

PEAPACK GLADSTONE FINANCIAL CORP

Form 10-Q

November 07, 2008

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

FORM 10-Q

(MARK ONE)

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

For the Quarter Ended September 30, 2008

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 No. 001-16197

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

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

22-3537895  
(I.R.S. Employer  
Identification No.)

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

(908) 234-0700  
(Registrant's telephone number, including area code)

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

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

Large accelerated filer ☐

Accelerated filer ☒

Non-accelerated filer (do not check if a smaller reporting company) ☐ 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 ☒.

Number of shares of Common Stock outstanding as of November 3, 2008:  
8,288,634

PEAPACK-GLADSTONE FINANCIAL CORPORATION  
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## Item 1. Financial Statements (Unaudited)

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

|                                                                                                            | September 30,<br>2008 | December 31,<br>2007 |
|------------------------------------------------------------------------------------------------------------|-----------------------|----------------------|
| <b>ASSETS</b>                                                                                              |                       |                      |
| Cash and due from banks                                                                                    | \$ 28,108             | \$ 25,443            |
| Federal funds sold                                                                                         | 125                   | 1,771                |
| Interest-earning deposits                                                                                  | 3,265                 | 973                  |
| Total cash and cash equivalents                                                                            | 31,498                | 28,187               |
| Investment securities held to maturity (approximate market<br>value \$63,337 in 2008 and \$45,070 in 2007) | 86,327                | 45,139               |
| Securities available for sale                                                                              | 146,125               | 236,944              |
| FHLB and FRB Stock, at cost                                                                                | 6,705                 | 4,293                |
| Loans                                                                                                      | 1,036,379             | 981,180              |
| Less: Allowance for loan losses                                                                            | 9,088                 | 7,500                |
| Net Loans                                                                                                  | 1,027,291             | 973,680              |
| Premises and equipment                                                                                     | 26,439                | 26,236               |
| Other real estate owned                                                                                    | 1,211                 | -                    |
| Accrued interest receivable                                                                                | 4,884                 | 5,122                |
| Cash surrender value of life insurance                                                                     | 25,249                | 19,474               |
| Other assets                                                                                               | 13,169                | 7,901                |
| <b>TOTAL ASSETS</b>                                                                                        | <b>\$ 1,368,898</b>   | <b>\$ 1,346,976</b>  |
| <b>LIABILITIES</b>                                                                                         |                       |                      |
| Deposits:                                                                                                  |                       |                      |
| Noninterest-bearing demand deposits                                                                        | \$ 200,976            | \$ 199,266           |
| Interest-bearing deposits:                                                                                 |                       |                      |
| Checking                                                                                                   | 148,868               | 145,490              |
| Savings                                                                                                    | 67,611                | 64,772               |
| Money market accounts                                                                                      | 379,719               | 377,544              |
| Certificates of deposit over \$100,000                                                                     | 156,272               | 155,410              |
| Certificates of deposit less than \$100,000                                                                | 207,539               | 237,785              |
| Total deposits                                                                                             | 1,160,985             | 1,180,267            |
| Overnight borrowings                                                                                       | 55,000                | 15,650               |
| Long-term debt                                                                                             | 40,054                | 29,169               |
| Accrued expenses and other liabilities                                                                     | 7,007                 | 14,461               |
| <b>TOTAL LIABILITIES</b>                                                                                   | <b>1,263,046</b>      | <b>1,239,547</b>     |

## SHAREHOLDERS' EQUITY

|                                                                                                                                                                                                                                                                    |                     |                     |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------|---------------------|
| Common stock (no par value; \$0.83 per share;<br>authorized 20,000,000 shares; issued shares, 8,625,363 at<br>September 30, 2008 and 8,577,446 at December 31, 2007;<br>outstanding shares, 8,288,368 at September 30, 2008 and<br>8,304,486 at December 31, 2007) | 7,187               | 7,148               |
| Surplus                                                                                                                                                                                                                                                            | 92,034              | 90,677              |
| Treasury stock at cost, 336,995 shares at September 30, 2008<br>and 272,960 shares at December 31, 2007                                                                                                                                                            | (7,838)             | (6,255)             |
| Retained earnings                                                                                                                                                                                                                                                  | 27,883              | 21,750              |
| Accumulated other comprehensive loss, net of income tax                                                                                                                                                                                                            | (13,414)            | (5,891)             |
| <b>TOTAL SHAREHOLDERS' EQUITY</b>                                                                                                                                                                                                                                  | <b>105,852</b>      | <b>107,429</b>      |
| <b>TOTAL LIABILITIES &amp; SHAREHOLDERS' EQUITY</b>                                                                                                                                                                                                                | <b>\$ 1,368,898</b> | <b>\$ 1,346,976</b> |

See accompanying notes to consolidated financial statements.

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

|                                                                 | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|-----------------------------------------------------------------|-------------------------------------|-----------|------------------------------------|-----------|
|                                                                 | 2008                                | 2007      | 2008                               | 2007      |
| <b>INTEREST INCOME</b>                                          |                                     |           |                                    |           |
| Interest and fees on loans                                      | \$ 14,878                           | \$ 14,163 | \$ 43,845                          | \$ 40,918 |
| Interest on investment securities:                              |                                     |           |                                    |           |
| Taxable                                                         | 905                                 | 204       | 1,235                              | 655       |
| Tax-exempt                                                      | 225                                 | 259       | 699                                | 804       |
| Interest on securities available for sale:                      |                                     |           |                                    |           |
| Taxable                                                         | 1,727                               | 3,227     | 7,083                              | 9,720     |
| Tax-exempt                                                      | 164                                 | 245       | 758                                | 733       |
| Interest-earning deposits                                       | 10                                  | 9         | 134                                | 30        |
| Interest on federal funds sold                                  | 3                                   | 149       | 115                                | 585       |
| Total interest income                                           | 17,912                              | 18,256    | 53,869                             | 53,445    |
| <b>INTEREST EXPENSE</b>                                         |                                     |           |                                    |           |
| Interest on savings and interest-bearing deposit                |                                     |           |                                    |           |
| accounts                                                        | 2,307                               | 4,150     | 7,427                              | 12,487    |
| Interest on certificates of deposit over \$100,000              | 1,295                               | 1,826     | 4,696                              | 5,242     |
| Interest on other time deposits                                 | 1,696                               | 3,029     | 6,440                              | 9,004     |
| Interest on borrowed funds                                      | 461                                 | 364       | 1,222                              | 831       |
| Total interest expense                                          | 5,759                               | 9,369     | 19,785                             | 27,564    |
| <b>NET INTEREST INCOME BEFORE<br/>PROVISION FOR LOAN LOSSES</b> |                                     |           |                                    |           |
|                                                                 | 12,153                              | 8,887     | 34,084                             | 25,881    |
| Provision for loan losses                                       | 780                                 | 125       | 1,800                              | 350       |
| <b>NET INTEREST INCOME AFTER<br/>PROVISION FOR LOAN LOSSES</b>  |                                     |           |                                    |           |
|                                                                 | 11,373                              | 8,762     | 32,284                             | 25,531    |
| <b>OTHER INCOME</b>                                             |                                     |           |                                    |           |
| Trust department income                                         | 2,489                               | 2,252     | 7,639                              | 6,853     |
| Service charges and fees                                        | 554                                 | 494       | 1,583                              | 1,497     |
| Bank owned life insurance                                       | 293                                 | 223       | 866                                | 660       |
| Securities gains                                                | 104                                 | -         | 483                                | 382       |
| Other income                                                    | 117                                 | 195       | 376                                | 520       |
| Total other income                                              | 3,557                               | 3,164     | 10,947                             | 9,912     |
| <b>OTHER EXPENSES</b>                                           |                                     |           |                                    |           |
| Salaries and employee benefits                                  | 5,509                               | 4,402     | 15,253                             | 13,016    |
| Premises and equipment                                          | 2,116                               | 1,981     | 6,264                              | 5,583     |
| Other expenses                                                  | 1,966                               | 1,715     | 5,812                              | 5,076     |
| Total other expenses                                            | 9,591                               | 8,098     | 27,329                             | 23,675    |

|                                    |           |           |           |           |
|------------------------------------|-----------|-----------|-----------|-----------|
| INCOME BEFORE INCOME TAX EXPENSE   | 5,339     | 3,828     | 15,902    | 11,768    |
| Income tax expense                 | 1,822     | 1,179     | 5,343     | 3,614     |
| NET INCOME                         | \$ 3,517  | \$ 2,649  | \$ 10,559 | \$ 8,154  |
| EARNINGS PER SHARE                 |           |           |           |           |
| Basic                              | \$ 0.42   | \$ 0.32   | \$ 1.27   | \$ 0.98   |
| Diluted                            | \$ 0.42   | \$ 0.32   | \$ 1.26   | \$ 0.97   |
|                                    |           |           |           |           |
| Average basic shares outstanding   | 8,287,720 | 8,321,702 | 8,293,960 | 8,295,563 |
| Average diluted shares outstanding | 8,387,631 | 8,406,966 | 8,392,783 | 8,386,512 |

See accompanying notes to consolidated financial statements.

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

|                                                                                                          | Nine Months Ended<br>September 30, |            |
|----------------------------------------------------------------------------------------------------------|------------------------------------|------------|
|                                                                                                          | 2008                               | 2007       |
| Balance, beginning of period                                                                             | \$ 107,429                         | \$ 103,763 |
| Cumulative effect adjustment resulting from the adoption of EITF 06-04                                   | (449)                              | -          |
| Comprehensive income:                                                                                    |                                    |            |
| Net income                                                                                               | 10,559                             | 8,154      |
| Unrealized holding losses on securities arising during the period, net of tax                            | (8,353)                            | (1,024)    |
| Less: reclassification adjustment for gains included in net income, net of tax                           | 314                                | 248        |
| Less: reclassification adjustment for amortization of accumulated other comprehensive income, net of tax | 123                                | -          |
|                                                                                                          | (8,790)                            | (1,272)    |
| Settlement of Pension Plan, net of tax                                                                   | 1,267                              | -          |
| Total comprehensive income                                                                               | 3,036                              | 6,882      |
| Common stock options exercised                                                                           | 843                                | 1,070      |
| Purchase of treasury stock                                                                               | (1,583)                            | (1,017)    |
| Cash dividends declared                                                                                  | (3,978)                            | (3,823)    |
| Stock-based compensation expense                                                                         | 265                                | 151        |
| Tax benefit on disqualifying and nonqualifying exercise of stock options                                 | 289                                | 111        |
| Balance, September 30,                                                                                   | \$ 105,852                         | \$ 107,137 |

See accompanying notes to consolidated financial statements.



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

|                                                                                      | Nine Months Ended September<br>30, |                 |
|--------------------------------------------------------------------------------------|------------------------------------|-----------------|
|                                                                                      | 2008                               | 2007            |
| <b>OPERATING ACTIVITIES:</b>                                                         |                                    |                 |
| Net income:                                                                          | \$ 10,559                          | \$ 8,154        |
| Adjustments to reconcile net income to net cash<br>provided by operating activities: |                                    |                 |
| Depreciation                                                                         | 1,702                              | 1,650           |
| Amortization of premium and accretion of<br>discount on securities, net              | 128                                | 244             |
| Provision for loan losses                                                            | 1,800                              | 350             |
| Gains on security sales                                                              | (483)                              | (382)           |
| Gains on loans sold                                                                  | (104)                              | -               |
| Loss/(Gain) on disposal of fixed assets                                              | 153                                | (3)             |
| Gain on sale of other real estate owned                                              | 7                                  | -               |
| Stock-based compensation                                                             | 265                                | 151             |
| Increase in cash surrender value of life insurance, net                              | (775)                              | (576)           |
| Decrease/(increase) in accrued interest receivable                                   | 238                                | (739)           |
| (Increase)/decrease in other assets                                                  | (403)                              | (108)           |
| Decrease in accrued expenses and other liabilities                                   | (5,758)                            | (4,510)         |
| <b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>                                     | <b>7,329</b>                       | <b>4,231</b>    |
| <b>INVESTING ACTIVITIES:</b>                                                         |                                    |                 |
| Proceeds from maturities of investment securities                                    | 6,817                              | 7,000           |
| Proceeds from maturities of securities available for sale                            | 35,045                             | 37,748          |
| Proceeds from calls of investment securities                                         | 593                                | 150             |
| Proceeds from calls and sales of securities available for sale                       | 36,119                             | 5,108           |
| Purchase of investment securities                                                    | -                                  | (1,743)         |
| Purchase of securities available for sale                                            | (45,530)                           | (25,017)        |
| Purchase of life insurance                                                           | (5,000)                            | -               |
| Proceeds from sales of loans                                                         | 8,863                              | 2,821           |
| Net increase in loans                                                                | (65,902)                           | (76,030)        |
| Proceeds from sales of other real estate owned                                       | 514                                | -               |
| Purchases of premises and equipment                                                  | (2,090)                            | (3,344)         |
| Disposal of premises and equipment                                                   | 32                                 | 30              |
| <b>NET CASH USED IN INVESTING ACTIVITIES</b>                                         | <b>(30,539)</b>                    | <b>(53,277)</b> |
| <b>FINANCING ACTIVITIES:</b>                                                         |                                    |                 |
| Net (decrease)/increase in deposits                                                  | (19,282)                           | 6,661           |
| Net increase in other borrowings                                                     | 39,350                             | 34,300          |
| Proceeds from Federal Home Loan Bank advances                                        | 12,000                             | 8,000           |
| Repayments of Federal Home Loan Bank advances                                        | (1,115)                            | (1,341)         |
| Cash dividends paid                                                                  | (3,981)                            | (3,730)         |
| Tax benefit on stock option exercises                                                | 289                                | 111             |
| Exercise of stock options                                                            | 843                                | 1,070           |
| Purchase of treasury stock                                                           | (1,583)                            | (1,017)         |

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|                                                           |           |           |
|-----------------------------------------------------------|-----------|-----------|
| NET CASH PROVIDED BY FINANCING ACTIVITIES                 | 26,521    | 44,054    |
| Net increase/(decrease) in cash and cash equivalents      | 3,311     | (4,992)   |
| Cash and cash equivalents at beginning of period          | 28,187    | 30,258    |
| Cash and cash equivalents at end of period                | \$ 31,498 | \$ 25,266 |
| Supplemental disclosures of cash flow information:        |           |           |
| Cash paid during the period for:                          |           |           |
| Interest                                                  | \$ 23,232 | \$ 26,606 |
| Income taxes                                              | 6,881     | 4,501     |
| Supplemental noncash disclosures:                         |           |           |
| Transfer of securities to Held to Maturity, at fair value | \$ 48,429 | \$ -      |
| Transfer to Other Real Estate Owned                       | 1,438     | -         |

See accompanying notes to consolidated financial statements.

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

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

**Securities:** The Corporation accounts for its securities in accordance with Statement of Financial Accounting Standards Statement No. 115, "Accounting for Certain Investments in Debt and Equity Securities" (Statement No. 115). Debt securities are classified as held to maturity and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Debt securities are classified as available for sale when they might be sold before maturity due to changes in interest rates, prepayment, risk, liquidity or other factors. Equity securities with readily determinable fair values are classified as available for sale. Securities available for sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income, net of tax.

Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level-yield method without anticipating prepayments, except for mortgage-backed securities where prepayments are anticipated. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

Declines in the fair value of securities below their cost that are other than temporary are reflected as realized losses and results in a new cost basis being established. In estimating other-than-temporary losses, management considers the length of time and extent that fair value has been less than cost; the financial condition and near-term prospects of the issuer; and the Corporation's ability and intent to hold the security for a period sufficient to allow for any anticipated recovery in fair value.

Securities are evaluated on at least a quarterly basis to determine whether a decline in their value is other-than-temporary. To determine whether a loss in value is other-than-temporary, Management utilizes criteria such as the reasons underlying the decline, the magnitude and the duration of the decline and the intent and ability of the Corporation to retain its investment in the security for a period of time sufficient to allow for an anticipated recovery in the fair value. "Other-than-temporary" is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value is not necessarily favorable, or that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. Once a decline in value is

determined to be other-than-temporary, the value of the security is reduced and a corresponding charge to earnings is recognized. No impairment charge has been recognized for the three or nine months ended September 30, 2008 and 2007.

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

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

For the three months ended September 30, 2008 and 2007, the Corporation recorded total compensation cost for share-based payment arrangements of \$82 thousand and \$52 thousand, respectively, with a recognized tax benefit of \$6 thousand and \$3 thousand for the third quarter of 2008 and 2007, respectively.

The Corporation recorded total compensation cost for share-based payment arrangements of \$265 thousand and \$151 thousand for the nine months ended September 30, 2008 and 2007, respectively, with a recognized tax benefit of \$19 thousand and \$9 thousand for the same periods.

As of September 30, 2008, there was approximately \$1.1 million of unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the Corporation's stock incentive plans. That cost is expected to be recognized over a weighted average period of 1.7 years.

For the Corporation's stock option plans, changes in options outstanding during the nine months ended September 30, 2008 were as follows:

|                                          | Number<br>of | Exercise<br>Price | Weighted<br>Average<br>Exercise<br>Price | Aggregate<br>Intrinsic<br>Value |
|------------------------------------------|--------------|-------------------|------------------------------------------|---------------------------------|
| (Dollars in thousands except share data) | Shares       | Per Share         | Price                                    | Value                           |
| Balance, December 31, 2007               | 583,812      | \$ 13.62-\$32.14  | \$ 24.77                                 |                                 |
| Granted                                  | 71,260       | 21.97-33.00       | 24.98                                    |                                 |
| Exercised                                | (47,917)     | 13.68-28.89       | 17.59                                    |                                 |
| Forfeited                                | (2,526)      | 15.70-28.89       | 24.34                                    |                                 |
| Balance, September 30, 2008              | 604,629      | \$ 13.62-\$33.00  | \$ 25.36                                 | \$ 4,919                        |
| Options exercisable, September 30, 2008  | 471,752      |                   |                                          | \$ 3,978                        |

The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value (the difference between the Corporation's closing stock price on the last trading day of the third quarter of 2008 and the exercise price, multiplied by the number of in-the-money options).

The aggregate intrinsic value of options exercised during the nine months ended September 30, 2008 and 2007 was \$392 thousand and \$242 thousand, respectively.



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The per share weighted-average fair value of stock options granted during the first nine months of 2008 and 2007 for all plans was \$13.42 and \$10.38, respectively, on the date of grant using the Black Scholes option-pricing model with the following weighted average assumptions:

|                         | 2008    | 2007    |
|-------------------------|---------|---------|
| Dividend yield          | 2.40%   | 2.00%   |
| Expected volatility     | 50%     | 43%     |
| Expected life           | 7 years | 5 years |
| Risk-free interest rate | 3.81%   | 4.56%   |

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

| (In Thousands, except per share data) | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|---------------------------------------|-------------------------------------|-----------|------------------------------------|-----------|
|                                       | 2008                                | 2007      | 2008                               | 2007      |
| Net Income to Common Shareholders     | \$ 3,517                            | \$ 2,649  | \$ 10,559                          | \$ 8,154  |
| Basic Weighted-Average Common         |                                     |           |                                    |           |
| Shares Outstanding                    | 8,287,720                           | 8,321,702 | 8,293,960                          | 8,295,563 |
| Plus: Common Stock Equivalents        | 99,911                              | 85,264    | 98,823                             | 90,949    |
| Diluted Weighted-Average Common       |                                     |           |                                    |           |
| Shares Outstanding                    | 8,387,631                           | 8,406,966 | 8,392,783                          | 8,386,512 |
| Net Income Per Common Share           |                                     |           |                                    |           |
| Basic                                 | \$ 0.42                             | \$ 0.32   | \$ 1.27                            | \$ 0.98   |
| Diluted                               | 0.42                                | 0.32      | 1.26                               | 0.97      |

Stock options with an exercise price below the Corporation's market price equal to 315,384 and 379,708 shares were not included in the computation of diluted earnings per share in the third quarters of 2008 and 2007, respectively because they were antidilutive. Stock options with an exercise price below the Corporation's market price equal to 382,443 and 375,268 shares were not included in the computation of diluted earnings per share in the nine months ended September 30, 2008 and 2007, respectively because they would be antidilutive.

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

The Corporation is no longer subject to examination by the U.S. Federal tax authorities for years prior to 2004 or by New Jersey tax authorities for years prior to 2003. The Corporation does not expect the total amount of unrecognized tax benefits to significantly increase in the next 12 months. The Corporation is currently under an audit by the U.S. Federal tax authorities for 2006 and does not expect it to materially effect the financial statements.

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

1, 2008.

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**Comprehensive Income:** Comprehensive income consists of net income and the change during the period in the Corporation's pension benefit obligation and the net unrealized gains and losses on securities available for sale during the applicable period of time less adjustments for realized gains and losses and net amortization of the unrealized loss on securities transferred to held to maturity from available for sale. Total comprehensive income for the third quarter of 2008 was \$4.9 million and \$2.5 million for the third quarter in 2007. Total comprehensive income for the nine months ended September 30, 2008 and 2007 was \$3.0 million and \$6.9 million, respectively.

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

**2. LOANS**

Loans outstanding as of September 30, 2008, and December 31, 2007, consisted of the following:

| (In thousands)          | September 30,<br>2008 | December 31,<br>2007 |
|-------------------------|-----------------------|----------------------|
| Residential real estate | \$ 507,440            | \$ 497,016           |
| Commercial real estate  | 267,002               | 237,316              |
| Commercial loans        | 145,545               | 129,747              |
| Construction loans      | 57,122                | 60,589               |
| Consumer loans          | 31,092                | 37,264               |
| Other loans             | 28,178                | 19,248               |
| Total loans             | \$ 1,036,379          | \$ 981,180           |

Non-performing assets, which are loans past due in excess of 90 days and still accruing, non-accrual loans and other real estate owned totaled \$5.0 million at September 30, 2008 and \$2.1 million at December 31, 2007. Management believes that the value of the real estate exceeds the balance due on the loans and expects no loss.

**3. INVESTMENT SECURITIES HELD TO MATURITY**

A summary of amortized cost and approximate fair value of investment securities held to maturity included in the consolidated statements of condition as of September 30, 2008 and December 31, 2007 follows:

| (In Thousands)                   | Carrying<br>Amount | September 30, 2008             |                                 | Approximate<br>Fair<br>Value |
|----------------------------------|--------------------|--------------------------------|---------------------------------|------------------------------|
|                                  |                    | Gross<br>Unrecognized<br>Gains | Gross<br>Unrecognized<br>Losses |                              |
| U.S. Treasury                    | \$ 500             | \$ 13                          | \$ -                            | \$ 513                       |
| Mortgage-Backed Securities       | 10,549             | 84                             | (66)                            | 10,567                       |
| State and Political Subdivisions | 26,866             | 115                            | (36)                            | 26,945                       |
| Other Securities                 | 48,412             | -                              | (29,444)                        | 18,968                       |
| Total                            | \$ 86,327          | \$ 212                         | \$ (29,546)                     | \$ 56,993                    |

| (In Thousands)                   | Carrying<br>Amount | December 31, 2007              |                                 | Approximate<br>Fair<br>Value |
|----------------------------------|--------------------|--------------------------------|---------------------------------|------------------------------|
|                                  |                    | Gross<br>Unrecognized<br>Gains | Gross<br>Unrecognized<br>Losses |                              |
| U.S. Treasury                    | \$ 500             | \$ 14                          | \$ -                            | \$ 514                       |
| Mortgage-Backed Securities       | 13,196             | 84                             | (88)                            | 13,192                       |
| State and Political Subdivisions | 31,443             | 58                             | (137)                           | 31,364                       |

|                  |           |        |          |           |
|------------------|-----------|--------|----------|-----------|
| Other Securities | -         | -      | -        | -         |
| Total            | \$ 45,139 | \$ 156 | \$ (225) | \$ 45,070 |

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The following tables present the Corporation's investment securities held to maturity with continuous unrealized losses and the approximate fair value of these investments as of September 30, 2008 and December 31, 2007.

September 30, 2008

| (In Thousands)      | Duration of Unrealized Loss |                     |                        |                     |                        |                     |
|---------------------|-----------------------------|---------------------|------------------------|---------------------|------------------------|---------------------|
|                     | Less Than 12 Months         |                     | 12 Months or Longer    |                     | Total                  |                     |
|                     | Approximate Fair Value      | Unrecognized Losses | Approximate Fair Value | Unrecognized Losses | Approximate Fair Value | Unrecognized Losses |
| Mortgage-Backed     |                             |                     |                        |                     |                        |                     |
| Securities          | \$ 4,696                    | \$ (66)             | \$ -                   | \$ -                | \$ 4,696               | \$ (66)             |
| State and Political |                             |                     |                        |                     |                        |                     |
| Subdivisions        | 6,123                       | (36)                | -                      | -                   | 6,123                  | (36)                |
| Other Securities    | 8,528                       | (11,023)            | 10,440                 | (18,421)            | 18,968                 | (29,444)            |
| Total               | \$ 19,347                   | \$ (11,125)         | \$ 10,440              | \$ (18,421)         | \$ 29,787              | \$ (29,546)         |

December 31, 2008

| (In Thousands)      | Duration of Unrealized Loss |                     |                        |                     |                        |                     |
|---------------------|-----------------------------|---------------------|------------------------|---------------------|------------------------|---------------------|
|                     | Less Than 12 Months         |                     | 12 Months or Longer    |                     | Total                  |                     |
|                     | Approximate Fair Value      | Unrecognized Losses | Approximate Fair Value | Unrecognized Losses | Approximate Fair Value | Unrecognized Losses |
| Mortgage-Backed     |                             |                     |                        |                     |                        |                     |
| Securities          | \$ 2,235                    | \$ (2)              | \$ 6,025               | \$ (86)             | \$ 7,260               | \$ (88)             |
| State and Political |                             |                     |                        |                     |                        |                     |
| Subdivisions        | 5,449                       | (30)                | 15,634                 | (107)               | 21,083                 | (137)               |
| Other Securities    | -                           | -                   | -                      | -                   | -                      | -                   |
| Total               | \$ 6,684                    | \$ (32)             | \$ 21,659              | \$ (193)            | \$ 28,343              | \$ (225)            |

Management has determined that the unrealized losses on debt securities of state and political subdivisions are temporary and due to interest rate fluctuations rather than the credit ratings of the issuers. The Corporation has a policy to purchase only from issuers with an investment grade credit rating and monitors credit ratings periodically.

The unrealized losses on investments in mortgage-backed securities were caused by interest rate increases and recent volatile market conditions in the mortgage-backed securities market. These securities are all rated AAA. The Corporation has the ability and intent to hold these securities for a period of time sufficient to recover all gross unrealized losses.

Other securities represents the Corporation's investment in trust preferred pooled securities, which consist of 46 separate issues. The trust preferred pooled instruments consist of securities issued primarily by banks and insurance companies. Three of the issues held by the Corporation are senior tranches and the remainder are mezzanine tranches. The senior and mezzanine tranches generally are protected from defaults by over-collateralization and cash flow default protection provided by subordinated tranches, with senior tranches having the greatest protection and mezzanine tranches subordinated to the senior tranches. No single issuer comprised more than five percent of the total principal of any one pool.

Due to the challenging environment for most banks in the United States, there has been an increase in payment deferrals and defaults by issuers within these securities. In addition, the Corporation feels the market for these securities has been negatively and severely affected by the ongoing credit crisis, a lack of institutional buying activity leading to market illiquidity and forced sales by institutions in distressed situations. As a result of the increase in payment deferrals and defaults by the underlying issuers, and what the Corporation feels are non-functioning markets, the fair value of the securities, or the value the Corporation could realize if it were forced to sell the securities into the market now, has declined materially. The original cost of these securities was \$67.1 million, and as of September 30, 2008, the estimated fair value of these securities was \$19.0 million.

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At September 30, 2008, 38 of these securities maintained an investment grade rating of A3 or better, 6 of Baa or better, and two issues with an original cost of \$2.5 million were rated Ba1. In addition, the rating agencies have placed a number of these securities on credit watch while they evaluate the current rating for possible downgrade.

The Corporation has the intent and ability to hold these securities to maturity. Consequently, as of July 1, 2008, Management changed the accounting treatment for the portfolio from “available for sale” to “held to maturity.” As of that date, the fair value as of June 30, 2008, of \$48.4 million, became the new book value with the decline, net of tax, of \$11.2 million recorded as a component of accumulated other comprehensive income to be amortized into income over the remaining lives of the securities.

These securities are accounted for under the scope of EITF-99-20. Based on management’s review including cash flow analyses of each security, Management currently expects all to return 100% of their principal and interest. Accordingly, the corporation has not recorded a charge for other-than-temporary-impairment at this time. The Corporation will continue to evaluate these securities for possible impairment in future periods.

#### 4. SECURITIES AVAILABLE FOR SALE

A summary of amortized cost and approximate fair value of securities available for sale included in the consolidated statements of condition as of September 30, 2008 and December 31, 2007 follows:

| (In Thousands)                   | Amortized<br>Cost | September 30, 2008           |                               | Approximate<br>Fair<br>Value |
|----------------------------------|-------------------|------------------------------|-------------------------------|------------------------------|
|                                  |                   | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses |                              |
| U.S. Government-Sponsored        |                   |                              |                               |                              |
| Agencies                         | \$ -              | \$ -                         | \$ -                          | \$ -                         |
| Mortgage-Backed Securities       | 125,869           | 149                          | (1,547)                       | 124,471                      |
| State and Political Subdivisions | 14,768            | 130                          | (641)                         | 14,257                       |
| Other Securities                 | 9,269             | 103                          | (1,975)                       | 7,397                        |
| Total                            | \$ 149,906        | \$ 382                       | \$ (4,163)                    | \$ 146,125                   |

| (In Thousands)                   | Amortized<br>Cost | December 31, 2007            |                               | Approximate<br>Fair<br>Value |
|----------------------------------|-------------------|------------------------------|-------------------------------|------------------------------|
|                                  |                   | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses |                              |
| U.S. Government-Sponsored        |                   |                              |                               |                              |
| Agencies                         | \$ 23,999         | \$ 60                        | \$ (7)                        | \$ 24,052                    |
| Mortgage-Backed Securities       | 119,073           | 204                          | (784)                         | 118,493                      |
| State and Political Subdivisions | 24,926            | 192                          | (495)                         | 24,623                       |
| Other Securities                 | 76,631            | 349                          | (7,204)                       | 69,776                       |
| Total                            | \$ 244,629        | \$ 805                       | \$ (8,490)                    | \$ 236,944                   |

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The following tables present the Corporation's available for sale securities with continuous unrealized losses and the approximate fair value of these investments as of September 30, 2008 and December 31, 2007.

| (In Thousands)      | September 30, 2008     |            |                     |            |             |            |
|---------------------|------------------------|------------|---------------------|------------|-------------|------------|
|                     | Duration of Unrealized |            |                     |            |             |            |
|                     | Loss                   |            |                     |            |             |            |
|                     | Less Than 12 Months    |            | 12 Months or Longer |            | Total       |            |
|                     | Approximate            |            | Approximate         |            | Approximate |            |
|                     | Fair                   | Unrealized | Fair                | Unrealized | Fair        | Unrealized |
|                     | Value                  | Losses     | Value               | Losses     | Value       | Losses     |
| U.S. Government-    |                        |            |                     |            |             |            |
| Sponsored Agencies  | \$ -                   | \$ -       | \$ -                | \$ -       | \$ -        | \$ -       |
| Mortgage-Backed     |                        |            |                     |            |             |            |
| Securities          | 94,006                 | (1,255)    | 7,339               | (292)      | 101,345     | (1,547)    |
| State and Political |                        |            |                     |            |             |            |
| Subdivisions        | 7,703                  | (641)      | -                   | -          | 7,703       | (641)      |
| Other Securities    | -                      | -          | 2,963               | (1,033)    | 2,963       | (1,033)    |
| Marketable Equity   |                        |            |                     |            |             |            |
| Securities          | 1,286                  | (864)      | 215                 | (78)       | 1,501       | (942)      |
| Total               | \$ 102,995             | \$ (2,760) | \$ 10,517           | \$ (1,403) | \$ 113,512  | \$ (4,163) |

| (In Thousands)      | December 31, 2007      |            |                     |            |             |            |
|---------------------|------------------------|------------|---------------------|------------|-------------|------------|
|                     | Duration of Unrealized |            |                     |            |             |            |
|                     | Loss                   |            |                     |            |             |            |
|                     | Less Than 12 Months    |            | 12 Months or Longer |            | Total       |            |
|                     | Approximate            |            | Approximate         |            | Approximate |            |
|                     | Fair                   | Unrealized | Fair                | Unrealized | Fair        | Unrealized |
|                     | Value                  | Losses     | Value               | Losses     | Value       | Losses     |
| U.S. Government-    |                        |            |                     |            |             |            |
| Sponsored Agencies  | \$ -                   | \$ -       | \$ 1,491            | \$ (7)     | \$ 1,491    | \$ (7)     |
| Mortgage-Backed     |                        |            |                     |            |             |            |
| Securities          | 14,492                 | (57)       | 59,266              | (727)      | 73,758      | (784)      |
| State and Political |                        |            |                     |            |             |            |
| Subdivisions        | 16,363                 | (491)      | 328                 | (4)        | 16,691      | (495)      |
| Other Securities    | 53,297                 | (6,310)    | 3,459               | (538)      | 56,756      | (6,848)    |
| Marketable Equity   |                        |            |                     |            |             |            |
| Securities          | 2,350                  | (309)      | 176                 | (47)       | 2,526       | (356)      |
| Total               | \$ 86,502              | \$ (7,167) | \$ 64,720           | \$ (1,323) | \$ 151,222  | \$ (8,490) |

Management has determined that the unrealized losses on debt securities are temporary and due to interest rate fluctuations and volatility rather than the credit ratings of the issuers. The Corporation has a policy to purchase debt securities only from issuers with an investment grade credit rating and monitors credit ratings periodically.

The unrealized losses on investments in mortgage-backed securities were caused by interest rate increases and recent volatile market conditions in the mortgage-backed securities market. These securities are all rated AAA. The Corporation has the ability and intent to hold these securities for a period of time sufficient to recover all gross unrealized losses.

As noted above, Management reclassified the trust preferred pooled securities portfolio from “available for sale” to “held to maturity” as of July 1, 2008 since the Corporation has the ability and intent to hold these securities to maturity.

#### 5. FEDERAL HOME LOAN BANK ADVANCES AND OTHER BORROWINGS

Advances from the Federal Home Loan Bank of New York (FHLB) totaled \$40.1 million and \$29.2 million at September 30, 2008 and December 31, 2007, respectively, with a weighted average interest rate of 3.59 percent and 3.69 percent, respectively. Advances totaling \$13.0 million at September 30, 2008, have fixed maturity dates, while advances totaling \$4.1 million were amortizing advances with monthly payments of principal and interest. These advances are secured by blanket pledges of certain 1-4 family residential mortgages totaling \$208.0 million at September 30, 2008.

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At September 30, 2008, the Corporation had \$23.0 million in fixed rates advances that are noncallable for one, two or three years and then callable quarterly within final maturities of three, five or ten years. These advances are secured by pledges of investment securities totaling \$24.6 million at September 30, 2008.

Overnight borrowings at September 30, 2008 totaled \$55.0 million, while overnight borrowings at December 31, 2007 totaled \$15.7 million. For the three months ended September 30, 2008, overnight borrowings from the FHLB averaged \$13.9 million with a weighted average interest rate of 2.21 percent, while overnight borrowings for the same quarter last year averaged \$7.3 million with a weighted average interest rate of 5.20 percent. For the nine months ended September 30, 2008 and 2007, overnight borrowings from the FHLB averaged \$7.1 million with a weighted average interest rate of 2.36 percent and \$3.9 million with a weighted average interest rate of 5.25 percent, respectively.

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

(In thousands)

|              |           |
|--------------|-----------|
| 2008         | \$ 55,000 |
| 2009         | 2,000     |
| 2010         | 12,985    |
| 2011         | 3,000     |
| 2012         | 5,000     |
| Over 5 years | 17,069    |
| Total        | \$ 95,054 |

## 6. BENEFIT PLANS

The Corporation has a defined benefit pension plan covering substantially all of its salaried employees which was discontinued on May 12, 2008. The Plan was settled and substantially all benefits were paid to employees during September. Contributions totaling \$2.1 million have been made during 2008 and no further contributions are expected. The Corporation amended its existing 401-K profit-sharing and investment plan to enhance the contributions to its salaried employees starting in May 2008.

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

| (In thousands)                    | Three Months Ended<br>September 30, |        | Nine Months Ended<br>September 30, |        |
|-----------------------------------|-------------------------------------|--------|------------------------------------|--------|
|                                   | 2008                                | 2007   | 2008                               | 2007   |
| Service cost                      | \$ -                                | \$ 439 | \$ 637                             | \$ 877 |
| Interest cost                     | 176                                 | 194    | 633                                | 389    |
| Expected return on plan assets    | (261)                               | (252)  | (839)                              | (504)  |
| Amortization of:                  |                                     |        |                                    |        |
| Net loss                          | -                                   | 8      | 17                                 | 17     |
| Unrecognized remaining net assets | -                                   | (1)    | (3)                                | (3)    |
| Net periodic benefit cost         | \$ (85)                             | \$ 388 | \$ 445                             | \$ 776 |

## 7. BUSINESS SEGMENTS

Late in 2007, the Corporation changed internal accounting and reporting processes in order to segregate and assess its results among two operating segments, Banking and PGB Trust and Investments and adopted the new processes as of January 1, 2008. Management uses certain methodologies to allocate income and expense to the business

segments. A funds transfer pricing methodology is used to assign interest income and interest expense to each interest-earning asset and interest-bearing liability on a matched maturity funding basis. Certain indirect expenses are allocated to segments. These include support unit expenses such as technology and operations and other support functions. Taxes are allocated to each segment based on the effective rate for the period shown.

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## Banking

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

## PGB Trust &amp; Investments

PGB Trust & Investments includes asset management services provided for individuals and institutions; personal trust services, including services as executor, trustee, administrator, custodian and guardian; corporate trust services including services as trustee for pension and profit sharing plans; and other financial planning and advisory services. The following table presents the statements of income and total assets for the Corporation's reportable segments for the three and nine months ended September 30, 2008.

| (in thousands)                   | Three Months Ended September 30, 2008 |             |           |
|----------------------------------|---------------------------------------|-------------|-----------|
|                                  | PGB Trust &                           |             | Total     |
|                                  | Banking                               | Investments |           |
| Net interest income              | \$ 11,344                             | \$ 809      | \$ 12,153 |
| Noninterest income               | 1,027                                 | 2,530       | 3,557     |
| Total income                     | 12,371                                | 3,339       | 15,710    |
| Provision for loan losses        | 780                                   | -           | 780       |
| Premises and equipment expense   | 1,923                                 | 193         | 2,116     |
| Salaries and benefits            | 4,343                                 | 1,166       | 5,509     |
| Other noninterest expense        | 1,327                                 | 639         | 1,966     |
| Total noninterest expense        | 8,373                                 | 1,998       | 10,371    |
| Income before income tax expense | 3,998                                 | 1,341       | 5,339     |
| Income tax expense               | 1,363                                 | 459         | 1,822     |
| Net income                       | \$ 2,635                              | \$ 882      | \$ 3,517  |

| (in thousands)                   | Nine Months Ended September 30, 2008 |             |           |
|----------------------------------|--------------------------------------|-------------|-----------|
|                                  | PGB Trust &                          |             | Total     |
|                                  | Banking                              | Investments |           |
| Net interest income              | \$ 31,778                            | \$ 2,306    | \$ 34,084 |
| Noninterest income               | 3,166                                | 7,781       | 10,947    |
| Total income                     | 34,944                               | 10,087      | 45,031    |
| Provision for loan losses        | 1,800                                | -           | 1,800     |
| Premises and equipment expense   | 5,684                                | 580         | 6,264     |
| Salaries and benefits            | 12,082                               | 3,171       | 15,253    |
| Other noninterest expense        | 3,866                                | 1,946       | 5,812     |
| Total noninterest expense        | 23,432                               | 5,697       | 29,129    |
| Income before income tax expense | 11,512                               | 4,390       | 15,902    |
| Income tax expense               | 3,868                                | 1,475       | 5,343     |
| Net income                       | \$ 7,644                             | \$ 2,915    | \$ 10,559 |

|                            |    |           |    |           |
|----------------------------|----|-----------|----|-----------|
|                            |    |           |    |           |
| Total assets at period end | \$ | 1,367,889 | \$ | 1,009     |
|                            |    |           | \$ | 1,368,898 |

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## 8.

## FAIR VALUE

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

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

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

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

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

## Assets Measured on a Recurring Basis

Fair Value Measurements at September 30, 2008  
Using

|                               |                          | Quoted<br>Prices in<br>Active<br>Markets<br>For<br>Identical | Significant<br>Other<br>Observable | Significant<br>Unobservable |
|-------------------------------|--------------------------|--------------------------------------------------------------|------------------------------------|-----------------------------|
|                               | September<br>30,<br>2008 | Assets<br>(Level 1)                                          | Inputs<br>(Level 2)                | Inputs<br>(Level 3)         |
| Assets:                       |                          |                                                              |                                    |                             |
| Available for Sale Securities | \$ 146,125               | \$ 2,399                                                     | \$ 143,726                         | \$ -                        |

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Item 2

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

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

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

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

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

The provision for loan losses is based upon management's evaluation of the adequacy of the allowance, including an assessment of known and inherent risks in the portfolio, giving consideration to the size and composition of the loan portfolio, actual loan loss experience, level of delinquencies, detailed analysis of individual loans for which full collectibility may not be assured, the existence and estimated net realizable value of any underlying collateral and guarantees securing the loans, and current economic and market conditions. Although management uses the best information available, the level of the allowance for loan losses remains an estimate, which is subject to significant

judgment

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and short-term change. Various regulatory agencies, as an integral part of their examination process, periodically review the Corporation's provision for loan losses. Such agencies may require the Corporation to make additional provisions for loan losses based upon information available to them at the time of their examination. Furthermore, the majority of the Corporation's loans are secured by real estate in the State of New Jersey. Accordingly, the collectibility of a substantial portion of the carrying value of the Corporation's loan portfolio is susceptible to changes in local market conditions and may be adversely affected should real estate values decline or should New Jersey experience adverse economic conditions. Future adjustments to the provision for loan losses may be necessary due to economic, operating, regulatory and other conditions beyond the Corporation's control.

Securities are evaluated on at least a quarterly basis to determine whether a decline in their value is other-than-temporary. To determine whether a loss in value is other-than-temporary, Management utilizes criteria such as the reasons underlying the decline, the magnitude and the duration of the decline and the intent and ability of the Corporation to retain its investment in the security for a period of time sufficient to allow for an anticipated recovery in the fair value. "Other-than-temporary" is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value is not necessarily favorable, or that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. Once a decline in value is determined to be other-than-temporary, the value of the security is reduced and a corresponding charge to earnings is recognized. No impairment charge has been recognized for the three or nine months ended September 30, 2008 and 2007.

**EXECUTIVE SUMMARY:** The Corporation recorded net income of \$3.5 million for the third quarter of 2008 as compared to \$2.6 million for the third quarter of 2007, an increase of \$868 thousand, or 32.8 percent. Earnings per share were \$0.42 per diluted share in the third quarter of 2008 as compared to \$0.32 per diluted share for the same quarter of 2007. The primary factor contributing to the increase in net income is the improvement in net interest income and the net interest margin, which is explained below. Annualized return on average assets for the quarter was 1.04 percent and annualized return on average equity was 13.46 percent for the third quarter of 2008.

Net interest income, on a fully tax-equivalent basis, was \$12.4 million in the third quarter of 2008, an increase of \$3.3 million or 36.4 percent from the third quarter last year and an increase of \$706 thousand or 6.0 percent over the second quarter of 2008. On a fully tax-equivalent basis, the net interest margin was 3.92 percent for the third quarter of 2008 as compared to 2.92 percent for the same period last year and 3.63 percent for the second quarter of 2008.

For the third quarter of 2008, average loans increased \$102.2 million or 11.1 percent to \$1.02 billion. The Corporation's long-term plan calls for a substantial shift in the asset mix, with less emphasis on residential mortgages and more emphasis on higher yielding commercial loans and commercial mortgages. As a result of this strategy, the average commercial loan portfolios grew \$90.6 million or 24.7 percent, while the average mortgage loan portfolio increased \$9.8 million to \$504.7 million. Loan rates declined 33 basis points from the third quarter of 2007 to 5.85 percent for the same quarter of 2008.

Average deposits grew \$17.2 million, or 1.5 percent, to \$1.18 billion in the third quarter of 2008 over the levels of the same quarter in 2007. Deposit gathering remains highly competitive as short-term market rates have continued to decline in this year. Rates paid for interest-bearing deposits were 2.15 percent in the third quarter of 2008, as compared to 3.69 percent for the third quarter of 2007, a decline of 154 basis points.

For the first nine months of 2008, net income was \$10.6 million, an increase of \$2.4 million or 29.5 percent over the \$8.2 million recorded for the same period of 2007. For the nine months ended September 30, 2008 and 2007, earnings per diluted share were \$1.26 and \$0.97, respectively. Annualized return on average assets for the year to date was 1.04 percent and annualized return on average equity was 13.26 percent for the first nine months of 2008.



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On a fully tax-equivalent basis, net interest income was \$34.9 million for the nine months ended September 30, 2008, an increase of \$8.4 million or 31.5 percent from the same period a year ago. The net interest margin on a fully tax-equivalent basis was 3.63 percent and 2.86 percent for the nine months ended September 30, 2008 and 2007, respectively.

Average loans for the nine months ended September 30, 2008 totaled \$998.2 million, growing \$104.9 million, or 11.7 percent, as compared to \$893.3 million over the same period last year. While the average mortgage loan portfolio remained flat compared to the first nine months of 2007, the commercial loan portfolios averaged \$443.9, rising \$100.4 million or 29.2 percent. Loan rates declined 24 basis points to 5.87 percent for the first nine months of 2008 as compared to 2007.

In the nine months ended September 30, 2008 and 2007, deposits averaged \$1.19 billion and \$1.16 billion, respectively, an increase of \$31.0 million or 2.7 percent. Rates paid for interest-bearing deposits declined 118 basis points to 2.48 percent in the first nine months of 2008. Borrowings for the nine months ended September 30, 2008 averaged \$48.4 million, an increase of \$19.5 million. During the first quarter of 2008, the Corporation borrowed \$12.0 million in fixed rate advances that are noncallable for one, two or three years.

Average investments declined \$55.1 million for the first nine months of 2008 when compared to the same year-to-date period of 2007 and yields on investments remained relatively constant. For the past year, the Corporation followed a strategy of investing the proceeds of maturing and sold securities into higher yielding loans.

## EARNINGS ANALYSIS

**NET INTEREST INCOME:** For the third quarter of 2008, net interest income, on a tax-equivalent basis on interest-earning assets and before the provision for loan losses, was \$12.4 million as compared to \$9.1 million for the same quarter of 2007, an increase of \$3.3 million or 36.4 percent. On a fully tax-equivalent basis, the net interest margin was 3.92 percent and 2.92 percent in the third quarters of 2008 and 2007, respectively, an increase of 100 basis points. When compared to the second quarter of 2008, net interest income for the third quarter of 2008, rose \$706 thousand, or 6.0 percent, from \$11.7 million on a tax-equivalent basis. On a fully tax equivalent basis, the net interest margin, increased from 3.63 percent in the second quarter of 2008, to 3.92 percent in the third quarter of 2008.

Loans averaged \$1.02 billion for the third quarter of 2008, an increase of \$102.2 million or 11.1 percent from \$917.6 million for the same quarter of 2007. While the average mortgage loan portfolio increased slightly to \$504.7 million during this period, the average commercial loan portfolios grew \$90.6 million or 24.7 percent.

Average deposits were \$1.18 billion and \$1.16 billion for the quarters ended September 30, 2008 and 2007, respectively, growing \$17.2 million, or 1.5 percent. Average non-interest bearing demand deposits increased \$9.6 million, or 5.2 percent, to \$193.1 million for the third quarter of 2008, from the same quarter in 2007. Average money markets rose \$13.8 million or 3.6 percent from the third quarter in 2007, totaling \$397.8 million in the third quarter of 2008. Average certificates of deposit declined \$24.1 million or 6.1 percent due to competitive pressure on rates and the maturity of certificates offered at a special rate for the grand opening of the Summit Branch beginning in March 2007. Average borrowings increased by \$22.5 million to \$58.1 million in the third quarter of 2008, from \$35.6 million in the same quarter of 2007.



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On a tax-equivalent basis, average interest rates on interest-earning assets declined 19 basis points to 5.73 percent for the third quarter of 2008 from 5.92 percent for the third quarter of 2007. Average interest rates earned on loans and investment securities declined 33 basis points to 5.85 percent and 11 basis points to 5.32 percent, respectively, for the third quarter of 2008 as compared to the same period in 2007. The decline in interest income due to lower rates has been mitigated by the increase in the volume of loans due to our long-term plan, which calls for a substantial shift in our asset mix, with less emphasis on residential mortgages and more emphasis on higher yielding commercial loans and commercial mortgages. Adjustable rates on the commercial portfolios have declined due to competitive pressures and the lowering of the federal funds rate.

For the third quarter of 2008, average rates paid on interest-bearing deposits declined 154 basis points to 2.15 percent as compared to 3.69 percent for the same quarter of 2007. For the third quarter of 2008, yields on money market products averaged 1.91 percent, declining 203 basis points, while certificates of deposit yields averaged 3.21 percent, declining 169 basis points, from the same quarter of 2007. Overnight rates on borrowings have also declined 299 basis points since the third quarter of 2007 to 2.21 percent for the third quarter in 2008.

The cost of funds decreased to 1.87 percent for the third quarter of 2008 as compared to 3.14 percent for the same quarter in 2007, a decline of 127 basis points. The net interest income and net interest margin have benefited from the Federal Reserve Board's decisions to reduce the fed funds target rate 275 basis points since the beginning of the year.

Net interest income, on a fully tax-equivalent basis and before the provision for loan losses, for the nine months ended September 30, 2008 and 2007, was \$34.9 million and \$26.6 million, respectively, increasing \$8.4 million or 31.5 percent. The net interest margin, on a fully tax-equivalent basis, was 3.63 percent for the first nine months of 2008 as compared to 2.86 percent for the same nine month period in 2007, an increase of 77 basis points. Net interest income has mostly benefited from the reduction in short-term market rates as liability costs have declined \$7.8 million for the nine months ended September 30, 2008 when compared to the same period in 2007.

For the nine months ended September 30, 2008 and 2007, loans averaged \$998.2 million and \$893.3 million, respectively, an increase of \$104.9 million or 11.7 percent. The average commercial loan portfolios grew to \$443.9 million for the first nine months of 2008 from \$343.5 million for the same period in 2007, an increase of \$100.4 million or 29.2 percent. The average mortgage loan portfolio remained flat during this same period. Average investments declined \$55.1 million or 16.8 percent to \$273.3 million. As previously discussed, most maturities in this portfolio were reinvested in the loan portfolio.

Average deposits were \$1.19 billion, an increase of \$31.0 million or 2.7 percent. Non-interest bearing demand deposits averaged \$192.6 million and \$184.7 million for the first nine months of 2008 and 2007, respectively, rising \$7.9 million or 4.3 percent. Average money markets rose \$21.4 million or 5.7 percent from the nine months ended September 30, 2007, totaling \$399.4 million in the first nine months of 2008. Average certificates of deposit totaled \$391.0 million for the first nine months of 2008, remaining flat when compared to the same period a year ago. For the same nine months of 2008, average borrowings increased by \$19.5 million to \$48.4 million from \$28.9 million in the same period in 2007, as the Corporation increased its level of fixed rate advances. These advances are noncallable for one, two or three years and then callable quarterly within final maturities of three, five or ten years.

Average interest rates on assets, on a tax-equivalent basis, for the first nine months of 2008 and 2007 were 5.68 percent and 5.84 percent, respectively, declining 16 basis points between 2008 and 2007. Accounting for much of this decrease, average interest rates earned on loans declined 24 basis points to 5.87 percent for the period in 2008 from 6.11 percent for the same period in 2007.

For the nine months ended September 30, 2008, average rates paid on interest-bearing deposits declined 118 basis points to 2.48 percent as compared to 3.66 percent for the same period in 2007.



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Yields on money market products averaged 2.13 percent, while certificates of deposit yields averaged 3.80 percent for the first nine months of 2008. Average rates paid on borrowings declined 46 basis points, yielding 3.37 percent and 3.83 percent for the first nine months of 2008 and 2007, respectively.

The cost of funds for the first nine months of 2008 also declined to 2.13 percent from 3.10 percent for the same year ago period. The net interest income and net interest margin has benefited from the Federal Reserve Board's decisions to reduce the fed funds target rate 250 basis points since the beginning of the year.

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

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

|                                            | September 30, 2008 |                    |       | September 30, 2007 |                    |       |
|--------------------------------------------|--------------------|--------------------|-------|--------------------|--------------------|-------|
|                                            | Average<br>Balance | Income/<br>Expense | Yield | Average<br>Balance | Income/<br>Expense | Yield |
| <b>ASSETS:</b>                             |                    |                    |       |                    |                    |       |
| Interest-earnings assets:                  |                    |                    |       |                    |                    |       |
| Investments:                               |                    |                    |       |                    |                    |       |
| Taxable (1)                                | \$ 202,248         | \$ 2,632           | 5.21% | \$ 263,636         | \$ 3,431           | 5.21% |
| Tax-exempt (1) (2)                         | 44,121             | 643                | 5.83  | 55,041             | 717                | 5.21  |
| Loans (2) (3)                              | 1,019,791          | 14,903             | 5.85  | 917,599            | 14,179             | 6.18  |
| Federal funds sold                         | 716                | 3                  | 1.94  | 11,116             | 149                | 5.36  |
| Interest-earning deposits                  | 2,085              | 10                 | 1.91  | 706                | 9                  | 4.99  |
| Total interest-earning assets              | 1,268,961          | \$ 18,191          | 5.73% | 1,248,098          | \$ 18,485          | 5.92% |
| Noninterest -earning assets:               |                    |                    |       |                    |                    |       |
| Cash and due from banks                    | 20,586             |                    |       | 20,510             |                    |       |
| Allowance for loan losses                  | (8,313)            |                    |       | (6,996)            |                    |       |
| Premises and equipment                     | 26,507             |                    |       | 25,591             |                    |       |
| Other assets                               | 41,338             |                    |       | 26,015             |                    |       |
| Total noninterest-earning assets           | 80,118             |                    |       | 65,120             |                    |       |
| Total assets                               | \$ 1,349,079       |                    |       | \$ 1,313,218       |                    |       |
| <b>LIABILITIES:</b>                        |                    |                    |       |                    |                    |       |
| Interest-bearing deposits:                 |                    |                    |       |                    |                    |       |
| Checking                                   | \$ 146,673         | \$ 309             | 0.84% | \$ 126,506         | \$ 254             | 0.80% |
| Money markets                              | 397,778            | 1,896              | 1.91  | 384,013            | 3,778              | 3.94  |
| Savings                                    | 66,586             | 102                | 0.61  | 68,796             | 118                | 0.69  |
| Certificates of deposit                    | 372,465            | 2,991              | 3.21  | 396,529            | 4,855              | 4.90  |
| Total interest-bearing deposits            | 983,502            | 5,298              | 2.15  | 975,844            | 9,005              | 3.69  |
| Borrowings                                 | 58,076             | 461                | 3.18  | 35,578             | 364                | 4.09  |
| Total interest-bearing liabilities         | 1,041,578          | 5,759              | 2.21  | 1,011,422          | 9,369              | 3.71  |
| Noninterest bearing liabilities            |                    |                    |       |                    |                    |       |
| Demand deposits                            | 193,050            |                    |       | 183,500            |                    |       |
| Accrued expenses and other liabilities     | 9,951              |                    |       | 11,365             |                    |       |
| Total noninterest-bearing liabilities      | 203,001            |                    |       | 194,865            |                    |       |
| Shareholders' equity                       | 104,500            |                    |       | 106,931            |                    |       |
| Total liabilities and shareholders' equity | \$ 1,349,079       |                    |       | \$ 1,313,218       |                    |       |
| Net Interest income                        |                    |                    |       |                    |                    |       |

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|                           |           |          |
|---------------------------|-----------|----------|
| (tax-equivalent basis)    | 12,432    | 9,116    |
| Net interest spread       | 3.52%     | 2.21%    |
| Net interest margin (4)   | 3.92%     | 2.92%    |
| Tax equivalent adjustment | (279)     | (229)    |
| Net interest income       | \$ 12,153 | \$ 8,887 |

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Average Balance Sheet  
Unaudited  
Year-To-Date  
(Tax-Equivalent Basis, Dollars in Thousands)

|                                            | September 30, 2008 |                    |       | September 30, 2007 |                    |       |
|--------------------------------------------|--------------------|--------------------|-------|--------------------|--------------------|-------|
|                                            | Average<br>Balance | Income/<br>Expense | Yield | Average<br>Balance | Income/<br>Expense | Yield |
| <b>ASSETS:</b>                             |                    |                    |       |                    |                    |       |
| Interest-earnings assets:                  |                    |                    |       |                    |                    |       |
| Investments:                               |                    |                    |       |                    |                    |       |
| Taxable (1)                                | \$ 220,120         | \$ 8,317           | 5.04% | \$ 272,355         | \$ 10,375          | 5.08% |
| Tax-exempt (1) (2)                         | 53,153             | 2,248              | 5.64  | 56,041             | 2,196              | 5.22  |
| Loans (2) (3)                              | 998,228            | 43,917             | 5.87  | 893,319            | 40,962             | 6.11  |
| Federal funds sold                         | 4,891              | 115                | 3.14  | 14,664             | 585                | 5.32  |
| Interest-earning deposits                  | 8,081              | 134                | 2.20  | 773                | 30                 | 5.25  |
| Total interest-earning assets              | 1,284,473          | \$ 54,731          | 5.68% | 1,237,152          | \$ 54,148          | 5.84% |
| Noninterest -earning assets:               |                    |                    |       |                    |                    |       |
| Cash and due from banks                    | 20,708             |                    |       | 22,112             |                    |       |
| Allowance for loan losses                  | (7,850)            |                    |       | (6,888)            |                    |       |
| Premises and equipment                     | 26,488             |                    |       | 25,044             |                    |       |
| Other assets                               | 31,954             |                    |       | 26,500             |                    |       |
| Total noninterest-earning assets           | 71,300             |                    |       | 66,768             |                    |       |
| Total assets                               | \$ 1,355,773       |                    |       | \$ 1,303,920       |                    |       |
| <b>LIABILITIES:</b>                        |                    |                    |       |                    |                    |       |
| Interest-bearing deposits:                 |                    |                    |       |                    |                    |       |
| Checking                                   | \$ 139,945         | \$ 733             | 0.70% | \$ 133,954         | \$ 839             | 0.84% |
| Money markets                              | 399,367            | 6,392              | 2.13  | 377,922            | 11,283             | 3.98  |
| Savings                                    | 65,780             | 301                | 0.61  | 70,520             | 365                | 0.69  |
| Certificates of deposit                    | 391,047            | 11,137             | 3.80  | 390,621            | 14,246             | 4.86  |
| Total interest-bearing deposits            | 996,139            | 18,563             | 2.48  | 973,017            | 26,733             | 3.66  |
| Borrowings                                 | 48,390             | 1,222              | 3.37  | 28,939             | 831                | 3.83  |
| Total interest-bearing liabilities         | 1,044,529          | 19,785             | 2.53  | 1,001,956          | 27,564             | 3.67  |
| Noninterest bearing liabilities            |                    |                    |       |                    |                    |       |
| Demand deposits                            | 192,599            |                    |       | 184,738            |                    |       |
| Accrued expenses and other liabilities     | 12,472             |                    |       | 11,190             |                    |       |
| Total noninterest-bearing liabilities      | 205,071            |                    |       | 195,928            |                    |       |
| Shareholders' equity                       | 106,173            |                    |       | 106,036            |                    |       |
| Total liabilities and shareholders' equity | \$ 1,355,773       |                    |       | \$ 1,303,920       |                    |       |
| Net Interest income (tax-equivalent basis) |                    |                    |       |                    |                    |       |
|                                            |                    | 34,946             |       |                    | 26,584             |       |
| Net interest spread                        |                    |                    | 3.15% |                    |                    | 2.17% |

|                           |           |           |
|---------------------------|-----------|-----------|
| Net interest margin (4)   | 3.63%     | 2.86%     |
| Tax equivalent adjustment | (862)     | (703)     |
| Net interest income       | \$ 34,084 | \$ 25,881 |

- (1) Average balances for available-for sale securities are based on amortized cost.
- (2) Interest income is presented on a tax-equivalent basis using a 35 percent federal tax rate.
- (3) Loans are stated net of unearned income and include non-accrual loans.
- (4) Net interest income on a tax-equivalent basis as a percentage of total average interest-earning assets.

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OTHER INCOME: For the third quarter of 2008, other income was \$3.6 million, an increase of \$393 thousand or 12.4 percent over the same quarter of 2007. In the third quarter of 2008, PGB Trust and Investments, the Bank's trust division, generated \$2.5 million in fee income, an increase of \$237 thousand or 10.5 percent over the same quarter of 2007 due in part to higher levels of overall business and higher estate fees. The market value of trust assets under administration for PGB Trust and Investments was approximately \$1.86 billion at September 30, 2008.

The Corporation recorded net securities gains of \$104 thousand for the third quarter of 2008 as compared to no security gains or losses in the third quarter of 2007.

Other income, excluding trust fee income and the net gains noted above, totaled \$964 thousand and \$912 thousand for the third quarters of 2008 and 2007, respectively. In the first quarter of 2008, the Bank invested in an additional \$5.0 million of Bank Owned Life Insurance, which resulted in additional income of \$70 thousand in the third quarter of 2008. Also included in other income in this third quarter of 2008 is fee income from the sale of mortgage loans of \$24 thousand.

For the nine months ended September 30, 2008, other income was \$10.9 million, an increase of \$1.0 million or 10.4 percent when compared to the \$9.9 million recorded in the same period a year ago. PGB Trust and Investments generated fee income of \$7.6 million and \$6.9 million in the first nine months of 2008 and 2007, respectively.

Net securities gains for the nine months ended September 30, 2008 totaled \$483 thousand as compared to \$382 thousand in the same period a year ago. Included in net securities gains in 2008 was a gain of \$81 thousand from the mandatory redemption of Class B Visa shares in conjunction with Visa's initial public offering. Relocating the Shunpike Branch to Green Village Road and closing the New Vernon Branch in 2008 resulted in a \$153 thousand loss on disposal of fixed assets.

All other income, excluding trust fee income and net gains, for the nine months ended September 30, 2008 and 2007, totaled \$3.0 million and \$2.7 million, respectively, an increase of \$304 thousand or 11.4 percent. For the nine months ended September 30, 2008, income from Bank Owned Life Insurance increased \$206 thousand or 31.2 percent to \$866 thousand when compared to the year ago period, due in part to the additional \$5 million investment. Also included in other income in the first nine months of 2008 and 2007 is fee income from the sale of mortgage loans of \$104 thousand and \$28 thousand, respectively.

The following table presents the components of other income for the periods indicated:

| (In thousands)                             | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |          |
|--------------------------------------------|-------------------------------------|----------|------------------------------------|----------|
|                                            | 2008                                | 2007     | 2008                               | 2007     |
| Trust department income                    | \$ 2,489                            | \$ 2,252 | \$ 7,639                           | \$ 6,853 |
| Service charges and fees                   | 554                                 | 494      | 1,583                              | 1,497    |
| Bank owned life insurance                  | 293                                 | 223      | 866                                | 660      |
| Other non-interest income                  | 32                                  | 113      | 270                                | 271      |
| Safe deposit rental fees                   | 62                                  | 59       | 185                                | 181      |
| Fees for other services                    | 23                                  | 23       | 74                                 | 65       |
| (Losses)/gains on disposal of fixed assets | -                                   | -        | (153)                              | 3        |
| Securities gains, net                      | 104                                 | -        | 483                                | 382      |
| Total other income                         | \$ 3,557                            | \$ 3,164 | \$ 10,947                          | \$ 9,912 |



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OTHER EXPENSES: Other expenses totaled \$9.6 million for the third quarter of 2008, as compared to \$8.1 million recorded in the same quarter of 2007, an increase of \$1.5 million or 18.4 percent. Salaries and benefits, the Corporation's largest non-interest expense, was \$5.5 million and \$4.4 million for the third quarters of 2008 and 2007, respectively, an increase of \$1.1 million or 25.2 percent. This increase is due, in part, to an additional pension contribution of \$690 thousand recorded in September when the defined benefit pension plan was settled and substantially all benefits were paid to employees. The Plan, which covered substantially all of its salaried employees, was discontinued on May 12, 2008. Contributions totaling \$2.1 million, including the additional contribution noted above, were made during 2008 and no further contributions are expected. The Corporation amended its existing 401-K profit-sharing and investment plan to enhance the contributions to its salaried employees starting in May 2008. The Corporation also added new officers and support staff to carry out the Corporation's strategic plan, paid higher salaries and incurred higher health care costs as compared to prior periods. The Corporation also expensed \$82 thousand of stock-based compensation expense in the third quarter of 2008 as compared to \$52 thousand in the same quarter of 2007.

In the third quarter of 2009, premises and equipment expense increased \$135 thousand, or 6.8 percent, to \$2.1 million from the same quarter in 2007. The increase is due in part to the additional expenses associated with new branches and additional employees. New branches are vital to our future growth and profitability. We expect deposit and loan growth to continue as we add new markets and expand our staff to include professional commercial lenders. The Corporation continues to strive to operate in an efficient manner.

Professional services increased \$78 thousand or 40.8 percent for the third quarter of 2008 when compared to the same quarter last year and includes increased legal expenses related to nonperforming loans and other real estate owned. Advertising expenses were \$254 thousand for the third quarter of 2008 as compared to \$275 thousand for the same quarter in 2007. Trust department expenses rose \$51 thousand to \$153 thousand for the third quarter of 2008 due to increased tax preparation fees. Stationery and supplies and telephone expense were \$114 thousand and \$121 thousand for the third quarter of 2008, remaining flat to the same period of 2007.

Other expenses totaled \$27.3 million for the nine months ended September 30, 2008, an increase of \$3.6 million or 15.4 percent over the \$23.7 million recorded for the same period of 2007. For the first nine months of 2008, salaries and benefits expense was \$15.3 million, an increase of \$2.2 million or 17.2 percent over the expense recorded for the same period ended September 30, 2007. As noted above, the Corporation contributed an additional \$690 thousand to its discontinued defined benefit plan as full distributions were made to all covered employees. The Corporation has also hired additional commercial lending officers and support staff in order to increase the commercial and construction loan portfolios. In addition, branch expansion, normal salary increases and higher group health insurance costs contributed to the increase.

For the nine months ended September 30, 2008, the Corporation recorded \$6.3 million of premises and equipment expense as compared to \$5.6 million for the same period a year ago, an increase of \$681 thousand or 12.2 percent. The increase is due in part to the additional expenses, such as depreciation, utilities and various equipment associated with two new branches and additional employees.

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The following table presents the components of other expense for the periods indicated:

| (In thousands)                 | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |           |
|--------------------------------|-------------------------------------|----------|------------------------------------|-----------|
|                                | 2008                                | 2007     | 2008                               | 2007      |
| Salaries and employee benefits | \$ 5,509                            | \$ 4,402 | \$ 15,253                          | \$ 13,016 |
| Premises and equipment         | 2,116                               | 1,981    | 6,264                              | 5,583     |
| Professional fees              | 269                                 | 191      | 889                                | 814       |
| Advertising                    | 254                                 | 275      | 787                                | 789       |
| Trust department expense       | 153                                 | 102      | 490                                | 332       |
| Stationery and supplies        | 114                                 | 108      | 356                                | 303       |
| Telephone                      | 121                                 | 122      | 349                                | 333       |
| Postage                        | 76                                  | 90       | 273                                | 256       |
| Other expense                  | 979                                 | 827      | 2,668                              | 2,249     |
| Total other expense            | \$ 9,591                            | \$ 8,098 | \$ 27,329                          | \$ 23,675 |

**NON-PERFORMING ASSETS:** Other real estate owned (OREO), loans past due in excess of 90 days and still accruing, and non-accrual loans are considered non-performing assets. These assets totaled \$5.0 million and \$2.1 million at September 30, 2008 and December 31, 2007 respectively. The increase in non-performing assets from the year end 2007 was the result of higher non-accrual loans, including a commercial loan of \$1.2 million and several residential mortgage loans. Peapack-Gladstone Bank has no sub-prime loans or higher-interest rate loans to borrowers with impaired or non-existent credit histories, in its loan portfolio.

The following table sets forth non-performing assets on the dates indicated, in conjunction with asset quality ratios:

| (In thousands)                                                              | September<br>30,<br>2008 | December<br>31,<br>2007 |
|-----------------------------------------------------------------------------|--------------------------|-------------------------|
| Loans past due in excess of 90 days and still accruing                      | \$ -                     | \$ -                    |
| Non-accrual loans                                                           | 3,804                    | 2,131                   |
| Other real estate owned                                                     | 1,211                    | -                       |
| Total non-performing assets                                                 | \$ 5,015                 | \$ 2,131                |
| Non-performing loans as a % of total loans                                  | 0.37%                    | 0.22%                   |
| Non-performing assets as a % of total loans plus<br>other real estate owned | 0.48%                    | 0.22%                   |
| Allowance as a % of total loans                                             | 0.88%                    | 0.76%                   |

**PROVISION FOR LOAN LOSSES:** The provision for loan losses was \$780 thousand for the third quarter of 2008 as compared to \$125 thousand for the same period of 2007 and \$590 thousand for the second quarter of 2008. The provision for loan losses for the first nine months of 2008 and 2007 was \$1.8 million and \$350 thousand, respectively. The amount of the loan loss provision and the level of the allowance for loan losses are based upon a number of factors including management's evaluation of probable losses inherent in the portfolio, after consideration of appraised collateral values, financial condition and past credit history of the borrowers as well as prevailing economic conditions. The higher provision reflects the increased percentage of commercial credits in relation to the entire loan portfolio. Commercial credits carry a higher risk profile, which is reflected in Management's determination of the proper level of the allowance for loan losses. In addition, Management has determined a higher provision prudent because of continued weakness in the housing markets.

For the third quarter of 2008 there were net recoveries of \$13 thousand as compared to \$7 thousand of net charge-offs in the same quarter of 2007. Net charge-offs for the nine months ended September 30, 2008 were \$212 thousand as compared to net charge-offs of \$6 thousand for the same period months of 2007.

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A summary of the allowance for loan losses for the periods indicated:

| (In thousands)               | 2008     | 2007     |
|------------------------------|----------|----------|
| Balance, January 1,          | \$ 7,500 | \$ 6,768 |
| Provision charged to expense | 1,800    | 350      |
| Charge-offs                  | (239)    | (10)     |
| Recoveries                   | 27       | 4        |
| Balance, September 30,       | \$ 9,088 | \$ 7,112 |

**INCOME TAXES:** : Income tax expense as a percentage of pre-tax income was 34.1 percent and 30.8 percent for the quarters ended September 30, 2008 and 2007, respectively. Pre-tax income increased from \$3.8 million for the third quarter in 2007 to \$5.3 million from the same period in 2008. For the first nine months in 2008 and 2007, income tax expense as a percentage of pre-tax income was 33.6 percent and 30.7 percent, respectively, due in part to higher taxable income in the Bank subsidiary.

**CAPITAL RESOURCES:** At September 30, 2008, total shareholders' equity was \$105.9 million as compared to \$107.1 million at September 30, 2007 and \$107.4 million at December 31, 2007. The primary reason for the decline reflects the recognition of unrealized losses as a component of shareholders' equity in the Bank's available for sale corporate securities portfolio, offset in part by higher net income.

The Federal Reserve Board has adopted risk-based capital guidelines for banks. The minimum guideline for the ratio of total capital to risk-weighted assets is 8 percent. Tier 1 Capital consists of common stock, retained earnings, minority interests in the equity accounts of consolidated subsidiaries and non-cumulative preferred stock, less goodwill and certain other intangibles. The remainder may consist of other preferred stock, certain other instruments and a portion of the allowance for loan loss. At September 30, 2008, the Corporation's Tier 1 Capital and Total Capital ratios were 12.41 percent and 13.36 percent, respectively.

In addition, the Federal Reserve Board has established minimum leverage ratio guidelines. These guidelines provide for a minimum ratio of Tier 1 Capital to average total assets of 3 percent for banks that meet certain specified criteria, including having the highest regulatory rating. All other banks are generally required to maintain a leverage ratio of at least 3 percent plus an additional 100 to 200 basis points. The Corporation's leverage ratio at September 30, 2008, was 8.76 percent.

**LIQUIDITY:** Liquidity refers to an institution's ability to meet short-term requirements in the form of loan requests, deposit withdrawals and maturing obligations. Principal sources of liquidity include cash, temporary investments and securities available for sale.

Management's opinion is that the Corporation's liquidity position is sufficient to meet future needs. Cash and cash equivalents, interest earning deposits and federal funds sold totaled \$31.5 million at September 30, 2008. In addition, the Corporation has \$146.1 million in securities designated as available for sale. These securities can be sold in response to liquidity concerns or pledged as collateral for borrowings as discussed below. Carrying value as of September 30, 2008, of investment securities and securities available for sale maturing within one year totals \$10.8 million.

The primary source of funds available to meet liquidity needs is the Corporation's core deposit base, which excludes certificates of deposit greater than \$100 thousand. As of September 30, 2008, core deposits equaled \$1.0 billion.



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Another source of liquidity is borrowing capacity. The Corporation has a variety of sources of short-term liquidity available, including federal funds purchased from correspondent banks, short-term and long-term borrowings from the Federal Home Loan Bank of New York, access to the Federal Reserve Bank discount window and loan participations of sales of loans. The Corporation also generates liquidity from the regular principal payments made on its mortgage-backed securities and loan portfolios.

**RECENT ACCOUNTING PRONOUNCEMENTS:**

In September 2006, the FASB issued Statement No. 157, "Fair Value Measurements" (Statement No. 157). Statement No. 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. Statement No. 157 establishes a fair value hierarchy about the assumptions used to measure fair value and clarifies assumptions about risk and the effect of a restriction on the sale or use of an asset. The standard is effective for fiscal years beginning after November 15, 2007. The adoption of Statement No. 157 did not have a material impact on the Corporation's financial statements.

In February 2007, the Financial Accounting Standards Board (FASB) issued FASB Statement No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" (Statement No. 159). Statement No. 159 provides companies with an option to report selected financial assets and liabilities at fair value. Statement No. 159's objective is to reduce both complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. Statement No. 159 is effective as of the beginning of an entity's first fiscal year beginning after November 15, 2007. The adoption of Statement No. 159 did not have a material impact on the Corporation's financial statements.

In September 2006, the FASB Emerging Issues Task Force (EITF) finalized Issue No. 06-4, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements." EITF 06-4 requires that a liability be recorded during the service period when a split-dollar life insurance agreement continues after participants' employment or retirement. The required accrued liability will be based on either the post-employment benefit cost for the continuing life insurance or based on the future death benefit depending on the contractual terms of the underlying agreement. EITF 06-4 is effective for fiscal years beginning after December 15, 2007. The adoption of EITF 06-4 resulted in an accrued benefit liability of \$449 thousand, which was taken against retained earnings and an annual expense of approximately \$94 thousand in 2008.

In November 2007, the SEC issued Staff Accounting Bulletin No. 109, "Written Loan Commitments Recorded at Fair Value through Earnings" (SAB 109). Previously, SAB 105, "Application of Accounting Principles to Loan Commitments," stated that in measuring the fair value of a derivative loan commitment, a company should not incorporate the expected net future cash flows related to the associated servicing of the loan. SAB 109 supersedes SAB 105 and indicates that the expected net future cash flows related to the associated servicing of the loan should be included in measuring fair value for all written loan commitments that are accounted for at fair value through earnings. SAB 105 also indicated that internally-developed intangible assets should not be recorded as part of the fair value of a derivative loan commitment, and SAB 109 retains that view. SAB 109 is effective for derivative loan commitments issued or modified in fiscal quarters beginning after December 15, 2007. The adoption of SAB 109 did not have a material impact on the Corporation's consolidated financial statements.

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In December 2007, the SEC issued Staff Accounting Bulletin No. 110, “Share-Based Payment” (SAB 110) allows companies to continue to use a “simplified” method, as discussed in SAB 107, in developing an estimate of the expected term of “plain vanilla” share options in accordance with FAS 123R. SAB 107 originally indicated that use of the “simplified” method could not continue beyond December 31, 2007. The simplified method can only be used under certain circumstances. Examples of situations where it may be appropriate to use the simplified method include 1) instances where a company does not have sufficient historical exercise data, 2) significantly changes the terms of its share option grants or types of employees who receive grants and 3) instances when a company expects significant changes to its business that would impact the reliance on historical exercise data. The adoption of SAB 110 did not have a material effect on the Corporation’s financial statements.

### ITEM 3. Quantitative and Qualitative Disclosures about Market Risk

There have been no material changes to information required regarding quantitative and qualitative disclosures about market risk from the end of the preceding fiscal year to the date of the most recent interim financial statements (September 30, 2008).

### ITEM 4. Controls and Procedures

The Corporation’s Chief Executive Officer and Chief Financial Officer, with the assistance of other members of the Corporation’s management, have evaluated the effectiveness of the Corporation’s disclosure controls and procedures (as defined in Rule 13a-15(e) or Rule 15d-15(e) under the Exchange Act) as of the end of the period covered by this Quarterly report on Form 10-Q. Based on such evaluation, the Corporation’s Chief Executive Officer and Chief Financial Officer have concluded that the Corporation’s disclosure controls and procedures are effective.

The Corporation’s Chief Executive Officer and Chief Financial Officer have also concluded that there have not been any changes in the Corporation’s internal control over financial reporting that have materially affected, or is reasonable likely to materially affect, the Corporation’s internal control over financial reporting.

The Corporation’s management, including the CEO and CFO, does not expect that our disclosure controls and procedures of our internal controls will prevent all errors and all fraud. A control system, no matter how well conceived and operated, provides reasonable, not absolute, assurance that the objectives of the control system are met. The design of a control system reflects resource constraints; the benefits of controls must be considered relative to their costs. Because there are inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Corporation have been or will be detected. These inherent limitations include the realities that judgments in decision-making can be faulty that breakdowns occur because of simple error or mistake. Controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part upon certain assumptions about the likelihood of future events. There can be no assurance that any design will succeed in achieving its stated goals under all future conditions; over time, control may become inadequate because of changes in conditions or deterioration in the degree of compliance with the policies or procedures. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

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## PART II. OTHER INFORMATION

## ITEM 1A. Risk Factors

There were no material changes in the Corporation's risk factors during the three months ended September 30, 2008 from the risk factors disclosed in Part I, Item 1A of the Corporation's Annual Report on Form 10-K for the year ended December 31, 2007, except for the following addition:

The national and global economic downturn has recently resulted in unprecedented levels of financial market volatility which may depress the overall market value of financial institutions, limit access to capital, or have a material adverse effect on the financial condition or results of operations of banking companies in general and the Corporation in particular. In addition, the possible duration and severity of the adverse economic cycle is unknown and may exacerbate the Corporation's exposure to credit risk.

## ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds

## Issuer Purchases of Equity Securities

| Period               | Total<br>Number of<br>Shares<br>Purchased | Average<br>Price Paid<br>Per Share | Total<br>Number of<br>Shares<br>Purchased as<br>Part of<br>Publicly<br>Announced<br>Plans<br>Or Programs | Maximum<br>Number<br>Of Shares That<br>May<br>Yet be<br>Purchased<br>Under the<br>Plans or<br>Programs |
|----------------------|-------------------------------------------|------------------------------------|----------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------|
| July 1-31, 2008      | 12,952                                    | \$ 22.66                           | 12,952                                                                                                   | 29,500                                                                                                 |
| August 1-31, 2008    | -                                         | -                                  | -                                                                                                        | 29,500                                                                                                 |
| September 1-30, 2008 | -                                         | -                                  | -                                                                                                        | 29,500                                                                                                 |
| Total                | 12,952                                    | \$ 22.66                           | 12,952                                                                                                   |                                                                                                        |

On April 15, 2005, the Board of Directors of Peapack-Gladstone Financial Corporation announced the authorization of a stock repurchase plan. The Board authorized the purchase of up to 150,000 shares of outstanding common stock, to be made from time to time, in the open market or in privately negotiated transactions, at prices not exceeding prevailing market prices. The Board of Directors authorized another extension of the stock buyback program for an additional twelve months to April 15, 2009.

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ITEM 6. Exhibits

3 Articles of Incorporation and By-Laws:

A. Restated Certificate of Incorporation as in effect on the date of this filing are incorporated herein by reference to the Registrant's Current Report on Form 10-Q filed on May 8, 2008.

B. Amended By-Laws of the Registrant as in effect on the date of this filing are incorporated herein by reference to the Registrant's Current Report on Form 8-K filed on April 27, 2007.

31.1 Certification of Frank A. Kissel, Chief Executive Officer of the Corporation, pursuant to Securities Exchange Act Rule 13a-14(a).

31.2 Certification of Arthur F. Birmingham, Chief Financial Officer of the Corporation, pursuant to Securities Exchange Act Rule 13a-14(a).

32 Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act Of 2002, signed by Frank A. Kissel, Chief Executive Officer of the Corporation, and Arthur F. Birmingham, Chief Financial Officer of the Corporation.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PEAPACK-GLADSTONE FINANCIAL  
CORPORATION  
(Registrant)

DATE: November 7, 2008

By: /s/ Frank A. Kissel  
Frank A. Kissel  
Chairman of the Board and Chief Executive  
Officer

DATE: November 7, 2008

By: /s/ Arthur F. Birmingham  
Arthur F. Birmingham  
Executive Vice President and Chief Financial  
Officer

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EXHIBIT INDEX

| Number      | Description                                                                                                                                                                                                                                                                                                                                                                                                                            |
|-------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
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| <u>31.1</u> | Certification of Frank A. Kissel, Chief Executive Officer of the Corporation, pursuant to Securities Exchange Act Rule 13a-14(a).                                                                                                                                                                                                                                                                                                      |
| <u>31.2</u> | Certification of Arthur F. Birmingham, Chief Financial Officer of the Corporation, pursuant to Securities Exchange Act Rule 13a-14(a).                                                                                                                                                                                                                                                                                                 |
| <u>32</u>   | Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act Of 2002, signed by Frank A. Kissel, Chief Executive Officer of the Corporation, and Arthur F. Birmingham, Chief Financial Officer of the Corporation.                                                                                                                                                                   |