LAKELAND BANCORP INC
Form 10-Q
November 09, 2012
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SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark one)

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

For the quarterly period ended September 30, 2012

OR

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

For the transition period from to

Commission file number 000-17820

LAKELAND BANCORP, INC.

(Exact name of registrant as specified in its charter)

New Jersey	**22-2953275**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
250 Oak Ridge Road,	
Oak Ridge, New Jersey	**07438**
(Address of principal executive offices)	**(Zip Code)**

(973) 697-2000

(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x 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 x 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	x
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 x

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

As of October 25, 2012 there were 29,692,241 outstanding shares of Common Stock, no par value.

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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.

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Lakeland Bancorp, Inc. and Subsidiaries

CONSOLIDATED BALANCE SHEETS

	September 30, 2012 (unaudited)	December 31, 2011
	(dollars in thousands except share and per share amounts)	
ASSETS:		
Cash	$ 95,702	$ 60,688
Interest-bearing deposits due from banks	7,349	11,870
Total cash and cash equivalents	103,051	72,558
Investment securities available for sale, at fair value	419,449	463,611
Investment securities held to maturity; fair value of $99,237 at September 30, 2012 and $74,274 at December 31, 2011	95,996	71,700
Federal Home Loan Bank Stock, at cost	5,849	8,333
Loans, net of deferred costs	2,064,779	2,041,575
Less: allowance for loan and lease losses	28,669	28,416
Net loans	2,036,110	2,013,159
Premises and equipment, net	33,237	27,917
Accrued interest receivable	8,065	8,369
Goodwill	87,111	87,111
Bank owned life insurance	45,773	44,760
Other assets	25,006	28,432
TOTAL ASSETS	$ 2,859,647	$ 2,825,950
LIABILITIES		
Deposits:		
Noninterest bearing	$ 485,256	$ 449,560
Savings and interest-bearing transaction accounts	1,535,422	1,440,541
Time deposits under $100 thousand	196,939	211,797
Time deposits $100 thousand and over	123,491	147,755
Total deposits	2,341,108	2,249,653
Federal funds purchased and securities sold under agreements to repurchase	54,581	72,131
Other borrowings	95,000	155,000
Subordinated debentures	77,322	77,322
Other liabilities	14,092	12,061
TOTAL LIABILITIES	2,582,103	2,566,167
Commitments and contingencies		
STOCKHOLDERS EQUITY		
Preferred stock, Series A, no par value, $1,000 liquidation value, authorized 1,000,000 shares; issued 0 shares at September 30, 2012 and 19,000 shares at December 31, 2011		18,480
Common stock, no par value; authorized shares, 40,000,000; issued 29,941,967 shares at September 30, 2012 and 27,275,480 shares at December 31, 2011	303,719	270,044
Accumulated deficit	(27,895)	(26,061)
Treasury stock, at cost, 251,425 shares at September 30, 2012 and 439,340 at December 31, 2011	(3,163)	(5,551)

Accumulated other comprehensive income		4,883		2,871
TOTAL STOCKHOLDERS EQUITY		277,544		259,783
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$	2,859,647	$	2,825,950

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

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Lakeland Bancorp, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF INCOME - UNAUDITED

	For the Three Months Ended September 30, 2012	For the Three Months Ended September 30, 2011	For the Nine Months Ended September 30, 2012	For the Nine Months Ended September 30, 2011
	(In thousands, except per share data)			
INTEREST INCOME				
Loans, leases and fees	$ 24,929	$ 25,999	$ 75,659	$ 78,784
Federal funds sold and interest-bearing deposits with banks	17	16	29	39
Taxable investment securities and other	2,121	2,773	6,668	8,448
Tax-exempt investment securities	428	500	1,371	1,506
TOTAL INTEREST INCOME	27,495	29,288	83,727	88,777
INTEREST EXPENSE				
Deposits	2,026	2,572	6,421	8,310
Federal funds purchased and securities sold under agreements to repurchase	12	18	68	73
Other borrowings	1,802	2,347	5,889	7,038
TOTAL INTEREST EXPENSE	3,840	4,937	12,378	15,421
NET INTEREST INCOME	23,655	24,351	71,349	73,356
Provision for loan and lease losses	3,350	4,058	11,783	14,391
NET INTEREST INCOME AFTER PROVISION FOR LOAN AND LEASE LOSSES	20,305	20,293	59,566	58,965
NONINTEREST INCOME				
Service charges on deposit accounts	2,757	2,623	7,914	7,672
Commissions and fees	1,162	915	3,401	2,787
Gains on investment securities		785	273	1,229
Income on bank owned life insurance	357	356	1,035	1,070
Gains on leasing related assets	100	117	403	810
Other income	264	299	442	467
TOTAL NONINTEREST INCOME	4,640	5,095	13,468	14,035
NONINTEREST EXPENSE				
Salaries and employee benefits	9,578	9,280	28,578	27,465
Net occupancy expense	1,807	1,692	5,131	5,205
Furniture and equipment	1,205	1,172	3,427	3,561
Stationery, supplies and postage	388	298	1,079	1,058
Marketing expense	718	612	1,646	1,846
Core deposit intangible amortization		46		577
FDIC insurance expense	519	636	1,620	2,178
Collection expense	58	70	231	195
Legal expense	135	457	880	1,163
Expenses on other real estate owned and other repossessed assets	13	336	89	808
Long term debt prepayment fee		800		800
Other expenses	2,547	2,641	7,032	6,942
TOTAL NONINTEREST EXPENSE	16,968	18,040	49,713	51,798

Income before provision for income taxes	7,977	7,348	23,321	21,202
Income tax expense	2,488	2,242	7,408	6,467
NET INCOME	$ 5,489	$ 5,106	$ 15,913	$ 14,735
Dividends on Preferred Stock and Accretion		293	620	1,873
Net Income Available to Common Stockholders	$ 5,489	$ 4,813	$ 15,293	$ 12,862
PER SHARE OF COMMON STOCK				
Basic earnings	$ 0.20	$ 0.18	$ 0.56	$ 0.48
Diluted earnings	$ 0.20	$ 0.18	$ 0.56	$ 0.48
Dividends	$ 0.06	$ 0.06	$ 0.18	$ 0.17

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

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Lakeland Bancorp, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME - UNAUDITED

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in thousands)		(in thousands)	
NET INCOME	$ 5,489	$ 5,106	$ 15,913	$ 14,735
OTHER COMPREHENSIVE INCOME, NET OF TAX:				
Unrealized securities gains during period	1,220	1,067	2,174	4,171
Less: reclassification for gains included in net income	0	509	177	799
Change in pension liability, net	5	5	15	15
Other Comprehensive Income	1,225	563	2,012	3,387
TOTAL COMPREHENSIVE INCOME	$ 6,714	$ 5,669	$ 17,925	$ 18,122

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

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Lakeland Bancorp, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY - UNAUDITED

Nine Months Ended September 30, 2012

	Common stock						
	Number of Shares	Amount	Series A Preferred Stock	Accumulated deficit	Treasury Stock	Accumulated Other Comprehensive Income	Total
				(dollars in thousands)			
BALANCE January 1, 2012	25,976,648	$ 270,044	$ 18,480	($ 26,061)	($ 5,551)	$ 2,871	$ 259,783
Net Income				15,913			15,913
Other comprehensive income, net of tax						2,012	2,012
Preferred dividends				(100)			(100)
Accretion of discount			520	(520)			
Stock based compensation		559					559
Redemption of preferred stock			(19,000)				(19,000)
Warrant repurchase		(2,800)					(2,800)
Adjustment for stock dividend	1,298,066	12,345		(12,345)			
Stock issuance, net of expenses	2,667,253	25,021					25,021
Issuance of restricted stock awards		(1,153)			1,153		
Issuance of stock to dividend reinvestment and stock purchase plan		(315)		(779)	1,235		141
Exercise of stock options, net of excess tax benefits		18					18
Cash dividends, common stock				(4,003)			(4,003)
BALANCE September 30, 2012 (UNAUDITED)	29,941,967	$ 303,719	$	($ 27,895)	($ 3,163)	$ 4,883	$ 277,544

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

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Lakeland Bancorp, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF CASH FLOWS - UNAUDITED

	For the Nine Months Ended September 30, 2012	2011
	(dollars in thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 15,913	$ 14,735
Adjustments to reconcile net income to net cash provided by operating activities:		
Net amortization of premiums, discounts and deferred loan fees and costs	4,616	4,161
Depreciation and amortization	2,229	2,962
Provision for loan and lease losses	11,783	14,391
Gains on securities	(273)	(1,229)
Gains on leases	(365)	(824)
Losses (gains) on sales of other real estate and other repossessed assets	(240)	77
Gains on sales of premises and equipment	(2)	(163)
Stock-based compensation	559	474
Decrease in other assets	1,131	2,643
Increase in other liabilities	2,171	2,326
NET CASH PROVIDED BY OPERATING ACTIVITIES	37,522	39,553
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from repayments on and maturity of securities:		
Available for sale	87,327	115,072
Held to maturity	24,640	15,652
Proceeds from sales of securities		
Available for sale	53,718	92,409
Purchase of securities:		
Available for sale	(97,545)	(169,123)
Held to maturity	(49,066)	(15,299)
Net decrease in Federal Home Loan Bank Stock	2,484	3,555
Proceeds from sales of leases		16,433
Net increase in loans and leases	(35,403)	(10,414)
Proceeds from sales of other real estate and repossessed assets	1,299	1,720
Capital expenditures	(7,549)	(2,096)
Proceeds from sales of bank premises and equipment	2	321
NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES	(20,093)	48,230
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in deposits	91,455	36,677
(Decrease) increase in federal funds purchased and securities sold under agreements to repurchase	(17,550)	1,052
Proceeds from other borrowings	280,000	
Repayments of other borrowings	(340,000)	(85,000)
Redemption of preferred stock and common stock warrant	(21,800)	(20,000)
Proceeds from issuance of common stock, net of expenses	25,021	
Exercise of stock options		72
Excess tax benefits	18	29
Issuance of stock to dividend reinvestment and stock purchase plan	141	175
Dividends paid	(4,221)	(4,808)
NET CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES	13,064	(71,803)

Net increase in cash and cash equivalents	30,493	15,980
Cash and cash equivalents, beginning of period	72,558	49,278
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 103,051	$ 65,258

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

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 statement of the results of the interim periods presented. The results of operations for the quarter presented do not necessarily indicate the results that the Company will achieve for all of 2012. 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, 2011.

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.

On March 19, 2012, the Company s Board of Directors authorized a 5% stock dividend which was distributed on April 16, 2012 to holders of record as of March 30, 2012. All weighted average, actual share and per share information set forth in this Quarterly Report on Form 10-Q have been adjusted retroactively for the effects of the stock dividend.

Certain reclassifications have been made to prior period financial statements to conform to the 2012 presentation.

Note 2. Stock-Based Compensation

Share-based compensation expense of $559,000 and $474,000 was recognized for the nine months ended September 30, 2012 and 2011, respectively. As of September 30, 2012, there was unrecognized compensation cost of $1.4 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 $29,000 as of September 30, 2012 and is expected to be recognized over a period of 1.7 years.

In the first nine 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 Company s 2009 equity compensation program. These shares vest over a five year period. Compensation expense on these shares is expected to average approximately $173,000 per year for the next five years. In the first nine months of 2011, the Company granted 100,112 shares of restricted stock at a grant date fair value of $9.40 per share under the 2009 program. Compensation expense on these shares is expected to average approximately $188,000 per year over a five year period.

There were no grants of stock options in the first nine months of 2012 and 2011.

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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, 2012	598,477	$ 12.57		$
Issued				
Exercised				
Forfeited	(1,693)	12.87		
Outstanding, September 30, 2012	596,784	$ 12.57	2.34	$ 58,539
Options exercisable at September 30, 2012	585,630	$ 12.66	2.24	$ 35,045

The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value (the difference between the Company s closing stock price on the last trading day of the first nine months of 2012 and the exercise price, multiplied by the number of in-the-money options).

There were no options exercised in the first nine months of 2012. The aggregate intrinsic value of options exercised during the nine months ended September 30, 2011 was $78,000. Exercise of stock options during the first nine months of 2011 resulted in cash receipts of $72,000.

Information regarding the Company s restricted stock (all unvested) and changes during the nine months ended September 30, 2012 is as follows:

	Number of shares	Weighted average price
Outstanding, January 1, 2012	172,772	$ 8.96
Granted	91,269	9.50
Vested	(21,655)	6.96
Forfeited	(1,106)	9.29
Outstanding, September 30, 2012	241,280	$ 9.34

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Note 3. Comprehensive Income

The components of other comprehensive income are as follows:

For the quarter ended:	September 30, 2012 Before tax amount	Tax Benefit (Expense) (in thousands)	Net of tax amount	September 30, 2011 Before tax amount	Tax Benefit (Expense) (in thousands)	Net of tax amount
Net unrealized gains on available for sale securities						
Net unrealized holding gains arising during period	$ 1,933	($ 713)	$ 1,220	$ 1,701	($ 634)	$ 1,067
Less reclassification adjustment for net gains arising during the period	0	(0)	(0)	785	(276)	509
Net unrealized gains	$ 1,933	($ 713)	$ 1,220	$ 916	($ 358)	$ 558
Change in minimum pension liability	8	(3)	5	8	(3)	5
Other comprehensive income, net	$ 1,941	($ 716)	$ 1,225	$ 924	($ 361)	$ 563

For the nine months ended:	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 arising during period	$ 3,441	($ 1,267)	$ 2,174	$ 6,568	($ 2,397)	$ 4,171
Less reclassification adjustment for net gains arising during the period	273	(96)	177	1,229	(430)	799
Net unrealized gains	$ 3,168	($ 1,171)	$ 1,997	$ 5,339	($ 1,967)	$ 3,372
Change in minimum pension liability	23	(8)	15	23	(8)	15
Other comprehensive income, net	$ 3,191	($ 1,179)	$ 2,012	$ 5,362	($ 1,975)	$ 3,387

Note 4. Statement of Cash Flow Information, Supplemental Information

	For the Nine Months Ended September 30, 2012 (in thousands)	2011
Supplemental schedule of noncash investing and financing activities:		
Cash paid during the period for income taxes	$ 6,467	$ 6,084
Cash paid during the period for interest	12,504	15,609
Transfer of loans and leases into other repossessed assets and other real estate owned	651	1,547
Transfer of leases held for sale to leases held for investment		1,517

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Note 5. Earnings Per Share

All weighted average, actual share and per share information set forth in this quarterly report on Form 10-Q for the nine months ended September 30, 2012 and 2011 have been adjusted retroactively for the effects of the stock dividend distributed on April 16, 2012. The following schedule shows the Company s earnings per share for the periods presented:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
(In thousands, except per share data)	2012	2011	2012	2011
Net income available to common shareholders	$ 5,489	$ 4,813	$ 15,293	$ 12,862
Less: earnings allocated to participating securities	49	36	134	95
Net income allocated to common shareholders	$ 5,440	$ 4,777	$ 15,159	$ 12,767
Weighted average number of common shares outstanding - basic (1)	27,550	26,588	26,998	26,552
Share-based plans (1)	92	50	67	129
Weighted average number of common shares - diluted (1)	27,642	26,638	27,065	26,681
Basic earnings per share	$ 0.20	$ 0.18	$ 0.56	$ 0.48
Diluted earnings per share	$ 0.20	$ 0.18	$ 0.56	$ 0.48

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

Options to purchase 569,222 shares of common stock at a weighted average price of $12.79 per share were outstanding and were not included in the computation of diluted earnings per share for the quarter ended September 30, 2012 because the exercise price was greater than the average market price. Options to purchase 723,467 shares of common stock at a weighted average price of $12.35 per share and a warrant to purchase 1,046,901 shares of common stock at a price of $8.45 per share were outstanding and were not included in the computation of diluted earnings per share for the quarter ended September 30, 2011 because the exercise price was greater than the average market price.

Options to purchase 569,222 shares of common stock at a weighted average price of $12.79 per share were outstanding and were not included in the computation of diluted earnings per share for the nine months ended September 30, 2012 because the exercise price was greater than the average market price. Options to purchase 723,467 shares of common stock at a weighted average price of $12.35 per share were outstanding and were not included in the computation of diluted earnings per share for the nine months ended September 30, 2011 because the exercise price was greater than the average market price.

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Note 6. Investment Securities

AVAILABLE FOR SALE	September 30, 2012				December 31, 2011			
(in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government agencies	$ 51,449	$ 507	$	$ 51,956	$ 43,463	$ 140	$	$ 43,603
Mortgage-backed securities - residential	291,186	6,025	(222)	296,989	344,938	5,014	(428)	349,524
Obligations of states and political subdivisions	35,606	1,925	(42)	37,489	34,102	1,875	(9)	35,968
Other debt securities	17,585	247	(411)	17,421	20,965	72	(1,320)	19,717
Equity securities	14,855	762	(23)	15,594	14,543	306	(50)	14,799
	$ 410,681	$ 9,466	$ (698)	$ 419,449	$ 458,011	$ 7,407	$ (1,807)	$ 463,611

HELD TO MATURITY	September 30, 2012				December 31, 2011			
(in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government agencies	$ 16,123	$ 391	$	$ 16,514	$ 9,005	$ 134	$	$ 9,139
Mortgage-backed securities - residential	39,554	1,509		41,063	20,577	1,148	(1)	21,724
Obligations of states and political subdivisions	38,768	1,151	(20)	39,899	40,559	1,305	(9)	41,855
Other debt securities	1,551	210		1,761	1,559	72	(75)	1,556
	$ 95,996	$ 3,261	$ (20)	$ 99,237	$ 71,700	$ 2,659	$ (85)	$ 74,274

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

	September 30, 2012			
	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$ 5,430	$ 5,446	$ 15,077	$ 15,131
Due after one year through five years	40,630	41,300	12,488	13,115
Due after five years through ten years	55,477	57,190	26,227	27,261
Due after ten years	3,103	2,930	2,650	2,667
	104,640	106,866	56,442	58,174
Mortgage-backed securities - residential	291,186	296,989	39,554	41,063
Equity securities	14,855	15,594		
Total securities	$ 410,681	$ 419,449	$ 95,996	$ 99,237

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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 September 30, 2012	For the Three Months Ended September 30, 2011	For the Nine Months Ended September 30, 2012	For the Nine Months Ended September 30, 2011
Sale proceeds	$	$ 52,481	$ 53,718	$ 92,409
Gross gains		785	584	1,285
Gross losses			(311)	(56)
Other than temporary impairment				

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 $347.7 million and $343.7 million at September 30, 2012 and December 31, 2011, respectively, were pledged to secure public deposits and for other purposes required by applicable laws and regulations.

The following table indicates the length of time individual securities have been in a continuous unrealized loss position at September 30, 2012 and December 31, 2011:

September 30, 2012	Less than 12 months Fair value	Less than 12 months Unrealized Losses	12 months or longer Fair value	12 months or longer Unrealized Losses	Number of securities	Total Fair value	Total Unrealized Losses
	(dollars in thousands)						
AVAILABLE FOR SALE							
Mortgage-backed securities - residential	$ 17,208	$ 188	$ 8,036	$ 34	8	$ 25,244	$ 222
Obligations of states and political subdivisions	1,733	42			5	1,733	42
Other debt securities			5,572	411	2	5,572	411
Equity securities	236	23			2	236	23
	$ 19,177	$ 253	$ 13,608	$ 445	17	$ 32,785	$ 698
HELD TO MATURITY							
Obligations of states and political subdivisions	$ 2,776	$ 14	$ 395	$ 6	8	$ 3,171	$ 20
	$ 2,776	$ 14	$ 395	$ 6	8	$ 3,171	$ 20

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December 31, 2011	Less than 12 months Fair value	Unrealized Losses	12 months or longer Fair value	Unrealized Losses	Number of securities	Total Fair value	Unrealized Losses
	(dollars in thousands)						
AVAILABLE FOR SALE							
U.S. government agencies	$	$	$	$		$	$
Mortgage-backed securities - residential	81,067	398	9,201	30	23	90,268	428
Obligations of states and political subdivisions	2,171	9	20		5	2,191	9
Other debt securities	467	12	5,645	1,308	4	6,112	1,320
Equity securities	5,043	50			4	5,043	50
	$ 88,748	$ 469	$ 14,866	$ 1,338	36	$ 103,614	$ 1,807
HELD TO MATURITY							
Mortgage-backed securities - residential	$ 1,513	$ 1	$	$	1	$ 1,513	$ 1
Obligations of states and political subdivisions	790	2	395	7	4	1,185	9
Other debt securities	957	75			2	957	75
	$ 3,260	$ 78	$ 395	$ 7	7	$ 3,655	$ 85

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

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;

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

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

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

As of September 30, 2012, equity securities included $13.2 million in investment funds that do not have a quoted market price but use net asset value per share or its equivalent to measure fair value.

The funds include $2.9 million in funds that are primarily invested in community development loans that are guaranteed by the Small Business Administration (SBA). Because the funds are primarily guaranteed by the federal government there are minimal changes in market value between accounting periods. These funds can be redeemed within 60 days notice at the net asset value less unpaid management fees with the approval of the fund manager. As of September 30, 2012, 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 September 30, 2012, the amortized cost of these securities was $10.0 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.

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Note 7. Loans and Leases.

The following sets forth the composition of Lakeland s loan and lease portfolio as of September 30, 2012 and December 31, 2011:

	September 30, 2012	December 31, 2011
	(in thousands)	
Commercial, secured by real estate	$ 1,058,747	$ 1,012,982
Commercial, industrial and other	201,308	209,915
Leases	26,548	28,879
Real estate-residential mortgage	419,685	406,222
Real estate-construction	49,160	79,138
Home equity and consumer	309,465	304,190
Total loans	2,064,913	2,041,326
Plus: deferred costs, net of fees	(134)	249
Loans, net of deferred costs	$ 2,064,779	$ 2,041,575

Non-Performing Assets and Past Due Loans

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

(in thousands)	September 30, 2012	December 31, 2011
Commercial, secured by real estate	$ 10,114	$ 16,578
Commercial, industrial and other	1,533	4,608
Leases	294	575
Real estate - residential mortgage	9,235	11,610
Real estate - construction	4,097	12,393
Home equity and consumer	3,104	3,252
Total non-accrual loans and leases	$ 28,377	$ 49,016
Other real estate and other repossessed assets	774	1,182
TOTAL NON-PERFORMING ASSETS	$ 29,151	$ 50,198
Troubled debt restructurings, still accruing	$ 10,937	$ 8,856

Non-accrual loans included $3.5 million and $4.6 million of troubled debt restructurings as of September 30, 2012 and December 31, 2011, respectively.

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An age analysis of past due loans, segregated by class of loans as of September 30, 2012 and December 31, 2011, is as follows:

September 30, 2012	30-59 Days Past Due	60-89 Days Past Due	Greater Than 89 Days	Total Past Due	Current	Total Loans and Leases	Recorded Investment greater than 89 Days and still accruing
				(in thousands)			
Commercial, secured by real estate	$ 10,773	$ 3,199	$ 10,518	$ 24,490	$ 1,034,257	$ 1,058,747	$ 404
Commercial, industrial and other	1,121	482	1,534	3,137	198,171	201,308	1
Leases	78	58	294	430	26,118	26,548	
Real estate - residential mortgage	2,611	785	10,558	13,954	405,731	419,685	1,323
Real estate - construction	552	1,100	4,097	5,749	43,411	49,160	
Home equity and consumer	2,588	367	3,204	6,159	303,306	309,465	100
	$ 17,723	$ 5,991	$ 30,205	$ 53,919	$ 2,010,994	$ 2,064,913	$ 1,828
December 31, 2011							
Commercial, secured by real estate	$ 3,638	$ 1,731	$ 16,578	$ 21,947	$ 991,035	$ 1,012,982	$
Commercial, industrial and other	512	49	4,608	5,169	204,746	209,915	
Leases	397	164	575	1,136	27,743	28,879	
Real estate - residential mortgage	3,059	1,235	12,818	17,112	389,110	406,222	1,208
Real estate - construction			12,393	12,393	66,745	79,138	
Home equity and consumer	2,350	448	3,411	6,209	297,981	304,190	159
	$ 9,956	$ 3,627	$ 50,383	$ 63,966	$ 1,977,360	$ 2,041,326	$ 1,367

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Impaired Loans

Impaired loans as of September 30, 2012, September 30, 2011 and December 31, 2011 are as follows:

September 30, 2012	Recorded Investment in Impaired loans	Contractual Unpaid Principal Balance	Specific Allowance (in thousands)	Interest Income Recognized	Average Investment in Impaired loans
Loans without specific allowance:					
Commercial, secured by real estate	$ 14,263	$ 18,253	$	$ 260	$ 15,605
Commercial, industrial and other	4,927	4,938		67	3,555
Leases					
Real estate - residential mortgage	366	366		6	386
Real estate - construction	3,977	4,606			7,611
Home equity and consumer	350	350			337
Loans with specific allowance:					
Commercial, secured by real estate	3,127	3,895	313	45	4,389
Commercial, industrial and other	787	902	216		641
Leases					
Real estate - residential mortgage	288	288	43	4	384
Real estate - construction	120	997	12		331
Home equity and consumer	946	946	142	36	946
Total:					
Commercial, secured by real estate	$ 17,390	$ 22,148	$ 313	$ 305	$ 19,994
Commercial, industrial and other	5,714	5,840	216	67	4,196
Leases					
Real estate - residential mortgage	654	654	43	10	770
Real estate - construction	4,097	5,603	12		7,942
Home equity and consumer	1,296	1,296	142	36	1,283
	$ 29,151	$ 35,541	$ 726	$ 418	$ 34,185

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September 30, 2011	Recorded Investment in Impaired loans	Contractual Unpaid Principal Balance	Specific Allowance (in thousands)	Interest Income Recognized	Average Investment in Impaired loans
Loans without specific allowance:					
Commercial, secured by real estate	$ 18,858	$ 23,984	$	$ 252	$ 16,441
Commercial, industrial and other	4,103	8,185			2,883
Leases					
Real estate - residential mortgage	415	415		7	260
Real estate - construction	12,587	15,771		14	10,935
Home equity and consumer	400	485		1	19
Loans with specific allowance:					
Commercial, secured by real estate	4,453	5,465	472	24	4,395
Commercial, industrial and other	313	389	63	8	496
Leases					
Real estate - residential mortgage	501	509	75		
Real estate - construction	244	518	24		36
Home equity and consumer	157	157	24	20	753
Total:					
Commercial, secured by real estate	$ 23,311	$ 29,449	$ 472	$ 276	$ 20,836
Commercial, industrial and other	4,416	8,574	63	8	3,379
Leases					
Real estate - residential mortgage	916	924	75	7	260
Real estate - construction	12,831	16,289	24	14	10,971
Home equity and consumer	557	642	24	21	772
	$ 42,031	$ 55,878	$ 658	$ 326	$ 36,218

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December 31, 2011	Recorded Investment in Impaired loans	Contractual Unpaid Principal Balance	Specific Allowance (in thousands)	Interest Income Recognized	Average Investment in Impaired loans
Loans without specific allowance:					
Commercial, secured by real estate	$ 19,648	$ 24,922	$	$ 332	$ 14,792
Commercial, industrial and other	4,074	8,155			3,445
Leases					
Real estate - residential mortgage	415	415		29	542
Real estate - construction	12,400	16,353		14	11,231
Home equity and consumer	400	485		1	14
Loans with specific allowance:					
Commercial, secured by real estate	3,920	6,421	392	18	6,209
Commercial, industrial and other	534	647	172		768
Leases					
Real estate - residential mortgage	561	570	75	19	332
Real estate - construction	244	518	24		333
Home equity and consumer	949	963	142	34	800
Total:					
Commercial, secured by real estate	$ 23,568	$ 31,343	$ 392	$ 350	$ 21,001
Commercial, industrial and other	4,608	8,802	172		4,213
Leases					
Real estate - residential mortgage	976	985	75	48	874
Real estate - construction	12,644	16,871	24	14	11,564
Home equity and consumer	1,349	1,448	142	35	814
	$ 43,145	$ 59,449	$ 805	$ 447	$ 38,466

Interest that would have been accrued on impaired loans and leases during the first nine months of 2012 and 2011 had the loans been performing under original terms would have been $2.1 million and $2.2 million, respectively. Interest that would have accrued for the year ended December 31, 2011 was $2.9 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.

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The following table shows the Company s commercial loan portfolio as of September 30, 2012 and December 31, 2011, by the risk ratings discussed above (in thousands):

September 30, 2012 Risk Rating	Commercial, secured by real estate	Commercial, industrial and other	Real estate - construction
1	$	$ 996	$
2		11,472	
3	39,417	17,662	
4	309,519	55,617	7,865
5	618,742	85,324	29,589
5W - Watch	24,734	6,591	300
6 - Other Assets Especially Mentioned	22,656	5,360	6,528
7 - Substandard	43,509	18,286	4,758
8 - Doubtful	170		120
9 - Loss			
Total	$ 1,058,747	$ 201,308	$ 49,160

December 31, 2011 Risk Rating	Commercial, secured by real estate	Commercial, industrial and other	Real estate - construction
1	$	$	$
2		11,323	
3	26,085	17,658	11,175
4	301,490	48,835	14,185
5	575,061	95,040	36,088
5W - Watch	31,648	9,346	198
6 - Other Assets Especially Mentioned	30,666	11,708	2,315
7 - Substandard	47,861	16,005	14,866
8 - Doubtful	171		311
9 - Loss			
Total	$ 1,012,982	$ 209,915	$ 79,138

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

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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 nine months ended September 30, 2012 and the year ended December 31, 2011:

Nine Months Ended September 30, 2012	Commercial, secured by real estate	Commercial, industrial and other	Leases	Real estate - residential mortgage (in thousands)	Real estate - construction	Home equity and consumer	Total
Allowance for Loan and Lease Losses:							
Beginning Balance	$ 16,618	$ 3,477	$ 688	$ 3,077	$ 1,424	$ 3,132	$ 28,416
Charge-offs	(5,648)	(841)	(694)	(1,436)	(2,402)	(1,705)	($ 12,726)
Recoveries	106	355	463	10	36	226	$ 1,196
Provision	5,937	287	(300)	2,302	1,941	1,616	$ 11,783
Ending Balance	$ 17,013	$ 3,278	$ 157	$ 3,953	$ 999	$ 3,269	$ 28,669
Ending Balance: Individually evaluated for impairment	$ 313	$ 216	$	$ 43	$ 12	$ 142	$ 726
Ending Balance: Collectively evaluated for impairment	16,700	3,062	157	3,910	987	3,127	$ 27,943
Ending Balance	$ 17,013	$ 3,278	$ 157	$ 3,953	$ 999	$ 3,269	$ 28,669
Loans and Leases:							
Ending Balance: Individually evaluated for impairment	$ 17,390	$ 5,714	$	$ 654	$ 4,097	$ 1,296	$ 29,151
Ending Balance: Collectively evaluated for impairment	1,041,357	195,594	26,548	419,031	45,063	308,169	$ 2,035,762
Ending Balance (1)	$ 1,058,747	$ 201,308	$ 26,548	$ 419,685	$ 49,160	$ 309,465	$ 2,064,913

(1) Excludes deferred costs

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Year Ended December 31, 2011	Commercial, secured by real estate	Commercial, industrial and other	Leases	Real estate - residential mortgage (in thousands)	Real estate - construction	Home equity and consumer	Total
Allowance for Loan and Lease Losses:							
Beginning Balance	$ 11,366	$ 5,113	$ 3,477	$ 2,628	$ 2,176	$ 2,571	$ 27,331
Charge-offs	(5,352)	(5,249)	(2,858)	(1,772)	(3,636)	(3,010)	($ 21,877)
Recoveries	2,084	439	1,206	32	67	318	$ 4,146
Provision	8,520	3,174	(1,137)	2,189	2,817	3,253	$ 18,816
Ending Balance	$ 16,618	$ 3,477	$ 688	$ 3,077	$ 1,424	$ 3,132	$ 28,416
Ending Balance: Individually evaluated for impairment	$ 392	$ 172	$	$ 75	$ 24	$ 142	$ 805
Ending Balance: Collectively evaluated for impairment	16,226	3,305	688	3,002	1,400	2,990	$ 27,611
Ending Balance	$ 16,618	$ 3,477	$ 688	$ 3,077	$ 1,424	$ 3,132	$ 28,416
Loans and Leases:							
Ending Balance: Individually evaluated for impairment	$ 23,568	$ 4,608	$	$ 976	$ 12,644	$ 1,349	$ 43,145
Ending Balance: Collectively evaluated for impairment	989,414	205,307	28,879	405,246	66,494	302,841	$ 1,998,181
Ending Balance (1)	$ 1,012,982	$ 209,915	$ 28,879	$ 406,222	$ 79,138	$ 304,190	$ 2,041,326

(1) Excludes deferred costs

Lakeland also maintains a reserve for unfunded lending commitments which are included in other liabilities. This reserve was $1,232,000 and $1,015,000 at September 30, 2012 and December 31, 2011, 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.

The following table summarizes loans that have been restructured during the three months ended September 30, 2012 and 2011:

	For the Three Months Ended September 30, 2012			For the Three Months Ended September 30, 2011		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
		(Dollars in thousands)			(Dollars in thousands)	
Troubled Debt Restructurings:						
Commercial, secured by real estate	3	521	432	5	1,772	1,411
Commercial, industrial and other	2	56	52			
Leases						
Real estate - residential mortgage						
Real estate - construction						
Home equity and consumer						
	5	$ 577	$ 484	5	$ 1,772	$ 1,411

The following table summarizes loans that have been restructured during the nine months ended September 30, 2012 and 2011:

	For the Nine Months Ended September 30, 2012			For the Nine Months Ended September 30, 2011		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
		(Dollars in thousands)			(Dollars in thousands)	
Troubled Debt Restructurings:						
Commercial, secured by real estate	8	$ 1,524	$ 1,407	7	$ 3,188	$ 2,827
Commercial, industrial and other	4	4,231	4,218			
Leases						
Real estate - residential mortgage				1	415	415
Real estate - construction						
Home equity and consumer						
	12	$ 5,755	$ 5,625	8	$ 3,603	$ 3,242

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The following table summarizes as of September 30, 2012, loans that were restructured within the last 12 months that have subsequently defaulted:

	Number of Contracts	Recorded Investment
	(Dollars in thousands)	
Defaulted Troubled Debt Restructurings:		
Commercial, secured by real estate	2	$ 267
Commercial, industrial and other	1	62
Leases		
Real estate - residential mortgage		
Real estate - construction		
Home equity and consumer		
	3	$ 329

Leases

Lakeland had no leases held for sale as of September 30, 2012 and December 31, 2011. The following table shows the components of gains on leasing related assets for the periods presented:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in thousands)		(in thousands)	
Gains on sales of leases	$	$	$	$ 143
Realized gains on paid off leases	92	125	365	681
Gains (losses) on other repossessed assets	8	(8)	38	(14)
Total gains on leasing related assets	$ 100	$ 117	$ 403	$ 810

Other Real Estate and Other Repossessed Assets

At September 30, 2012, the Company had other repossessed assets and other real estate owned of $104,000 and $670,000, respectively. At December 31, 2011, the Company had other repossessed assets and other real estate owned of $236,000 and $946,000, 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 September 30,		For the Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in thousands)		(in thousands)	
Interest cost	$ 22	$ 24	$ 65	$ 72
Expected return on plan assets	(19)	(23)	(57)	(67)
Amortization of unrecognized net actuarial loss	18	12	54	36
Net periodic benefit expense	$ 21	$ 13	$ 62	$ 41

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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 September 30,		For the Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in thousands)		(in thousands)	
Service cost	$ 8	$ 6	$ 23	$ 18
Interest cost	11	12	31	36
Amortization of prior service cost	3	4	10	12
Amortization of unrecognized net actuarial loss	3	1	9	5
Net periodic benefit expense	$ 25	$ 23	$ 73	$ 71

The Company made contributions of $88,000 to the plan during each of the nine month periods ended September 30, 2012 and 2011, respectively. The Company does not expect to make any more contributions for the remainder of 2012.

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 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. The Company had no liabilities accounted for at fair value as of September 30, 2012 or December 31, 2011. During the nine months ended September 30, 2012, 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:

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September 30, 2012	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)		
Assets:				
Investment securities, available for sale				
US government agencies	$	$ 51,956	$	$ 51,956
Mortgage backed securities - residential		296,989		296,989
Obligations of states and political subdivisions		37,489		37,489
Corporate debt securities		17,421		17,421
Equity securities	2,017	13,577		15,594
Total securities available for sale	$ 2,017	$ 417,432	$	$ 419,449
December 31, 2011				
Assets:				
Investment securities, available for sale				
US government agencies	$	$ 43,603	$	$ 43,603
Mortgage backed securities - residential		349,524		349,524
Obligations of states and political subdivisions		35,968		35,968
Corporate debt securities		19,717		19,717
Equity securities	1,732	13,067		14,799
Total securities available for sale	$ 1,732	$ 461,879	$	$ 463,611

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:

September 30, 2012	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)		
Assets:				
Impaired Loans and Leases	$	$	$ 29,151	$ 29,151
Other real estate owned and other repossessed assets			774	774
December 31, 2011				
Assets:				
Impaired Loans and Leases			$ 43,145	$ 43,145
Other real estate owned and other repossessed assets			1,182	1,182

Impaired loans and leases are evaluated and valued at the time the loan is identified as impaired at the lower of cost or market value. Because most of Lakeland s impaired loans are collateral dependant, 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 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 and leases are reviewed and evaluated on at least a quarterly basis for additional impairment and adjusted accordingly, based on the same factors identified above.

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 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 a recognized valuation resource.

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 September 30, 2012 and December 31, 2011 are outlined below.

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

The fair value of Investment Securities Held to Maturity was measured using information from the same third-party servicer used for Investment Securities Available for Sale using the same methodologies discussed above.

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

The net loan portfolio at September 30, 2012 and December 31, 2011 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 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 at September 30, 2012 is based on bid/ask prices from brokers for similar types of instruments based on updated accounting guidance on fair value measurement. The junior subordinated debentures issued to Lakeland Bancorp Capital Trust III for $25.8 million were redeemed on October 7, 2012. As a result, market value equals book value in the table below. For more information see Note 12 below. As of December 31, 2011, the fair value of the subordinated debentures was based on discounted cash flows using discount rates currently offered for similar borrowing arrangements.

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

The following table presents the carrying values, fair values and placement in the fair value hierarchy of the Company s financial instruments as of September 30, 2012 and December 31, 2011:

September 30, 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)				
Financial Instruments - Assets					
Investment securities held to maturity	$ 95,996	$ 99,237	$	$ 99,237	$
Federal Home Loan Bank Stock	5,849	5,849		5,849	
Loans and leases	2,064,779	2,074,032			2,074,032
Financial Instruments - Liabilities					
Certificates of Deposit	320,430	322,461		322,461	
Other borrowings	95,000	103,756		103,756	
Subordinated debentures	77,322	56,599			56,599
Commitments:					
Standby letters of credit		13			13
December 31, 2011					
Financial Assets:					
Investment securities held to maturity	$ 71,700	$ 74,274	$	$ 74,274	$
Federal Home Loan Bank Stock	8,333	8,333		8,333	
Loans and leases	2,041,575	2,055,448			2,055,448
Financial Liabilities:					
Certificates of Deposit	359,552	362,408		362,408	
Other borrowings	155,000	165,821		165,821	
Subordinated debentures	77,322	77,973			77,973
Commitments:					
Standby letters of credit		71			71

Note 11. 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.

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Note 12. 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 13. Recent Accounting Pronouncements

In April 2011, the Financial Accounting Standards Board (the FASB) issued new accounting guidance regarding the reconsideration of effective control for repurchase agreements. This guidance modifies the criteria for determining when repurchase agreements would be accounted for as a secured borrowing rather than as a sale. Currently, an entity that maintains effective control over transferred financial assets must account for the transfer as a secured borrowing rather than as a sale. This guidance removes from the assessment of effective control the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee. The FASB believes that contractual rights and obligations determine effective control and that there does not need to be a requirement to assess the ability to exercise those rights. This guidance does not change the other existing criteria used in the assessment of effective control. The Company adopted the provisions of this guidance prospectively for transactions or modifications of existing transactions that occurred on or after January 1, 2012. As the Company accounted for all of its repurchase agreements as collateralized financing arrangements prior to the adoption of this guidance, the adoption had no impact on the Company s consolidated financial statements.

In May 2011, the FASB and the International Accounting Standards Board (the IASB) issued new accounting guidance on fair value measurement and disclosure requirements. This guidance is the result of work by the FASB and IASB to develop common requirements for measuring fair value and disclosing information about fair value measurements in accordance with U.S. GAAP and International Financial Reporting Standards (IFRS). As a result, the amendments change the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. The guidance is effective during interim and annual periods beginning after December 15, 2011. The Company adopted this guidance in the first quarter of 2012. Adoption of this guidance did not have a significant impact on the Company s consolidated financial statements.

In June 2011, the FASB issued accounting guidance updating the requirements regarding the presentation of comprehensive income to increase the prominence of items reported in other comprehensive income and to facilitate convergence of U.S. GAAP and IFRS. Under the new guidance, the components of net income and the components of other comprehensive income can be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. This guidance eliminates the option to present components of other comprehensive income as part of the changes in stockholders equity. This amendment will be applied prospectively and the amendments are effective for fiscal years and interim periods beginning after December 15, 2011. In December 2011, the FASB deferred certain aspects of this guidance related to the requirement to present items that are reclassified from accumulated other comprehensive income to net income separately with their respective components of net income and other comprehensive income. The Company adopted this guidance during the first quarter of 2012. Adoption of this guidance did not have a significant impact on the Company s consolidated financial statements, but resulted in additional disclosure.

In September 2011, the FASB issued accounting guidance related to the annual testing of goodwill for impairment. Under the new guidance, an entity has the option to first determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events or circumstances, an entity determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary. If, however, the entity concludes otherwise, then it is required to perform the first step of the two-step impairment test and then perform the second test, if required. This amendment is effective for annual and interim goodwill impairment tests performed for the fiscal years beginning after December 15, 2011. The Company adopted this guidance for its goodwill review as of November 30, 2011. Adoption did not have a significant impact on the Company s consolidated financial statements.

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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, 2011.

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 statemen Company cautions that these forward-looking statements are necessarily speculative and speak only as of the date made, and are subject to numerous assumptions, risks and uncertainties, all of which may change over time. Actual results could differ materially from such forward-looking statements.

In addition to the risk factors disclosed elsewhere in this document, the following factors, among others, could cause the Company s actual results to differ materially and adversely from such forward-looking statements: changes in the financial services industry and the U.S. and global capital markets, changes in economic conditions nationally, regionally and in the Company s markets, the nature and timing of actions of the Federal Reserve Board and other regulators, the nature and timing of legislation affecting the financial services industry including, but not limited to, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, government intervention in the U.S. financial system, changes in levels of market interest rates, pricing pressures on loan and deposit products, credit risks of the Company s lending and leasing activities, customers acceptance of the Company s products and services and competition.

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

Critical Accounting Policies, Judgments and Estimates

The accounting and reporting policies of the Company and its subsidiaries conform 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 quarter and nine months ended September 30, 2012, represented a period of earnings improvement for the Company. As discussed in this management discussion and analysis:

- Net income available to common shareholders increased $676,000, or 14%, from the third quarter of 2011 to the same period in 2012. Net income available to common shareholders increased $2.4 million, or 19%, from the first nine months of 2011 to the first nine months of 2012.

- Diluted earnings per share increased from $0.18 for the third quarter of 2011 to $0.20 for the third quarter of 2012. Diluted earnings per share increased from $0.48 for the first nine months for 2011 to $0.56 for the same period in 2012.

- Non-performing assets declined for the fourth consecutive quarter. Non-performing assets have declined $21.0 million, or 42%, from $50.2 million reported at year end.

- As a result of improving loan quality, the provision for loan and lease losses was reduced from $4.1 million in the third quarter of 2011 to $3.4 million in the third quarter of 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). As a result of CPP repayments, dividends on preferred stock and accretion of the preferred stock discount declined from $1.9 million in the first nine months of 2011 to $620,000 in the first nine months of 2012. In 2012, the Company also repurchased the outstanding common stock warrant previously issued to the Treasury for a price of $2.8 million, completing the Company s participation in the Treasury s CPP.

- In September 2012, the Company received $25.0 million in net proceeds from common stock offerings which allowed the Company to increase its tangible equity. On October 7, 2012 the Company redeemed $25.8 million in subordinated debentures that had a coupon rate of 7.535%.

- The Company continues to experience downward pressure on its net interest margin from the continuing low interest rate environment. The net interest margin declined from 3.85% in the third quarter of 2011 to 3.66% in the third quarter of 2012. The Company expects that the redemption of its 7.535% subordinated debentures will positively contribute to its net interest margin.

- Management continues to manage expenses in an effort to offset its lower net interest margins.

Results of Operations

(Third Quarter 2012 Compared to Third Quarter 2011)

Net Income

Net income for the third quarter of 2012 was $5.5 million, compared to net income of $5.1 million for the same period in 2011. Net income available to common shareholders was $5.5 million compared to net income available to common stockholders of $4.8 million for the third quarter of 2011. Diluted earnings per share was $0.20 for the third quarter of 2012, compared to diluted earnings per share of $0.18 for the same period last year. Net interest income declined $696,000 from the third quarter of 2011 to the third quarter of 2012 due to the continuing low interest rate environment. This decline was offset by declines in non-interest expense, the provision for loan and lease losses and dividends on preferred stock and accretion during that same time period.

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

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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 it 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. On October 7, 2012, the Company redeemed $25.8 million in junior subordinated debentures which will positively impact its net interest margin.

Net interest income on a tax equivalent basis for the third quarter of 2012 was $23.9 million, compared to $24.6 million earned in the third quarter of 2011. The net interest margin decreased from 3.85% in the third quarter of 2011 to 3.66% in the third quarter of 2012, primarily as a result of a 38 basis point decline in the yield on interest-earning assets, which was partially offset by a 21 basis point reduction in the cost of interest-bearing liabilities. The net interest margin would have been 3.74% and 3.97% for the third quarter of 2012 and 2011, respectively, had the Company s non-performing loans performed in accordance with their terms. The net interest spread, as a result of the low rate environment, declined 17 basis points to 3.51%. Although the net interest spread declined, the decline was 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 $52.4 million. Also mitigating the decline in the net interest margin was a change in mix in interest-bearing deposits from time deposits to lower interest-bearing transaction accounts. 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%.

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	For the Three Months Ended, September 30, 2012			For the Three Months Ended, September 30, 2011		
	Average Balance	Interest Income/ Expense	Average rates earned/ paid	Average Balance	Interest Income/ Expense	Average rates earned/ paid
			(dollars in thousands)			
Assets						
Interest - earning assets:						
Loans and leases (A)	$ 2,062,928	$ 24,929	4.81%	$ 1,982,637	$ 25,999	5.20%
Taxable investment securities and other	433,233	2,121	1.96%	447,196	2,773	2.48%
Tax-exempt securities	68,629	658	3.84%	70,998	769	4.33%
Federal funds sold (B)	33,271	17	0.20%	36,453	16	0.18%
Total interest - earning assets	2,598,061	27,725	4.25%	2,537,284	29,557	4.63%
Noninterest - earning assets:						
Allowance for loan and lease losses	(28,515)			(29,132)		
Other assets	258,339			254,153		
TOTAL ASSETS	$ 2,827,885			$ 2,762,305		
Liabilities and Stockholders Equity						
Interest - bearing liabilities:						
Savings accounts	$ 350,135	$ 92	0.10%	$ 334,909	$ 105	0.12%
Interest - bearing transaction accounts	1,169,953	1,168	0.40%	1,058,085	1,345	0.50%
Time deposits	324,355	766	0.94%	397,029	1,122	1.13%
Borrowings	234,204	1,814	3.10%	281,069	2,365	3.37%
Total interest - bearing liabilities	2,078,647	3,840	0.74%	2,071,092	4,937	0.95%
Noninterest - bearing liabilities:						
Demand deposits	477,311			424,938		
Other liabilities	14,370			12,101		
Stockholders equity	257,557			254,174		
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 2,827,885			$ 2,762,305		
Net interest income/spread		23,885	3.51%		24,620	3.68%
Tax equivalent basis adjustment		230			269	
NET INTEREST INCOME		$ 23,655			$ 24,351	
Net interest margin (C)			3.66%			3.85%

(A) Includes non-accrual loans, the effect of which is to reduce the yield earned on loans, and deferred loan fees.
(B) Includes interest-bearing cash accounts.
(C) Net interest income divided by interest-earning assets.

Interest income on a tax equivalent basis decreased from $29.6 million in the third quarter of 2011 to $27.7 million in the third quarter of 2012, a decrease of $1.8 million, or 6%. The decrease in interest income was due primarily to a 38 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 4.81% in the third quarter of 2012 was 39 basis points lower than the third quarter of 2011. The yield on average taxable and tax exempt investment securities decreased by 52 basis points and 49 basis points, respectively, compared to the third quarter of 2011. Average loans and leases at $2.06 billion increased $80.3 million from the third quarter of 2011, while average investment securities at $501.9 million decreased $16.3 million.

Total interest expense decreased from $4.9 million in the third quarter of 2011 to $3.8 million in the third quarter of 2012, a decrease of $1.1 million, or 22%. The cost of average interest-bearing liabilities decreased from 0.95% in the third quarter of 2011 to 0.74% in 2012. The decrease in yield was due to the continuing low interest rate environment along with a $72.7 million reduction in higher yielding time deposits as customers preferred to keep their deposits in short-term transaction accounts. From the third quarter of 2011 to the third quarter of 2012, average savings and interest-bearing transaction accounts increased by $15.2 million and $111.9 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 and lease review.

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In the third quarter of 2012, a $3.4 million provision for loan and lease losses was recorded, which was $708,000 lower than the provision for the same period last year. During the third quarter of 2012, the Company charged off loans and leases of $3.4 million and recovered $180,000 in previously charged off loans and leases compared to $4.5 million and $260,000, respectively, during the same period in 2011. 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 decreased $455,000, or 9%, to $4.6 million in the third quarter of 2012 compared to the third quarter of 2011 primarily due to gains on sales of investment securities which were $785,000 during the third quarter of 2011 compared to none during the same period in 2012. Service charges on deposit accounts at $2.8 million increased $134,000, or 5%, due primarily to the implementation of a new demand deposit pricing structure in the second quarter of 2012. Commissions and fees totaled $1.2 million in the third quarter of 2012 and were $247,000, or 27%, higher than the same period last year due primarily to an increase in loan fees. Gains on leasing related assets decreased $17,000 from the third quarter of 2011 to the third quarter of 2012. The decline in gains on leasing related assets reflects the reduction in the leasing portfolio.

Noninterest Expense

Noninterest expense totaling $17.0 million decreased $1.1 million in the third quarter of 2012 from the third quarter of 2011. Net occupancy expense at $1.8 million in the third quarter of 2012 increased $115,000 from the same period last year due primarily to expenses relating to the new operations and training center that was opened in the second quarter of 2012. Stationery, supplies and postage at $388,000 in the third quarter increased $90,000 primarily as a result of the opening of a new branch office and the new operations and training center. Marketing expense totaling $718,000 increased $106,000 compared to the third quarter of 2011 primarily due to expenses related to the previously mentioned branch opening. During the third quarter of 2011 the Company completed its core deposit intangible amortization, which resulted in a $46,000 decrease in that category in the third quarter of 2012 compared to the same period in 2011. Collection expense at $58,000 decreased $12,000 primarily as a result of reduced loan work out expenses, while legal expense at $135,000 decreased $322,000 partially due to a $150,000 recovery in the third quarter of 2012 of previously expensed legal fees. In the third quarter of 2011 long term debt prepayment fee was $800,000 compared to none in the third quarter of 2012. Other real estate and repossessed asset expense at $13,000 decreased $323,000. The Company s efficiency ratio, a non-GAAP financial measure, was 58.91% in the third quarter of 2012, compared to 57.01% for the same period last year as a result of a decline in revenue, offset by continued management of expenses. 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:

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	For the Three Months Ended September 30, 2012	2011
	(dollars in thousands)	
Calculation of efficiency ratio		
Total noninterest expense	$ 16,968	$ 18,040
Less:		
Amortization of core deposit intangibles		(46)
Other real estate owned and other repossessed asset expense	(13)	(336)
Long term debt prepayment fee		(800)
Provision for unfunded lending commitments	(150)	(365)
Noninterest expense, as adjusted	$ 16,805	$ 16,493
Net interest income	$ 23,655	$ 24,351
Noninterest income	4,640	5,095
Total revenue	28,295	29,446
Plus: Tax-equivalent adjustment on municipal securities	230	269
Less: gains on investment securities		(785)
Total revenue, as adjusted	$ 28,525	$ 28,930
Efficiency ratio	58.91%	57.01%

Income Tax Expense

The effective tax rate increased from 30.5% in the third quarter of 2011 to 31.2% in the third quarter of 2012 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.

(Year to Date 2012 Compared to Year to Date 2011)

Net Income

Net income for the first nine months of 2012 was $15.9 million, compared to net income of $14.7 million for the same period in 2011. Net income available to common shareholders was $15.3 million compared to net income available to common shareholders of $12.9 million for the same period last year. Diluted earnings per share was $0.56 for the first nine months of 2012, compared to diluted earnings per share of $0.48 for the same period last year. Dividends on preferred stock and accretion decreased to $620,000 in the first nine months of 2012 from $1.9 million for the same period last year. The lower dividends and accretion reflect repayments to the U.S. Department of the Treasury to repurchase preferred stock under the CPP. During the first nine months of 2012 the Company repaid the remaining $19.0 million in preferred stock to the U.S. Department of the Treasury, resulting in a non cash charge of $501,000, reflecting the acceleration of the preferred stock discount accretion. During the first nine months of 2011 the Company incurred a similar charge of $745,000, as $20.0 million in repayments to repurchase preferred stock were made during that period.

Net Interest Income

Net interest income on a tax equivalent basis for the first nine months of 2012 was $72.1 million, compared to $74.2 million earned in the first nine months of 2011. The net interest margin decreased from 3.89% in the first nine months of 2011 to 3.70% in the first nine months of 2012, primarily as a result of a 35 basis point decline in the yield on interest-earning assets, which was partially offset by a 19 basis point reduction in the cost of interest-bearing liabilities. The net

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interest margin would have been 3.82% and 4.00% for the first nine months of 2012 and 2011, respectively, had the Company s non-performing loans performed in accordance with their terms. The net interest spread declined 16 basis points to 3.55% as a result of the low rate environment. Although the net interest spread declined, the decline was 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 $54.3 million. Also mitigating the decline in the net interest margin was a change in mix in interest-bearing deposits from time deposits to lower interest-bearing transaction accounts. 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%.

CONSOLIDATED STATISTICS ON A TAX EQUIVALENT BASIS

	For the Nine Months Ended, September 30, 2012			For the Nine Months Ended, September 30, 2011		
	Average Balance	Interest Income/ Expense	Average rates earned/ paid	Average Balance	Interest Income/ Expense	Average rates earned/ paid
			(dollars in thousands)			
Assets						
Interest - earning assets:						
Loans (A)	$ 2,063,609	$ 75,659	4.90%	$ 1,988,585	$ 78,784	5.30%
Taxable investment securities and other	438,418	6,668	2.03%	461,149	8,448	2.44%
Tax - exempt securities	69,836	2,109	4.03%	69,929	2,317	4.42%
Federal funds sold (B)	27,300	29	0.14%	32,481	39	0.16%
Total interest - earning assets	2,599,163	84,465	4.34%	2,552,144	89,588	4.69%
Noninterest - earning assets:						
Allowance for loan and lease losses	(29,077)			(29,127)		
Other assets	248,240			250,841		
TOTAL ASSETS	$ 2,818,326			$ 2,773,858		
Liabilities and Stockholders Equity						
Interest - bearing liabilities:						
Savings accounts	$ 346,829	$ 274	0.11%	$ 330,103	$ 361	0.15%
Interest - bearing transaction accounts	1,149,501	3,683	0.43%	1,075,313	4,314	0.54%
Time deposits	335,947	2,464	0.98%	407,182	3,635	1.19%
Borrowings	254,394	5,957	3.12%	282,133	7,111	3.36%
Total interest - bearing liabilities	2,086,671	12,378	0.79%			