

1ST COLONIAL BANCORP INC
Form 10QSB
November 15, 2004

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-QSB

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

For the quarterly period ended September 30, 2004.

OR

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

Commission file number 333-84114

1st Colonial Bancorp, Inc.

(Exact name of registrant as specified in its charter)

Pennsylvania
(State or other jurisdiction of
incorporation or organization)

1040 Haddon Avenue
Collingswood, NJ
(Address of Principal
Executive Offices)

01-0715542
(I.R.S. Employer
Identification No.)

08108
(Zip Code)

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(856) 858-1100

(Registrant's telephone number, including area code)

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

Yes No

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

Class	Number of Shares Outstanding as of November 12, 2004
Common Stock, without par value	2,251,642

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PART 1 - FINANCIAL INFORMATION

1st COLONIAL BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

(Dollars in thousands)

	September 30, 2004 (unaudited)	December 31, 2003
Assets:		
Cash and due from banks	\$ 4,670	\$ 6,281
Federal funds sold	19,386	9,735
Interest bearing deposits		500
Investments held to maturity (fair value of \$10,747 at September 30, 2004 and \$5,796 at December 31, 2003)	10,756	5,808
Securities available for sale (amortized cost of \$34,080 at September 30, 2004 and \$28,107 at December 31, 2003)	34,013	27,985
Mortgages loans available for sale	375	281
Loans	74,233	66,550
Less: Allowance for loan losses	(946)	(768)
Net loans	73,287	65,782
Bank premises and equipment, net	980	935
Accrued interest receivable	425	373
Deferred tax assets	289	301
Other assets	266	91
Total Assets	\$ 144,447	\$ 118,072
Liabilities:		
Demand deposits	\$ 56,268	\$ 57,717
Savings deposits	28,264	20,374
Other time deposits	36,121	26,232
Total deposits	120,653	104,323
Short-term borrowings	6,402	4,087
Accrued interest payable	16	8
Taxes payable	74	48
Other liabilities	40	55
Total liabilities	\$ 127,185	\$ 108,521
Shareholders' equity:		
Common stock (no par value)		
Authorized: 5,000,000 shares, issued and outstanding: 2,251,642 shares at September 30, 2004 and 1,414,677 shares at December 31, 2003		
Preferred stock, 1,000,000 shares authorized, no shares issued		
Additional paid in capital	17,003	9,238
Retained earnings	299	386
Accumulated other comprehensive income, net	(40)	(73)
Total shareholders' equity	17,262	9,551
Total liabilities & shareholders' equity	\$ 144,447	\$ 118,072

The accompanying notes are an integral part of these statements.

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1st COLONIAL BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF INCOME

AND COMPREHENSIVE INCOME(LOSS) (UNAUDITED)

FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2004 AND 2003

(Dollars in thousands, except per share data)

	Three months ended September 30,		Nine months ended September 30,	
	2004	2003	2004	2003
Interest income:				
Interest and fees on loans	1,096	\$ 960	\$ 3,124	\$ 2,780
Interest on federal funds sold	45	23	87	68
Interest and dividends on investments:				
Taxable	241	204	632	656
Nontaxable	33	15	71	30
Total interest income	1,415	1,202	3,914	3,534
Interest expense:				
Interest on demand deposits	122	130	388	383
Interest on savings deposits	30	27	68	108
Interest on time deposits	179	128	501	410
Interest on short-term borrowings	7	11	16	35
Total interest expense	338	296	973	936
Net interest income	1,077	906	2,941	2,598
Provision for loan losses	67	60	192	180
Net interest income after provision for loan losses	1,010	846	2,749	2,418
Other income:				
Service charges on deposit accounts	35	37	107	105
Gain on sale of mortgage loans	12	41	45	91
Other income, service charges and fees	20	13	56	38
Total other income	67	91	208	234
Other expenses:				
Salaries, wages and employee benefits	343	300	975	870
Occupancy and equipment expenses	100	89	286	249
Advertising expense	39	40	76	118
Data processing expense	68	74	226	205
Professional Fees	60	45	188	159
Other Operating Expenses	171	161	524	446
Total other expenses	781	709	2,275	2,047
Income before income taxes	296	228	682	605
Income tax expense	120	92	273	244
Net income	\$ 176	\$ 136	\$ 409	\$ 361
Other comprehensive income(loss)	304	(176)	33	(162)
Total comprehensive income(loss)	\$ 480	\$ (40)	\$ 442	\$ 199

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Net income per share information:

Basic earnings per share	\$	0.08	\$	0.10	\$	0.22	\$	0.26
Diluted earnings per share	\$	0.08	\$	0.09	\$	0.21	\$	0.25

The accompanying notes are an integral part of these statements.

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1st COLONIAL BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(Dollars in thousands)

	For the Nine Months Ended September 30,	
	2004	2003
Net income	\$ 409	\$ 361
Adjustments to reconcile net income to net cash provided/(used) by operating activities:		
Depreciation and amortization	110	83
Amortization of premium (discount) on securities, net	117	143
Amortization of deferred loan fees/cost, net	6	23
Deferred taxes	(10)	(5)
Gain on sale of mortgage loans available for sale	(45)	(91)
Loss on retirement of fixed assets	2	
Provision for loan losses	192	180
Cash disbursed for mortgage banking activities	(11,114)	(19,639)
Cash received for mortgage banking activities	11,065	19,287
Increase in accrued interest receivable	(52)	(78)
Increase in other assets	(175)	(141)
Increase(decrease) in accrued interest payable	8	(3)
Increase(decrease) in income taxes payable	26	(11)
(Decrease)increase in other liabilities	(15)	27
Total Adjustments	115	(225)
Net cash provided by operating activities	524	136
Cash flows used in investing activities:		
Proceeds from maturity and sale of securities available-for-sale	7,200	24,001
Proceeds from maturity of securities held to maturity	5,004	613
Purchases of securities available-for-sale	(16,201)	(29,278)
Purchases of securities held to maturity	(9,952)	(5,068)
Repayment of principal of securities available-for-sale	2,911	4,040
Increase in loans receivable, net	(7,703)	(9,527)
Capital expenditures	(157)	(280)
Net cash used in investing activities	(18,898)	(15,499)
Cash flows from financing activities:		
Net increase in deposits	16,330	15,384
Net increase(decrease) in short-term borrowings	2,315	(1,538)
Exercise of warrants	78	7
Net proceeds from sale of common stock	7,191	(9)
Net cash provided by financing activities	25,914	13,844
Net increase(decrease) in cash and cash equivalents	7,540	(1,519)
Cash and cash equivalents as of beginning of period	16,516	12,161
Cash and cash equivalents as of September 30,	\$ 24,056	\$ 10,642
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Interest	\$ 965	\$ 933

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Income taxes	257	258
Noncash items:		
Change in unrealized gains for securities available-for-sale, net of taxes of (\$22)for 2004 and \$98 for 2003	33	(162)
Transferred from retained earnings to additional Paid in capital as a result of the 5% stock dividend	496	279

The accompanying notes are an integral part of these statements.

NOTES TO FINANCIAL STATEMENTS

Note 1. General

1st Colonial Bancorp, Inc. (the Company) was formed on February 26, 2002 pursuant to the filing of Articles of Incorporation with the Commonwealth of Pennsylvania. Prior to June 30, 2002, the Company did not have any material assets or liabilities. On June 30, 2002, the Company acquired 1st Colonial National Bank (the Bank) pursuant to the merger of the Bank with and into Interim 1st Colonial National Bank (Interim), a wholly-owned subsidiary of the Company. The acquisition was part of the reorganization of the Bank from a stand-alone national bank to a bank holding company structure.

In the reorganization, each existing shareholder of the Bank received an equal number of shares of the Company's common stock in exchange for his or her Bank common stock. The shares of the Company's common stock issued in the reorganization were registered under the Securities Act of 1933, as amended, pursuant to the Company's Registration Statement No. 333-84114 filed with the SEC. The reorganization was accounted for in a manner similar to a pooling of interests. The Bank's business and operations were unchanged by the reorganization and merger.

Note 2. Summary of Significant Accounting Policies

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiary, 1st Colonial National Bank. Any material intercompany balances and transactions have been eliminated in consolidation.

In the opinion of management, the accompanying unaudited financial statements contain adjustments consisting only of normal recurring adjustments, necessary to present fairly the consolidated financial position of the Company as of September 30, 2004 and December 31, 2003 and the consolidated results of operations for the three and nine month periods ended September 30, 2004 and 2003. The accounting policies and reporting practices of the Company are in accordance with U.S. generally accepted accounting principles and have been followed on a consistent basis.

The accompanying financial statements have been prepared in accordance with instructions for Form 10-QSB and accordingly do not include all of the detailed schedules, information and notes necessary for a fair presentation of financial condition, results of operations and cash flows in accordance with U.S. generally accepted accounting principles.

The results of operations for the three and nine months ended September 30, 2004 are not necessarily indicative of the results to be expected for the full year.

The preparation of financial statements in conformity with U.S. generally accepted accounting 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 and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of the allowance for loan losses and the valuation of the deferred tax assets.

Note 3. Earnings Per Share

Basic earnings per common share is calculated on the basis of the weighted average number of common shares outstanding. Diluted earnings per common share includes dilutive common stock equivalents as computed under the treasury stock method using average common stock prices for the respective period. All share and per share amounts have been adjusted to account for the 5% stock dividend paid on April 15, 2004 and the 5% stock dividend paid on April 15, 2003. Options and warrants to purchase 501,659 and 456,338 shares of common stock were outstanding at September 30, 2004 and 2003, respectively, and to the extent dilutive, were included in the computation of earnings per diluted common share.

The following is a reconciliation of the numerators and denominators of the basic and diluted earnings per common share calculations.

(Dollars are in thousands, except per share data)

	Three months ended September 30,		Nine months ended September 30,	
	2004	2003	2004	2003
Numerator:				
Net Income	\$ 176	\$ 136	\$ 409	\$ 361
Denominator for basic earnings per share- weighted average shares				
	2,251	1,411	1,898	1,411
Effect of dilutive securities(1):				
Director and employee stock options	11	11	14	7
Warrants	21	27	40	12
Denominator for diluted earnings per share- weighted average shares and assumed exercised				
	2,283	1,449	1,952	1,430
Basic earnings per share	\$ 0.08	\$ 0.10	\$ 0.22	\$ 0.26
Diluted earnings per share	\$ 0.08	\$ 0.09	\$ 0.21	\$ 0.25

(1) For the three months ended September 30, 2004, 57,300 options and 97,023 warrants are anti-dilutive and are not included in the above calculations. For the nine months ended September 30, 2004, 48,300 options are anti-dilutive and are not included in the above calculations. For the three months ended September 30, 2003, all warrants and options were dilutive and are included in the above calculations. For the nine

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months ended September 30, 2003, 97,023 warrants and 11,026 options are anti-dilutive and are not included in the above calculations.

Warrants were issued to the Bank's underwriter in connection with the Bank's initial public offering of common stock in June 2000. The total number of these warrants outstanding at September 30, 2004 entitled the holders to purchase 97,023 shares of common stock at a purchase price of \$9.56 per share. These warrants are exercisable until June 29, 2005.

On June 29, 2000, the Bank issued stock options to the Bank's employees entitling them to purchase a total of 17,224 shares of Bank common stock. Eighty percent of these options have vested and are exercisable, and the remainder will vest and become exercisable on June 29, 2005. These options are exercisable at \$6.60 per share for a period of ten years after the grant date. At September 30, 2004, all of these options were still outstanding.

On June 29, 2000, the Bank also issued stock options to the Bank's directors entitling them to purchase a total of 5,230 shares of Bank common stock. These options are fully vested and exercisable at \$6.60 per share for a period of ten years after the date of the grant. Of these options, at September 30, 2004, options to purchase 4,619 shares were still outstanding.

In April 2001, options to purchase a total of 7,277 shares of Bank common stock were granted to the Bank's directors at an exercise price of \$8.25 per share. These options are fully vested and expire ten years from the date of the grant. Of these options, at September 30, 2004, options to purchase 6,384 shares were still outstanding.

In June 2001, options to purchase a total of 4,315 shares of Bank common stock were granted to certain Bank employees at an exercise price of \$8.25 per share, 60% of which are vested and an additional 20% become vested on each anniversary of the grant date. These options expire ten years from the date of the grant. At September 30, 2004, all of these options were still outstanding.

On February 20, 2002, options to purchase a total of 11,030 shares of Bank common stock were granted to certain Bank employees at an exercise price of \$9.30 per share. At September 30, 2004, 10,753 of these options were still outstanding, 40% of which are vested and an additional 20% become vested on each anniversary of the grant date. These options expire ten years from the date of the grant.

On June 12, 2002, options to purchase a total of 8,895 shares of Bank common stock were granted to the Bank's directors at an exercise price of \$8.69 per share. These options are fully vested and expire ten years from the date of the grant. At September 30, 2004, all of these options were still outstanding.

When the Company became the holding company for the Bank in June 2002, all outstanding warrants and options issued by the Bank with respect to Bank common stock became warrants and stock options to purchase the common stock of the Company.

Warrants were issued to purchasers of the Company's common stock in an offering that closed on December 16, 2002. Warrants were issued to purchase up to 280,475 shares of the Company's common stock at a price of \$8.71 per share. These warrants are immediately exercisable and expire on December 16, 2005. At September 30, 2004, 267,958 of these warrants were still outstanding.

On January 15, 2003, options to purchase a total of 11,028 shares of Company common stock were granted to certain Bank employees at an exercise price of \$7.82 per share, 20% of which are vested and an additional 20% become vested on each anniversary of the grant date. These options expire ten years from the date of the grant. At September 30, 2004, all of these options were still outstanding.

On January 15, 2003, options to purchase a total of 8,280 shares of Company common stock were granted to the Bank's directors at an exercise price of \$7.82 per share. These options are fully vested and expire ten years from the date of the grant. At September 30, 2004, all of these options were still outstanding.

On April 22, 2003, options to purchase a total of 7,880 shares of Company common stock were granted to the Bank's directors at an exercise price of \$8.71 per share. These options are fully vested and expire ten years from the date of the grant. At September 30, 2004, all of these options were still outstanding.

On January 2, 2004, options to purchase a total of 32,550 shares of common stock were granted to certain Bank employees at an exercise price of \$10.89 per share. These options become fully vested one year from the date of the grant and expire ten years from the date of the grant. At September 30, 2004, all of these options were still outstanding.

On January 2, 2004, options to purchase a total of 15,750 shares of common stock were granted to the Bank's directors at an exercise price of \$10.89 per share. These options become fully vested eleven months from the date of the grant and expire ten years from the date of the grant. At September 30, 2004, all of these options were still outstanding.

On May 19, 2004 options to purchase a total of 9,000 shares of common stock were granted to the Bank's directors at an exercise price of \$9.88 per share. These options become fully vested eleven months from the date of the grant and expire ten years from the date of the grant. At September 30, 2004, all of these options were outstanding.

Note 4. Allowance for Loan Losses

The Bank determines the provision for loan losses through a quarterly analysis of the allowance for loan losses. Factors such as changes in the nature and volume of the portfolio, overall portfolio quality, concentrations of credit risk, review of specific problem loans, current economic conditions and trends that may affect the ability of borrowers to pay, and prior loss experience within the various categories of the portfolio are considered when reviewing the risks in the portfolio. All loans greater than \$100,000 and all classified loans are analyzed

individually. While management believes the allowance for loan losses is currently appropriate, future additions to the allowance may be necessary based on changes in general economic conditions and/or the condition of specific borrowers. The allowance is reviewed quarterly by the Board of Directors and senior management of the Bank. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the allowance for loan losses. Such agencies may require the Bank to recognize additions to the allowance based on their judgments about information available to them at the time of their examination.

In addition to management review, an external service provides a detailed loan review analysis. In the course of a year, all loans in excess of \$100,000 are reviewed and rated by this external source. In addition, other smaller loans are reviewed on a random basis.

At each quarterly review cycle, all classified loans are assigned a specific reserve allocation based on the guidelines established in the Bank's credit policy which was approved by the Board of Directors. These could range from 2.5%-10% of the principal balance of special mention loans; 10%-25% of substandard loans; 50%-75% of loans rated doubtful and 100% of any loan rated loss.

The principal balance of any classified loan is deducted from the general portfolio classification. The general category is currently segregated by commercial real estate loans, commercial and industrial loans, residential real estate loans, construction loans and other consumer loans. Each category of loan is then assigned loss factors based on a review of the following areas: (i) historical losses (due to limited loss experience, we use the loss experience of peer banks as reported in the Uniform Bank Performance Report); (ii) policies and procedures; (iii) economic conditions; (iv) nature and volume; (v) management; (vi) oversight; (vii) concentrations; and (viii) external factors. After the deduction of the classified loans, the sum of the assigned loss factors is then applied to the outstanding balance of the respective category.

Note 5. Litigation

We are periodically parties to or otherwise involved in legal proceedings arising in the normal course of business, such as claims to enforce liens, claims involving the making and servicing of real property loans, and other issues incident to our business. We do not believe that there is any pending or threatened proceeding against us which, if determined adversely, would have a material effect on our business or financial position.

Note 6. Stock Options

At September 30, 2004, the Company has two stock-based compensation plans, which are described more fully in note 3. The Company accounts for those plans under the recognition and measurement principles of APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations. No stock-based employee compensation cost is reflected in net income, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition

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provision of FASB Statement No. 123, *Accounting for Stock-Based Compensation*, to stock-based employee compensation.

	Three Months Ended					
	As reported	September 30, 2004 Pro forma Compensation expense	Pro forma earnings	As reported	September 30, 2003 Pro forma Compensation expense	Pro forma earnings
Net income	\$ 176	92	84	136	25	111
Basic earnings per share	0.08	0.04	0.04	0.10	0.02	0.08
Dilutive earnings per share	0.08	0.04	0.04	0.09	0.01	0.08

	Nine Months Ended					
	As reported	September 30, 2004 Pro forma Compensation expense	Pro forma earnings	As reported	September 30, 2003 Pro forma Compensation expense	Pro forma earnings
Net income	\$ 409	247	162	361	77	284
Basic earnings per share	0.22	0.13	0.09	0.26	0.06	0.20
Dilutive earnings per share	0.21	0.13	0.08	0.25	0.05	0.20

Note 7. Common Stock Offering

On April 26, 2004, the Company completed its offering of common stock. In the offering, the Company sold, through Ryan Beck & Co., Inc. as underwriter, 828,000 shares at an offering price of \$10.00 per share. Net proceeds were \$7.2 million. The proceeds are being used to fund, among other things, the continued growth of the Bank, including the establishment of additional branches.

Note 8. Recent Accounting Pronouncements

In September 2004, the Emerging Issues Task Force (EITF) issued Financial Accounting Standards Board (FASB) Staff Position (FSP) EITF Issue No. 03-1-1, *Effective Date of Paragraphs 10-20 of EITF Issue No. 03-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*. The proposed FSP would provide implementation guidance with respect to debt securities that are impaired solely due to interest rates and/or sector spreads and analyzed for other-than-temporary impairment under paragraph 16 of EITF Issue No. 03-1. The Board has directed the FASB staff to delay the effective date for the measurement and recognition guidance contained in paragraphs 10-20 of EITF Issue No. 03-1. This delay does not suspend the requirement to recognize other-than-temporary impairments as required by existing authoritative literature. The delay of the effective date for paragraphs 10-20 of EITF Issue No. 03-1 will be superseded concurrently with the final issuance of proposed FSB EITF Issue No. 03-1-a, *Implication Guidance for the Application of Paragraph 16 of EITF Issue No. 03-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*. The disclosure guidance in paragraphs 21 and 22 of E

ITF Issue No. 03-1 remains effective. The Company will evaluate any potential impact of this revised proposed statement when it is available.

In March 2004, the FASB issued an exposure draft, *Share-Based Payment - An Amendment of Statements No. 123 and 95* that addresses the accounting for equity-based compensation arrangements, including employee stock options. Upon implementation of the changes proposed in this statement, entities would no longer be able to account for equity-based compensation using the intrinsic value method under Opinion No. 25. Entities would be required to measure the cost of employee services received in exchange for awards of equity instruments at the grant date of the award using a fair value based method. The comment period for this proposed statement ended on June 30, 2004. In October 2004, FASB announced that for public entities, this proposed statement would apply prospectively for reporting periods, beginning after June 15, 2005 as if all equity-based compensation awards granted, modified or settled after December 15, 1994 had been accounted for using a fair value based method of accounting. The Company is currently evaluating the potential impact of the proposed statement.

Note 9. Comprehensive Income

Accounting principles generally require that recognized revenue, expense, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available for sales securities are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income. The components of other comprehensive income (loss) and related tax effects were as follows:

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	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Unrealized holding gains (losses) on available for sale securities	505	(283)	55	(260)
Reclassification adjustment for gains realized in income				
Net unrealized gain (losses)	505	(283)	55	(260)
Income tax effect	(201)	107	(22)	98
Other comprehensive income (loss)	304	(176)	33	(162)

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

GENERAL

The following presents management's discussion and analysis of our financial condition and results of operations and should be read in conjunction with the financial statements and related notes included in the Company's Form 10-KSB for the year ended December 31, 2003 filed with the Securities and Exchange Commission on March 23, 2004. This Form 10-QSB contains forward-looking statements. You can find many of these statements before and after words such as may, could, should, will, would, believe, expect, anticipate, estimate, plan, seek, assume or similar expressions.

These forward-looking statements, implicitly and explicitly, include the assumptions underlying the statements and other information with respect to our beliefs, plans, objectives, goals, expectations, anticipations, estimates, intentions, financial condition, results of operations, future performance and business, including our:

plans for the use of the net proceeds of our underwritten public offering of 828,000 shares of common stock, which was completed on April 26, 2004;

expectations for continued acceptance and success in the banking and business communities in our market area;

expectations as to the amount, mix, yield and other characteristics of the deposits and loans we expect to acquire and make; and

expectations and estimates with respect to our revenues, expenses, earnings, return on equity, return on assets, efficiency ratio, asset quality and other financial data and capital and performance ratios.

Although we believe that the expectations reflected in our forward-looking statements are reasonable, these statements involve risks and uncertainties that are subject to change based on various important factors (some of which are beyond our control). The following factors, among others, could cause our financial performance to differ materially from our goals, plans, objectives, intentions, expectations, and other forward-looking statements:

the strength of the United States economy in general and the strength of the regional and local economies in which we conduct operations;

the effects of, and changes in, trade, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System;

inflation, interest rate, market and monetary fluctuations;

our ability to branch in successful locations;

our ability to maintain and continue to obtain the desired customers and employees;

our timely development of new products and services in a changing environment, including the features, pricing and quality compared to the products and services of our competitors;

the willingness of prospective customers to substitute our products and services for the bank products and services they currently use, and the impact of competition from banks, thrifts and others in our market;

changes in the timing and structure of our growth and related transactions and other changed facts and circumstances resulting from the passage of time;

the impact of changes in financial services policies, laws and regulations, including laws, regulations and policies concerning taxes, banking, securities and insurance, and the application thereof by regulatory bodies;

technological changes;

change in consumer spending and savings habits; and

regulatory or judicial proceedings.

If one or more of the factors affecting our forward-looking information and statements proves incorrect, then our actual results, performance or achievements could differ materially from those expressed in, or implied by, forward-looking information and statements contained in this form 10-QSB. Therefore, we caution you not to place undue reliance on our forward-looking information and statements.

We do not intend to update our forward-looking information and statements, whether written or oral, to reflect change. All forward-looking statements attributable to us are expressly qualified by these cautionary statements.

Overview

Effective June 30, 2002, the Bank became a wholly owned subsidiary of the Company, which has no material operations other than ownership of the Bank. Therefore, the financial statements of the Company prior to June 30, 2002 are the historical statements of the Bank. All per share data has been restated for the effect of the 10% stock dividend paid on January 15, 2002 to shareholders of record as of January 2, 2002, the 5% stock dividend paid on April 15, 2003 to shareholders of record as of April 1, 2003 and the 5% stock dividend paid on April 15, 2004 to shareholders of record as of April 1, 2004.

The Bank conducts community banking activities by accepting deposits from the public and investing the proceeds in loans and investment securities. The Bank's lending products include commercial loans and lines of credit, consumer and home equity loans, and multi-family residential and non-residential real estate loans. In order to manage its liquidity and interest rate risk, the Bank maintains an investment portfolio consisting of municipal, U.S. government and mortgage-backed securities, most of which are investment grade. The Bank's loan and investment portfolios are funded with deposits as well as collateralized borrowings secured by the Bank's investment securities.

Our earnings are largely dependent upon net interest income (the difference between what we earn on our loans and investments and what we pay on deposits and borrowings). In addition to net interest income, our net income is impacted by our loan loss provision, other income (mostly deposit fees and income from sale of loans held for sale) and other expense (such as salaries and benefits, professional fees, occupancy cost and data processing expenses). In 2005, the Company will be required to comply with Section 404 of the Sarbanes-Oxley Act of 2002, which among other things requires us to formalize and document an extensive internal control structure and detailed procedures for financial reporting. It is estimated that the cost of implementation and compliance in 2005 could range from \$224,000 to \$280,000.

The Bank's main office is located at 1040 Haddon Avenue, Collingswood, New Jersey. The Bank has one additional branch located in Westville, New Jersey. At September 30, 2004, the Bank had 24 full-time and 4 part-time employees.

CRITICAL ACCOUNTING MATTERS

The preparation of financial statements in conformity with U.S. generally accepted accounting principles 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 and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of the allowance for loan losses and the valuation of the deferred tax assets.

See note 4 to the financial statements in Item 1 above for a description of the Bank's policies with respect to the allowance for loan losses.

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, as well as operating loss carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is established against deferred tax assets when, in the judgment of management, it is more likely than not that such deferred tax assets will not become available. The realizability of deferred tax assets is dependent upon various factors, including the generation of future taxable income, the existence of taxes paid and recoverable, the reversal of deferred tax liabilities, and tax planning strategies.

FINANCIAL CONDITION

The Company's assets totaled \$144.4 million at September 30, 2004, as compared to \$118.1 million at December 31, 2003, an increase of \$26.3 million or 22.3%. This increase was primarily funded by an increase of \$16.3 million in deposits and \$2.3 million in short-term borrowings. In addition, the Company realized net proceeds of approximately \$7.2 million from the sale of 828,000 shares of the Company's common stock that was completed on April 26, 2004. The Bank's assets at September 30, 2004, consisted primarily of cash and cash equivalents, including federal funds sold and interest bearing deposits, which totaled \$24.1 million, investment securities, which totaled \$44.8 million, and loans, including loans available for sale, which totaled \$74.6 million. The Bank's premises and equipment totaled \$980,000 at September 30, 2004, consisting primarily of leasehold improvements at the Collingswood main office and land and improvements for the Westville branch. The Bank's assets at December 31, 2003 consisted primarily of cash and cash equivalents, including federal funds sold and interest bearing deposits, which totaled \$16.5 million, investment securities which totaled \$33.8 million, and loans, including loans available for sale, which totaled \$66.8 million.

During the first nine months of 2004, we continued to concentrate our efforts in building our loan portfolio. Total loans, including loans available for sale, increased during such period by \$7.8 million, or 11.6%. Deposits totaled \$120.7 million at September 30, 2004, as compared to \$104.3 million at December 31, 2003, an increase of \$16.3 million or 15.7%. Non-interest bearing demand deposits totaled \$23.7 million and interest-bearing demand deposits totaled \$32.6 million at September 30, 2004, as compared to \$20.4 million and \$37.3 million, respectively, at December 31, 2003. A \$3.3 million increase in non-interest bearing demand accounts was offset by a decrease of \$2.7 million in interest bearing municipal demand deposits and a \$2.7 million decrease in interest bearing labor union demand deposits. Other interest bearing demand deposits increased by \$755,000. Savings deposits totaled \$28.3 million and certificates of deposit totaled \$36.1 million at September 30, 2004, as compared to \$20.4 and \$26.2 million, respectively, at December 31, 2003. The increase in savings deposits is primarily due to a large deposit into a money market account. There were also a number of new large certificates opened in August 2004.

RESULTS OF OPERATIONS

Three months ended September 30, 2004 compared to the three months ended September 30, 2003.

General. Net income increased 29.4% to \$176,000 for the three months ended September 30, 2004, as compared to net income of \$136,000 for the period ended September 30, 2003. This increase was due to a \$171,000 increase in net interest income, partially offset by a decrease of \$24,000 in other income and a \$72,000 increase in other expense. The provision for loan losses increased by \$7,000 to \$67,000 for the three months ended September 30, 2004 compared to the comparable period in 2003. Due to higher operating income, income tax expense increased by \$28,000.

Basic earnings per share were \$0.08 for the three months ended September 30, 2004 compared to \$0.10 for the three months ended September 30, 2003. This decrease was due primarily to the sale of 828,000 shares that was completed on April 26, 2004. For the same reason diluted earnings per share decreased to \$0.08 for the three months ended September 30, 2004 from \$0.09 for the comparable prior period.

Net Interest Income. Interest income increased by \$213,000 to \$1.4 million, primarily due to an increase in interest and fees on loans of \$136,000 for the three months ended September 30, 2004. Average loans and loans available for sale outstanding increased by \$11.9 million or 19.0% from the prior period, which more than offset the decline in the average yield on the loan portfolio. While short-term interest rates have been rising in 2004, the effective yield on loans is still below the 2003 levels. The average yield on our loan portfolio declined from 6.09% for the three month period ended September 30, 2003 to 5.86% for the current three month period due to fact that the yields on the loan portfolio do not adjust as quickly as other short term interest rates. Interest on federal funds sold and interest bearing deposits increased by \$22,000 due to an increase of \$3.0 million in average balances. The yield on federal funds sold and interest bearing deposits increased to 1.49% for the three months ended September 30, 2004 compared to 1.03% for the comparable period ended September 30, 2003. The average balance of the investment portfolio increased \$9.6 million from the prior period. Due to this increase, interest and dividends on investments increased by \$55,000 for the three months ended September 30, 2004 compared to the three months ended September 30, 2003. The average tax-equivalent yield on investment securities remained unchanged at 2.60% .

Total interest expense increased \$42,000 from the prior period, due principally to a \$19.9 million increase in average interest bearing liabilities ameliorated by a decline in the cost from 1.55% for the three months ended September 30, 2003 to 1.40% for the current period. Our net interest margin was 3.33% for the three months ended September 30, 2004 as compared to 3.41% for the prior period ended September 30, 2003, as our interest-earning assets have not repriced as quickly as our interest-bearing liabilities.

Provision for Loan Losses. The provision for loan losses increased to \$67,000 for three months ended September 30, 2004 compared to \$60,000 for the prior period. Factors such as changes in the nature and volume of the portfolio, overall portfolio quality, concentrations of

credit risk, review of specific problem loans, current economic conditions and trends that may affect the ability of borrowers to pay, and prior loss experience within the various categories of the portfolio are considered when reviewing the risks in the portfolio. The allowance for loan losses was \$946,000 at September 30, 2004, or 1.27% of total outstanding loans, compared to \$768,000 or 1.15% of total outstanding loans at December 31, 2003.

Total Other Income. Other income, primarily service charges on deposit accounts and gains on sale of mortgages held for sale, was \$67,000 for the three months ended September 30, 2004 compared to \$91,000 for the three months ended September 30, 2003. Fees from deposit account holders for the three months ended September 30, 2004 were approximately \$35,000 compared to \$37,000 in the prior period. For the three months ended September 30, 2004, we recorded fees on the sale of residential mortgage loans held for sale of \$12,000 compared to \$41,000 in the prior period. This decline was primarily due to decreased refinancing activity as a result of higher interest rates during the current three month period. In general, we sell all newly originated fixed-rate residential mortgage loans into the secondary market on a servicing released basis. The increase in other income, service charges and fees of \$7,000 to \$20,000 in 2004 from \$13,000 in 2003, was primarily due to increased business volume.

Total Other Expense. Total other expenses for the three months ended September 30, 2004 increased \$72,000 or 10.2% to \$781,000 compared to \$709,000 in the prior period. Most of the increases were due to growth related factors:

Employee related expenses were \$343,000 for the period compared to \$300,000 for the three months ended September 30, 2003, reflecting additions to our staff as well as normal compensation increases.

Occupancy and equipment expenses increased \$11,000 to \$100,000 for the three months ended September 30, 2004, compared to \$89,000 in the prior period. Additional equipment for new staff, normal equipment upgrades and increased maintenance costs accounted for these increases.

Due to renegotiated contract pricing with our data processing provider, data processing expenses decreased 8.1% to \$68,000 for the three months ended September 30, 2004 compared to \$74,000 for the prior period.

Professional services, including audit, loan review, and legal expenses, increased \$15,000 to \$60,000 during the three months ended September 30, 2004 compared to \$45,000 for the comparable prior period. This increase was primarily related to our growth, as well as increased compliance costs resulting from the impact of the Sarbanes-Oxley Act of 2002 and similar laws and regulations.

Other operating expenses included postage, ATM charges, telephone expenses, business development costs and other miscellaneous expenses. Due to growth and increased business activity, other operating expenses increased \$10,000 or 6.3% to \$171,000 for the three months ended September 30, 2004, compared to \$161,000 for the three

months ended September 30, 2003.

Income Taxes. Our recorded income tax expense for the three months ended September 30, 2004 was \$120,000 compared to \$92,000 in the prior period. The increase in income tax expense is due to higher pre-tax income for the three months ended September 30, 2004 as compared to the prior period. The effective rates for the three months ended September 30, 2004 and 2003 were 40.5% and 40.4%, respectively.

Nine months ended September 30, 2004 compared to the nine months ended September 30, 2003.

General. Net income increased 13.3% to \$409,000 for the nine months ended September 30, 2004, as compared to net income of \$361,000 for the period ended September 30, 2003. This increase was due to a \$343,000 increase in net interest income, partially offset by a \$228,000 increase in other expense. Other income decreased \$26,000 to \$208,000 for the nine months ended September 30, 2004 compared to \$234,000 in the prior period. The provision for loan losses increased by \$12,000 to \$192,000 for the nine months ended September 30, 2004 compared to the comparable period in 2003. Due to higher operating income, income tax expense increased by \$29,000.

Basic earnings per share were \$0.22 for the nine months ended September 30, 2004 compared to \$0.26 for the nine months ended September 30, 2003. Diluted earnings per share declined to \$0.21 for the nine months ended September 30, 2004 compared to \$0.25 per share for the prior period. These decreases were due primarily to the sale of 828,000 shares of common stock that was completed on April 26, 2004.

Net Interest Income. Interest income increased by \$380,000 to \$3.9 million, primarily due to an increase in interest and fees on loans of \$344,000. Average loans and loans available for sale outstanding increased by \$12.6 million or 21.6% from the prior period, which more than offset the decline in the average yield on the loan portfolio. While short-term yields have increased during the most recent quarter, the overall level of interest rates for 2004 is lower than the comparable period in 2003. The average yield on our loan portfolio declined from 6.35% for the nine month period ended September 30, 2003 to 5.87% for the current nine month period due to the declining interest rate environment. Interest on federal funds sold and interest bearing deposits increased by \$19,000 for the nine months ended September 30, 2004 compared to the comparable prior period. An increase of \$2.1 million in average balances combined with an increase of 0.06% in yield to 1.20% accounted for the change. Interest and dividends on investments for the nine months ended September 30, 2004 increased \$17,000 from the prior period. The increase of \$6.1 million in the average balance of the investment portfolio more than offset the decline in yields due to the overall decline in market rates from the comparable prior period. The average tax-equivalent yield on investment securities declined to 2.57% in 2004 from 2.92% in 2003.

Total interest expense increased \$37,000 from the prior period, due principally to an increase in interest bearing liabilities partially offset by the year-to-date decline in market interest rates. A \$11.9 million increase in average interest bearing liabilities was ameliorated by the lower rates paid on deposit accounts and short-term borrowings, as the cost of interest-bearing liabilities declined from 1.64% in 2003 to 1.47% in 2004. Our net interest margin was

3.33% for the nine months ended September 30, 2004 as compared to 3.86% for the prior period ended September 30, 2003, as our interest-earning assets repriced downward to a greater degree than our interest-bearing liabilities.

Provision for Loan Losses. The provision for loan losses increased to \$192,000 for nine months ended September 30, 2004 compared to \$180,000 for the prior period. Factors such as changes in the nature and volume of the portfolio, overall portfolio quality, concentrations of credit risk, review of specific problem loans, current economic conditions and trends that may affect the ability of borrowers to pay, and prior loss experience within the various categories of the portfolio are considered when reviewing the risks in the portfolio.

Total Other Income. Other income, primarily service charges on deposit accounts and gains on sale of mortgages held for sale, declined \$26,000 or 11.1% to \$208,000 for the nine months ended September 30, 2004 compared to the nine months ended September 30, 2003. Fees from deposit account holders for the nine months ended September 30, 2004 were approximately \$107,000 compared to \$105,000 in the prior period. For the nine months ended September 30, 2004, we recorded fees on the sale of residential mortgage loans held for sale of \$45,000 compared to \$91,000 in the prior period. This decline was primarily due to decreased refinancing activity as a result of higher interest rates on residential mortgage loans during the current nine month period. In general, we sell all newly originated fixed-rate residential mortgage loans into the secondary market on a servicing released basis. The increase in other income, service charges and fees of \$18,000 in 2004 to \$56,000 from \$38,000 in 2003, was primarily due to an increase in business volume.

Total Other Expense. Total other expenses for the nine months ended September 30, 2004 increased \$228,000 or 11.1% to \$2.3 million compared to \$2.0 million in the prior period. Most of the increases were due to growth related factors:

Employee related expenses were \$975,000 for the current period compared to \$870,000 for the nine months ended September 30, 2003, reflecting additions to our staff as well as normal compensation increases.

Occupancy and equipment expenses increased \$37,000 to \$286,000 for the nine months ended September 30, 2004, compared to \$249,000 in the prior period. Additional equipment for new staff, normal equipment upgrades and increased maintenance costs accounted for these increases.

Increases in data processing expenses due to increased business volume was somewhat offset by lower fees resulting from a renegotiation of our contract with our data processing provider. Data processing increased 10.2% to \$226,000 for the nine months ended September 30, 2004 compared to \$205,000 for the prior period.

Professional services, including audit, loan review, and legal expenses increased \$29,000 to \$188,000 during the nine months ended September 30, 2004 compared to \$159,000 for the comparable prior period. This increase was

primarily related to our growth, as well as increased compliance costs

resulting from the impact of the Sarbanes-Oxley Act of 2002 and similar laws and regulations.

Other operating expenses included postage, ATM charges, telephone expenses, business development costs and other miscellaneous expenses. Due to growth and increased business activity, other operating expenses increased \$78,000 or 17.5% to \$524,000 for the nine months ended September 30, 2004, compared to \$446,000 for the nine months ended September 30, 2003.

The increases above were partially offset by a decrease in advertising expenses of \$42,000 for the nine months ended September 30, 2004 to \$76,000 compared to \$118,000 in the prior period. The prior period contained activity relating to our Westville opening and other marketing campaigns designed to increase community awareness of our presence, products and capabilities.

Income Taxes. Our recorded income tax expense for the nine months ended September 30, 2004 was \$273,000 compared to \$244,000 in the prior period. The increase in income tax expense is due to higher pre-tax income for the nine months ended September 30, 2004 as compared to the prior period. The effective rates for the nine months ended September 30, 2004 and 2003 were 40.0% and 40.3%, respectively.

KEY FINANCIAL RATIOS

	As of or for the nine months ended September 30,	
	2004	2003
Return on average assets (1)	0.44%	0.46%
Return on average equity (1)	3.68%	5.14%
Net interest margin (1)	3.33%	3.86%
Efficiency ratio (1) (2)	72.25%	72.27%
Non-interest income/operating revenue	6.60%	8.26%
Non-performing assets/assets	0.02%	0.00%
Net charge offs/average loans (1)	0.07%	0.01%
Allowance for loan losses/loans	1.27%	1.18%

(1) These ratios are annualized.

(2) Efficiency ratio is total other expense divided by the sum of net interest income and total other income.

LIQUIDITY

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Liquidity represents the ability to meet present and future financial obligations through either the sale or maturity of existing assets or the acquisition of additional funds through deposits and borrowings. Liquid assets include cash, federal funds sold, securities classified as available for sale, and loans maturing within one year. As a result of the Bank's management of liquid assets, and the ability to generate liquidity through deposits and short-term customer

repos, management believes that the Bank maintains overall liquidity sufficient to satisfy its deposit requirements and meet its customers' credit needs. In addition, the Bank maintains a \$2.4 secured line of credit and a \$5.0 million unsecured line of credit with commercial banks.

At September 30, 2004, cash, securities classified as available for sale, interest bearing deposits, and federal funds sold were 40.2% of total assets. Asset liquidity is also provided by managing loans and the maturity of investment securities. To the extent possible, loans are funded with deposits or other funding with coinciding maturity or repricing dates. At September 30, 2004, our ratio of deposits to total loans was 162.5%.

Net cash provided by operating activities for the nine months ended September 30, 2004 was \$524,000 as compared to \$136,000 in the prior period. The change relates primarily to a decrease in the level of mortgage loans held for sale. Net cash used by investing activities was \$18.9 million compared to \$15.5 million in the prior period. The net change was largely due to an increase in the amount of cash being invested in securities and new loans. Funds provided by financing activities were \$25.9 million for the period ended September 30, 2004 compared to \$13.8 million for the prior period. The primary reason was increased growth in deposits, borrowed funds and proceeds from the sale of the Company's common stock. Borrowed funds increased as a result of a daily sweep from a large depository account. All collected balances in excess of a threshold amount are swept into an overnight repurchase agreement.

CAPITAL RESOURCES

The assessment of capital adequacy depends on a number of factors such as asset quality, liquidity, earnings performance, changing competitive conditions, economic forces and growth and expansion activities. The Bank seeks to maintain a capital base to support its growth and expansion activities, to provide stability to current operations and to promote public confidence.

The Bank's capital position exceeds regulatory minimums. The primary indicators relied on by the Office of the Comptroller of the Currency and other bank regulators in measuring strength of capital position are the Tier 1 Risk-Based Capital Ratio, Total Risk-Based Capital Ratio and Leverage Ratio. Tier 1 Capital consists of common and qualifying preferred stockholders equity less goodwill. Total Capital consists of Tier 1 Capital, and a portion of the allowance for possible loan losses. Risk-based capital ratios are calculated with reference to risk weighted assets, which consist of both on and off balance sheet risks (such as letters of credit and unused lines of credit). The Leverage Ratio consists of Tier 1 capital divided by quarterly average assets.

For capital adequacy purposes, the following table shows the Bank's regulatory capital ratios and shareholders' equity to total assets as of September 30, 2004:

	Regulatory Minimum	Actual Ratio
Total risk-based capital ratio	8.0%	20.25%
Tier 1 risk-based capital ratio	4.0%	19.11%
Tier 1 leverage ratio	4.0%	11.74%
Shareholders' equity to total assets	None	