expected cash flows (accretable difference)	322	107,333	107,655
Fair value of acquired loans, including mortgages held for sale	\$ 1,644	\$ 244,815	\$ 246,459

The core deposit intangible totaled \$2.7 million and is being amortized over its estimated useful life of approximately 10 years using an accelerated method. The goodwill will be evaluated annually for impairment. The goodwill is not deductible for tax purposes.

The fair values of deposit liabilities with no stated maturities such as checking, money market and savings accounts, were assumed to equal the carrying amounts since these deposits are payable on demand. The fair values of certificates of deposits and IRAs represent the present value of contractual cash flows discounted at market rates for similar certificates of deposit.

Direct costs related to the acquisition were expensed as incurred. During the three and nine months ended September 30, 2013, the Company incurred \$744,000 and \$2.8 million, respectively, of merger and acquisition integration-related expenses, which have been separately stated in the Company's Consolidated Statements of Income.

**Note 3. Share-Based Compensation**

The Company grants stock options, restricted stock and restricted stock units (RSUs) under the 2009 Equity Compensation Program. Share-based compensation expense of \$1,121,000 and \$669,000 was recognized for the nine months ended September 30, 2014 and 2013, respectively. As of September 30, 2014, there was unrecognized compensation cost of \$851,000 related to unvested restricted stock; that cost is expected to be recognized over a weighted average period of approximately 2.2 years. Unrecognized compensation expense related to unvested stock options was approximately \$93,000 as of September 30, 2014 and is expected to be recognized over a period of 2.7 years. Unrecognized compensation expense related to RSUs was approximately \$810,000 as of September 30, 2014, and that cost is expected to be recognized over a period of 2.3 years.

In the first nine months of 2014, the Company granted 1,942 shares of restricted stock at an average grant date fair value of \$11.21 per share under the Company's 2009 equity compensation program. These shares vest over a five year period. Compensation expense on these shares is expected to average approximately \$4,000 per year for the next five years. In the first nine months of 2013, the Company granted 109,391 shares of restricted stock at a grant date fair value of \$9.41 per share under the 2009 program. Compensation expense on these shares is expected to average approximately \$206,000 per year over a five year period.



In the first nine months of 2014, the Company granted 127,797 RSUs at a weighted average grant date fair value of \$10.65 per share under the Company's 2009 equity compensation program. These units cliff vest within a range of two to three years. A portion of these RSUs will vest subject to certain performance conditions in the restricted stock unit agreement. There are also certain provisions in the compensation program which state that if a holder of the RSUs reaches a certain age and years of service, the person has effectively earned a portion of the RSUs at that time. Compensation expense on these restricted stock units is expected to average approximately \$453,000 per year over a three year period.

There were no grants of stock options in the first nine months of 2014.

**Table of Contents**

On May 31, 2013, the Company granted options to purchase 52,500 shares to two new non-employee directors of the Company at an exercise price of \$9.44 per share under the 2009 program. Each director's options are exercisable in five equal installments beginning at the date of grant and continuing on the next four anniversaries of the grant date. The fair value of these options were estimated using the Black-Scholes option pricing model with the following weighted average assumptions:

Risk-free interest rates	1.55%
Expected dividend yield	2.82%
Expected volatility	45.45%
Expected lives (years)	7.00
Weighted average fair value of options granted	\$ 3.31

Option activity under the Company's stock option plans is as follows:

	Number of shares	Weighted average exercise price	Weighted average remaining contractual term (in years)	Aggregate intrinsic value
Outstanding, January 1, 2014	514,626	\$ 10.67		\$ 754,938
Issued				
Exercised	(11,420)	7.51		
Forfeited	(2,486)	12.57		
Expired	(68,015)	11.95		
Outstanding, September 30, 2014	432,705	\$ 10.54	3.24	\$ 296,664
Options exercisable at September 30, 2014	401,205	\$ 10.62	2.82	\$ 286,221

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 nine months of 2014 and the exercise price, multiplied by the number of in-the-money options).

The aggregate intrinsic value of stock options exercised during the nine months ended September 30, 2014 and 2013 was \$42,000 and \$391,000, respectively. Exercise of stock options during the first nine months of 2014 and 2013 resulted in cash receipts of \$86,000 and \$709,000, respectively.

**Table of Contents**

Information regarding the Company's restricted stock (all unvested) and changes during the nine months ended September 30, 2014 is as follows:

	Number of shares	Weighted average price
Outstanding, January 1, 2014	262,270	\$ 9.12
Granted	1,942	11.21
Vested	(99,528)	9.01
Forfeited	(2,998)	9.72
Outstanding, September 30, 2014	161,686	\$ 9.21

Information regarding the Company's RSUs (all unvested) and changes during the nine months ended September 30, 2014 is as follows:

	Number of shares	Weighted average price
Outstanding, January 1, 2014		\$
Granted	127,797	10.65
Vested	(27,248)	10.66
Forfeited	(121)	10.66
Outstanding, September 30, 2014	100,428	\$ 10.64

**Note 4. Comprehensive Income**

The components of other comprehensive income are as follows:

	September 30, 2014			September 30, 2013		
	Before tax amount	Tax Benefit (Expense) (in thousands)	Net of tax amount	Before tax amount	Tax Benefit (Expense) (in thousands)	Net of tax amount
For the quarter ended:						
Net unrealized gains (losses) on available for sale securities						
Net unrealized holding gains (losses) arising during period	(\$1,787)	\$ 651	(\$1,136)	\$ 1,765	(\$647)	\$ 1,118
Reclassification adjustment for net gains arising during the period						

Edgar Filing: LAKELAND BANCORP INC - Form 10-Q

Net unrealized gains (losses)	(\$1,787)	\$ 651	(\$1,136)	\$ 1,765	(\$647)	\$ 1,118
Change in minimum pension liability	7	(2)	5	8	(3)	5
Other comprehensive income (loss), net	(\$1,780)	\$ 649	(\$1,131)	\$ 1,773	(\$650)	\$ 1,123
	Before tax amount	Tax Benefit (Expense) (in thousands)	Net of tax amount	Before tax amount	Tax Benefit (Expense) (in thousands)	Net of tax amount
For the nine months ended:						
Net unrealized gains (losses) on available for sale securities						
Net unrealized holding gains (losses) arising during period	\$ 7,253	(\$2,604)	\$ 4,649	(\$8,635)	\$ 3,181	(\$5,454)
Reclassification adjustment for net gains arising during the period	(3)	1	(2)	(506)	177	(329)
Net unrealized gains (losses)	\$ 7,250	(\$2,603)	\$ 4,647	(\$9,141)	\$ 3,358	(\$5,783)
Change in minimum pension liability	23	(8)	15	23	(8)	15
Other comprehensive income (loss), net	\$ 7,273	(\$2,611)	\$ 4,662	(\$9,118)	\$ 3,350	(\$5,768)

**Table of Contents**

The following table shows the changes in the balances of each of the components of other comprehensive income for the periods presented:

## Changes in Accumulated Other Comprehensive Income by Component (a)

	For the Three Months Ended			For the Three Months Ended		
	September 30, 2014			September 30, 2013		
	Unrealized Gains and Losses on Available- for-sale Securities	Pension Items	Total	Unrealized Gains and Losses on Available- for-sale Securities	Pension Items	Total
Beginning Balance	\$ 1,136	(\$18)	\$ 1,118	(\$2,348)	(\$607)	(\$2,955)
	(in thousands)					
Other comprehensive income (loss) before classifications	(1,136)	5	(1,131)	1,118	5	1,123
Amounts reclassified from accumulated other comprehensive income						
Net current period other comprehensive income (loss)	(1,136)	5	(1,131)	1,118	5	1,123
Ending balance	\$ 0	(\$13)	(\$13)	(\$1,230)	(\$602)	(\$1,832)

(a) All amounts are net of tax.

## Changes in Accumulated Other Comprehensive Income by Component (a)

	For the Nine Months Ended			For the Nine Months Ended		
	September 30, 2014			September 30, 2013		
	Unrealized Gains and Losses on Available- for-sale	Pension Items	Total	Unrealized Gains and Losses on Available- for-sale	Pension Items	Total

Edgar Filing: LAKELAND BANCORP INC - Form 10-Q

	Securities		Securities			
Beginning Balance	(\$4,647)	(\$28)	(\$4,675)	\$ 4,553	(\$617)	\$ 3,936
	(in thousands)					
Other comprehensive income (loss) before classifications	4,649	15	4,664	(5,454)	15	(5,439)
Amounts reclassified from accumulated other comprehensive income	(2)		(2)	(329)		(329)
Net current period other comprehensive income (loss)	4,647	15	4,662	(5,783)	15	(5,768)
Ending balance	\$ 0	(\$13)	(\$13)	(\$1,230)	(\$602)	(\$1,832)

(a) All amounts are net of tax.

**Table of Contents****Note 5. Statement of Cash Flow Information, Supplemental Information**

	For the Nine Months Ended	
	September 30, 2014	September 30, 2013
	(in thousands)	
<b>Supplemental schedule of noncash investing and financing activities:</b>		
Cash paid during the period for income taxes	\$ 10,824	\$ 8,497
Cash paid during the period for interest	6,492	7,750
Transfer of loans and leases into other repossessed assets and other real estate owned	1,417	3,098
<b>Acquisition of Somerset Hills Bancorp:</b>		
<b>Non-cash assets acquired:</b>		
Investment securities available for sale		1,777
Investment securities held for maturity		8,686
Loans, including loans held for sale		246,459
Goodwill and other intangible assets, net		25,574
Other assets		15,653
Total non-cash assets acquired		298,149
<b>Liabilities assumed:</b>		
Deposits		311,801
Other liabilities		1,745
Total liabilities assumed		313,546
Common stock issued and fair value of stock options converted to Lakeland Bancorp stock options		58,919

**Table of Contents****Note 6. Earnings Per Share**

The following schedule shows the Company's earnings per share for the periods presented:

(In thousands, except per share data)	For the Three Months Ended		For the Nine Months Ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
Net income available to common shareholders	\$ 8,246	\$ 6,617	\$ 23,190	\$ 17,628
Less: earnings allocated to participating securities	65	48	162	125
Net income allocated to common shareholders	\$ 8,181	\$ 6,569	\$ 23,028	\$ 17,503
Weighted average number of common shares outstanding - basic (1)	37,764	37,288	37,741	33,834
Share-based plans (1)	113	235	109	138
Weighted average number of common shares - diluted (1)	37,877	37,523	37,850	33,972
Basic earnings per share	\$ 0.22	\$ 0.18	\$ 0.61	\$ 0.52
Diluted earnings per share	\$ 0.22	\$ 0.18	\$ 0.61	\$ 0.52

(1) Adjusted for 5% stock dividend distributed June 17, 2014 to shareholders of record on June 3, 2014. Options to purchase 288,850 shares of common stock at a weighted average price of \$11.88 per share were outstanding and were not included in the computations of diluted earnings per share for the three months and for the nine months ended September 30, 2014 because the exercise price was greater than the average market price.

Options to purchase 484,434 shares of common stock at a weighted average price of \$11.82 were outstanding and were not included in the computations of diluted earnings per share for the three months ended September 30, 2013 because the exercise price was greater than the average market price. Options to purchase 514,822 shares of common stock at a weighted average price of \$11.70 were outstanding and were not included in the computations of diluted earnings per share for the nine months ended September 30, 2013 because the exercise price was greater than the average market price.



**Table of Contents****Note 7. Investment Securities**

AVAILABLE FOR SALE	September 30, 2014				December 31, 2013			
	Amortized Cost	Gross Unrealized Gains (in thousands)	Gross Unrealized Losses (in thousands)	Fair Value	Amortized Cost	Gross Unrealized Gains (in thousands)	Gross Unrealized Losses (in thousands)	Fair Value
U.S. treasury and U.S. government agencies	\$ 84,439	\$ 103	\$ (1,363)	\$ 83,179	\$ 72,828	\$	\$ (2,663)	\$ 70,165
Mortgage-backed securities, residential	309,188	2,505	(3,139)	308,554	310,088	1,752	(7,338)	304,502
Mortgage-backed securities, multifamily	4,972		(91)	4,881				
Obligations of states and political subdivisions	29,117	966	(140)	29,943	36,482	914	(523)	36,873
Other debt securities	492	14		506	3,541	37	(158)	3,420
Equity securities	16,100	1,367	(238)	17,229	15,433	1,097	(384)	16,146
	<b>\$ 444,308</b>	<b>\$ 4,955</b>	<b>\$ (4,971)</b>	<b>\$ 444,292</b>	<b>\$ 438,372</b>	<b>\$ 3,800</b>	<b>\$ (11,066)</b>	<b>\$ 431,106</b>

HELD TO MATURITY	September 30, 2014				December 31, 2013			
	Amortized Cost	Gross Unrealized Gains (in thousands)	Gross Unrealized Losses (in thousands)	Fair Value	Amortized Cost	Gross Unrealized Gains (in thousands)	Gross Unrealized Losses (in thousands)	Fair Value
U.S. government agencies	\$ 14,652	\$ 108	\$ (179)	\$ 14,581	\$ 19,732	\$ 3	\$ (576)	\$ 19,159
Mortgage-backed securities, residential	42,352	550	(804)	42,098	34,596	524	(1,025)	34,095
Mortgage-backed securities, multifamily	2,283		(100)	2,183	2,355		(166)	2,189
Obligations of states and political subdivisions	44,089	659	(158)	44,590	43,521	495	(770)	43,246
Other debt securities	1,533	142		1,675	1,540	165		1,705
	<b>\$ 104,909</b>	<b>\$ 1,459</b>	<b>\$ (1,241)</b>	<b>\$ 105,127</b>	<b>\$ 101,744</b>	<b>\$ 1,187</b>	<b>\$ (2,537)</b>	<b>\$ 100,394</b>



**Table of Contents**

The following table shows investment securities by stated maturity. Securities backed by mortgages have expected maturities that differ from contractual maturities because borrowers have the right to call or prepay, and are, therefore, classified separately with no specific maturity date (in thousands):

	September 30, 2014			
	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	\$ 1,103	\$ 1,114	\$ 9,939	\$ 9,996
Due after one year through five years	67,615	67,352	14,472	14,830
Due after five years through ten years	44,508	44,353	29,192	29,361
Due after ten years	822	809	6,671	6,659
	114,048	113,628	60,274	60,846
Mortgage-backed securities	314,160	313,435	44,635	44,281
Equity securities	16,100	17,229		
Total securities	\$ 444,308	\$ 444,292	\$ 104,909	\$ 105,127

The following table shows proceeds from sales of securities, gross gains and gross losses on sales or calls of securities and other than temporary impairments for the periods indicated (in thousands):

	For the Nine Months Ended September 30,	
	2014	2013
Sale proceeds	\$ 17,020	\$ 53,670
Gross gains	346	509
Gross losses	(344)	(3)

The above sales in 2014 include sales of \$1.4 million in held to maturity mortgage-backed securities of which the Company had already collected over 90% of the principal outstanding. The Company realized \$73,000 in gains on sales of these securities. There were no sales of securities in the third quarter of 2014 or 2013.

Gains or losses on sales of investment securities are based on the net proceeds and the adjusted carrying amount of the securities sold using the specific identification method.

Securities with a carrying value of approximately \$365.7 million and \$324.5 million at September 30, 2014 and December 31, 2013, respectively, were pledged to secure public deposits and for other purposes required by applicable laws and regulations.



Edgar Filing: LAKELAND BANCORP INC - Form 10-Q

\$ 255,927   \$ 9,721   \$ 23,831   \$ 1,345   92   \$ 279,758   \$ 11,066

**HELD TO MATURITY**

U.S. government agencies	\$ 14,153	\$ 576	\$	\$	5	\$ 14,153	\$ 576
Mortgage-backed securities, residential	22,939	889	1,097	136	11	24,036	1,025
Mortgage-backed securities, multifamily	895	99	1,294	67	2	2,189	166
Obligations of states and political subdivisions	17,826	607	1,456	163	51	19,282	770
	\$ 55,813	\$ 2,171	\$ 3,847	\$ 366	69	\$ 59,660	\$ 2,537

Management has evaluated the securities in the above table and has concluded that none of the securities are other-than-temporarily impaired. The primary cause of the fair values being below cost is due to interest rate movements and is deemed temporary. All investment securities are evaluated on a periodic basis to identify any factors that would require a further analysis. In evaluating the Company's securities, management considers the following items:

The Company's ability and intent to hold the securities, including an evaluation of the need to sell the security to meet certain liquidity measures, or whether the Company has sufficient levels of cash to hold the identified security in order to recover the entire amortized cost of the security;

**Table of Contents**

The financial condition of the underlying issuer;

The credit ratings of the underlying issuer and if any changes in the credit rating have occurred;

The length of time the security's fair value has been less than amortized cost; and

Adverse conditions related to the security or its issuer if the issuer has failed to make scheduled payments or other factors.

If the above factors indicate that an additional analysis is required, management will perform and consider the results of a discounted cash flow analysis.

As of September 30, 2014, the equity securities include investments in other financial institutions for market appreciation purposes. Those equities had a purchase price of \$2.6 million and a market value of \$4.0 million as of September 30, 2014.

As of September 30, 2014, equity securities also included \$13.3 million in investment funds that do not have a quoted market price but use net asset value per share or its equivalent to measure fair value.

The funds include \$2.9 million in funds that are primarily invested in community development loans that are guaranteed by the Small Business Administration (SBA). Because the funds are primarily guaranteed by the federal government there are minimal changes in market value between accounting periods. These funds can be redeemed within 60 days notice at the net asset value less unpaid management fees with the approval of the fund manager. As of September 30, 2014, the net amortized cost equaled the market value of the investment. There are no unfunded commitments related to this investment.

The funds also include \$10.4 million in funds that are invested in government guaranteed loans, mortgage-backed securities, small business loans and other instruments supporting affordable housing and economic development. The Company may redeem these funds at the net asset value calculated at the end of the current business day less any unpaid management fees. As of September 30, 2014, the amortized cost of these securities was \$10.6 million and the fair value was \$10.4 million. There are no restrictions on redemptions for the holdings in these investments other than the notice required by the fund manager. There are no unfunded commitments related to this investment.

**Note 8. Loans, Leases and Other Real Estate.**

The following sets forth the composition of Lakeland's loan and lease portfolio as of September 30, 2014 and December 31, 2013:

	September 30, 2014	December 31, 2013
	(in thousands)	
Commercial, secured by real estate	\$ 1,489,219	\$ 1,389,861
Commercial, industrial and other	231,961	213,808
Leases	52,285	41,332

Edgar Filing: LAKELAND BANCORP INC - Form 10-Q

Real estate-residential mortgage	431,477	432,831
Real estate-construction	67,949	53,119
Home equity and consumer	340,513	339,338
<b>Total loans</b>	<b>2,613,404</b>	<b>2,470,289</b>
Less: deferred fees	(1,639)	(1,273)
<b>Loans, net of deferred fees</b>	<b>\$ 2,611,765</b>	<b>\$ 2,469,016</b>

**Table of Contents**

At September 30, 2014 and December 31, 2013, home equity and consumer loans included overdraft deposit balances of \$652,000 and \$590,000, respectively. At September 30, 2014 and December 31, 2013, the Company had \$348.6 million and \$263.1 million in residential loans pledged for potential borrowings at the Federal Home Loan Bank of New York (FHLB).

Purchased Credit-Impaired ( PCI ) loans, are loans acquired at a discount that is due, in part, to credit quality. In conjunction with the Somerset Hills acquisition, three loans totaling \$1.6 million were deemed to be PCI loans at May 31, 2013 (the acquisition date ). PCI loans are accounted for in accordance with ASC Subtopic 310-30 and are initially recorded at fair value (as determined by the present value of expected future cash flows) with no valuation allowance (i.e., allowance for loan losses). For more information, see Note 2 Acquisitions.

Subsequent to the acquisition date, one PCI loan for \$149,000 was paid in full in the first quarter of 2014. There was credit deterioration in the remaining two loans. One loan totaling \$250,000 was charged off in the third quarter of 2014. The remaining loan at a balance \$1.3 million is being evaluated for impairment with the remainder of the Company s impaired loans.

*Non-Performing Assets and Past Due Loans*

The following schedule sets forth certain information regarding the Company s non-performing assets and its accruing troubled debt restructurings:

(in thousands)	September 30, 2014	December 31, 2013
Commercial, secured by real estate	\$ 8,361	\$ 7,697
Commercial, industrial and other	599	88
Leases	141	
Real estate residential mortgage	7,221	6,141
Real estate construction	188	831
Home equity and consumer	2,114	2,175
<b>Total non-accrual loans and leases</b>	<b>\$ 18,624</b>	<b>\$ 16,932</b>
Other real estate and other repossessed assets	982	520
<b>TOTAL NON-PERFORMING ASSETS</b>	<b>\$ 19,606</b>	<b>\$ 17,452</b>
Troubled debt restructurings, still accruing	\$ 7,957	\$ 10,289

Non-accrual loans included \$1.3 million and \$2.3 million of troubled debt restructurings as of September 30, 2014 and December 31, 2013, respectively.



**Table of Contents**

An age analysis of past due loans, segregated by class of loans as of September 30, 2014 and December 31, 2013, is as follows:

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 89 Days	Total Past Due (in thousands)	Current	Total Loans and Leases	Recorded Investment greater than 89 Days and still accruing
September 30, 2014							
Commercial, secured by real estate	\$ 2,759	\$ 3,698	\$ 7,227	\$ 13,684	\$ 1,475,535	\$ 1,489,219	\$
Commercial, industrial and other	808	601	523	1,932	230,029	231,961	
Leases	133	92	141	366	51,919	52,285	
Real estate residential mortgage	3,184	2,192	6,787	12,163	419,314	431,477	27
Real estate construction			189	189	67,760	67,949	
Home equity and consumer	3,191	216	2,375	5,782	334,731	340,513	402
	\$ 10,075	\$ 6,799	\$ 17,242	\$ 34,116	\$ 2,579,288	\$ 2,613,404	\$ 429
December 31, 2013							
Commercial, secured by real estate	\$ 7,355	\$ 5,438	\$ 6,059	\$ 18,852	\$ 1,371,009	\$ 1,389,861	\$ 697
Commercial, industrial and other	482	159	20	661	213,147	213,808	
Leases	77	179		256	41,076	41,332	
Real estate residential mortgage	5,792	1,306	5,365	12,463	420,368	432,831	414
Real estate construction			831	831	52,288	53,119	
Home equity and consumer	1,776	533	2,884	5,193	334,145	339,338	886
	\$ 15,482	\$ 7,615	\$ 15,159	\$ 38,256	\$ 2,432,033	\$ 2,470,289	\$ 1,997

**Table of Contents***Impaired Loans*

The Company defines impaired loans as all non-accrual commercial real estate, commercial, industrial and other, and commercial real estate construction loans with recorded investments of \$500,000 or greater. Impaired loans also includes all loans modified in troubled debt restructurings. Impaired loans as of September 30, 2014, September 30, 2013 and December 31, 2013 are as follows:

September 30, 2014	Recorded Investment in Impaired loans	Contractual Unpaid Principal Balance	Specific Allowance (in thousands)	Interest Income Recognized	Average Investment in Impaired loans
Loans without specific allowance:					
Commercial, secured by real estate	\$ 15,393	\$ 16,047	\$	\$ 318	\$ 15,899
Commercial, industrial and other	416	920		43	1,446
Real estate-residential mortgage	252	252			275
Real estate-construction	189	189			411
Home equity and consumer					
Loans with specific allowance:					
Commercial, secured by real estate	3,301	3,771	219	119	3,875
Commercial, industrial and other	149	149	12	5	170
Real estate-residential mortgage	1,211	1,013	171	6	170
Real estate-construction					
Home equity and consumer	1,326	1,326	686	36	1,044
Total:					
Commercial, secured by real estate	\$ 18,694	\$ 19,818	\$ 219	\$ 437	\$ 19,774
Commercial, industrial and other	565	1,069	12	48	1,616
Real estate residential mortgage	1,463	1,265	171	6	445
Real estate-construction	189	189			411
Home equity and consumer	1,326	1,326	686	36	1,044
	\$ 22,237	\$ 23,667	\$ 1,088	\$ 527	\$ 23,290

**Table of Contents**

September 30, 2013	Recorded Investment in Impaired loans	Contractual Unpaid Principal Balance	Specific Allowance (in thousands)	Interest Income Recognized	Average Investment in Impaired loans
<b>Loans without specific allowance:</b>					
Commercial, secured by real estate	\$ 7,098	\$ 7,352	\$	\$ 137	\$ 7,663
Commercial, industrial and other	4,037	4,002		142	4,428
Real estate-residential mortgage					
Real estate-construction					1,328
Home equity and consumer	18	18		1	18
<b>Loans with specific allowance:</b>					
Commercial, secured by real estate	11,769	12,890	1,044	298	11,024
Commercial, industrial and other	388	498	78	6	659
Real estate-residential mortgage	479	479	72		497
Real estate-construction	921	3,015	41		1,307
Home equity and consumer	1,351	1,351	203	33	1,292
<b>Total:</b>					
Commercial, secured by real estate	\$ 18,867	\$ 20,242	\$ 1,044	\$ 435	\$ 18,687
Commercial, industrial and other	4,425	4,500	78	148	5,087
Real estate residential mortgage	479	479	72		497
Real estate-construction	921	3,015	41		2,635
Home equity and consumer	1,369	1,369	203	34	1,310
	\$ 26,061	\$ 29,605	\$ 1,438	\$ 617	\$ 28,216

**Table of Contents**

December 31, 2013	Recorded Investment in Impaired loans	Contractual Unpaid Principal Balance	Specific Allowance (in thousands)	Interest Income Recognized	Average Investment in Impaired loans
<b>Loans without specific allowance:</b>					
Commercial, secured by real estate	\$ 8,223	\$ 9,656	\$	\$ 198	\$ 8,853
Commercial, industrial and other	4,020	4,118		189	4,333
Real estate-residential mortgage	617	672			622
Real estate-construction	501	2,411			2,111
Home equity and consumer	17	17		1	17
<b>Loans with specific allowance:</b>					
Commercial, secured by real estate	10,152	10,217	739	442	9,727
Commercial, industrial and other	155	155	31	5	396
Real estate-residential mortgage					
Real estate-construction					
Home equity and consumer	934	936	140	42	907
<b>Total:</b>					
Commercial, secured by real estate	\$ 18,375	\$ 19,873	\$ 739	\$ 640	\$ 18,580
Commercial, industrial and other	4,175	4,273	31	194	4,729
Real estate residential mortgage	617	672			622
Real estate-construction	501	2,411			2,111
Home equity and consumer	951	953	140	43	924
	\$ 24,619	\$ 28,182	\$ 910	\$ 877	\$ 26,966

Interest that would have been accrued on impaired loans during the first nine months of 2014 and 2013 had the loans been performing under original terms would have been \$1.3 million and \$1.7 million, respectively. Interest that would have accrued for the year ended December 31, 2013 was \$2.2 million.

*Credit Quality Indicators*

The class of loans are determined by internal risk rating. Management closely and continually monitors the quality of its loans and leases and assesses the quantitative and qualitative risks arising from the credit quality of its loans and leases. It is the policy of Lakeland to require that a Credit Risk Rating be assigned to all commercial loans and loan commitments. The Credit Risk Rating System has been developed by management to provide a methodology to be used by Loan Officers, department heads and Senior Management in identifying various levels of credit risk that exist within Lakeland's loan portfolios. The risk rating system assists Senior Management in evaluating Lakeland's commercial loan portfolio, analyzing trends, and determining the proper level of required reserves to be recommended to the Board. In assigning risk ratings, management considers, among other things, a borrower's debt service coverage, earnings strength, loan to value ratios, industry conditions and economic conditions. Management categorizes commercial loans and commitments into a one (1) to nine (9) numerical structure with rating 1 being the strongest rating and rating 9 being the weakest. Ratings 1 through 5W are considered "Pass" ratings.

**Table of Contents**

The following table shows the Company's commercial loan portfolio as of September 30, 2014 and December 31, 2013, by the risk ratings discussed above (in thousands):

September 30, 2014

Risk Rating	Commercial, secured by real estate	Commercial, industrial and other	Real estate- construction
1	\$	\$ 913	\$
2		10,126	
3	69,582	27,773	
4	479,080	83,989	4,600
5	824,573	71,342	60,383
5W - Watch	40,681	15,224	
6 - Other Assets Especially Mentioned	29,563	11,225	1,239
7 - Substandard	45,740	11,369	1,727
8 - Doubtful			
9 - Loss			
<b>Total</b>	<b>\$ 1,489,219</b>	<b>\$ 231,961</b>	<b>\$ 67,949</b>

December 31, 2013

Risk Rating	Commercial, secured by real estate	Commercial, industrial and other	Real estate- construction
1	\$	\$ 952	\$
2		12,964	
3	70,811	9,263	
4	442,933	60,002	1,178
5	754,275	85,939	48,243
5W - Watch	38,893	12,278	
6 - Other Assets Especially Mentioned	27,640	9,596	1,245
7 - Substandard	55,309	22,814	2,453
8 - Doubtful			
9 - Loss			
<b>Total</b>	<b>\$ 1,389,861</b>	<b>\$ 213,808</b>	<b>\$ 53,119</b>

The risk rating tables above do not include consumer or residential loans or leases because they are evaluated on their payment status.



**Table of Contents***Allowance for Loan and Lease Losses*

The following table details activity in the allowance for loan and lease losses by portfolio segment for the three months ended September 30, 2014 and 2013:

<b>Three Months Ended September 30, 2014</b>	Commercial, secured by real estate (in thousands)	Commercial, industrial and other	Leases	Real estate- residential mortgage	Real estate- construction	Home equity and consumer	Unallocated	Total
Beginning Balance	\$ 14,042	\$ 3,601	\$ 654	\$ 4,231	\$ 536	\$ 4,111	\$ 2,691	\$ 29,866
Charge-offs	(134)	(143)	(229)	(192)		(675)		(1,373)
Recoveries	97	215		3	8	37		360
Provision	(714)	(678)	403	97	(36)	1,465	657	1,194
Ending Balance	\$ 13,291	\$ 2,995	\$ 828	\$ 4,139	\$ 508	\$ 4,938	\$ 3,348	\$ 30,047

<b>Three Months Ended September 30, 2013 Allowance for Loan and Lease Losses:</b>	Commercial, secured by real estate (in thousands)	Commercial, industrial and other	Leases	Real estate- residential mortgage	Real estate- construction	Home equity and consumer	Total
Beginning Balance	\$ 18,439	\$ 5,120	\$ 399	\$ 3,121	\$ 371	\$ 2,176	29,626
Charge-offs	(378)	(444)	(34)	(152)	(1,250)	(561)	(2,819)
Recoveries	875	77	12	34	5	68	1,071
Provision	(1,231)	357	131	182	1,252	1,188	1,879
Ending Balance	\$ 17,705	\$ 5,110	\$ 508	\$ 3,185	\$ 378	\$ 2,871	\$ 29,757

**Table of Contents**

The following table details activity in the allowance for loan and lease losses by portfolio segment for the nine months ended September 30, 2014 and 2013:

<b>Nine Months Ended September 30, 2014</b>	Commercial, secured by real estate	Commercial, industrial and other	Leases	Real estate- residential mortgage	Real estate- construction	Home equity and consumer	Unallocated	Total
<b>Allowance for Loan and Lease Losses:</b>	(in thousands)							
Beginning Balance	\$ 14,463	\$ 5,331	\$ 504	\$ 3,214	\$ 542	\$ 2,737	\$ 3,030	\$ 29,821
Charge-offs	(1,925)	(755)	(394)	(701)	(25)	(1,759)		(5,559)
Recoveries	451	894		12	9	143		1,509
Provision	302	(2,475)	718	1,614	(18)	3,817	318	4,276
Ending Balance	\$ 13,291	\$ 2,995	\$ 828	\$ 4,139	\$ 508	\$ 4,938	\$ 3,348	\$ 30,047

<b>Nine Months Ended September 30, 2013</b>	Commercial, secured by real estate	Commercial, industrial and other	Leases	Real estate- residential mortgage	Real estate- construction	Home equity and consumer	Total
<b>Allowance for Loan and Lease Losses:</b>	(in thousands)						
Beginning Balance	\$ 16,258	\$ 5,103	\$ 578	\$ 3,568	\$ 587	\$ 2,837	28,931
Charge-offs	(1,192)	(1,103)	(206)	(903)	(3,652)	(1,252)	(8,308)
Recoveries	955	139	119	97	12	156	1,478
Provision	1,684	971	17	423	3,431	1,130	7,656
Ending Balance	\$ 17,705	\$ 5,110	\$ 508	\$ 3,185	\$ 378	\$ 2,871	\$ 29,757

Loans receivable summarized by portfolio segment and impairment method are as follows:

<b>At September 30, 2014</b>	Commercial, secured by real estate	Commercial, industrial and other	Leases	Real estate- residential mortgage	Real estate- construction	Home equity and consumer	Total
<b>Ending Balance:</b>	(in thousands)						
Individually evaluated for impairment	\$ 18,694	\$ 565	\$	\$ 1,463	\$ 189	\$ 1,326	\$ 22,237
Ending Balance: Collectively evaluated for impairment	1,470,525	231,396	52,285	430,014	67,760	339,187	\$ 2,591,167
Ending Balance: Loans acquired with deteriorated credit quality							\$ 0



Edgar Filing: LAKELAND BANCORP INC - Form 10-Q

Ending Balance (1)      \$ 1,489,219    \$ 231,961    \$ 52,285    \$ 431,477    \$ 67,949    \$ 340,513    \$ 2,613,404

(1) Excludes deferred fees

<b>At December 31, 2013</b>	Commercial, secured by real estate	Commercial, industrial and other	Leases	Real estate- residential mortgage	Real estate- construction	Home equity and consumer	Total
	(in thousands)						
Ending Balance: Individually evaluated for impairment	\$ 18,375	\$ 4,175	\$	\$ 617	\$ 501	\$ 951	\$ 24,619
Ending Balance: Collectively evaluated for impairment	1,371,486	209,633	41,332	432,214	52,618	337,976	\$ 2,445,259
Ending Balance: Loans acquired with deteriorated credit quality						411	\$ 411
Ending Balance(1)	\$ 1,389,861	\$ 213,808	\$ 41,332	\$ 432,831	\$ 53,119	\$ 339,338	\$ 2,470,289

(1) Excludes deferred fees

**Table of Contents**

The allowance for loan losses is summarized by portfolio segment and impairment classification as follows:

At September 30, 2014	Commercial, secured by real estate	Commercial, industrial and other	Leases	Real estate- residential mortgage	Real estate- construction	Home equity and consumer	Unallocated	Total
	(in thousands)							
Ending Balance: Individually evaluated for impairment	\$ 219	\$ 12	\$	\$ 171	\$	\$ 686	\$	\$ 1,088
Ending Balance: Collectively evaluated for impairment	13,072	2,983	828	3,968	508	4,252	3,348	\$ 28,959
Ending Balance: Loans acquired with deteriorated credit quality								
Ending Balance	\$ 13,291	\$ 2,995	\$ 828	\$ 4,139	\$ 508	\$ 4,938	\$ 3,348	\$ 30,047

  

At December 31, 2013	Commercial, secured by real estate	Commercial, industrial and other	Leases	Real estate- residential mortgage	Real estate- construction	Home equity and consumer	Unallocated	Total
	(in thousands)							
Ending Balance: Individually evaluated for impairment	\$ 739	\$ 31	\$	\$	\$	\$ 140	\$	\$ 910
Ending Balance: Collectively evaluated for impairment	13,724	5,300	504	3,214	542	2,597	3,030	\$ 28,911
Ending Balance: Loans acquired with deteriorated credit quality								
Ending Balance	\$ 14,463	\$ 5,331	\$ 504	\$ 3,214	\$ 542	\$ 2,737	\$ 3,030	\$ 29,821

Lakeland also maintains a reserve for unfunded lending commitments which are included in other liabilities. This reserve was \$1.2 million for each of the periods ended September 30, 2014 and December 31, 2013. The Company analyzes the adequacy of the reserve for unfunded lending commitments in conjunction with its analysis of the adequacy of the allowance for loan and lease losses. For more information on this analysis, see *Risk Elements* in *Management's Discussion and Analysis*.

*Troubled Debt Restructurings*

Troubled debt restructurings are those loans where concessions have been made due to borrowers' financial difficulties. Restructured loans typically involve a modification of terms such as a reduction of the stated interest rate, a moratorium of principal payments and/or an extension of the maturity date at a stated interest rate lower than the current market rate of a new loan with similar risk. The Company considers the potential losses on these loans as well as the remainder of its impaired loans while considering the adequacy of the allowance for loan and lease losses.

**Table of Contents**

The following table summarizes loans that have been restructured during the three and nine months ended September 30, 2014 and 2013:

	For the Three Months Ended September 30, 2014			For the Three Months Ended September 30, 2013		
	Pre- Modification Outstanding Number of Recorded Contracts	Post- Modification Outstanding Recorded Investment (Dollars in thousands)	Recorded Investment (Dollars in thousands)	Pre- Modification Outstanding Number of Recorded Contracts	Post- Modification Outstanding Recorded Investment (Dollars in thousands)	Recorded Investment (Dollars in thousands)
<b>Troubled Debt Restructurings:</b>						
Commercial, secured by real estate		\$	\$		\$	\$
Commercial, industrial and other						
Leases						
Real estate residential mortgage	4	1,211	1,211			
Real estate construction						
Home equity and consumer	3	317	317			
	7	\$ 1,528	\$ 1,528		\$	\$
	For the Nine Months Ended September 30, 2014			For the Nine Months Ended September 30, 2013		
	Pre- Modification Outstanding Number of Recorded Contracts	Post- Modification Outstanding Recorded Investment (Dollars in thousands)	Recorded Investment (Dollars in thousands)	Pre- Modification Outstanding Number of Recorded Contracts	Post- Modification Outstanding Recorded Investment (Dollars in thousands)	Recorded Investment (Dollars in thousands)
<b>Troubled Debt Restructurings:</b>						
Commercial, secured by real estate	2	\$ 1,697	\$ 1,697	11	\$ 5,472	\$ 5,468
Commercial, industrial and other				1	127	125
Leases						
Real estate residential mortgage	4	1,211	1,211			
Real estate construction						
Home equity and consumer	6	652	652	1	11	11
	12	\$ 3,560	\$ 3,560	13	\$ 5,610	\$ 5,604

**Table of Contents**

The following table summarizes as of September 30, 2014 and 2013, loans that were restructured within the last 12 months that have subsequently defaulted:

	For the Nine Months Ended			
	September 30, 2014		September 30, 2013	
	Number of Contracts	Recorded Investment (Dollars in thousands)	Number of Contracts	Recorded Investment (Dollars in thousands)
<b>Defaulted Troubled Debt Restructurings:</b>				
Commercial, secured by real estate	1	\$ 32	5	\$ 3,084
Commercial, industrial and other				
Leases				
Real estate residential mortgage	1	179		
Real estate construction				
Home equity and consumer				
	2	\$ 211	5	\$ 3,084

*Mortgages Held for Sale*

Residential mortgages originated by the bank and held for sale in the secondary market are carried at the lower of cost or fair market value. Fair value is generally determined by the value of purchase commitments on individual loans. Losses are recorded as a valuation allowance and charged to earnings. As of September 30, 2014, the Company had \$1.5 million in mortgages held for sale compared to \$1.2 million as of December 31, 2013.

*Other Real Estate and Other Repossessed Assets*

At September 30, 2014, the Company had other repossessed assets and other real estate owned of \$43,000 and \$939,000, respectively. At December 31, 2013, the Company had other repossessed assets and other real estate owned of \$54,000 and \$466,000, respectively.

**Note 9. Employee Benefit Plans**

The components of net periodic pension cost for the Newton Trust Company's defined benefit pension plan are as follows:

	For the Three Months Ended		For the Nine Months Ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
	(in thousands)		(in thousands)	
Interest cost	\$ 24	\$ 22	\$ 71	\$ 67
Expected return on plan assets	(24)	(18)	(72)	(54)

Edgar Filing: LAKELAND BANCORP INC - Form 10-Q

Amortization of unrecognized net actuarial loss	9	21	29	62
Net periodic benefit expense	\$ 9	\$ 25	\$ 28	\$ 75

30

**Table of Contents****Note 10. Directors Retirement Plan**

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

	For the Three Months Ended		For the Nine Months Ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
	(in thousands)		(in thousands)	
Service cost	\$ 6	\$ 8	\$ 19	\$ 22
Interest cost	10	9	29	27
Amortization of prior service cost	3	3	10	10
Amortization of unrecognized net actuarial loss	1	2	1	6
<b>Net periodic benefit expense</b>	<b>\$ 20</b>	<b>\$ 22</b>	<b>\$ 59</b>	<b>\$ 65</b>

The Company made contributions of \$65,000 and \$75,000 to the plan during the nine month periods ended September 30, 2014 and 2013, respectively. The Company does not expect to make any more contributions for the remainder of 2014.

**Note 11. Estimated Fair Value of Financial Instruments and Fair Value Measurement*****Fair Value Measurement***

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market for an asset or liability in an orderly transaction between market participants at the measurement date. U.S. GAAP 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; includes U.S. Treasury Notes, and other U.S. Government Agency securities that actively trade in over-the-counter markets; equity securities and mutual funds that actively trade in over-the-counter markets.

Level 2 quoted prices for similar assets or liabilities in active markets; or quoted prices for identical or similar assets or liabilities in markets that are not active; or inputs other than quoted prices that are observable for the asset or liability including yield curves, volatilities, and prepayment speeds.

Level 3 unobservable inputs for the asset or liability that reflect the Company's own assumptions about assumptions that market participants would use in the pricing of the asset or liability and that are consequently not based on market activity but upon particular valuation techniques.

The Company's assets that are measured at fair value on a recurring basis are its available for sale investment securities. The Company obtains fair values on its securities using information from a third party servicer. If quoted prices for securities are available in an active market, those securities are classified as Level 1 securities. The Company has U.S. Treasury Notes and certain equity securities that are classified as Level 1 securities. Level 2

securities were primarily comprised of U.S. Agency bonds, residential mortgage-backed securities, obligations of state and political subdivisions and corporate securities. Fair values were estimated primarily by obtaining quoted prices for similar assets in active markets or through the use of pricing models supported with market data information. Standard inputs include benchmark yields, reported trades, issuer spreads, bids and offers. On a quarterly basis, the Company reviews the pricing information received from the Company's third party pricing service. This review includes a comparison to non-binding third-party quotes.

The fair values of derivatives are based on valuation models from a third party using current market terms (including interest rates and fees), the remaining terms of the agreements and the credit worthiness of the counter party as of the measurement date (Level 2).



**Table of Contents**

The following table sets forth the Company's financial assets that were accounted for at fair value on a recurring basis as of the periods presented by level within the fair value hierarchy. During the three months ended September 30, 2014, the Company did not make any transfers between any levels within the fair value hierarchy. Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement:

	Quoted Prices in Active Markets for Identical Assets  (Level 1)	Significant Other Observable Inputs  (Level 2)  (in thousands)	Significant Unobservable Inputs (Level 3)	Total  Fair Value
September 30, 2014				
<b>Assets:</b>				
Investment securities, available for sale				
U.S. treasury and government agencies	\$ 8,241	\$ 74,938	\$	\$ 83,179
Mortgage backed securities		313,435		313,435
Obligations of states and political subdivisions		29,943		29,943
Corporate debt securities		506		506
Equity securities	3,956	13,273		17,229
Total securities available for sale	12,197	432,095		444,292
Non-hedging interest rate derivatives		266		266
Total Assets	\$ 12,197	432,361		\$ 444,558
Non-hedging interest rate derivatives	\$	\$ 266	\$	\$ 266
Total Liabilities	\$	\$ 266	\$	\$ 266
December 31, 2013				
<b>Assets:</b>				
Investment securities, available for sale				
U.S. treasury and government agencies	\$ 4,330	\$ 65,835	\$	\$ 70,165
Mortgage backed securities		304,502		304,502
Obligations of states and political subdivisions		36,873		36,873
Corporate debt securities		3,420		3,420
Equity securities	3,239	12,907		16,146
Total securities available for sale	7,569	423,537		431,106
Non-hedging interest rate derivatives		562		562

Edgar Filing: LAKELAND BANCORP INC - Form 10-Q

Total Assets	\$	7,569	\$	424,099	\$	\$	431,668
Non-hedging interest rate derivatives	\$		\$	562	\$	\$	562
Total Liabilities	\$		\$	562	\$	\$	562

**Table of Contents**

The following table sets forth the Company's assets subject to fair value adjustments (impairment) on a nonrecurring basis. Assets are classified in their entirety based on the lowest level of input that is significant to the fair value measurement:

	Quoted Prices iSignificant			Total
	Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
September 30, 2014				Fair Value (in thousands)
<b>Assets:</b>				
Impaired Loans and Leases	\$	\$	\$ 22,237	\$ 22,237
Loans held for sale		1,519		1,519
Other real estate owned and other repossessed assets			982	982
December 31, 2013				
<b>Assets:</b>				
Impaired Loans and Leases	\$	\$	\$ 24,619	\$ 24,619
Loans held for sale		1,206		1,206
Other real estate owned and other repossessed assets			520	520

Impaired loans are evaluated and valued at the time the loan is identified as impaired at the lower of cost or market value of the underlying collateral. Because most of Lakeland's impaired loans are collateral dependent, fair value is generally 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, inventory, equipment and/or other business assets. The value of the real estate is assessed based on appraisals by qualified third party licensed appraisers. The appraisers may use the sales comparison approach, the cost approach or the income approach to value the collateral using discount rates (with ranges of 5-11%) or capitalization rates (with ranges of 5-9%) to evaluate the property. The value of the equipment may be determined by an appraiser, if significant, inquiry through a recognized valuation resource, or by the value on the borrower's financial statements. Field examiner reviews on business assets may be conducted based on the loan exposure and reliance on this type of collateral. Appraised and reported values may be adjusted 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. Loans that are not collateral dependent are evaluated based on a discounted cash flow method. Impaired loans are reviewed and evaluated on at least a quarterly basis for additional impairment and adjusted accordingly, based on the same factors identified above.

The Company has a held for sale loan portfolio that consists of residential mortgages that are being sold in the secondary market. The Company records these mortgages at the lower of cost or market value. Fair value is generally determined by the value of purchase commitments.

Other real estate owned (OREO) and other repossessed assets, representing property acquired through foreclosure, are recorded at fair value less estimated disposal costs of the acquired property on the date of acquisition and thereafter remeasured and carried at lower of cost or fair market value. Fair value on other real estate owned is based on the appraised value of the collateral using the sales comparison approach or the income approach with discount rates or

capitalization rates similar to those used in impaired loan valuation. The fair value of other repossessed assets is estimated by inquiry through recognized valuation resources.

Changes in the assumptions or methodologies used to estimate fair values may materially affect the estimated amounts. Changes in economic conditions, locally or nationally, could impact the value of the estimated amounts of impaired loans, OREO and other repossessed assets.

***Fair Value of Certain Financial Instruments***

Estimated fair values have been determined by the Company using the best available data and an estimation methodology suitable for each category of financial instruments. Management is concerned that there may not be reasonable comparability between institutions due to the wide range of permitted assumptions and methodologies in the absence of active markets. This lack of uniformity gives rise to a high degree of subjectivity in estimating financial instrument fair values.

## **Table of Contents**

The estimation methodologies used, the estimated fair values, and recorded book balances at September 30, 2014 and December 31, 2013 are outlined below.

This summary, as well as the table below, excludes financial assets and liabilities for which carrying value approximates fair value. For financial assets, these include cash and cash equivalents. For financial liabilities, these include noninterest bearing demand deposits, savings and interest-bearing transaction accounts and federal funds sold and securities sold under agreements to repurchase. The estimated fair value of demand, savings and interest-bearing transaction accounts is the amount payable on demand at the reporting date. Carrying value is used because there is no stated maturity on these accounts, and the customer has the ability to withdraw the funds immediately. Also excluded from this summary and the following table are those financial instruments recorded at fair value on a recurring basis, as previously described.

The fair value of Investment Securities Held to Maturity was measured using information from the same third-party servicer used for Investment Securities Available for Sale using the same methodologies discussed above. Investment Securities Held to Maturity includes \$6.0 million in short-term municipal bond anticipation notes that are non-rated and do not have an active secondary market or information readily available on standard financial systems. As a result, the securities are classified as Level 3 securities. These are investments in municipalities in the Company's market area, and management performs a credit analysis on the municipality before investing in these securities.

Federal Home Loan Bank of New York (FHLB) stock is an equity interest that can be sold to the issuing FHLB, to other FHLBs, or to other member banks at its par value. Because ownership of these securities is restricted, they do not have a readily determinable fair value. As such, the Company's FHLB Stock is recorded at cost or par value and is evaluated for impairment each reporting period by considering the ultimate recoverability of the investment rather than temporary declines in value. The Company's evaluation primarily includes an evaluation of liquidity, capitalization, operating performance, commitments, and regulatory or legislative events.

The net loan portfolio at September 30, 2014 and December 31, 2013 has been valued using a present value discounted cash flow where market prices were not available. The discount rate used in these calculations is the estimated current market rate adjusted for credit risk. The valuation of the Company's loan portfolio is consistent with accounting guidance but does not fully incorporate the exit price approach.

For fixed maturity certificates of deposit, fair value was estimated based on the present value of discounted cash flows using the rates currently offered for deposits of similar remaining maturities. The carrying amount of accrued interest payable approximates its fair value.

The fair value of long-term debt is based upon the discounted value of contractual cash flows. The Company estimates the discount rate using the rates currently offered for similar borrowing arrangements. The fair value of subordinated debentures is based on bid/ask prices from brokers for similar types of instruments.

The fair values of commitments to extend credit and standby letters of credit are estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates. The fair value of guarantees and letters of credit is based on fees currently charged for similar agreements or on the estimated cost to terminate them or otherwise settle the obligations with the counterparties at the reporting date. The fair value of commitments to extend credit and standby letters of credit are deemed immaterial.



**Table of Contents**

The following table presents the carrying values, fair values and placement in the fair value hierarchy of the Company's financial instruments as of September 30, 2014 and December 31, 2013:

	Carrying	Fair	Quoted Prices in Significant		
			Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>September 30, 2014</b>	Value	Value			
(in thousands)					
<b>Financial Instruments Assets</b>					
Investment securities held to maturity	\$ 104,909	\$ 105,127	\$	\$ 99,116	\$ 6,011
Federal Home Loan Bank and other membership bank stocks	8,831	8,831		8,831	
Loans and leases, net	2,581,718	2,583,421			2,583,421
<b>Financial Instruments Liabilities</b>					
Certificates of Deposit	281,341	280,856		280,856	
Other borrowings	179,700	182,285		182,285	
Subordinated debentures	41,238	30,929			30,929
<b>December 31, 2013</b>					
<b>Financial Instruments Assets</b>					
Investment securities held to maturity	\$ 101,744	\$ 100,394	\$	\$ 95,194	\$ 5,200
Federal Home Loan Bank and other membership bank stocks	7,938	7,938		7,938	
Loans and leases, net	2,439,195	2,432,447			2,432,447
<b>Financial Instruments Liabilities</b>					
Certificates of Deposit	296,086	296,237		296,237	
Other borrowings	119,000	121,870		121,870	
Subordinated debentures	41,238	27,835			27,835

**Note 12. Derivatives**

Lakeland is a party to interest rate derivatives that are not designated as hedging instruments. These derivatives relate to interest rate swaps that the Company enters into with customers to allow customers to convert variable rate loans to a fixed rate. Lakeland pays interest to the customer at a floating rate on the notional amount and receives interest from the customer at a fixed rate for the same notional amount. At the same time the interest rate swap is entered into with the customer, an offsetting interest rate swap is entered into with another financial institution. Lakeland pays the other financial institution interest at the same fixed rate on the same notional amount as the swap entered into with the customer, and receives interest from the financial institution for the same floating rate on the same notional amount. The changes in the fair value of the swaps offset each other, except for the credit risk of the counterparties, which is determined by taking into consideration the risk rating, probability of default and loss of given default for all counterparties. As of September 30, 2014 and December 31, 2013, Lakeland had \$483,000 and \$1.5 million, respectively, in securities pledged for collateral on its interest rate swaps with the financial institution.





**Table of Contents**

The following table presents summary information regarding these derivatives for the periods presented (dollars in thousands):

	Notional Amount	Average Maturity (Years)	Weighted Average Rate Fixed	Weighted Average Variable Rate	Fair Value
September 30, 2014					
3rd party interest rate swaps	\$ 17,382	6.0	3.840%	1 Mo Libor + 2.21	(\$266)
Customer interest rate swaps	(17,382)	6.0	3.840%	1 Mo Libor + 2.21	266
December 31, 2013					
3rd party interest rate swaps	\$ 17,691	6.7	3.830%	1 Mo Libor + 2.21	(\$562)
Customer interest rate swaps	(17,691)	6.7	3.830%	1 Mo Libor + 2.21	\$ 562

**Note 13. Goodwill and Intangible Assets**

The Company has recorded goodwill of \$110.0 million at September 30, 2014 and December 31, 2013 which includes \$22.9 million from the Somerset Hills acquisition and \$87.1 million from prior acquisitions. The Company reviews its goodwill and intangible assets annually, on November 30, or more frequently if conditions warrant, for impairment. In testing goodwill for impairment, the Company compares the estimated fair value of each reporting unit to their respective carrying amounts, including goodwill. The Company has determined that it has one reporting unit, Community Banking.

As stated above, the Company recorded \$2.7 million in core deposit intangible for the Somerset Hills acquisition. Year-to-date, it has amortized \$353,000 in core deposit intangible. The estimated future amortization expense for each of the succeeding six years ended December 31 is as follows (dollars in thousands):

For the year ended:	
2014	\$ 111
2015	415
2016	366
2017	316
2018	267
2019	218

**Note 14. Recent Accounting Pronouncements**

In June 2014, the Financial Accounting Standards Board (FASB) issued an accounting standards update regarding share based payments that requires that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. This update is effective for interim and annual periods beginning after December 15, 2015. The amendments can be applied prospectively to all awards granted or modified after the effective date or retrospectively to all awards with performance targets that are outstanding as of the beginning of the earliest annual period presented and to all new or modified awards thereafter. Early adoption is permitted. The Company has determined that adoption of this update will not have a material impact on its accounting and disclosures.



## **Table of Contents**

In June 2014, the FASB issued an accounting standards update that aligns the accounting for repurchase to maturity transactions and repurchase agreements executed as a repurchase financing with the accounting for other typical repurchase agreements. Going forward, these transactions would all be accounted for as secured borrowings. This update is effective for the first interim or annual period beginning after December 15, 2014. In addition the disclosure of certain transactions accounted for as a sale is effective for the first interim or annual period beginning on or after December 15, 2014, and the disclosure for transactions accounted for as secured borrowings is required for annual periods beginning after December 15, 2014, and interim periods after March 15, 2015. Early adoption is prohibited. The Company does not engage in repurchase to maturity transactions, and therefore has determined that the adoption of this update is not expected to have a material impact on the Company's financial results.

In January 2014, the Financial Accounting Standards Board (the FASB) issued an accounting standards update to clarify when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan should be derecognized and the real estate recognized. These amendments clarify that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either: (a) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure; or (b) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. This update is effective for annual periods and interim periods within those annual periods beginning after December 15, 2014. The adoption of this update is not expected to have a material impact on the Company's financial statements.

In July 2013, the FASB issued an accounting pronouncement to improve the reporting for unrecognized tax benefits when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. The pronouncement is expected to reduce diversity in practice by providing guidance on the presentation of unrecognized tax benefits and will better reflect the manner in which an entity would settle at the reporting date any additional income taxes that would result from the disallowance of a tax position when net operating loss carryforwards, similar tax losses, or tax credit carryforwards exist. The pronouncement is effective prospectively for fiscal years, and interim periods within those years, beginning after December 15, 2013. The adoption of this pronouncement did not have a material impact on the Company's financial statements.

## **PART I ITEM 2**

### **Management's Discussion and Analysis of**

### **Financial Condition and Results of Operations**

This section should be read 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, 2013.

### **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, could, and other similar expressions are intended to identify such forward-looking statements. The 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 risk factors disclosed 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: changes in the financial services industry and the U.S. and global capital markets, changes in economic conditions nationally, regionally and in the Company's markets, the nature and timing of actions of the Federal Reserve Board and other regulators, the nature and timing of legislation affecting the financial services industry including, but not limited to, the Dodd-Frank Wall Street

## **Table of Contents**

Reform and Consumer Protection Act of 2010, government intervention in the U.S. financial system, changes in levels of market interest rates, pricing pressures on loan and deposit products, credit risks of the Company's lending and leasing activities, customers' acceptance of the Company's products and services and competition.

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.

## **Critical Accounting Policies, Judgments and Estimates**

The accounting and reporting policies of the Company and its subsidiaries conform to 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 NJ Investment Corp., Lakeland Investment Corp., Lakeland Equity, Inc., Lakeland Preferred Equity, Inc., and Sullivan Financial Services, Inc. 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. There have been no material changes in the Company's critical accounting policies, judgments and estimates, including assumptions or estimation techniques utilized, as compared to those disclosed in the Company's most recent Annual Report on Form 10-K.

## **Management Overview**

The quarter and nine months ended September 30, 2014 represented a period of continued growth for the Company. As discussed in this Management's Discussion and Analysis:

Net income available to common shareholders in the third quarter of 2014 was \$8.2 million or \$0.22 per diluted share compared to \$6.6 million or \$0.18 per diluted share for the same period last year. Exclusive of \$744,000 in merger related expenses, net income in the third quarter of 2013 was \$7.2 million or \$0.20 per diluted share.

Net income available to common shareholders at \$23.2 million or \$0.61 per diluted share in the first nine months of 2014 compared to \$17.6 million or \$0.52 per diluted share reported for the same period in 2013. Excluding \$2.8 million in -tax merger related expenses due to the Somerset Hills acquisition and a \$1.2 million gain on debt extinguishment, net income was \$19.0 million or \$0.56 per share for the first nine months of 2013.

Although loan levels at September 30, 2014 remained generally the same as they were at June 30, 2014, the Company reported strong loan growth from December 31, 2013 to September 30, 2014.

Edgar Filing: LAKELAND BANCORP INC - Form 10-Q

Loans totaling \$2.61 billion at September 30, 2014 increased by \$143.1 million or 6% from December 31, 2013, including a \$99.4 million or 7% increase in commercial loans secured by real estate.

Non-interest bearing demand deposits totaled \$674.9 million at September 30, 2014, an increase of \$25.7 million or 4% in third quarter 2014, and \$74.3 million, or 12%, from year-end 2013. Non-interest bearing demand represented 24% of total deposits at September 30, 2014.

Non-performing assets totaled \$19.6 million at September 30, 2014 compared to \$17.5 million at December 31, 2013 and \$18.7 million reported at September 30, 2013.

As a result of declining charge-offs, the provision for loan and lease losses was reduced from \$7.7 million in the first nine months of 2013 to \$4.3 million in the first nine months of 2014.

**Table of Contents**

The Somerset Hills acquisition, which was consummated on May 31, 2013, added six full service branches, \$356.1 million in total assets, \$10.4 million in investment securities, \$246.5 million in loans (including \$2.5 million in residential mortgages held for sale), and \$311.8 million in deposits (\$80.8 million in non-interest bearing demand deposits and \$231.0 million in interest-bearing deposits) at fair value. The Company's financial statements reflect the impact of the merger from the date of acquisition, which should be considered when comparing earnings for the periods presented. For more information on the Somerset Hills acquisition, please see Note 2 Acquisitions in this Quarterly Report on Form 10-Q.

**Results of Operations****(Third Quarter 2014 Compared to Third Quarter 2013)****Net Income**

Net income was \$8.2 million in the third quarter of 2014 compared to net income of \$6.6 million for the third quarter of 2013. Diluted earnings per share was \$0.22 for the third quarter of 2014, compared to diluted earnings per share of \$0.18 for the same period last year. Net interest income at \$28.5 million for the third quarter of 2014 increased \$965,000 compared to the third quarter of 2013 due primarily to a \$941,000 increase in interest income. The increase in net interest income reflects an increase in interest earning assets resulting from organic growth.

**Net Interest Income**

Net interest income is the difference between interest income on earning assets and the cost of funds supporting those assets. The Company's net interest income is determined by: (i) the volume of interest-earning assets that it holds and the yields that it earns on those assets, and (ii) the volume of interest-bearing liabilities that it has assumed and the rates that it pays on those liabilities.

Net interest income on a tax equivalent basis for the third quarter of 2014 was \$28.7 million, compared to \$27.7 million for the third quarter of 2013. The net interest margin decreased from 3.68% in the third quarter of 2013 to 3.58% in the third quarter of 2014 primarily as a result of a 13 basis point decrease in the yield on interest earning assets partially offset by a three basis point reduction in the cost of interest bearing liabilities. The decrease in the net interest margin was somewhat mitigated by an increase in interest income earned on free funds (interest earning assets funded by non-interest bearing liabilities) resulting from an increase in average non-interest bearing deposits of \$50.6 million. 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, September 30, 2014			For the Three Months Ended, September 30, 2013		
	Average Balance	Interest Income/ Expense	Average rates earned/ paid (dollars in thousands)	Average Balance	Interest Income/ Expense	Average rates earned/ paid
<b>Assets</b>						
Interest-earning assets:						
Loans and leases (A)	\$ 2,608,687	\$ 27,949	4.25%	\$ 2,435,658	\$ 27,350	4.45%
Taxable investment securities and other	458,568	2,387	2.08%	430,369	2,017	1.87%
Tax-exempt securities	70,811	671	3.79%	75,894	709	3.74%
Federal funds sold (B)	45,295	24	0.21%	45,487	27	0.24%
Total interest-earning assets	3,183,361	31,031	3.87%	2,987,408	30,103	4.00%
Noninterest-earning assets:						
Allowance for loan and lease losses	(30,151)			(30,039)		
Other assets	290,736			286,628		
<b>TOTAL ASSETS</b>	<b>\$ 3,443,946</b>			<b>\$ 3,243,997</b>		
<b>Liabilities and Stockholders Equity</b>						
Interest-bearing liabilities:						
Savings accounts	\$ 382,642	\$ 49	0.05%	\$ 374,141	\$ 51	0.05%
Interest-bearing transaction accounts	1,457,680	863	0.23%	1,403,227	955	0.27%
Time deposits	280,200	344	0.49%	322,371	512	0.64%
Borrowings	266,773	1,088	1.63%	165,261	850	2.06%
Total interest-bearing liabilities	2,387,295	2,344	0.39%	2,265,000	2,368	0.42%
Noninterest-bearing liabilities:						
Demand deposits	671,049			620,499		
Other liabilities	15,154			15,016		
Stockholders equity	370,448			343,482		
<b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b>	<b>\$ 3,443,946</b>			<b>\$ 3,243,997</b>		
Net interest income/spread		28,687	3.48%		27,735	3.58%
Tax equivalent basis adjustment		235			248	
<b>NET INTEREST INCOME</b>		<b>\$ 28,452</b>			<b>\$ 27,487</b>	
Net interest margin (C)			3.58%			3.68%

(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 \$30.1 million in the third quarter of 2013 to \$31.0 million in the third quarter of 2014, an increase of \$928,000, or 3%. The increase in interest income was primarily a result of a \$196.0 million increase in average interest earning assets partially offset by a 13 basis point decrease in the yield on interest earning assets. The yield on average loans and leases at 4.25% in the third quarter of 2014 was 20 basis points lower than the third quarter of 2013 due primarily to strong growth in new loans and leases originated or refinanced at lower rates. The yield on average taxable and tax exempt investment securities increased by 21 basis points and five basis points, respectively, compared to the third quarter of 2013.

Total interest expense at \$2.3 million in the third quarter of 2014 was equivalent to total interest expense for the same period in 2013. The cost of average interest-bearing liabilities decreased from 0.42% in the third quarter of 2013 to 0.39% in 2014. The decrease in the cost of funds was due primarily to the continuing low rate environment which resulted in a four basis point reduction in the cost of interest-bearing transaction accounts, a 15 basis point reduction in the cost of time deposits and a 43 basis point reduction in the cost of borrowings. The cost of borrowings declined primarily as a result of new borrowings at lower rates as well as restructurings of other long-term borrowings in 2013. From the third quarter of 2013 to the third quarter of 2014, average savings accounts and interest-bearing transaction accounts increased by \$8.5 million and \$54.5 million, respectively. Average time deposits declined by \$42.2 million or 13%, while average borrowings increased \$101.5 million to \$266.8 million as the Company funded its loan growth with term borrowings.

---

**Table of Contents****Provision for Loan and Lease Losses**

In determining the provision for loan and lease losses, management considers national and local economic conditions; trends in the portfolio including orientation to specific loan types or industries; experience, ability and depth of lending management in relation to the complexity of the portfolio; adequacy and adherence to policies, procedures and practices; levels and trends in delinquencies, impaired loans and net charge-offs; and the results of independent third party loan review.

In the third quarter of 2014, a \$1.2 million provision for loan and lease losses was recorded, which was \$685,000 lower than the provision for the same period last year. During the third quarter of 2014, the Company charged off loans and leases of \$1.4 million and recovered \$360,000 in previously charged off loans and leases compared to \$2.8 million and \$1.1 million, respectively, during the same period in 2013. The lower provision resulted from lower net charge-offs during the quarter as well as a decline in impaired loans. For more information regarding the determination of the provision, see Risk Elements below.

**Noninterest Income**

Noninterest income at \$4.8 million in the third quarter of 2014 increased by \$164,000 or 4% compared to the third quarter of 2013. Service charges on deposit accounts at \$2.7 million decreased \$149,000 primarily due to a decline in overdraft fees. Commissions and fees at \$1.4 million in the third quarter of 2014 increased \$232,000 or 20% compared to the same period last year due primarily to an increase in loan fees. Income on bank owned life insurance at \$365,000 decreased \$18,000 or 5% compared to the third quarter of 2013 primarily resulting from a decrease in yield on the underlying policies. Other income totaling \$384,000 in the third quarter of 2014 was \$99,000 higher than the same period in 2013 due primarily to gains recorded on the sale of bank owned real estate properties.

**Noninterest Expense**

Noninterest expense totaling \$19.7 million decreased \$722,000 in the third quarter of 2014 from the third quarter of 2013. There were no merger related expenses in the third quarter of 2014 compared to \$744,000 in the third quarter of 2013. Exclusive of merger related expenses total noninterest expense increased \$22,000 from the third quarter of 2013 to the third quarter of 2014. Marketing expense at \$629,000 in the third quarter of 2014 decreased \$86,000 compared to the third quarter of 2013 due primarily to the timing of marketing campaigns. Legal expense at \$144,000 decreased \$262,000 or 65% compared to the same period last year primarily resulting from the continuing reduction in delinquencies, while other real estate owned and other repossessed assets expense increased \$52,000. The Company's efficiency ratio, a non-GAAP financial measure, was 58.0% in the third quarter of 2014, compared to 60.0% for the same period last year. The decrease was primarily due to an increase in tax-equivalent revenue. The Company uses this ratio because it believes that the ratio provides a good comparison of period-to-period performance and because the ratio is widely accepted in the banking industry. The following table shows the calculation of the efficiency ratio for the periods presented:

**Table of Contents**

	For the Three Months Ended September 30,	
	2014	2013
	(dollars in thousands)	
Calculation of efficiency ratio:		
Total noninterest expense	\$ 19,685	\$ 20,407
Less:		
Amortization of core deposit intangibles	(111)	(123)
Other real estate owned and other repossessed asset expense	(50)	2
Merger related expenses		(744)
Provision for unfunded lending commitments	(106)	(121)
Noninterest expense, as adjusted	\$ 19,418	\$ 19,421
Net interest income	\$ 28,452	\$ 27,487
Noninterest income	4,809	4,645
Total revenue	33,261	32,132
Plus: Tax-equivalent adjustment on municipal securities	235	248
Total revenue, as adjusted	\$ 33,496	\$ 32,380
Efficiency ratio	58.0%	60.0%

**Income Tax Expense**

The effective tax rate increased from 32.8% in the third quarter of 2013 to 33.4% in the third quarter of 2014 primarily as a result of increased earnings and because of a reduction in tax advantaged items as a percent of pretax income.

**(Year to Date 2014 Compared to Year to Date 2013)****Net Income**

Net income was \$23.2 million in the first nine months of 2014 compared to net income of \$17.6 million for the first nine months of 2013. Diluted earnings per share was \$0.61 for the first nine months of 2014, compared to diluted earnings per share of \$0.52 for the same period last year. Net interest income at \$84.7 million for the first nine months of 2014 increased \$8.1 million compared to the first nine months of 2013 due to a \$7.2 million increase in interest income and a \$926,000 reduction in interest expense. The increase in net interest income reflects an increase in interest earning assets resulting from the Somerset Hills acquisition as well as organic growth.

**Net Interest Income**

Net interest income on a tax equivalent basis for the first nine months of 2014 was \$85.5 million, compared to \$77.3 million for the first nine months of 2013 resulting primarily from growth in average interest-earning assets of \$320.6 million. The net interest margin decreased from 3.69% in the first nine months of 2013 to 3.66% in the first nine months of 2014 primarily as a result of an 11 basis point decline in the yield on interest earning assets partially offset by a nine basis point decrease in the cost of interest bearing liabilities. The decrease in the net interest margin was

somewhat mitigated by an increase in interest income earned on free funds (interest earning assets funded by non-interest bearing liabilities) resulting from an increase in average non-interest bearing deposits of \$87.9 million. 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****CONSOLIDATED STATISTICS ON A TAX EQUIVALENT BASIS**

	For the Nine Months Ended, September 30, 2014			For the Nine Months Ended, September 30, 2013		
	Average Balance	Interest Income/ Expense	Average rates earned/ paid (dollars in thousands)	Average Balance	Interest Income/ Expense	Average rates earned/ paid
<b>Assets</b>						
Interest-earning assets:						
Loans (A)	\$ 2,549,675	\$ 82,405	4.32%	\$ 2,279,972	\$ 77,122	4.52%
Taxable investment securities and other	461,576	7,448	2.15%	410,508	5,544	1.80%
Tax-exempt securities	74,737	2,117	3.78%	73,638	2,048	3.71%
Federal funds sold (B)	34,277	46	0.18%	35,578	57	0.21%
<b>Total interest-earning assets</b>	<b>3,120,265</b>	<b>92,016</b>	<b>3.94%</b>	<b>2,799,696</b>	<b>84,771</b>	<b>4.05%</b>
Noninterest-earning assets:						
Allowance for loan and lease losses	(30,041)			(30,004)		
Other assets	282,366			269,474		
<b>TOTAL ASSETS</b>	<b>\$ 3,372,590</b>			<b>\$ 3,039,166</b>		
<b>Liabilities and Stockholders Equity</b>						
Interest-bearing liabilities:						
Savings accounts	\$ 384,934	\$ 151	0.05%	\$ 367,245	\$ 171	0.06%
Interest-bearing transaction accounts	1,444,006	2,491	0.23%	1,305,173	2,902	0.30%
Time deposits	285,919	1,120	0.52%	311,994	1,667	0.71%
Borrowings	235,524	2,797	1.58%	174,025	2,745	2.10%
<b>Total interest-bearing liabilities</b>	<b>2,350,383</b>	<b>6,559</b>	<b>0.37%</b>	<b>2,158,437</b>	<b>7,485</b>	<b>0.46%</b>
Noninterest-bearing liabilities:						
Demand deposits	643,548			555,663		
Other liabilities	14,876			14,434		
Stockholders equity	363,783			310,632		
<b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b>	<b>\$ 3,372,590</b>			<b>\$ 3,039,166</b>		
Net interest income/spread		85,457	3.57%		77,286	3.59%
Tax equivalent basis adjustment		741			717	
<b>NET INTEREST INCOME</b>		<b>\$ 84,716</b>			<b>\$ 76,569</b>	
Net interest margin (C)			3.66%			3.69%

- (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 \$84.8 million in the first nine months of 2013 to \$92.0 million in the first nine months of 2014, an increase of \$7.2 million, or 9%. The increase in interest income was primarily a result of a \$269.7 million increase in average loans and leases partially offset by an 11 basis point decrease in the yield on interest earning assets. The increase in average loans and leases is due primarily to the acquisition of Somerset Hills loans and leases which totaled \$246.5 million at the time of acquisition. The yield on average loans and leases at 4.32% for the first nine months of 2014 was 20 basis points lower than the first nine months of 2013 due to the same reasons discussed in the quarterly comparison. The yield on average taxable and tax exempt investment securities increased by 35 basis points and seven basis points, respectively, compared to the first nine months of 2013.

Total interest expense decreased from \$7.5 million in the first nine months of 2013 to \$6.6 million in the first nine months of 2014, a decrease of \$926,000, or 12%. The cost of average interest-bearing liabilities decreased from 0.46% in the first nine months of 2013 to 0.37% in 2014. The decrease in the cost of interest-bearing liabilities was due to the same reasons discussed in the quarterly comparison. From the first nine months of 2013 to the first nine months of 2014, average savings accounts and interest-bearing transaction accounts increased by \$17.7 million and \$138.8 million, respectively. Time deposits decreased by \$26.1 million to \$285.9 million, while borrowings increased \$61.5 million to \$235.5 million from the first nine months of 2013 to the same period in 2014. The costs of borrowings declined from year-to-date 2013 to year-to-date 2014 as a result of the extinguishment of \$9.0 million in subordinated debentures in the second quarter of 2013 as well as restructurings of other borrowings in 2013.

---

**Table of Contents****Provision for Loan and Lease Losses**

In the first nine months of 2014, a \$4.3 million provision for loan and lease losses was recorded, which was \$3.4 million lower than the provision for the same period last year. During the first nine months of 2014, the Company charged off loans and leases of \$5.6 million and recovered \$1.5 million in previously charged off loans and leases compared to \$8.3 million and \$1.5 million, respectively, during the same period in 2013. The lower provision reflected lower net charge-offs during the nine months ended September 30, 2014 as well as from a decline in impaired loans from \$26.1 million on September 30, 2013 to \$22.2 million on September 30, 2014. For more information regarding the determination of the provision, see Risk Elements below.

**Noninterest Income**

Noninterest income at \$13.3 million in the first nine months of 2014 decreased by \$2.2 million compared to the first nine months of 2013. Included in noninterest income for the first nine months of 2013 was gain on debt extinguishment of \$1.2 million. Additionally, gains on sales and calls of securities totaled \$2,000 in the first nine months of 2014 compared to \$506,000 in the first nine months of 2013. Income on bank owned life insurance at \$1.1 million increased \$54,000 or 5% compared to the first nine months of 2013 primarily resulting from the addition of policies acquired in the Somerset Hills merger. Other income totaling \$784,000 in the first nine months of 2014 was \$419,000 lower than the same period in 2013. Within other income, the Company recorded no swap income and \$378,000 in gains on residential mortgages in the first nine months of 2014 compared to \$181,000 in swap income and \$612,000 in gains on sales of mortgages in the first nine months of 2013.

**Noninterest Expense**

Noninterest expense totaling \$59.0 million increased \$930,000 in the first nine months of 2014 from the first nine months of 2013. There were no long term debt prepayment fees or merger related expenses in the first nine months of 2014 compared to \$526,000 and \$2.8 million, respectively, in the first nine months of 2013. Excluding these nonrecurring expenses, noninterest expense increased \$4.3 million. Salary and employee benefits at \$33.3 million increased by \$2.2 million, or 7%, primarily due to increased staffing resulting from the Somerset Hills merger. Net occupancy expense at \$6.7 million in the first nine months of 2014 increased \$754,000 from the same period last year, due primarily to expenses relating to the six new branch locations acquired in the Somerset Hills acquisition and increased snow removal expenses during the first quarter of 2014. Furniture and equipment expense at \$5.0 million increased \$466,000 due primarily to the new branches previously mentioned and increased service contract expenses. Legal expense at \$636,000 in the first nine months of 2014 decreased \$298,000 due to the same reasons discussed in the quarterly comparison, while other real estate owned and other repossessed assets at \$165,000 increased \$150,000 compared to the same period last year. Other expenses at \$8.8 million increased \$768,000 compared to the first nine months of 2013, due primarily to an increase in professional fees. The Company's efficiency ratio, a non-GAAP financial measure, was 59.2% in the first nine months of 2014, compared to 59.8% for the same period last year. The Company uses this ratio because it believes that the ratio provides a good comparison of period-to-period performance and because the ratio is widely accepted in the banking industry. The following table shows the calculation of the efficiency ratio for the periods presented:

**Table of Contents**

	For the Nine Months Ended September 30,	
	2014	2013
	(dollars in thousands)	
Calculation of efficiency ratio:		
Total noninterest expense	\$ 58,957	\$ 58,027
Less:		
Amortization of core deposit intangibles	(353)	(164)
Other real estate owned and other repossessed asset expense	(165)	(15)
Long term debt prepayment fee		(526)
Merger related expenses		(2,827)
Provision for unfunded lending commitments	(24)	8
<b>Noninterest expense, as adjusted</b>	<b>\$ 58,415</b>	<b>\$ 54,503</b>
Net interest income	\$ 84,716	\$ 76,569
Noninterest income	13,253	15,489
Total revenue	97,969	92,058
Plus: Tax-equivalent adjustment on municipal securities	741	717
Less:		
Gains on debt extinguishment		(1,197)
Gains on sales of investment securities	(2)	(506)
<b>Total revenue, as adjusted</b>	<b>\$ 98,708</b>	<b>\$ 91,072</b>
Efficiency ratio	59.2%	59.8%

**Income Tax Expense**

The effective tax rate remained substantially the same at 33.2% in the first nine months of 2014 compared to the first nine months of 2013.

In the first quarter of 2014, the State of New York lowered its corporate franchise tax rate from 7.1% to 6.5% as well as changed some of its tax law governing nexus into the state. The Company has evaluated its deferred tax assets and liabilities in relation to these changes in tax law and has determined that there is no material change to its deferred tax assets and liabilities.

**Financial Condition**

The Company's total assets increased \$181.1 million from \$3.32 billion at December 31, 2013, to \$3.50 billion at September 30, 2014. Total loans were \$2.61 billion, an increase of \$143.1 million from \$2.47 billion at December 31, 2013. Total deposits were \$2.78 billion, an increase of \$67.7 million from December 31, 2013.

**Loans and Leases**



Gross loans and leases at \$2.61 billion increased by \$143.1 million from December 31, 2013 primarily in the commercial loans secured by real estate category. Commercial loans secured by real estate and commercial, industrial and other increased \$99.4 million (7%) and \$18.2 million (8%), respectively, from December 31, 2013 to September 30, 2014. Real estate construction loans at \$67.9 million increased \$14.8 million or 28%. Leases also increased \$11.0 million or 27%. For more information on the loan portfolio, see Note 8 in Notes to the Consolidated Financial Statements in this Quarterly Report on Form 10-Q.

**Table of Contents**

**Risk Elements**

Non-performing assets increased from \$17.5 million, or 0.53% of total assets, on December 31, 2013 to \$19.6 million, or 0.56% of total assets, on September 30, 2014. Non-performing assets increased primarily in the residential mortgage category, which increased by \$1.1 million. Non-performing commercial, industrial and other and commercial loans secured by real estate also increased by \$511,000 and \$664,000, respectively. Commercial loan non-accruals at September 30, 2014 included one loan relationship with a balance of \$1.0 million or over, totaling \$1.3 million, and six loan relationships between \$500,000 and \$1.0 million, totaling \$4.1 million.

There were \$429,000 in loans and leases past due ninety days or more and still accruing at September 30, 2014 compared to \$2.0 million at December 31, 2013. These loans primarily consisted of consumer loans which are generally placed on non-accrual and reviewed for charge-off when principal and interest payments are four months in arrears unless the obligations are well-secured and in the process of collection.

On September 30, 2014, the Company had \$8.0 million in loans that were troubled debt restructurings and still accruing interest income compared to \$10.3 million on December 31, 2013. Two troubled debt restructurings totaling \$4.0 million were fully paid off in the first quarter of 2014. Troubled debt restructurings are those loans where the Company has granted concessions to the borrower in payment terms, either in rate or in term, as a result of the financial condition of the borrower.

On September 30, 2014, the Company had \$22.2 million in impaired loans (consisting primarily of non-accrual and restructured loans and leases) compared to \$24.6 million at year-end 2013. For more information on impaired loans and leases see Note 8 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 is based on the fair value of the underlying collateral for collateral dependent loans and leases. Based on such evaluation, \$1.1 million has been allocated as a portion of the allowance for loan and lease losses for impairment at September 30, 2014. At September 30, 2014, the Company also had \$45.0 million in loans and leases that were rated substandard that were not classified as non-performing or impaired compared to \$62.5 million at December 31, 2013.

There were no loans and leases at September 30, 2014, 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. The following table sets forth for the periods presented, the historical relationships among the allowance for loan and lease losses, the provision for loan and lease losses, the amount of loans and leases charged-off and the amount of loan and lease recoveries:

**Table of Contents**

(dollars in thousands)	Nine Months Ended September 30, 2014	Nine Months Ended September 30, 2013	Year Ended December 31, 2013
Balance of the allowance at the beginning of the year	\$ 29,821	\$ 28,931	\$ 28,931
Loans and leases charged off:			
Commercial, secured by real estate	1,925	1,192	2,026
Commercial, industrial and other	755	1,103	1,324
Leases	394	206	206
Real estate mortgage	701	903	1,257
Real estate-construction	25	3,652	3,854
Home equity and consumer	1,759	1,252	1,624
<b>Total loans charged off</b>	<b>5,559</b>	<b>8,308</b>	<b>10,291</b>
Recoveries:			
Commercial, secured by real estate	451	955	1,061
Commercial, industrial and other	894	139	260
Leases		119	121
Real estate mortgage	12	97	99
Real estate-construction	9	12	14
Home equity and consumer	143	156	283
<b>Total Recoveries</b>	<b>1,509</b>	<b>1,478</b>	<b>1,838</b>
Net charge-offs:	4,050	6,830	8,453
Provision for loan and lease losses	4,276	7,656	9,343
Ending balance	\$ 30,047	\$ 29,757	\$ 29,821
Ratio of annualized net charge-offs to average loans and leases outstanding	0.21%	0.40%	0.36%
Ratio of allowance at end of period as a percentage of period end total loans and leases	1.15%	1.23%	1.21%

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 consultants.

The establishment of reserves for pools of homogeneous types of loans and leases not subject to specific review, including impaired commercial loans under \$500,000, leases, 1-4 family residential mortgages and consumer loans.

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

The allowance for loan losses contains a reserve identified as unallocated reserves to cover inherent losses within a given loan category which have not been otherwise reviewed or measured on an individual basis. These reserves reflect management's attempt to ensure that the overall allowance for loan and lease losses reflects a margin for imprecision and the uncertainty that is inherent in estimates of possible credit losses.

## **Table of Contents**

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.

Although the overall balance of the allowance for loan losses at \$30.0 million at September 30, 2014 was equivalent to the balance at December 31, 2013, the distribution of the allowance changed between segments of the loan portfolio. Loan reserves are based on a combination of historical charge-off experience (analyzing gross charge-offs over a twelve quarter period for commercial loans, and an eight quarter period for all other portfolios) and qualitative factors based on general economic conditions and specific bank portfolio characteristics. Based on the trends of these charge-offs, the allowances for commercial real estate loans and commercial, industrial and other loans have declined as a result of a significant reduction in charge-offs over the three year period. On the other hand, home equity, consumer and residential loan charge-offs have not experienced the same level of decline. The home equity and consumer loan portfolio has had increasing charge-offs both in the three month and nine month periods ending September 30, 2014 compared to the same period last year. Residential non-performings have increased since December 31, 2013. Because of the negative trends in the charge-offs and non-performings in the home equity, consumer and residential mortgage portfolio, management believed that a higher allowance was required for these portfolios.

Non-performing loans and leases increased from \$16.9 million on December 31, 2013 to \$18.6 million on September 30, 2014. The allowance for loan and lease losses as a percent of total loans was 1.15% of total loans on September 30, 2014, compared to 1.21% as of December 31, 2013. Management believes, based on appraisals and estimated selling costs, that its non-performing loans and leases are adequately secured and reserves on these loans and leases are adequate. Based upon the process employed and giving recognition to all accompanying factors related to the loan and lease portfolio, management considers the allowance for loan and lease losses to be adequate at September 30, 2014.

## **Investment Securities**

For detailed information on the composition and maturity distribution of the Company's investment securities portfolio, see the Notes to Consolidated Financial Statements contained in this Form 10-Q. Total investment securities increased from \$532.9 million on December 31, 2013 to \$549.2 million on September 30, 2014, an increase of \$16.4 million, or 3%.

## **Deposits**

Total deposits increased from \$2.71 billion on December 31, 2013 to \$2.78 billion on September 30, 2014, an increase of \$67.7 million, or 2% primarily resulting from a \$74.3 million or 12% increase in noninterest bearing deposits. The increase in noninterest bearing deposits was partially offset by a \$14.7 million decrease in time deposits. The continuing low interest rate environment has influenced customers to keep their funds in transaction accounts.

## **Liquidity**

Liquidity measures whether an entity has sufficient cash flow to meet its financial obligations and commitments on a timely basis. The Company is liquid when its subsidiary bank has the cash available to meet the borrowing and cash withdrawal requirements of customers and the Company can pay for current and planned expenditures and satisfy its debt obligations.

Lakeland funds loan demand and operation expenses from several sources:

Cash provided by operating activities was \$34.2 million for the first nine months of 2014 compared to \$40.3 million for the same period in 2013.

**Table of Contents**

Deposits. Lakeland can offer new products or change its rate structure in order to increase deposits. In the first nine months of 2014, Lakeland's deposits increased \$67.7 million.

Sales of securities and overnight funds. At September 30, 2014, the Company had \$444.3 million in securities designated available for sale. Of these securities, \$321.0 million were pledged to secure public deposits and for other purposes required by applicable laws and regulations.

Repayments on loans and leases can also be a source of liquidity to fund further loan growth.

Overnight credit lines. As a member of the Federal Home Loan Bank of New York (FHLB), Lakeland has the ability to borrow overnight based on the market value of collateral pledged. Lakeland had no overnight borrowings from the FHLB on September 30, 2014. Lakeland also has overnight federal funds lines available for it to borrow up to \$162.0 million. Lakeland had borrowings against these lines of \$82.0 million at September 30, 2014. Lakeland may also borrow from the discount window of the Federal Reserve Bank of New York based on the market value of collateral pledged. Lakeland had no borrowings with the Federal Reserve Bank of New York as of September 30, 2014.

Other borrowings. Lakeland can also generate funds by utilizing long-term debt or securities sold under agreements to repurchase that would be collateralized by security or mortgage collateral. At times the market values of securities collateralizing our securities sold under agreements to repurchase may decline due to changes in interest rates and may necessitate our lenders to issue a margin call which requires Lakeland to pledge additional collateral to meet that margin call.

Management and the Board monitor the Company's liquidity through the asset/liability committee, which monitors the Company's compliance with certain regulatory ratios and other various liquidity guidelines.

The cash flow statements for the periods presented provide an indication of the Company's sources and uses of cash, as well as an indication of the ability of the Company to maintain an adequate level of liquidity. A discussion of the cash flow statement for the nine months ended September 30, 2014 follows.

Cash and cash equivalents totaling \$127.2 million on September 30, 2014, increased \$24.4 million from December 31, 2013. Operating activities provided \$34.2 million in net cash. Investing activities used \$161.3 million in net cash, primarily reflecting an increase in loans and leases. Financing activities provided \$151.5 million in net cash primarily reflecting the increase in deposits, federal funds purchased and other borrowings of \$67.9 million, \$30.8 million and \$60.7 million, respectively. 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.

The following table sets forth contractual obligations and other commitments representing required and potential cash outflows as of September 30, 2014. Interest on subordinated debentures and long-term borrowed funds is calculated based on current contractual interest rates.





**Table of Contents**

(dollars in thousands)	Total	Within one year	After one but within three years	After three but within five years	After five years
Minimum annual rentals on noncancellable operating leases	\$ 24,931	\$ 2,531	\$ 4,141	\$ 2,707	\$ 15,552
Benefit plan commitments	5,371	174	432	669	4,096
Remaining contractual maturities of time deposits	281,341	197,659	68,037	15,518	127
Subordinated debentures	41,238				41,238
Loan commitments	630,959	521,768	65,013	620	43,558
Other borrowings	179,700	20,000	65,700	84,000	10,000
Interest on other borrowings*	31,714	4,176	7,512	3,871	16,155
Standby letters of credit	10,753	9,725	948		80
<b>Total</b>	<b>\$ 1,206,007</b>	<b>\$ 756,033</b>	<b>\$ 211,783</b>	<b>\$ 107,385</b>	<b>\$ 130,806</b>

\* Includes interest on other borrowings and subordinated debentures at a weighted rate of 1.92%.

**Capital Resources**

Total stockholders' equity increased from \$351.4 million on December 31, 2013 to \$372.5 million on September 30, 2014, an increase of \$21.1 million, or 6%. Book value per common share increased to \$9.83 on September 30, 2014 from \$9.28 on December 31, 2013. The increase in stockholders' equity from December 31, 2013 to September 30, 2014 was primarily due to \$23.2 million in net income and \$4.7 million in other comprehensive income on the Company's available for sale securities portfolio, partially offset by the payment of dividends on common stock of \$8.0 million.

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 adverse effect on the Company or Lakeland's financial statements. Management believes, as of September 30, 2014, that the Company and Lakeland meet all capital adequacy requirements to which they are subject.

The capital ratios for the Company and Lakeland at September 30, 2014 are as follows:

Tier 1 Capital to Total Average Assets Ratio	Tier 1 Capital to Risk-Weighted Assets Ratio	Total Capital to Risk-Weighted Assets Ratio
	September 30,	September 30,

Edgar Filing: LAKELAND BANCORP INC - Form 10-Q

	September 30, 2014	2014	2014
<b>Capital Ratios:</b>			
The Company	9.02%	11.75%	12.97%
Lakeland Bank	8.41%	10.96%	12.18%
Well capitalized institution under FDIC Regulations	5.00%	6.00%	10.00%

**Table of Contents***Basel III*

On July 2, 2013, the FRB approved the final rules implementing the Basel Committee on Banking Supervision's (BCBS) capital guidelines for U.S. banks. Under the final rules, minimum requirements will increase for both the quantity and quality of capital held by the Company. The rules include a new common equity Tier 1 capital to risk-weighted assets ratio of 4.5% and a common equity Tier 1 capital conservation buffer of 2.5% of risk-weighted assets. The final rules also raise the minimum ratio of Tier 1 capital to risk-weighted assets from 4.0% to 6.0% and require a minimum leverage ratio of 4.0%. The final rules also implement strict eligibility criteria for regulatory capital instruments. On July 9, 2013, the FDIC also approved, as an interim final rule, the regulatory capital requirements for U.S. banks, following the actions of the FRB. The FDIC's rule is identical in substance to the final rules issued by the FRB. The phase-in period for the final rules will begin for the Company on January 1, 2015, with full compliance with all of the final rules' requirements phased in over a multi-year schedule through January 1, 2019. The Company believes that as of September 30, 2014, the Company and Lakeland would meet all of the requirements under the new rules on a fully phased-in basis, if such requirements were in effect.

**Non-GAAP Financial Measures**

Reported amounts are presented in accordance with U.S. GAAP. The Company's management believes that the supplemental non-GAAP information, which consists of measurements and ratios based on tangible equity and tangible assets, is utilized by regulators and market analysts to evaluate a company's financial condition and therefore, such information is useful to investors. These disclosures should not be viewed as a substitute for financial results determined in accordance with U.S. GAAP, nor are they necessarily comparable to non-GAAP performance measures which may be presented by other companies.

(dollars in thousands, except per share amounts)	September 30, 2014	December 31, 2013
<b>Calculation of tangible book value per common share</b>		
Total common stockholders' equity at end of period - GAAP	\$ 372,539	\$ 351,424
Less:		
Goodwill	109,974	109,974
Other identifiable intangible assets, net	2,071	2,424
 Total tangible common stockholders' equity at end of period - Non-GAAP	 \$ 260,494	 \$ 239,026
 Shares outstanding at end of period (1)	 37,910	 37,874
 Book value per share - GAAP (1)	 \$ 9.83	 \$ 9.28
 Tangible book value per share - Non-GAAP (1)	 \$ 6.87	 \$ 6.31

(1) Adjusted for 5% stock dividend distributed June 17, 2014 to shareholders of record on June 3, 2014

**Calculation of tangible common equity to tangible assets**

Total tangible common stockholders equity at end of period - Non- GAAP	\$ 260,494	\$ 239,026
Total assets at end of period	\$ 3,498,905	\$ 3,317,791
Less:		
Goodwill	109,974	109,974
Other identifiable intangible assets, net	2,071	2,424
Total tangible assets at end of period - Non-GAAP	\$ 3,386,860	\$ 3,205,393
Common equity to assets - GAAP	10.65%	10.59%
Tangible common equity to tangible assets - Non-GAAP	7.69%	7.46%

**Table of Contents**

(In thousands)	For the three months ended, September 30,		For the nine months ended, September 30,	
	2014	2013	2014	2013
<b>Calculation of return on average tangible common equity</b>				
Net income - GAAP	\$ 8,246	\$ 6,617	\$ 23,190	\$ 17,628
Total average common stockholders equity	\$ 370,448	\$ 343,482	\$ 363,783	\$ 310,632
Less:				
Average goodwill	109,974	110,381	109,974	97,510
Average other identifiable intangible assets, net	2,141	2,624	2,257	1,182
Total average tangible common stockholders equity - Non-GAAP	\$ 258,333	\$ 230,477	\$ 251,552	\$ 211,940
Return on average common stockholders equity - GAAP	8.83%	7.64%	8.52%	7.59%
Return on average tangible common stockholders equity - Non-GAAP	12.66%	11.39%	12.33%	11.12%

**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 and economic value at risk models. 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 income 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. Changes in estimates and assumptions made for interest rate sensitivity modeling could have a significant impact on projected results and conclusions. These assumptions could include prepayment rates, sensitivity of non-maturity deposits and other similar assumptions. Therefore, if our assumptions should change, this technique may not accurately reflect the impact of general interest rate movements on the Company's net interest income or net portfolio value.

The starting point (or base case) for the following table is an estimate of the following year's net interest income assuming that both interest rates and the Company's interest-sensitive assets and liabilities remain at period-end levels. The net interest income estimated for the next twelve months (the base case) is \$111.6 million. The information provided for net interest income assumes that changes in interest rates of plus 200 basis points and minus 200 basis points change gradually in equal increments (rate ramp) over the twelve month period.

Rate Ramp	Changes in interest rates	
	+200 bp	-200 bp
Asset/Liability Policy Limit	-5.0%	-5.0%

Edgar Filing: LAKELAND BANCORP INC - Form 10-Q

September 30, 2014	-3.4%	-1.8%
December 31, 2013	-3.9%	-2.0%

The Company's review of interest rate risk also includes policy limits for net interest income changes in various rate shock scenarios. Rate shocks assume that current interest rates change immediately. The information provided for net interest income assumes fluctuations or rate shocks for changes in interest rates as shown in the table below.

Rate Shock	Changes in interest rates					
	+300 bp	+200 bp	+100 bp	-100 bp	-200 bp	-300 bp
Asset/Liability Policy Limit	-15.0%	-10.0%	-5.0%	-5.0%	-10.0%	-15.0%
September 30, 2014	-6.1%	-3.9%	-1.7%	-4.4%	-6.7%	-7.4%
December 31, 2013	-8.2%	-5.1%	-2.1%	-4.8%	-7.1%	-8.2%

**Table of Contents**

The base case for the following table is an estimate of the Company's net portfolio value for the periods presented using current discount rates, and assuming the Company's interest-sensitive assets and liabilities remain at period-end levels. The net portfolio value at September 30, 2014 (the base case) was \$498.9 million. The information provided for the net portfolio value assumes fluctuations or rate shocks of plus 300 basis points and minus 300 basis points for changes in interest rates as shown in the table below. Rate shocks assume that current interest rates change immediately.

Rate Shock	Changes in interest rates					
	+300 bp	+200 bp	+100 bp	-100 bp	-200 bp	-300 bp
Asset/Liability Policy Limit	-35.0%	-25.0%	-15.0%	-15.0%	-25.0%	-35.0%
September 30, 2014	-14.4%	-9.3%	-4.1%	1.4%	-3.0%	-7.6%
December 31, 2013	-17.8%	-11.3%	-5.0%	1.6%	-1.5%	-6.0%

The information set forth in the above tables 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, 2013.

**ITEM 4. Controls and Procedures**

(a) **Disclosure controls and procedures.** As of the end of the Company's most recently completed fiscal quarter 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 and are operating in an effective manner and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

(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 quarter ended September 30, 2014 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**Table of Contents****PART II OTHER INFORMATION**

## Item 1. Legal Proceedings

There are no pending legal proceedings involving the Company or Lakeland other than those arising in the normal course of business. Management does not anticipate that the potential liability, if any, arising out of such legal proceedings will have a material effect on the financial condition or results of operations of the Company and Lakeland on a consolidated basis.

## Item 1A. Risk Factors

There have been no material changes in risk factors from those disclosed under Item 1A, Risk Factors in the Company's Annual Report on Form 10-K for the year ended December 31, 2013.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds Not Applicable

Item 3. Defaults Upon Senior Securities Not Applicable

Item 4. Mine Safety Disclosures Not Applicable

Item 5. Other Information Not Applicable

## Item 6. Exhibits

10.1	Amendment to Change of Control Agreement among Lakeland Bancorp. Inc, Lakeland Bank and Timothy J. Matteson.
31.1	Certification by Thomas J. Shara pursuant to Section 302 of the Sarbanes Oxley Act.
31.2	Certification by Joseph F. Hurley pursuant to Section 302 of the Sarbanes Oxley Act.
32.1	Certification by Thomas J. Shara and Joseph F. Hurley pursuant to Section 906 of the Sarbanes Oxley Act.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document



**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

Date: November 10, 2014