

LAKELAND BANCORP INC  
Form 10-Q  
May 10, 2013  
Table of Contents

## SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

### FORM 10-Q

(Mark one)

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

For the quarterly period ended March 31, 2013

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)

Edgar Filing: LAKELAND BANCORP INC - Form 10-Q

**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)

**07438**  
(Zip Code)

**(973) 697-2000**  
(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report.)

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

Indicate by check mark whether the registrant 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

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 April 26, 2013 there were 29,864,460 outstanding shares of Common Stock, no par value.

**Table of Contents**

LAKELAND BANCORP, INC.

Form 10-Q Index

	PAGE
Part I Financial Information	
Item 1. Financial Statements:	
<u>Consolidated Balance Sheets March 31, 2013 (unaudited) and December 31, 2012</u>	3
<u>Consolidated Statements of Income Unaudited Three Months Ended March 31, 2013 and 2012</u>	4
<u>Consolidated Statements of Comprehensive Income Unaudited Three Months Ended March 31, 2013 and 2012</u>	5
<u>Consolidated Statements of Changes in Stockholders' Equity Unaudited Three Months Ended March 31, 2013</u>	6
<u>Consolidated Statements of Cash Flows Unaudited Three Months Ended March 31, 2013 and 2012</u>	7
<u>Notes to Consolidated Financial Statements (unaudited)</u>	8
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	32
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	44
Item 4. <u>Controls and Procedures</u>	45
Part II Other Information	
Item 1. <u>Legal Proceedings</u>	46
Item 1A. <u>Risk Factors</u>	46
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	46
Item 3. <u>Defaults Upon Senior Securities</u>	46
Item 4. <u>Mine Safety Disclosures</u>	46
Item 5. <u>Other Information</u>	46
Item 6. <u>Exhibits</u>	46
<u>Signatures</u>	48

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

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

	March 31, 2013 (unaudited)	December 31, 2012
	(dollars in thousands except share and per share amounts)	
<b>ASSETS:</b>		
Cash	\$ 88,744	\$ 100,926
Interest-bearing deposits due from banks	8,322	6,619
Total cash and cash equivalents	97,066	107,545
Investment securities available for sale, at fair value	370,234	393,710
Investment securities held to maturity; fair value of \$98,827 at March 31, 2013 and \$99,784 at December 31, 2012	96,864	96,925
Federal Home Loan Bank Stock, at cost	5,381	5,382
Loans, net of deferred costs (fees)	2,170,743	2,146,843
Less: allowance for loan and lease losses	29,623	28,931
Net loans	2,141,120	2,117,912
Premises and equipment, net	32,722	33,280
Accrued interest receivable	7,743	7,643
Goodwill	87,111	87,111
Bank owned life insurance	46,456	46,143
Other assets	23,272	23,052
<b>TOTAL ASSETS</b>	<b>\$ 2,907,969</b>	<b>\$ 2,918,703</b>
<b>LIABILITIES</b>		
Deposits:		
Noninterest bearing	\$ 521,045	\$ 498,066
Savings and interest-bearing transaction accounts	1,566,421	1,569,139
Time deposits under \$100 thousand	184,356	188,278
Time deposits \$100 thousand and over	116,853	115,514
Total deposits	2,388,675	2,370,997
Federal funds purchased and securities sold under agreements to repurchase	94,315	117,289
Other borrowings	75,000	85,000
Subordinated debentures	51,548	51,548
Other liabilities	14,554	13,002
<b>TOTAL LIABILITIES</b>	<b>2,624,092</b>	<b>2,637,836</b>
<b>STOCKHOLDERS EQUITY</b>		
Common stock, no par value; authorized shares, 40,000,000; issued 29,941,967 shares at March 31, 2013 and December 31, 2012	302,660	303,794
Accumulated deficit	(21,117)	(24,145)
Treasury stock, at cost, 82,685 shares at March 31, 2013 and 216,077 at December 31, 2012	(1,029)	(2,718)
Accumulated other comprehensive income	3,363	3,936
<b>TOTAL STOCKHOLDERS EQUITY</b>	<b>283,877</b>	<b>280,867</b>

<b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b>	\$ 2,907,969	\$ 2,918,703
--	--------------	--------------

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 March 31,	
	2013	2012
	(In thousands, except per share data)	
<b>INTEREST INCOME</b>		
Loans, leases and fees	\$ 24,407	\$ 25,458
Federal funds sold and interest-bearing deposits with banks	13	6
Taxable investment securities and other	1,719	2,340
Tax-exempt investment securities	430	490
<b>TOTAL INTEREST INCOME</b>	<b>26,569</b>	<b>28,294</b>
<b>INTEREST EXPENSE</b>		
Deposits	1,662	2,256
Federal funds purchased and securities sold under agreements to repurchase	9	28
Other borrowings	962	2,064
<b>TOTAL INTEREST EXPENSE</b>	<b>2,633</b>	<b>4,348</b>
<b>NET INTEREST INCOME</b>	<b>23,936</b>	<b>23,946</b>
Provision for loan and lease losses	3,183	4,556
<b>NET INTEREST INCOME AFTER PROVISION FOR LOAN AND LEASE LOSSES</b>	<b>20,753</b>	<b>19,390</b>
<b>NONINTEREST INCOME</b>		
Service charges on deposit accounts	2,522	2,447
Commissions and fees	1,213	980
Gains on investment securities	505	32
Income on bank owned life insurance	313	339
Other income	498	259
<b>TOTAL NONINTEREST INCOME</b>	<b>5,051</b>	<b>4,057</b>
<b>NONINTEREST EXPENSE</b>		
Salaries and employee benefits	9,953	9,435
Net occupancy expense	1,974	1,688
Furniture and equipment	1,405	1,083
Stationery, supplies and postage	370	336
Marketing expense	288	470
FDIC insurance expense	513	555
Legal expense	242	399
Expenses on other real estate owned and other repossessed assets	19	38
Long term debt prepayment fee	526	
Merger related expenses	631	
Other expenses	2,306	2,271
<b>TOTAL NONINTEREST EXPENSE</b>	<b>18,227</b>	<b>16,275</b>
Income before provision for income taxes	7,577	7,172
Income tax expense	2,469	2,201

Edgar Filing: LAKELAND BANCORP INC - Form 10-Q

<b>NET INCOME</b>	\$	5,108	\$	4,971
Dividends on Preferred Stock and Accretion				620
<b>Net Income Available to Common Stockholders</b>	\$	5,108	\$	4,351
<b>PER SHARE OF COMMON STOCK</b>				
Basic earnings	\$	0.17	\$	0.16
Diluted earnings	\$	0.17	\$	0.16
Dividends	\$	0.07	\$	0.06

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 UNAUDITED**

	For the Three Months Ended March 31,	
	2013	2012
	(in thousands)	
<b>NET INCOME</b>	<b>\$ 5,108</b>	<b>\$ 4,971</b>
<b>OTHER COMPREHENSIVE INCOME, NET OF TAX:</b>		
Unrealized securities gains (losses) during period	(251)	131
Less: reclassification for gains included in net income	328	21
Change in pension liability, net	6	5
Other Comprehensive Income (Loss)	(573)	115
<b>TOTAL COMPREHENSIVE INCOME</b>	<b>\$ 4,535</b>	<b>\$ 5,086</b>

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

**Three Months Ended March 31, 2013**

	Common stock		Accumulated deficit (dollars in thousands)	Treasury Stock	Accumulated	Total
	Number of Shares	Amount			Other Comprehensive Income	
BALANCE January 1, 2013	29,941,967	\$ 303,794	(\$ 24,145)	(\$ 2,718)	\$ 3,936	\$ 280,867
Net Income			5,108			5,108
Other comprehensive loss, net of tax					(573)	(573)
Stock based compensation		185				185
Issuance of restricted stock awards		(1,240)		1,240		
Issuance of stock to dividend reinvestment and stock purchase plan		(106)	(299)	449		44
Exercise of stock options, net of excess tax benefits		27				27
Cash dividends, common stock			(1,781)			(1,781)
BALANCE March 31, 2013 (UNAUDITED)	29,941,967	\$ 302,660	(\$ 21,117)	(\$ 1,029)	\$ 3,363	\$ 283,877

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 Three Months Ended March 31,	
	2013	2012
	(dollars in thousands)	
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$ 5,108	\$ 4,971
Adjustments to reconcile net income to net cash provided by operating activities:		
Net amortization of premiums, discounts and deferred loan fees and costs	1,501	1,803
Depreciation and amortization	860	715
Provision for loan and lease losses	3,183	4,556
Gains on securities	(505)	(32)
Gains on sales of other real estate and other repossessed assets	(29)	(27)
Gains on sales of premises and equipment	(68)	
Stock-based compensation	185	178
Increase in other assets	(109)	(144)
Increase in other liabilities	1,558	1,555
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>11,684</b>	<b>13,575</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Proceeds from repayments on and maturity of securities:		
Available for sale	20,608	36,189
Held to maturity	2,543	8,030
Proceeds from sales of securities		
Available for sale	53,670	16,540
Purchase of securities:		
Available for sale	(52,239)	(36,483)
Held to maturity	(2,609)	(5,607)
Net decrease in Federal Home Loan Bank Stock	1	916
Net increase in loans and leases	(27,428)	(36,731)
Proceeds from sales of other real estate and repossessed assets	531	154
Capital expenditures	(696)	(1,906)
Proceeds from sales of bank premises and equipment	462	
<b>NET CASH USED IN INVESTING ACTIVITIES</b>	<b>(5,157)</b>	<b>(18,898)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Net increase in deposits	17,678	38,475
(Decrease) increase in federal funds purchased and securities sold under agreements to repurchase	(22,974)	24,322
Proceeds from other borrowings		130,000
Repayments of other borrowings	(10,000)	(150,000)
Redemption of preferred stock and common stock warrant		(21,800)
Excess tax benefits	27	18
Issuance of stock to dividend reinvestment and stock purchase plan	44	77
Dividends paid	(1,781)	(1,506)
<b>NET CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES</b>	<b>(17,006)</b>	<b>19,586</b>
Net increase (decrease) in cash and cash equivalents	(10,479)	14,263
Cash and cash equivalents, beginning of period	107,545	72,558

<b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>	\$ 97,066	\$ 86,821
---	-----------	-----------

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 presented do not necessarily indicate the results that the Company will achieve for all of 2013. 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, 2012.

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.

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 dividends.

Certain reclassifications have been made to prior period financial statements to conform to the 2013 presentation.

**Note 2. Stock-Based Compensation**

Share-based compensation expense of \$185,000 and \$178,000 was recognized for the three months ended March 31, 2013 and 2012, respectively. As of March 31, 2013, there was unrecognized compensation cost of \$2.0 million related to unvested restricted stock; that cost is expected to be recognized over a weighted average period of approximately 3.1 years. Unrecognized compensation expense related to unvested stock options was approximately \$20,000 as of March 31, 2013 and is expected to be recognized over a period of 1.2 years.

In the first three months of 2013, the Company granted 99,182 shares of restricted stock at a grant date fair value of \$9.82 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 \$195,000 per year for the next five years. In the first three months of 2012, the Company granted 91,269 shares of restricted stock at a grant date fair value of \$9.50 per share under the 2009 program. Compensation expense on these shares is expected to average approximately \$173,000 per year over a five year period.

There were no grants of stock options in the first three months of 2013 and 2012.

**Table of Contents**

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, 2013	475,697	\$ 12.31		\$ 53,853
Issued				
Exercised				
Forfeited	(3,757)	12.91		
Outstanding, March 31, 2013	471,940	\$ 12.31	2.28	\$ 44,753
Options exercisable at March 31, 2013	460,914	\$ 12.41	2.16	\$ 26,791

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 three months of 2013 and the exercise price, multiplied by the number of in-the-money options).

There were no options exercised in the first three months of 2013 and 2012.

Information regarding the Company's restricted stock (all unvested) and changes during the three months ended March 31, 2013 is as follows:

	Number of shares	Weighted average price
Outstanding, January 1, 2013	222,556	\$ 9.15
Granted	99,182	9.82
Vested	(64,680)	8.59
Forfeited	(1,909)	9.18
Outstanding, March 31, 2013	255,149	\$ 9.55

**Table of Contents**

**Note 3. Comprehensive Income**

The components of other comprehensive income are as follows:

For the quarter ended:	March 31, 2013			March 31, 2012		
	Before tax amount	Tax Benefit (Expense) (in thousands)	Net of tax amount	Before tax amount	Tax Benefit (Expense) (in thousands)	Net of tax amount
Net unrealized gains on available for sale securities						
Net unrealized holding gains (losses) arising during period	(\$ 414)	\$ 163	(\$ 251)	\$ 194	(\$ 63)	\$ 131
Less reclassification adjustment for net gains arising during the period	505	(177)	328	32	(11)	21
Net unrealized gains (losses)	(\$ 919)	\$ 340	(\$ 579)	\$ 162	(\$ 52)	\$ 110
Change in minimum pension liability	8	(2)	6	8	(3)	5
Other comprehensive income (loss), net	(\$ 911)	\$ 338	(\$ 573)	\$ 170	(\$ 55)	\$ 115

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		
	March 31, 2013			March 31, 2012		
	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	\$ 4,553	(\$ 617)	\$ 3,936	\$ 3,506	(\$ 635)	\$ 2,871
Other comprehensive income (loss) before classifications	(251)	6	(245)	131	5	136
Amounts reclassified from accumulated other comprehensive income	328	0	328	21	0	21
Net current period other comprehensive income (loss)	(579)	6	(573)	110	5	115
Ending balance	\$ 3,974	(\$ 611)	\$ 3,363	\$ 3,616	(\$ 630)	\$ 2,986

(a) All amounts are net of tax.

**Table of Contents****Note 4. Statement of Cash Flow Information, Supplemental Information**

	For the Three Months Ended March 31,	
	2013	2012
	(in thousands)	
<b>Supplemental schedule of noncash investing and financing activities:</b>		
Cash paid during the period for income taxes	\$ 99	\$ 517
Cash paid during the period for interest	2,676	4,406
Transfer of loans and leases into other repossessed assets and other real estate owned	688	259

**Note 5. 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 March 31,	
	2013	2012
Net income available to common shareholders	\$ 5,108	\$ 4,351
Less: earnings allocated to participating securities	29	36
<b>Net income allocated to common shareholders</b>	<b>\$ 5,079</b>	<b>\$ 4,315</b>
Weighted average number of common shares outstanding - basic	29,563	26,700
Share-based plans	62	47
Weighted average number of common shares - diluted	29,625	26,747
<b>Basic earnings per share</b>	<b>\$ 0.17</b>	<b>\$ 0.16</b>
Diluted earnings per share	\$ 0.17	\$ 0.16

Options to purchase 444,375 shares of common stock at a weighted average price of \$12.56 per share were outstanding and were not included in the computation of diluted earnings per share for the quarter ended March 31, 2013 because the exercise price was greater than the average market price. Options to purchase 570,914 shares of common stock at a weighted average price of \$12.79 were outstanding and were not included in the computation of diluted earnings per share for the quarter ended March 31, 2012 because the exercise price was greater than the average market price.

**Table of Contents****Note 6. Investment Securities**

AVAILABLE FOR SALE	March 31, 2013				December 31, 2012			
	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	\$ 61,191	\$ 251	\$ (61)	\$ 61,381	\$ 86,002	\$ 577	\$ (8)	\$ 86,571
Mortgage-backed securities, residential	237,700	4,747	(1,124)	241,323	235,052	5,086	(579)	239,559
Obligations of states and political subdivisions	36,379	1,660	(123)	37,916	36,848	1,832	(60)	38,620
Other debt securities	13,570	255	(214)	13,611	13,576	189	(321)	13,444
Equity securities	15,065	1,021	(83)	16,003	14,984	608	(76)	15,516
	<b>\$ 363,905</b>	<b>\$ 7,934</b>	<b>\$ (1,605)</b>	<b>\$ 370,234</b>	<b>\$ 386,462</b>	<b>\$ 8,292</b>	<b>\$ (1,044)</b>	<b>\$ 393,710</b>

HELD TO MATURITY	March 31, 2013				December 31, 2012			
	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	\$ 16,056	\$ 343	\$	\$ 16,399	\$ 16,089	\$ 385	\$	\$ 16,474
Mortgage-backed securities, residential	37,996	949	(301)	38,644	39,065	1,313	(27)	40,351
Mortgage-backed securities, multifamily	1,406		(38)	1,368	1,421		(13)	1,408
Obligations of states and political subdivisions	39,859	952	(147)	40,664	38,801	1,068	(68)	39,801
Other debt securities	1,547	205		1,752	1,549	201		1,750
	<b>\$ 96,864</b>	<b>\$ 2,449</b>	<b>\$ (486)</b>	<b>\$ 98,827</b>	<b>\$ 96,925</b>	<b>\$ 2,967</b>	<b>\$ (108)</b>	<b>\$ 99,784</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):

	March 31, 2013			
	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	\$ 2,451	\$ 2,463	\$ 14,330	\$ 14,359
Due after one year through five years	37,156	37,850	13,449	14,079
Due after five years through ten years	68,370	69,622	26,444	27,218
Due after ten years	3,163	2,973	3,239	3,159
	111,140	112,908	57,462	58,815
Mortgage-backed securities	237,700	241,323	39,402	40,012
Equity securities	15,065	16,003		
Total securities	\$ 363,905	\$ 370,234	\$ 96,864	\$ 98,827

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 Three Months Ended	
	March 31,	
	2013	2012
Sale proceeds	\$ 53,670	\$ 16,540
Gross gains	508	99
Gross losses	(3)	(67)

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 \$315.5 million and \$328.4 million at March 31, 2013 and December 31, 2012, respectively, were pledged to secure public deposits and for other purposes required by applicable laws and regulations.

**Table of Contents**

The following table indicates the length of time individual securities have been in a continuous unrealized loss position at March 31, 2013 and December 31, 2012:

March 31, 2013	Less than 12 months		12 months or longer		Number of securities	Total Fair value	Unrealized Losses
	Fair value	Unrealized Losses	Fair value	Unrealized Losses			
<b>AVAILABLE FOR SALE</b>							
			(dollars in thousands)				
U.S. government agencies	\$ 21,783	\$ 61	\$	\$	4	\$ 21,783	\$ 61
Mortgage-backed securities, residential	61,294	1,118	2,025	6	14	63,319	1,124
Obligations of states and political subdivisions	4,466	83	909	40	11	5,375	123
Other debt securities			5,766	214	2	5,766	214
Equity securities	4,656	83			2	4,656	83
	\$ 92,199	\$ 1,345	\$ 8,700	\$ 260	33	\$ 100,899	\$ 1,605
<b>HELD TO MATURITY</b>							
Mortgage-backed securities, residential	\$ 15,228	\$ 301	\$	\$	5	\$ 15,228	\$ 301
Mortgage-backed securities, multifamily	1,406	38			1	1,406	38
Obligations of states and political subdivisions	5,203	142	371	5	13	5,574	147
	\$ 21,837	\$ 481	\$ 371	\$ 5	19	\$ 22,208	\$ 486
<b>December 31, 2012</b>							
<b>AVAILABLE FOR SALE</b>							
			(dollars in thousands)				
U.S. government agencies	\$ 3,992	\$ 8	\$	\$	1	\$ 3,992	\$ 8
Mortgage-backed securities, residential	30,359	572	3,239	7	10	33,598	579
Obligations of states and political subdivisions	2,825	60			7	2,825	60
Other debt securities			5,661	321	2	5,661	321
Equity securities	4,621	76			2	4,621	76
	\$ 41,797	\$ 716	\$ 8,900	\$ 328	22	\$ 50,697	\$ 1,044
<b>HELD TO MATURITY</b>							
Mortgage-backed securities, residential	\$ 1,239	\$ 27	\$	\$	1	\$ 1,239	\$ 27
Mortgage-backed securities, multifamily	1,408	13			1	1,408	13
Obligations of states and political subdivisions	3,705	63	371	5	10	4,076	68
	\$ 6,352	\$ 103	\$ 371	\$ 5	12	\$ 6,723	\$ 108

Management has evaluated the securities in the above table and has concluded that none of the securities with unrealized losses have impairments that are other-than-temporary. All investment securities are evaluated on a periodic basis to determine if factors are identified that would require 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;

Edgar Filing: LAKELAND BANCORP INC - Form 10-Q

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.

**Table of Contents**

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

As of March 31, 2013, the equity securities include investments in other financial institutions for market appreciation purposes. Those equities had a net amortized cost of \$2.1 million and a market value of \$2.8 million as of March 31, 2012.

As of March 31, 2013, equity securities also included \$13.1 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 March 31, 2013, the net amortized cost equaled the market value of the investment. There are no unfunded commitments related to this investment.

The funds also include \$10.3 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 March 31, 2013, the amortized cost of these securities was \$10.1 million and the fair value was \$10.3 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 7. Loans and Leases.**

The following sets forth the composition of Lakeland's loan and lease portfolio as of March 31, 2013 and December 31, 2012:

	March 31, 2013	December 31, 2012
	(in thousands)	
Commercial, secured by real estate	\$ 1,168,873	\$ 1,125,137
Commercial, industrial and other	211,078	216,129
Leases	28,190	26,781
Real estate-residential mortgage	412,006	423,262
Real estate-construction	45,594	46,272
Home equity and consumer	305,715	309,626
<b>Total loans</b>	<b>2,171,456</b>	<b>2,147,207</b>
Plus: deferred fees	(713)	(364)
<b>Loans, net of deferred fees</b>	<b>\$ 2,170,743</b>	<b>\$ 2,146,843</b>

At March 31, 2013 and December 31, 2012, home equity and consumer loans included overdraft deposit balances of \$336,000 and \$532,000, respectively. At March 31, 2013 and December 31, 2012, the Company had \$296.8 million and \$203.1 million in residential loans pledged for potential borrowings at the Federal Home Loan Bank of New York (FHLB).

**Table of Contents**

*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)	March 31, 2013	December 31, 2012
Commercial, secured by real estate	\$ 8,962	\$ 10,511
Commercial, industrial and other	1,203	1,476
Leases		32
Real estate residential mortgage	8,481	8,733
Real estate construction	3,560	4,031
Home equity and consumer	2,838	3,197
<b>Total non-accrual loans and leases</b>	<b>\$ 25,044</b>	<b>\$ 27,980</b>
Other real estate and other repossessed assets	715	529
<b>TOTAL NON-PERFORMING ASSETS</b>	<b>\$ 25,759</b>	<b>\$ 28,509</b>
Troubled debt restructurings, still accruing	\$ 9,012	\$ 7,336

Non-accrual loans included \$3.2 million and \$3.4 million of troubled debt restructurings as of March 31, 2013 and December 31, 2012, respectively.

An age analysis of past due loans, segregated by class of loans as of March 31, 2013 and December 31, 2012, 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
<b>March 31, 2013</b>							
Commercial, secured by real estate	\$ 4,527	\$ 214	\$ 9,257	\$ 13,998	\$ 1,154,875	\$ 1,168,873	\$ 295
Commercial, industrial and other	420	20	1,222	1,662	209,416	211,078	19
Leases	78	14		92	28,098	28,190	
Real estate residential mortgage	3,694	165	9,856	13,715	398,291	412,006	1,375
Real estate construction	48		3,560	3,608	41,986	45,594	
Home equity and consumer	1,955	381	2,901	5,237	300,478	305,715	63
	\$ 10,722	\$ 794	\$ 26,796	\$ 38,312	\$ 2,133,144	\$ 2,171,456	\$ 1,752
<b>December 31, 2012</b>							
Commercial, secured by real estate	\$ 3,831	\$ 2,308	\$ 10,511	\$ 16,650	\$ 1,108,487	\$ 1,125,137	\$
Commercial, industrial and other	400	171	1,476	2,047	214,082	216,129	
Leases	367	36	32	435	26,346	26,781	
Real estate residential mortgage	2,370	821	10,012	13,203	410,059	423,262	1,279
Real estate construction	1,100		4,031	5,131	41,141	46,272	
Home equity and consumer	2,479	363	3,355	6,197	303,429	309,626	158
	\$ 10,547	\$ 3,699	\$ 29,417	\$ 43,663	\$ 2,103,544	\$ 2,147,207	\$ 1,437



**Table of Contents***Impaired Loans*

Impaired loans as of March 31, 2013, March 31, 2012 and December 31, 2012 are as follows:

	Recorded Investment in Impaired loans	Contractual Unpaid Principal Balance	Specific Allowance (in thousands)	Interest Income Recognized	Average Investment in Impaired loans
<b>March 31, 2013</b>					
Loans without specific allowance:					
Commercial, secured by real estate	\$ 17,275	\$ 29,572	\$	\$ 125	\$ 16,995
Commercial, industrial and other	4,860	4,937		48	4,858
Real estate-residential mortgage	355	355			357
Real estate-construction	3,413	4,826			3,672
Home equity and consumer	369	369			369
Loans with specific allowance:					
Commercial, secured by real estate	2,632	3,175	279	14	2,694
Commercial, industrial and other	535	594	148	1	736
Real estate-residential mortgage	288	288	43		288
Real estate-construction	146	534	15		146
Home equity and consumer	970	970	146	14	970
Total:					
Commercial, secured by real estate	\$ 19,907	\$ 32,747	\$ 279	\$ 139	\$ 19,689
Commercial, industrial and other	5,395	5,531	148	49	5,594
Real estate residential mortgage	643	643	43		645
Real estate-construction	3,559	5,360	15		3,818
Home equity and consumer	1,339	1,339	146	14	1,339
	\$ 30,843	\$ 45,620	\$ 631	\$ 202	\$ 31,085

**Table of Contents**

	Recorded Investment in Impaired loans	Contractual Unpaid Principal Balance	Specific Allowance (in thousands)	Interest Income Recognized	Average Investment in Impaired loans
<b>March 31, 2012</b>					
Loans without specific allowance:					
Commercial, secured by real estate	\$ 16,795	\$ 22,849	\$	\$ 103	\$ 17,684
Commercial, industrial and other	4,887	9,056			4,180
Real estate-residential mortgage	377	377		6	378
Real estate-construction	10,013	14,488			11,051
Home equity and consumer	350	350			312
Loans with specific allowance:					
Commercial, secured by real estate	3,556	5,874	355	10	4,040
Commercial, industrial and other	776	889	221		516
Real estate-residential mortgage	329	337	49	4	482
Real estate-construction	489	1,429	49		522
Home equity and consumer	958	958	144	12	958
Total:					
Commercial, secured by real estate	\$ 20,351	\$ 28,723	\$ 355	\$ 113	\$ 21,724
Commercial, industrial and other	5,663	9,945	221		4,696
Real estate residential mortgage	706	714	49	10	860
Real estate-construction	10,502	15,917	49		11,573
Home equity and consumer	1,308	1,308	144	12	1,270
	\$ 38,530	\$ 56,607	\$ 818	\$ 135	\$ 40,123



**Table of Contents**

	Recorded Investment in Impaired loans	Contractual Unpaid Principal Balance	Specific Allowance (in thousands)	Interest Income Recognized	Average Investment in Impaired loans
<b>December 31, 2012</b>					
Loans without specific allowance:					
Commercial, secured by real estate	\$ 16,458	\$ 21,665	\$	\$ 495	\$ 18,301
Commercial, industrial and other	4,896	4,932		116	3,838
Real estate-residential mortgage	360	360		6	385
Real estate-construction	3,332	4,433			5,533
Home equity and consumer	369	369		1	360
Loans with specific allowance:					
Commercial, secured by real estate	3,346	4,088	368	46	3,825
Commercial, industrial and other	808	871	219	1	769
Real estate-residential mortgage	288	288	43	4	374
Real estate-construction	698	1,085	97		1,445
Home equity and consumer	976	976	146	55	934
Total:					
Commercial, secured by real estate	\$ 19,804	\$ 25,753	\$ 368	\$ 541	\$ 22,126
Commercial, industrial and other	5,704	5,803	219	117	4,607
Real estate residential mortgage	648	648	43	10	759
Real estate-construction	4,030	5,518	97		6,978
Home equity and consumer	1,345	1,345	146	56	1,294
	\$ 31,531	\$ 39,067	\$ 873	\$ 724	\$ 35,764

Interest that would have been accrued on impaired loans during the first three months of 2013 and 2012 had the loans been performing under original terms would have been \$621,000 and \$812,000, respectively. Interest that would have accrued for the year ended December 31, 2012 was \$2.8 million.

*Credit Quality Indicators*

The classes 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 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 March 31, 2013 and December 31, 2012, by the risk ratings discussed above (in thousands):

**March 31, 2013**

Risk Rating	Commercial, secured by real estate	Commercial, industrial and other	Real estate- construction
1	\$	\$ 955	\$
2		12,909	
3	44,222	15,272	
4	380,135	58,487	875
5	634,304	84,622	34,344
5W Watch	28,378	8,099	
6 Other Assets Especially Mentioned	36,294	9,351	3,097
7 Substandard	45,458	21,383	7,278
8 Doubtful	82		
9 Loss			
<b>Total</b>	<b>\$ 1,168,873</b>	<b>\$ 211,078</b>	<b>\$ 45,594</b>

**December 31, 2012**

Risk Rating	Commercial, secured by real estate	Commercial, industrial and other	Real estate- construction
1	\$	\$ 996	\$
2		12,899	
3	44,448	15,676	
4	350,145	62,676	795
5	623,912	88,033	34,682
5W - Watch	43,515	13,261	
6 - Other Assets Especially Mentioned	21,132	2,845	6,535
7 - Substandard	41,817	19,743	4,260
8 - Doubtful	168		
9 - Loss			
<b>Total</b>	<b>\$ 1,125,137</b>	<b>\$ 216,129</b>	<b>\$ 46,272</b>

The risk rating tables above do not include consumer or residential loans or leases because they are evaluated on their payment performance 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 and the related recorded investment in loans and leases for the three months ended March 31, 2013 and the year ended December 31, 2012:

<b>Three Months Ended March 31, 2013</b>	Commercial, secured by real estate	Commercial, industrial and other	Leases	Real estate- residential mortgage (in thousands)	Real estate- construction	Home equity and consumer	Total
<b>Allowance for Loan and Lease Losses:</b>							
Beginning Balance	\$ 16,258	\$ 5,103	\$ 578	\$ 3,568	\$ 587	\$ 2,837	\$ 28,931
Charge-offs	(749)	(177)	(112)	(565)	(652)	(455)	(\$ 2,710)
Recoveries	44	30	88	1	7	49	\$ 219
Provision	868	288	(72)	824	1,304	(29)	\$ 3,183
<b>Ending Balance</b>	<b>\$ 16,421</b>	<b>\$ 5,244</b>	<b>\$ 482</b>	<b>\$ 3,828</b>	<b>\$ 1,246</b>	<b>\$ 2,402</b>	<b>\$ 29,623</b>
Ending Balance: Individually evaluated for impairment	\$ 279	\$ 148	\$ 0	\$ 43	\$ 15	\$ 146	\$ 631
Ending Balance: Collectively evaluated for impairment	16,142	5,096	482	3,785	1,231	2,256	28,992
<b>Ending Balance</b>	<b>\$ 16,421</b>	<b>\$ 5,244</b>	<b>\$ 482</b>	<b>\$ 3,828</b>	<b>\$ 1,246</b>	<b>\$ 2,402</b>	<b>\$ 29,623</b>
<b>Loans and Leases:</b>							
Ending Balance: Individually evaluated for impairment	\$ 19,907	\$ 5,395	\$ 0	\$ 643	\$ 3,559	\$ 1,339	\$ 30,843
Ending Balance: Collectively evaluated for impairment	1,148,966	205,683	28,190	411,363	42,035	304,376	2,140,613
<b>Ending Balance (1)</b>	<b>\$ 1,168,873</b>	<b>\$ 211,078</b>	<b>\$ 28,190</b>	<b>\$ 412,006</b>	<b>\$ 45,594</b>	<b>\$ 305,715</b>	<b>\$ 2,171,456</b>

(1) Excludes deferred fees

**Table of Contents**

<b>Year Ended December 31, 2012</b>	Commercial, secured by real estate	Commercial, industrial and other	Leases	Real estate- residential mortgage (in thousands)	Real estate- construction	Home equity and consumer	Total
<b>Allowance for Loan and Lease Losses:</b>							
Beginning Balance	\$ 16,618	\$ 3,477	\$ 688	\$ 3,077	\$ 1,424	\$ 3,132	\$ 28,416
Charge-offs	(7,287)	(949)	(999)	(1,822)	(2,888)	(2,074)	(\$ 16,019)
Recoveries	280	428	504	66	43	306	\$ 1,627
Provision	6,647	2,147	385	2,247	2,008	1,473	\$ 14,907
<b>Ending Balance</b>	<b>\$ 16,258</b>	<b>\$ 5,103</b>	<b>\$ 578</b>	<b>\$ 3,568</b>	<b>\$ 587</b>	<b>\$ 2,837</b>	<b>\$ 28,931</b>
Ending Balance: Individually evaluated for impairment	\$ 368	\$ 219	\$	\$ 43	\$ 97	\$ 146	\$ 873
Ending Balance: Collectively evaluated for impairment	15,890	4,884	578	3,525	490	2,691	\$ 28,058
<b>Ending Balance</b>	<b>\$ 16,258</b>	<b>\$ 5,103</b>	<b>\$ 578</b>	<b>\$ 3,568</b>	<b>\$ 587</b>	<b>\$ 2,837</b>	<b>\$ 28,931</b>
<b>Loans and Leases:</b>							
Ending Balance: Individually evaluated for impairment	\$ 19,804	\$ 5,704	\$	\$ 648	\$ 4,030	\$ 1,345	\$ 31,531
Ending Balance: Collectively evaluated for impairment	1,105,333	210,425	26,781	422,614	42,242	308,281	\$ 2,115,676
<b>Ending Balance(1)</b>	<b>\$ 1,125,137</b>	<b>\$ 216,129</b>	<b>\$ 26,781</b>	<b>\$ 423,262</b>	<b>\$ 46,272</b>	<b>\$ 309,626</b>	<b>\$ 2,147,207</b>

(1) Excludes deferred fees

Lakeland also maintains a reserve for unfunded lending commitments which are included in other liabilities. This reserve was \$973,000 and \$1,108,000 at March 31, 2013 and December 31, 2012, respectively. 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 months ended March 31, 2013 and 2012:

	For the Three Months Ended March 31, 2013			For the Three Months Ended March 31, 2012		
	Number of Contracts	Pre- Modification Outstanding Recorded Investment (Dollars in thousands)	Post- Modification Outstanding Recorded Investment (Dollars in thousands)	Number of Contracts	Pre- Modification Outstanding Recorded Investment (Dollars in thousands)	Post- Modification Outstanding Recorded Investment (Dollars in thousands)
<b>Troubled Debt Restructurings:</b>						
Commercial, secured by real estate	4	\$ 2,000	\$ 2,000	3	\$ 529	\$ 528
Commercial, industrial and other						
Leases						
Real estate residential mortgage						
Real estate construction						
Home equity and consumer						
	4	\$ 2,000	\$ 2,000	3	\$ 529	\$ 528

The following table summarizes as of March 31, 2013 and 2012, loans that were restructured within the last 12 months that have subsequently defaulted:

	For the Three Months Ended March 31, 2013		For the Three Months Ended March 31, 2012	
	Number of Contracts (Dollars in thousands)	Recorded Investment (Dollars in thousands)	Number of Contracts (Dollars in thousands)	Recorded Investment (Dollars in thousands)
<b>Defaulted Troubled Debt Restructurings:</b>				
Commercial, secured by real estate	4	\$ 731	4	\$ 1,484
Commercial, industrial and other				
Leases				
Real estate residential mortgage			3	706
Real estate construction				
Home equity and consumer			1	350
	4	\$ 731	8	\$ 2,540

**Table of Contents***Leases*

Lakeland had no leases held for sale as of March 31, 2013 and December 31, 2012. The following table shows the components of gains on leasing related assets for the periods presented:

	For the Three Months Ended March 31,	
	2013	2012
	(in thousands)	
Gains on sales of leases	\$	\$
Realized gains on paid off leases	19	157
Gains on other repossessed assets	11	27
Total gains on leasing related assets	\$ 30	\$ 184

*Other Real Estate and Other Repossessed Assets*

At March 31, 2013, the Company had other repossessed assets and other real estate owned of \$147,000 and \$568,000, respectively. At December 31, 2012, the Company had other repossessed assets and other real estate owned of \$77,000 and \$452,000, respectively.

**Note 8. 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 March 31,	
	2013	2012
	(in thousands)	
Interest cost	\$ 22	\$ 22
Expected return on plan assets	(18)	(19)
Amortization of unrecognized net actuarial loss	21	18
Net periodic benefit expense	\$ 25	\$ 21

**Note 9. Directors' Retirement Plan**

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

	For the Three Months Ended March 31,	
	2013	2012
	(in thousands)	
Service cost	\$ 7	\$ 8
Interest cost	9	10
Amortization of prior service cost	3	3
Amortization of unrecognized net actuarial loss	2	3
Net periodic benefit expense	\$ 21	\$ 24

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

The Company made contributions of \$75,000 and \$88,000 to the plan during the three month periods ended March 31, 2013 and 2012, respectively. The Company does not expect to make any more contributions for the remainder of 2013.

**Table of Contents**

**Note 10. 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 a U.S. Treasury Note 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, broker-dealer quotes, 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. As a result of our review, we did not have any adjustments to prices from our third party servicer.

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.



**Table of Contents**

During the three months ended March 31, 2013, the Company did not make any transfers between recurring Level 1 fair value measurements and recurring Level 2 fair value measurements. 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)	Significant Unobservable Inputs (Level 3)	Total Fair Value
	(in thousands)			
<b>March 31, 2013</b>				
<b>Assets:</b>				
Investment securities, available for sale				
U.S. treasury and government agencies	\$ 3,494	\$ 57,887	\$	\$ 61,381
Mortgage backed securities		241,323		241,323
Obligations of states and political subdivisions		37,916		37,916
Corporate debt securities		13,611		13,611
Equity securities	2,414	13,589		16,003
<b>Total securities available for sale</b>	<b>\$ 5,908</b>	<b>\$ 364,326</b>	<b>\$</b>	<b>\$ 370,234</b>
Other Assets (a)	\$	\$ 404	\$	\$ 404
<b>Total Assets</b>	<b>\$ 5,908</b>	<b>\$ 364,730</b>	<b>\$</b>	<b>\$ 370,638</b>
Other Liabilities (a)	\$	\$ 404	\$	\$ 404
<b>Total Liabilities</b>	<b>\$</b>	<b>404</b>	<b>\$</b>	<b>404</b>
<b>December 31, 2012</b>				
<b>Assets:</b>				
Investment securities, available for sale				
U.S. treasury and government agencies	\$ 3,493	\$ 83,078	\$	\$ 86,571
Mortgage backed securities		239,559		239,559
Obligations of states and political subdivisions		38,620		38,620
Corporate debt securities		13,444		13,444
Equity securities	2,010	13,506		15,516
<b>Total securities available for sale</b>	<b>5,503</b>	<b>388,207</b>		<b>393,710</b>
Other Assets (a)		195		195
<b>Total Assets</b>	<b>\$ 5,503</b>	<b>\$ 388,402</b>	<b>\$</b>	<b>\$ 393,905</b>
Other Liabilities (a)	\$	\$ 195	\$	\$ 195
<b>Total Liabilities</b>	<b>\$</b>	<b>\$ 195</b>	<b>\$</b>	<b>\$ 195</b>

(a) Non-hedging interest rate derivatives



**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 in Active Markets for Identical Assets (Level 1)			Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Fair Value
	(in thousands)					
<b>March 31, 2013</b>						
<b>Assets:</b>						
Impaired Loans and Leases	\$	\$	\$	30,843	\$	30,843
Other real estate owned and other repossessed assets				715		715
<b>December 31, 2012</b>						
<b>Assets:</b>						
Impaired Loans and Leases			\$	31,531	\$	31,531
Other real estate owned and other repossessed assets				529		529

Impaired loans are evaluated and valued at the time the loan is identified as impaired at the lower of cost or market value. 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 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 discounted based on management's historical knowledge, changes in market conditions from the time of valuation, and/or management's expertise and knowledge of the client and client's business. Impaired loans are reviewed and evaluated on at least a quarterly basis for additional impairment and adjusted accordingly, based on the same factors identified above.

Other real estate owned (OREO) and other repossessed assets, representing property acquired through foreclosure, are carried at fair value less estimated disposal costs of the acquired property. Fair value on other real estate owned is based on the appraised value of the collateral using the sales comparison approach or 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.

The estimation methodologies used, the estimated fair values, and recorded book balances at March 31, 2013 and December 31, 2012 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

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

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.

**Table of Contents**

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 \$12.4 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 March 31, 2013 and December 31, 2012 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 carrying value of accrued interest approximates fair value.

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.

**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 March 31, 2013 and December 31, 2012:

	Carrying Value	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(in thousands)					
<b>March 31, 2013</b>					
Financial Instruments Assets					
Investment securities held to maturity	\$ 96,864	\$ 98,827	\$	\$ 86,390	\$ 12,437
Federal Home Loan Bank Stock	5,381	5,381		5,381	
Loans and leases	2,170,743	2,176,887			2,176,887
Financial Instruments Liabilities					
Certificates of Deposit	301,209	302,437		302,437	
Other borrowings	75,000	80,511		80,511	
Subordinated debentures	51,548	34,434			34,434
Commitments:					
Standby letters of credit		2			2
<b>December 31, 2012</b>					
Financial Assets:					
Investment securities held to maturity	\$ 96,925	\$ 99,784	\$	\$ 87,336	\$ 12,448
Federal Home Loan Bank Stock	5,382	5,382		5,382	
Loans and leases	2,146,843	2,154,507			2,154,507
Financial Liabilities:					
Certificates of Deposit	303,792	305,398		305,398	
Other borrowings	85,000	91,325		91,325	
Subordinated debentures	51,548	33,403			33,403
Commitments:					
Standby letters of credit		4			4

**Note 11. Derivatives**

The Company 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. The Company 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. The Company 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 March 31, 2013 and December 31, 2012, the Company had \$493,000 and \$497,000, 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:

March 31, 2013

	Notional Amount	Average Maturity	Weighted Average Rate Fixed	Weighted Average Variable Rate	Fair Value
3rd party interest rate swaps	\$ 24,396	8.2	4.040%	1 Mo Libor + 2.31	\$ 404
Customer interest rate swaps	(24,396)	8.2	4.040%	1 Mo Libor + 2.31	(404)

December 31, 2012

	Notional Amount	Average Maturity	Weighted Average Rate Fixed	Weighted Average Variable Rate	Fair Value
3rd party interest rate swaps	\$ 6,400	10.1	4.625%	1 Mo Libor + 2.61	\$ 195
Customer interest rate swaps	(6,400)	10.1	4.625%	1 Mo Libor + 2.61	(\$ 195)

The following shows the Company's transactions that are subject to an enforceable master netting arrangement or other such similar agreements for the periods presented:

March 31, 2013

Description	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Balance Sheet	Net Amounts of Assets Presented in the Balance Sheet (in thousands)	Gross Amounts not Offset in the Balance Sheet		Net Amount
				Financial Instruments	Cash Collateral Received	
Third party interest rate swaps	\$ 24,396	(\$ 23,992)	\$ 404	\$ 0	\$ 0	\$ 404
<b>Total</b>	<b>\$ 24,396</b>	<b>(\$ 23,992)</b>	<b>\$ 404</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 404</b>

Offsetting of Financial Liabilities and Derivative Liabilities

Description	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Balance Sheet	Net Amounts of Liabilities Presented in the Balance Sheet (in thousands)	Gross Amounts not Offset in the Balance Sheet		Net Amount
				Financial Instruments	Cash Collateral Received	
Customer interest rate swaps	\$ 24,396	(\$ 23,992)	\$ 404	\$ 0	\$ 0	\$ 404

Edgar Filing: LAKELAND BANCORP INC - Form 10-Q

Total	\$ 24,396	(\$ 23,992)	\$ 404	\$ 0	\$ 0	\$ 404
-------	-----------	-------------	--------	------	------	--------



**Table of Contents**

December 31, 2012

Description	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Balance Sheet	Net Amounts of Assets Presented in the Balance Sheet (in thousands)	Gross Amounts not Offset in the Balance Sheet		Net Amount
				Financial Instruments	Cash Collateral Received	
Offsetting of Financial Assets and Derivative Assets						
Third party interest rate swaps	\$ 6,400	(\$ 6,205)	\$ 195	\$ 0	\$ 0	\$ 195
<b>Total</b>	<b>\$ 6,400</b>	<b>(\$ 6,205)</b>	<b>\$ 195</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 195</b>

Description	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Balance Sheet	Net Amounts of Liabilities Presented in the Balance Sheet (in thousands)	Gross Amounts not Offset in the Balance Sheet		Net Amount
				Financial Instruments	Cash Collateral Received	
Offsetting of Financial Liabilities and Derivative Liabilities						
Customer interest rate swaps	\$ 6,400	(\$ 6,205)	\$ 195	\$ 0	\$ 0	\$ 195
<b>Total</b>	<b>\$ 6,400</b>	<b>(\$ 6,205)</b>	<b>\$ 195</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 195</b>

**Note 12. Preferred Stock**

On February 8, 2012, the Company redeemed its remaining 19,000 shares of its Fixed Rate Cumulative Preferred Stock, Series A originally issued to the U.S. Department of the Treasury under the Troubled Asset Relief Program Capital Purchase Program ( CPP ). The Company paid to the Treasury \$19.2 million, which included \$19.0 million of principal and \$219,000 in accrued and unpaid dividends, on February 8, 2012. As a result of the early payment, the Company also accelerated the accretion of \$501,000 of the preferred stock discount.

On February 29, 2012, the Company repurchased the outstanding common stock warrant previously issued to the Treasury for the purchase of 1,046,901 shares of its common stock at an exercise price of \$8.45 per share, for \$2.8 million, completing the Company's participation in the Treasury's CPP. Upon repurchase, the common stock warrant had a carrying value of \$3.3 million. The repurchase price of \$2.8 million was recorded as a reduction to common stock on the statement of changes in stockholders' equity.

**Note 13. Common Stock**

On September 4, 2012, the Company issued and sold an aggregate of 2,667,253 shares of common stock at a price of \$9.65 per share pursuant to a takedown off of the Company's shelf registration statement. The Company received net proceeds of \$25.0 million which it used to repay \$25.8 million in junior subordinated debentures on October 7, 2012. The junior subordinated debentures had been issued by the Company to Lakeland Capital Trust III in December 2003, had a coupon rate of 7.535% at the time of redemption and were due on January 7, 2034. The capital and

common securities issued by the Trust in December 2003 were also redeemed.

## Note 14. Acquisitions

### **Note 14. Acquisitions**

On January 28, 2013, the Company entered into an Agreement and Plan of Merger (the Merger Agreement) with Somerset Hills Bancorp, pursuant to which Somerset Hills Bancorp will merge with and into the Company. The Merger Agreement provides that the shareholders of Somerset Hills Bancorp will 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 \$12.00 in cash, subject to proration as described in the Merger Agreement, so that 90% of the aggregate merger consideration will be shares of Lakeland Bancorp common stock and 10% will be cash. Lakeland Bancorp expects to issue an aggregate of 5,780,883 shares of its common stock in the merger, and will also assume outstanding Somerset Hills Bancorp stock options (which will be converted into options to purchase Lakeland Bancorp common stock). The transaction is valued at approximately \$64.4 million in the aggregate (excluding the assumption of stock options), or \$12.00 per share. As of December 31, 2012, Somerset Hills Bancorp had consolidated total assets, total loans, total deposits and total stockholders' equity of \$368.9 million, \$241.9 million, \$320.2 million and \$41.8 million, respectively. Somerset Hills Bancorp had net income of \$3.4 million for the year ended December 31, 2012.

---

**Table of Contents**

The transaction has been approved by the board of directors of each of Lakeland Bancorp and Somerset Hills Bancorp. On May 6, 2013, the Company was informed by the New Jersey Department of Banking, and Insurance that it had approved the proposed merger of Somerset Hills Bancorp with and into the Company and the merger of the bank subsidiaries. On May 8, 2013, the shareholders of Somerset Hills Bancorp voted to approve the merger and the shareholders of the Company voted to approve the issuance of the shares of the Company's common stock to be issued in the merger. Subject to additional required regulatory approval and other customary closing conditions, the Company anticipates completing the merger in the second or third quarter of 2013.

**Note 15. Recent Accounting Pronouncements**

In February 2013, the FASB issued guidance relating to the reporting of amounts reclassified out of accumulated other comprehensive income. This guidance further updates guidance issued in 2011 increasing the prominence of items reported in other comprehensive income and facilitating the convergence of U.S. GAAP and International Financial Reporting Standards (IFRS). The guidance issued in 2013 requires an entity to provide information about the items reclassified out of other comprehensive income by component. This guidance is effective during interim and annual periods beginning after December 15, 2012, and is to be applied retrospectively. The Company adopted this guidance in the first quarter of 2013. Adoption of this guidance did not have a significant impact on the Company's consolidated financial statements.

In December 2011, the FASB issued accounting guidance regarding disclosures about offsetting assets and liabilities. The scope of this accounting guidance was further clarified by the FASB on January 1, 2013. This guidance affects all entities that have financial instruments and derivative instruments that are either (1) offset in accordance with U.S. GAAP or (2) subject to an enforceable master netting arrangement or similar agreement. This information will enable users of an entity's financial statements to evaluate the effect or potential effect of netting arrangements on an entity's financial position, including the effect or potential effect of rights of setoff associated with certain financial instruments and derivative instruments in the scope of this guidance. An entity is required to apply the amendments for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the disclosures required by those amendments retrospectively for all comparative periods presented. The Company adopted this guidance in the first quarter of 2013. Adoption of this guidance did not have a significant impact on the Company's consolidated 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, 2012.

**Statements Regarding Forward Looking Information**

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

In addition to the 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

## **Table of Contents**

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 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, competition, failure to obtain required regulatory approvals for the merger of Somerset Hills Bancorp into Lakeland Bancorp and for the merger of Somerset Hills Bank into Lakeland Bank, and the failure to realize anticipated efficiencies and synergies if the mergers are consummated.

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 with accounting principles generally accepted in the United States of America and predominant practices within the banking industry. The consolidated financial statements include the accounts of the Company, Lakeland, Lakeland NJ Investment Corp., Lakeland Investment Corp., Lakeland Equity, Inc., and Lakeland Preferred Equity, 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 three months ended March 31, 2013, represented a period of earnings improvement for the Company. As discussed in this Management's Discussion and Analysis:

Net income available to common stockholders increased \$757,000, or 17%, from the first quarter of 2012 to the same period in 2013.

Diluted earnings per share increased from \$0.16 for the first quarter of 2012 to \$0.17 for the first quarter of 2013.

Included in the 2013 first quarter earnings was \$631,000 in expenses related to the proposed merger with Somerset Hills Bancorp. Exclusive of these expenses, EPS for the first quarter of 2013 was \$0.19 per common share, a 19% increase over the EPS for the same period last year.

Non-performing assets declined for the sixth consecutive quarter. Non-performing assets have declined \$2.8 million, or 10%, from \$28.5 million reported at year end.

As a result of improving loan quality, the provision for loan and lease losses was reduced from \$4.6 million in the first quarter of 2012 to \$3.2 million in the first quarter of 2013.

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

The Company continues to experience pressure on its net interest margin from the continuing low interest rate environment. The net interest margin declined from 3.76% in the first quarter of 2012 to 3.71% in the first quarter of 2013.

Noninterest income has increased related to management's efforts to increase fee income to offset declines in net interest income.

**Table of Contents****Results of Operations****(First Quarter 2013 Compared to First Quarter 2012)****Net Income**

Net income for the first quarter of 2013 was \$5.1 million, compared to net income of \$5.0 million for the same period in 2012. Net income available to common stockholders was \$5.1 million compared to net income available to common stockholders of \$4.4 million for the first quarter of 2012. Because the Company repaid its remaining preferred stock to the U.S. Department of the Treasury under the CPP in the first quarter of 2012, the Company had no dividends or accretion on preferred stock in the first quarter of 2013 compared to \$620,000 for the same period last year. Diluted earnings per share was \$0.17 for the first quarter of 2013, compared to diluted earnings per share of \$0.16 for the same period last year. Net interest income for the first quarter of 2013 was equivalent to the first quarter of 2012.

**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 increases when the Company can use noninterest-bearing deposits to fund or support interest-earning assets. The Company's net interest income is influenced by the current low interest rate environment. For information on how interest rate change can influence the Company's net interest income, and how the Company manages its net interest income, please see "Quantitative and Qualitative Disclosures About Market Risk" in Item 3 of this Quarterly Report on Form 10-Q. The Company's net interest margin can also be impacted by its level of non-performing loans. If non-performing loans decline, this could increase the net interest margin.

Net interest income on a tax equivalent basis for the first quarter of 2013 was \$24.2 million, which equaled the first quarter of 2012. The net interest margin decreased from 3.76% in the first quarter of 2012 to 3.71% in the first quarter of 2013 primarily as a result of net interest income remaining the same while average interest earning assets increased \$50.0 million during the same period. The net interest margin would have been 3.77% and 3.86% for the first quarter of 2013 and 2012, respectively, had the Company's non-performing loans performed in accordance with their terms. Declines in interest income resulting from a 32 basis point decline in the yield on interest-earning assets were partially offset by a 32 basis point reduction in the cost of interest-bearing liabilities. The decline in the net interest margin resulting from a decline in rates was somewhat mitigated by an increase in 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 \$53.3 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 Three Months Ended,			For the Three Months Ended,		
	March 31, 2013			March 31, 2012		
	Average	Interest	Average	Average	Interest	Average
	Balance	Income/ Expense	rates earned/ paid (dollars in thousands)	Balance	Expense	rates earned/ paid
<b>Assets</b>						
Interest-earning assets:						
Loans (A)	\$ 2,136,254	\$ 24,407	4.63%	\$ 2,050,093	\$ 25,458	4.99%
Taxable investment securities and other	404,582	1,719	1.70%	447,252	2,340	2.09%
Tax-exempt securities	71,241	662	3.71%	72,787	754	4.14%
Federal funds sold (B)	30,585	13	0.17%	22,522	6	0.11%
<b>Total interest-earning assets</b>	<b>2,642,662</b>	<b>26,801</b>	<b>4.11%</b>	<b>2,592,654</b>	<b>28,558</b>	<b>4.43%</b>
Noninterest-earning assets:						
Allowance for loan and lease losses	(29,485)			(29,162)		
Other assets	254,833			242,705		
<b>TOTAL ASSETS</b>	<b>\$ 2,868,010</b>			<b>\$ 2,806,197</b>		
<b>Liabilities and Stockholders Equity</b>						
Interest-bearing liabilities:						
Savings accounts	\$ 357,709	\$ 66	0.07%	\$ 338,221	\$ 90	0.11%
Interest-bearing transaction accounts	1,226,112	982	0.32%	1,137,069	1,272	0.45%
Time deposits	302,159	614	0.81%	350,937	894	1.02%
Borrowings	183,089	971	2.12%	267,165	2,092	3.13%
<b>Total interest-bearing liabilities</b>	<b>2,069,069</b>	<b>2,633</b>	<b>0.51%</b>	<b>2,093,392</b>	<b>4,348</b>	<b>0.83%</b>
Noninterest-bearing liabilities:						
Demand deposits	502,214			448,893		
Other liabilities	13,931			13,236		
Stockholders equity	282,796			250,676		
<b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b>	<b>\$ 2,868,010</b>			<b>\$ 2,806,197</b>		
Net interest income/spread		24,168	3.60%		24,210	3.60%
Tax equivalent basis adjustment		232			264	
<b>NET INTEREST INCOME</b>		<b>\$ 23,936</b>			<b>\$ 23,946</b>	
Net interest margin (C)			3.71%			3.76%

(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.

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

Interest income on a tax equivalent basis decreased from \$28.6 million in the first quarter of 2012 to \$26.8 million in the first quarter of 2013, a decrease of \$1.8 million, or 6%. The decrease in interest income was primarily due to a 32 basis point decrease in the yield on interest earning assets, as a result of loans being refinanced at lower rates and lower yields on new loans and investments. The yield on average loans and leases at 4.63% in the first quarter of 2013 was 36 basis points lower than the first quarter of 2012. The yield on average taxable and tax exempt investment securities decreased by 39 basis points and 43 basis points, respectively, compared to the first quarter of 2012. Average loans and leases at \$2.14 billion increased \$86.2 million from the first quarter of 2012, while average investment securities at \$475.8 million decreased \$44.2 million.

Total interest expense decreased from \$4.3 million in the first quarter of 2012 to \$2.6 million in the first quarter of 2013, a decrease of \$1.7 million, or 39%. The cost of average interest-bearing liabilities decreased from 0.83% in the first quarter of 2012 to 0.51% in 2013. The decrease in yield was due primarily to a 101 basis point reduction in the cost of borrowings, an \$84.1 million reduction in higher yielding borrowings, a \$48.8 million reduction in higher yielding time deposits and the continuing low rate environment. From the first quarter of 2012 to the first quarter of 2013, average savings accounts and interest-bearing transaction accounts increased by \$19.5 million and \$89.0 million, respectively. Average rates paid on interest-bearing liabilities declined in all categories.

### **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.



**Table of Contents**

In the first quarter of 2013, a \$3.2 million provision for loan and lease losses was recorded, which was \$1.4 million lower than the provision for the same period last year. During the first quarter of 2013, the Company charged off loans and leases of \$2.7 million and recovered \$219,000 in previously charged off loans and leases compared to \$5.0 million and \$735,000, respectively, during the same period in 2012. The lower provision resulted from a decline in non-performing assets and from lower charge-offs during the quarter. For more information regarding the determination of the provision, see **Risk Elements** below.

**Noninterest Income**

Noninterest income increased \$994,000, or 25%, to \$5.1 million in the first quarter of 2013 compared to the first quarter of 2012 primarily due to gains on sales of investment securities, an increase in commissions and fees and an increase in other income. Gains on sales of investment securities was \$505,000 during the first quarter of 2013 compared to \$32,000 during the same period in 2012. Commissions and fees totaled \$1.2 million in the first quarter of 2013 and were \$233,000, or 24%, higher than the same period last year due primarily to increased investment commission income. Other income totaling \$498,000 in the first quarter of 2013 was \$239,000 higher than the same period in 2012 primarily due to \$181,000 in income on loan swap transactions and \$152,000 in gains on sales of residential mortgage loans. Income on bank owned life insurance at \$313,000 declined \$26,000 compared to the first quarter of 2012 due primarily to decreases in rates on the underlying policies.

**Noninterest Expense**

Noninterest expense totaling \$18.2 million increased \$2.0 million in the first quarter of 2013 from the first quarter of 2012. In the first quarter of 2013 noninterest expense included \$526,000 in long term debt prepayment fees and \$631,000 in merger related expenses. Salary and employee benefits at \$10.0 million increased by \$518,000, or 5%, partially due to increased commission expenses. Net occupancy expense at \$2.0 million in the first quarter of 2013 increased \$286,000 from the same period last year due primarily to expenses relating to the new operations and training center and branch office opened in the second half of 2012 as well as increased snow removal expenses. Furniture and equipment at \$1.4 million increased \$322,000 from the same period last year due primarily to increased service contract expense, expenses relating to the new operations and training center and the opening of a branch office. Marketing expense totaling \$288,000 decreased \$182,000 compared to the first quarter of 2012 primarily due a reduction in advertising and the timing of marketing campaigns. FDIC insurance expense at \$513,000 decreased \$42,000 due primarily to lower assessment rates resulting from the reduction in nonperforming assets. Legal expense at \$242,000 and other real estate and repossessed asset expense at \$19,000 decreased \$157,000 and \$19,000, respectively, due primarily to the reduction in nonperforming assets. The Company's efficiency ratio, a non-GAAP financial measure, was 59.85% in the first quarter of 2013, compared to 57.71% for the same period last year as a result of an increase in total noninterest expense. 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 March 31,	
	2013	2012
	(dollars in thousands)	
Calculation of efficiency ratio		
Total noninterest expense	\$ 18,227	\$ 16,275
Less:		
Other real estate owned and other repossessed asset expense	(19)	(38)
Long term debt prepayment fee	(526)	
Merger related expenses	(631)	
Provision for unfunded lending commitments	135	56
Noninterest expense, as adjusted	\$ 17,186	\$ 16,293
Net interest income	\$ 23,936	\$ 23,946
Noninterest income	5,051	4,057
Total revenue	28,987	28,003
Plus: Tax-equivalent adjustment on municipal securities	232	264
Less: gains on sales of investment securities	(505)	(32)
Total revenue, as adjusted	\$ 28,714	\$ 28,235
Efficiency ratio	59.85%	57.71%

**Income Tax Expense**

The effective tax rate increased from 30.7% in the first quarter of 2012 to 32.6% in the first quarter of 2013 as a result of increased earnings and because of a reduction of tax advantaged items as a percent of pre-tax income. Tax advantaged items include interest income on tax-exempt securities and income on bank owned life insurance. Also contributing to the increase in the effective tax rate was the impact of non-deductible merger related expenses.

**Financial Condition**

The Company's total assets decreased \$10.7 million from \$2.92 billion at December 31, 2012, to \$2.91 billion at March 31, 2013. A \$23.5 million reduction in investment securities and a \$10.5 million reduction in total cash and cash equivalents was partially offset by a \$24.2 million increase in total loans. Total deposits increased \$17.7 million, with non-interest-bearing transaction accounts increasing \$23.0 million.

**Loans and Leases**

Gross loans and leases at \$2.17 billion increased by \$24.2 million from December 31, 2012. The increase in gross loans and leases is primarily due to an increase in commercial loans secured by real estate of \$43.7 million, partially offset by a reduction in residential mortgages of \$11.3 million. For more information on the loan portfolio, see Note 7 in Notes to the Consolidated Financial Statements in this Quarterly Report on Form 10-Q.

## **Table of Contents**

### **Risk Elements**

Non-performing assets decreased from \$28.5 million, or 0.98% of total assets, on December 31, 2012 to \$25.8 million, or 0.89% of total assets, on March 31, 2013. Non-performing assets decreased in all categories. The largest declines in non-performing loans were in commercial loans secured by real estate and real estate construction loans which declined by \$1.5 million and \$471,000, respectively. Commercial loan non-accruals at March 31, 2013 included 4 loan relationships with balances over \$1.0 million, totaling \$5.1 million, and 5 loan relationships between \$500,000 and \$1.0 million, totaling \$3.6 million.

There were \$1.8 million in loans and leases past due ninety days or more and still accruing at March 31, 2013 compared to \$1.4 million at December 31, 2012. Loans and leases past due 90 days or more and still accruing are those loans and leases that are considered both well-secured and in process of collection.

On March 31, 2013, the Company had \$9.0 million in loans that were troubled debt restructurings and still accruing interest income compared to \$7.3 million on December 31, 2012. 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 March 31, 2013, the Company had \$30.8 million in impaired loans (consisting primarily of non-accrual and restructured loans and leases) compared to \$31.5 million at year-end 2012. For more information on impaired loans and leases see Note 7 in Notes to the Consolidated Financial Statements of this Quarterly Report on Form 10-Q. The impairment of the loans and leases is measured using the present value of future cash flows on certain impaired loans and is based on the fair value of the underlying collateral for the remaining loans and leases. Based on such evaluation, \$631,000 has been allocated as a portion of the allowance for loan and lease losses for impairment at March 31, 2013. At March 31, 2013, the Company also had \$51.6 million in loans and leases that were rated substandard that were not classified as non-performing or impaired compared to \$42.7 million at December 31, 2012.

There were no loans and leases at March 31, 2013, 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**

	Three Months Ended March 31, 2013	Three Months Ended March 31, 2012	Year Ended December 31, 2012
(dollars in thousands)			
Balance of the allowance at the beginning of the year	\$ 28,931	\$ 28,416	\$ 28,416
Loans and leases charged off:			
Commercial, secured by real estate	749	2,090	7,287
Commercial, industrial and other	177	149	949
Leases	112	168	999
Real estate mortgage	565	357	1,822
Real estate-construction	652	1,526	2,888
Home equity and consumer	455	717	2,074
Total loans charged off	2,710	5,007	16,019
Recoveries:			
Commercial, secured by real estate	44	39	280
Commercial, industrial and other	30	179	428
Leases	88	378	504
Real estate mortgage	1	12	66
Real estate-construction	7	27	43
Home equity and consumer	49	100	306
Total Recoveries	219	735	1,627
Net charge-offs:	2,491	4,272	14,392
Provision for loan and lease losses	3,183	4,556	14,907
Ending balance	\$ 29,623	\$ 28,700	\$ 28,931
Ratio of annualized net charge-offs to average loans and leases outstanding	0.47%	0.83%	0.69%
Ratio of allowance at end of period as a percentage of period end total loans and leases	1.36%	1.38%	1.35%

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 \$250,000, leases, 1-4 family residential mortgages and consumer loans.

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

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

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

## **Table of Contents**

The overall balance of the allowance for loan losses increased \$692,000 to \$29.6 million at March 31, 2013 compared to December 31, 2012 reflecting an increase in the commercial loan portfolio and a \$659,000 increase in the allowance for the real estate-construction segment. The increase in the allowance for the real estate-construction segment reflected a downgrade of a certain construction loan to substandard which requires a higher reserve.

Non-performing loans and leases decreased from \$28.0 million on December 31, 2012 to \$25.0 million on March 31, 2013. The allowance for loan and lease losses as a percent of total loans was 1.36% of total loans on March 31, 2013, compared to 1.35% as of December 31, 2012. 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. The preceding statement constitutes a forward-looking statement under the Private Securities Litigation Reform Act of 1995.

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 March 31, 2013. The preceding statement constitutes a forward-looking statement under the Private Securities Litigation Reform Act of 1995.

## **Investment Securities**

For detailed information on the composition and maturity distribution of the Company's investment securities portfolio, see the Notes to Consolidated Financial Statements contained in this Form 10-Q. Total investment securities decreased from \$490.6 million on December 31, 2012 to \$467.1 million on March 31, 2013, a decrease of \$23.5 million, or 5%.

## **Deposits**

Total deposits increased from \$2.37 billion on December 31, 2012 to \$2.39 billion on March 31, 2013, an increase of \$17.7 million, or 1%. Noninterest bearing deposits increased \$23.0 million, or 5%, to \$521.0 million, while savings and interest-bearing transaction accounts and time deposits decreased \$2.7 million and \$2.6 million, respectively. The increase in noninterest bearing deposits resulted primarily from an increase in commercial noninterest bearing deposits.

## **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:

Net income. Cash provided by operating activities was \$11.7 million for the first three months of 2013 compared to \$13.6 million for the same period in 2012.

Deposits. Lakeland can offer new products or change its rate structure in order to increase deposits. In the first three months of 2013, Lakeland generated \$17.7 million in deposit growth.

Sales of securities and overnight funds. At March 31, 2013, the Company had \$370.2 million in securities designated available for sale. Of these securities, \$270.3 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.



**Table of Contents**

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 March 31, 2013. Lakeland also has overnight federal funds lines available for it to borrow up to \$162.0 million. Lakeland had borrowings against these lines of \$46.0 million at March 31, 2013. 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 March 31, 2013.

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 three months ended March 31, 2013 follows.

Cash and cash equivalents totaling \$97.1 million on March 31, 2013, decreased \$10.5 million from December 31, 2012. Operating activities provided \$11.7 million in net cash. Investing activities used \$5.2 million in net cash, primarily reflecting an increase in loans and leases offset by declines in investment securities. Financing activities used \$17.0 million in net cash, reflecting a \$23.0 million decrease in federal funds purchased and securities sold under agreement to repurchase and repayments of \$10.0 million in other borrowings, partially offset by a net increase of \$17.7 million in deposits. 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 March 31, 2013. Interest on subordinated debentures and long-term borrowed funds is calculated based on current contractual interest rates.

	Total	Within one year	After one but within three years	After three but within five years	After five years
(dollars in thousands)					
Minimum annual rentals on noncancellable operating leases	\$ 19,790	\$ 2,207	\$ 4,059	\$ 2,866	\$ 10,658
Benefit plan commitments	4,685	185	300	390	3,810
Remaining contractual maturities of time deposits	301,209	224,435	61,127	14,824	823
Subordinated debentures	51,548				51,548
Loan commitments	458,151	378,714	53,223	868	25,346
Other borrowings	75,000		45,000	30,000	
Interest on other borrowings*	40,622	3,588	7,185	6,186	23,663
Standby letters of credit	7,686	5,527	2,079		80
<b>Total</b>	<b>\$ 958,691</b>	<b>\$ 614,656</b>	<b>\$ 172,973</b>	<b>\$ 55,134</b>	<b>\$ 115,928</b>

\* Includes interest on other borrowings and subordinated debentures at a weighted rate of 2.87%.



**Table of Contents****Capital Resources**

Total stockholders' equity increased from \$280.9 million on December 31, 2012 to \$283.9 million on March 31, 2013, an increase of \$3.0 million, or 1%. Book value per common share increased to \$9.51 on March 31, 2013 from \$9.45 on December 31, 2012. The increase in stockholders' equity from December 31, 2012 to March 31, 2013 was primarily due to \$5.1 million in net income partially offset by the payment of dividends on common stock of \$1.8 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 March 31, 2013, that the Company and Lakeland meet all capital adequacy requirements to which they are subject.

The capital ratios for the Company and Lakeland at March 31, 2013 are as follows:

	Tier 1 Capital to Total Average Assets Ratio March 31, 2013	Tier 1 Capital to Risk-Weighted Assets Ratio March 31, 2013	Total Capital to Risk-Weighted Assets Ratio March 31, 2013
<b>Capital Ratios:</b>			
The Company	8.77%	11.59%	12.84%
Lakeland Bank	8.10%	10.70%	11.95%
Well capitalized institution under FDIC Regulations	5.00%	6.00%	10.00%

**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.

**Table of Contents**

(dollars in thousands, except per share amounts)	March 31, 2013	December 31, 2012
<b>Calculation of tangible book value per common share</b>		
Total common stockholders' equity at end of period GAAP	\$ 283,877	\$ 280,867
Less:		
Goodwill	87,111	87,111
<b>Total tangible common stockholders' equity at end of period Non-GAAP</b>	<b>\$ 196,766</b>	<b>\$ 193,756</b>
Shares outstanding at end of period (1)	29,859	29,726
<b>Book value per share GAAP (1)</b>	<b>\$ 9.51</b>	<b>\$ 9.45</b>
<b>Tangible book value per share Non-GAAP (1)</b>	<b>\$ 6.59</b>	<b>\$ 6.52</b>

(1) Adjusted for 5% stock dividend granted April 16, 2012 to shareholders of record March 30, 2012.

<b>Calculation of tangible common equity to tangible assets</b>		
Total tangible common stockholders' equity at end of period Non-GAAP	\$ 196,766	\$ 193,756
Total assets at end of period	\$ 2,907,969	\$ 2,918,703
Less:		
Goodwill	87,111	87,111
Total tangible assets at end of period Non-GAAP	\$ 2,820,858	\$ 2,831,592
<b>Common equity to assets GAAP</b>	<b>9.76%</b>	<b>9.62%</b>
<b>Tangible common equity to tangible assets Non-GAAP</b>	<b>6.98%</b>	<b>6.84%</b>

	For the Three Months Ended,	
	March 31, 2013	March 31, 2012
<b>Calculation of return on average tangible common equity</b>		
Net income GAAP	\$ 5,108	\$ 4,971
Total average common stockholders' equity	\$ 282,796	\$ 242,957
Less:		
Average goodwill	87,111	87,111
Average other identifiable intangible assets, net		
<b>Total average tangible common stockholders' equity Non-GAAP</b>	<b>\$ 195,685</b>	<b>\$ 155,846</b>
Return on average common stockholders' equity GAAP	7.33%	8.23%
<b>Return on average tangible common stockholders' equity Non-GAAP</b>	<b>10.59%</b>	<b>12.83%</b>



**Table of Contents****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 \$96.8 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%
March 31, 2013	-3.3%	-2.1%
December 31, 2012	-4.9%	-2.2%

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							
	+400 bp	+300 bp	+200 bp	+100 bp	-100 bp	-200 bp	-300 bp	-400 bp
Asset/Liability Policy Limit	-20.0%	-15.0%	-10.0%	-5.0%	-5.0%	-10.0%	-15.0%	-20.0%
March 31, 2013	-6.9%	-4.9%	-2.9%	-1.0%	-3.8%	-4.3%	-4.5%	-4.5%
December 31, 2012	-8.7%	-6.4%	-4.2%	-2.1%	-4.1%	-4.6%	-4.6%	-4.6%

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 March 31, 2013 (the base case) was \$352.6 million. The information provided for the net portfolio value assumes fluctuations or rate shocks of plus 200 basis points and minus 200 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%			-25.0%	-35.0%
March 31, 2013	-16.1%	-9.4%	-3.6%	-3.3%	-7.0%	-7.2%
December 31, 2012	-14.6%	-7.4%	-2.3%	-5.1%	-8.9%	-7.8%

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, 2012.

**Table of Contents**

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 March 31, 2013 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**

On February 15, 2013, the Company was served with a Civil Action Summons and Class Action Complaint that was filed in the Superior Court of New Jersey, Chancery Division, Somerset County. The complaint states that the plaintiff is bringing the class action on behalf of the public stockholders of Somerset Hills Bancorp against the Board of Directors of Somerset Hills for their alleged breach of fiduciary duties arising out of the Agreement and Plan of Merger, dated as of January 28, 2013, by and between the Company and Somerset Hills Bancorp. The complaint alleges that the Company has aided and abetted the individual defendants in their alleged breaches of fiduciary duties.

On or about April 4, 2013, the Company and Somerset Hills Bancorp began mailing the definitive joint proxy statement and prospectus (the Proxy Statement ) to their respective shareholders for their respective Annual Meetings of Shareholders scheduled for May 8, 2013. At Somerset Hill s Annual Shareholders Meeting, shareholders will be asked, among other things, to approve the proposed merger agreement under which Somerset Hills would merge with and into the Company. At the Company s Annual Shareholders Meeting, shareholders will be asked, among other things, to authorize the issuance of shares of the Company s common stock to the shareholders of Somerset Hills upon consummation of the merger.

On March 27, 2013, the plaintiff filed an Amended Complaint, alleging, among other things, inadequate disclosure in the Proxy Statement. On April 26, 2013, the defendants entered into a Memorandum of Understanding with the lead plaintiff regarding settlement of the action. As part of the settlement, the Registrant agreed to make certain additional disclosures, which are contained in a Current Report on Form 8-K filed on April 29, 2013. The Memorandum of Understanding contemplates that the parties will enter into a stipulation of settlement, which will be subject to customary conditions, including the consummation of the merger and court approval following notice. In the event that the parties enter into a stipulation of settlement, a hearing will be scheduled at which the Court will consider the fairness, reasonableness and adequacy of the settlement which, if finally approved by the Court, will resolve all of the claims that were or could have been brought in the action being settled, including all claims relating to the merger, the merger agreement and any disclosures made in connection therewith. The Court will also need to approve the conditional certification of the class of plaintiffs at such hearing. In addition, in connection with the settlement, the parties contemplate that the lead plaintiff s counsel will petition the Court for an award of attorneys fees and expenses to be paid by the Company and/or Somerset Hills. There can be no assurance that the parties will ultimately enter into a stipulation of settlement or that the Court will approve the settlement even if the parties were to enter into such a stipulation. In the event that neither of these occurs, the proposed settlement as contemplated by the Memorandum of Understanding may be terminated. The settlement will not affect the timing of consummation of the merger or the amount or nature of the merger consideration to be paid to the shareholders of the Company in the merger.

Other than as described above, 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, 2012.

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	

**Table of Contents**

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

\* Pursuant to Rule 406T of Regulation S-T, this interactive data file is deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.

**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: May 10, 2013