

LAKELAND BANCORP INC  
Form 10-K  
March 16, 2006  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

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**FORM 10-K**

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(MARK ONE)

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2005.

**TRANSITION REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_.

Commission file number:

33-27312

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**LAKELAND BANCORP, INC.**

(Exact name of registrant as specified in its charter)

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New Jersey  
(State or other jurisdiction of

incorporation or organization)

250 Oak Ridge Road, Oak Ridge, New Jersey  
(Address of principal executive offices)

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

22-2953275  
(I.R.S. Employer

Identification No.)

07438  
(Zip code)

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Securities registered pursuant to Section 12(b) of the Act: None

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Securities registered pursuant to Section 12(g) of the Act:

Title of Each Class

**Common Stock, no par value**

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes  No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act:

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by a check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

As of June 30, 2005, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was approximately \$291,000,000, based on the closing sale price as reported on the National Association of Securities Dealers Automated Quotation System National Market System.

The number of shares outstanding of the registrant's Common Stock, as of February 1, 2006, was 21,068,895.

DOCUMENTS INCORPORATED BY REFERENCE:

Lakeland Bancorp, Inc.'s Proxy Statement for its 2006 Annual Meeting of Shareholders (Part III).

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[Page numbers to be filled in once Items 6, 7 and 8 are added.]

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**PART I**

**ITEM 1 - Business**

**GENERAL**

Lakeland Bancorp, Inc. (the Company), a New Jersey corporation, is a bank holding company registered with and supervised by the Board of Governors of the Federal Reserve System (the Federal Reserve Board). The Company was organized in March of 1989 and commenced operations on May 19, 1989, upon consummation of the acquisition of all of the outstanding stock of Lakeland Bank, formerly named Lakeland State Bank (Lakeland). On February 20, 1998, the Company acquired Metropolitan State Bank, which became a subsidiary of the Company. On July 15, 1999, the Company completed its acquisition of The National Bank of Sussex County (NBSC). On January 28, 2000, the Company merged Metropolitan State Bank into Lakeland, with Lakeland as the survivor. On June 29, 2001, the Company merged NBSC into Lakeland, with Lakeland as the survivor. On August 25, 2003, the Company acquired CSB Financial Corp. and its subsidiary, Community State Bank, by merging CSB Financial Corp. into the Company and Community State Bank into Lakeland, with Lakeland as the survivor. On July 1, 2004, the Company acquired Newton Financial Corp. (NFC), which merged into the Company, and its subsidiary, Newton Trust Company (Newton). Newton operated as an independent bank until it merged into Lakeland, with Lakeland as the survivor, on November 4, 2005.

The Company's primary business currently consists of managing and supervising Lakeland. The principal source of the Company's income is dividends paid by Lakeland. At December 31, 2005, the Company had consolidated total assets, deposits, and stockholders' equity of approximately \$2.2 billion, \$1.8 billion, and \$191.8 million, respectively.

This Annual Report on Form 10-K contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 (Forward-Looking Statements). Such statements are subject to risks and uncertainties that could cause actual results to differ materially from those projected in such Forward-Looking Statements. Certain factors which could materially affect such results and the future performance of the Company are described in Item 1A - Risk Factors to this Annual Report on Form 10-K.

Lakeland is a state banking association, the deposits of which are insured by the Federal Deposit Insurance Corporation (FDIC). Lakeland is not a member of the Federal Reserve System. Lakeland is a full-service commercial bank, offering a complete range of consumer and commercial services. Lakeland's 47 branch offices are located in the following six New Jersey counties: Morris, Passaic, Sussex, Warren, Essex, and Bergen.

**Commercial Bank Services**

Through Lakeland, the Company offers a broad range of lending, depository, and related financial services to individuals and small to medium sized businesses in its northern New Jersey market area. In the lending area, these services include short and medium term loans, lines of credit, letters of credit, inventory and accounts receivable financing, real estate construction loans and mortgage loans. Depository products include demand deposits, savings accounts, and time accounts. In addition, the Company offers collection, wire transfer, and night depository services. In the second quarter of 2000, Lakeland acquired NIA National Leasing Inc. Since its acquisition, this company has operated as a division of Lakeland under the name Lakeland Bank Equipment Leasing Division. This division provides a solution to small and medium sized companies who prefer to lease equipment over other financial alternatives. In the third quarter of 2004, Lakeland acquired a \$25 million asset-based lending portfolio, which provides commercial borrowers with another lending alternative.

**Consumer Banking**

The Company also offers a broad range of consumer banking services, including checking accounts, savings accounts, NOW accounts, money market accounts, certificates of deposit, secured and unsecured loans, consumer installment loans, mortgage loans, and safe deposit services.

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### **Other Services**

Investment and advisory services for individuals are also available.

### **Competition**

The Company operates in a highly competitive market environment within northern New Jersey. Major multi-bank holding companies, several large independent regional banks, and several large multi-state thrift holding companies all operate within the Company's market area. These larger institutions have substantially larger lending capacities and typically offer services which the Company does not offer.

In recent years, the financial services industry has expanded rapidly as barriers to competition within the industry have become less significant. Within this industry, banks must compete not only with other banks and traditional financial institutions, but also with other business corporations that have begun to deliver financial services.

### **Concentration**

The Company is not dependent for deposits or exposed by loan concentrations to a single customer or a small group of customers the loss of any one or more of which would have a material adverse effect upon the financial condition of the Company.

### **Employees**

At December 31, 2005, there were 548 persons employed by the Company.

## **SUPERVISION AND REGULATION**

### **General**

The Company is a registered bank holding company under the federal Bank Holding Company Act of 1956, as amended (the Holding Company Act), and is required to file with the Federal Reserve Board an annual report and such additional information as the Federal Reserve Board may require pursuant to the Holding Company Act. The Company is subject to examination by the Federal Reserve Board.

Lakeland is a state chartered banking association subject to supervision and examination by the Department of Banking and Insurance of the State of New Jersey and the FDIC. The regulations of the State of New Jersey and FDIC govern most aspects of Lakeland's business, including reserves against deposits, loans, investments, mergers and acquisitions, borrowings, dividends, and location of branch offices. Lakeland is subject to certain restrictions imposed by law on, among other things, (i) the maximum amount of obligations of any one person or entity which may be outstanding at any one time, (ii) investments in stock or other securities of the Company or any subsidiary of the Company, and (iii) the taking of such stock or securities as collateral for loans to any borrower.

### **The Holding Company Act**

The Holding Company Act limits the activities which may be engaged in by the Company and its subsidiaries to those of banking, the ownership and acquisition of assets and securities of banking organizations, and the management of banking organizations, and to certain non-banking activities which the Federal Reserve Board finds, by order or regulation, to be so closely related to banking or managing or controlling a bank as to be a proper incident thereto. The Federal Reserve Board is empowered to differentiate between activities by a bank holding company or a subsidiary thereof and activities commenced by acquisition of a going concern.

With respect to non-banking activities, the Federal Reserve Board has by regulation determined that several non-banking activities are closely related to banking within the meaning of the Holding Company Act and thus may be performed by bank holding companies. Although the Company's management periodically reviews other avenues of business opportunities that are included in that regulation, the Company has no present plans to engage in any of these activities other than providing brokerage services through a third party.

With respect to the acquisition of banking organizations, the Company is required to obtain the prior approval of the Federal Reserve Board before it may, by merger, purchase or otherwise, directly or indirectly acquire all

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or substantially all of the assets of any bank or bank holding company, if, after such acquisition, it will own or control more than 5% of the voting shares of such bank or bank holding company.

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### **Regulation of Bank Subsidiaries**

There are various legal limitations, including Sections 23A and 23B of the Federal Reserve Act, which govern the extent to which a bank subsidiary may finance or otherwise supply funds to its holding company or its holding company's non-bank subsidiaries. Under federal law, no bank subsidiary may, subject to certain limited exceptions, make loans or extensions of credit to, or investments in the securities of, its parent or the non-bank subsidiaries of its parent (other than direct subsidiaries of such bank which are not financial subsidiaries) or take their securities as collateral for loans to any borrower. Each bank subsidiary is also subject to collateral security requirements for any loans or extensions of credit permitted by such exceptions.

### **Commitments to Affiliated Institutions**

The policy of the Federal Reserve Board provides that a bank holding company is expected to act as a source of financial strength to its subsidiary banks and to commit resources to support such subsidiary banks in circumstances in which it might not do so absent such policy.

### **Interstate Banking**

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 permits bank holding companies to acquire banks in states other than their home state, regardless of applicable state law. This act also authorizes banks to merge across state lines, thereby creating interstate branches. Under the act, each state had the opportunity either to opt out of this provision, thereby prohibiting interstate branching in such state, or to opt in. A state may opt in with respect to de novo branching, thereby permitting a bank to open new branches in a state in which the bank does not already have a branch. Without de novo branching, an out-of-state bank can enter the state only by acquiring an existing bank. New Jersey enacted legislation to authorize interstate banking and branching and the entry into New Jersey of foreign country banks. New Jersey did not authorize de novo branching into the state. However, under federal law, federal savings banks, which meet certain conditions, may branch de novo into a state, regardless of state law.

### **Gramm-Leach Bliley Act of 1999**

The Gramm-Leach-Bliley Financial Modernization Act of 1999 became effective in early 2000. The Modernization Act:

allows bank holding companies meeting management, capital, and Community Reinvestment Act standards to engage in a substantially broader range of nonbanking activities than previously was permissible, including insurance underwriting and making merchant banking investments in commercial and financial companies; if a bank holding company elects to become a financial holding company, it files a certification, effective in 30 days, and thereafter may engage in certain financial activities without further approvals;

allows insurers and other financial services companies to acquire banks;

removes various restrictions that previously applied to bank holding company ownership of securities firms and mutual fund advisory companies; and

establishes the overall regulatory structure applicable to bank holding companies that also engage in insurance and securities operations. The Modernization Act also modified other financial laws, including laws related to financial privacy and community reinvestment.

### **The USA PATRIOT Act**

In response to the events of September 11, 2001, the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the USA PATRIOT Act), was signed into law on October 26, 2001. The USA PATRIOT Act gives the federal government new powers to address terrorist threats through enhanced domestic security measures, expanded surveillance powers, increased information sharing, and broadened anti-money laundering requirements. By way of amendments to the Bank Secrecy Act, Title III of the USA PATRIOT Act encourages information sharing among bank





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regulatory agencies and law enforcement bodies. Further, certain provisions of Title III impose affirmative

obligations on a broad range of financial institutions, including banks, thrifts, brokers, dealers, credit unions, money transfer agents and parties registered under the Commodity Exchange Act.

Among other requirements, Title III of the USA PATRIOT Act imposes the following requirements with respect to financial institutions:

All financial institutions must establish anti-money laundering programs that include, at a minimum: (i) internal policies, procedures, and controls; (ii) specific designation of an anti-money laundering compliance officer; (iii) ongoing employee training programs; and (iv) an independent audit function to test the anti-money laundering program.

The Secretary of the Department of Treasury, in conjunction with other bank regulators, was authorized to issue regulations that provide for minimum standards with respect to customer identification at the time new accounts are opened.

Financial institutions that establish, maintain, administer, or manage private banking accounts or correspondence accounts in the United States for non-United States persons or their representatives (including foreign individuals visiting the United States) are required to establish appropriate, specific and, where necessary, enhanced due diligence policies, procedures, and controls designed to detect and report money laundering.

Financial institutions are prohibited from establishing, maintaining, administering or managing correspondent accounts for foreign shell banks (foreign banks that do not have a physical presence in any country), and will be subject to certain record keeping obligations with respect to correspondent accounts of foreign banks.

Bank regulators are directed to consider a holding company's effectiveness in combating money laundering when ruling on Federal Reserve Act and Bank Merger Act applications.

The United States Treasury Department has issued a number of implementing regulations which apply to various requirements of the USA PATRIOT Act to financial institutions such as Lakeland. These regulations impose obligations on financial institutions to maintain appropriate policies, procedures and controls to detect, prevent and report money laundering and terrorist financing and to verify the identity of their customers.

## **Sarbanes-Oxley Act of 2002**

On July 30, 2002, President Bush signed into law the Sarbanes-Oxley Act of 2002, or the SOA. The stated goals of the SOA are to increase corporate responsibility, to provide for enhanced penalties for accounting and auditing improprieties at publicly traded companies and to protect investors by improving the accuracy and reliability of corporate disclosures pursuant to the securities laws.

The SOA generally applies to all companies, both U.S. and non-U.S., that file or are required to file periodic reports with the Securities and Exchange Commission (the "SEC") under the Securities Exchange Act of 1934 (the "Exchange Act").

The SOA includes very specific additional disclosure requirements and new corporate governance rules, requires the SEC and securities exchanges to adopt extensive additional disclosure, corporate governance and other related rules and mandates further studies of certain issues by the SEC and the Comptroller General. The SOA represents significant federal involvement in matters traditionally left to state regulatory systems, such as the regulation of the accounting profession, and to state corporate law, such as the relationship between a board of directors and management and between a board of directors and its committees.

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The SOA addresses, among other matters:

audit committees for all reporting companies;

certification of financial statements by the chief executive officer and the chief financial officer;

the forfeiture of bonuses or other incentive-based compensation and profits from the sale of an issuer's securities by directors and senior officers in the twelve month period following initial publication of any financial statements that later require restatement;

a prohibition on insider trading during pension plan black out periods;

disclosure of off-balance sheet transactions;

a prohibition on personal loans to directors and officers (other than loans made by an insured depository institution (as defined in the Federal Deposit Insurance Act), if the loan is subject to the insider lending restrictions of section 22(h) of the Federal Reserve Act);

expedited filing requirements for Forms 4's;

disclosure of a code of ethics and filing a Form 8-K for a change or waiver of such code;

real time filing of periodic reports;

the formation of a public accounting oversight board;

auditor independence; and

various increased criminal penalties for violations of securities laws.

The SEC has enacted various rules to implement various provisions of the SOA with respect to, among other matters, disclosure in periodic filings pursuant to the Exchange Act.

**Regulation W**

Transactions between a bank and its affiliates are quantitatively and qualitatively restricted under the Federal Reserve Act. The Federal Deposit Insurance Act applies Sections 23A and 23B to insured nonmember banks in the same manner and to the same extent as if they were members of the Federal Reserve System. The Federal Reserve Board has also issued Regulation W, which codifies prior regulations under Sections 23A and 23B of the Federal Reserve Act and interpretative guidance with respect to affiliate transactions. Regulation W incorporates the exemption from the affiliate transaction rules but expands the exemption to cover the purchase of any type of loan or extension of credit from an affiliate.

Affiliates of a bank include, among other entities, the bank's holding company and companies that are under common control with the bank. The Company is considered to be an affiliate of Lakeland. In general, subject to certain specified exemptions, a bank or its subsidiaries are limited in

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their ability to engage in covered transactions with affiliates:

to an amount equal to 10% of the bank's capital and surplus, in the case of covered transactions with any one affiliate; and

to an amount equal to 20% of the bank's capital and surplus, in the case of covered transactions with all affiliates.

In addition, a bank and its subsidiaries may engage in covered transactions and other specified transactions only on terms and under circumstances that are substantially the same, or at least as favorable to the bank or its subsidiary, as those prevailing at the time for comparable transactions with nonaffiliated companies. A covered transaction includes:

a loan or extension of credit to an affiliate;

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a purchase of, or an investment in, securities issued by an affiliate;

a purchase of assets from an affiliate, with some exceptions;

the acceptance of securities issued by an affiliate as collateral for a loan or extension of credit to any party; and

the issuance of a guarantee, acceptance or letter of credit on behalf of an affiliate.

In addition, under Regulation W:

a bank and its subsidiaries may not purchase a low-quality asset from an affiliate;

covered transactions and other specified transactions between a bank or its subsidiaries and an affiliate must be on terms and conditions that are consistent with safe and sound banking practices; and

with some exceptions, each loan or extension of credit by a bank to an affiliate must be secured by certain types of collateral with a market value ranging from 100% to 130%, depending on the type of collateral, of the amount of the loan or extension of credit.

Regulation W generally excludes all non-bank and non-savings association subsidiaries of banks from treatment as affiliates, except to the extent that the Federal Reserve Board decides to treat these subsidiaries as affiliates.

**Community Reinvestment Act**

Under the Community Reinvestment Act (CRA), as implemented by FDIC regulations, a state bank has a continuing and affirmative obligation consistent with its safe and sound operation to help meet the credit needs of its entire community, including low and moderate income neighborhoods. The CRA does not establish specific lending requirements or programs for financial institutions nor does it limit an institution's discretion to develop the types of products and services that it believes are best suited to its particular community. The CRA requires the FDIC, in connection with its examination of a state non-member bank, to assess the bank's record of meeting the credit needs of its community and to take that record into account in its evaluation of certain applications by the bank. Under the FDIC's CRA evaluation system, the FDIC focuses on three tests: (i) a lending test, to evaluate the institution's record of making loans in its service areas; (ii) an investment test, to evaluate the institution's record of investing in community development projects, affordable housing and programs benefiting low or moderate income individuals and businesses; and (iii) a service test, to evaluate the institution's delivery of services through its branches, ATMs and other offices.

**Securities and Exchange Commission**

The Common Stock of the Company is registered with the SEC under the Exchange Act. As a result, the Company and its officers, directors, and major stockholders are obligated to file certain reports with the SEC. The Company is subject to proxy and tender offer rules promulgated pursuant to the Exchange Act. You may read and copy any document the Company files with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information about the Public Reference Room. The SEC maintains a website at <http://www.sec.gov> that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC, such as the Company.

The Company maintains a website at <http://www.lakelandbank.com>. The Company makes available on its website the proxy statements and reports on Forms 8-K, 10-K and 10-Q that it files with the SEC as soon as reasonably practicable after such material is electronically filed with or furnished to the SEC. Additionally, the Company has adopted and posted on its website a Code of Ethics that applies to its principal executive officer, principal financial officer and principal accounting officer. The Company intends to disclose any amendments to or waivers of the Code of Ethics on its website.



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### **Effect of Government Monetary Policies**

The earnings of the Company are and will be affected by domestic economic conditions and the monetary and fiscal policies of the United States government and its agencies.

The monetary policies of the Federal Reserve Board have had, and will likely continue to have, an important impact on the operating results of commercial banks through the Board's power to implement national monetary policy in order to, among other things, curb inflation or combat a recession. The Federal Reserve Board has a major effect upon the levels of bank loans, investments and deposits through its open market operations in United States government securities and through its regulation of, among other things, the discount rate of borrowings of banks and the reserve requirements against bank deposits. It is not possible to predict the nature and impact of future changes in monetary fiscal policies.

### **Dividend Restrictions**

The Company is a legal entity separate and distinct from Lakeland. Virtually all of the revenue of the Company available for payment of dividends on its capital stock will result from amounts paid to the Company by Lakeland. All such dividends are subject to various limitations imposed by federal and state laws and by regulations and policies adopted by federal and state regulatory agencies. Under State law, a bank may not pay dividends unless, following the dividend payment, the capital stock of the bank would be unimpaired and either (a) the bank will have a surplus of not less than 50% of its capital stock, or, if not, (b) the payment of the dividend will not reduce the surplus of the bank.

If, in the opinion of the FDIC, a bank under its jurisdiction is engaged in or is about to engage in an unsafe or unsound practice (which could include the payment of dividends), the FDIC may require, after notice and hearing, that such bank cease and desist from such practice or, as a result of an unrelated practice, require the bank to limit dividends in the future. The Federal Reserve Board has similar authority with respect to bank holding companies. In addition, the Federal Reserve Board and the FDIC have issued policy statements which provide that insured banks and bank holding companies should generally only pay dividends out of current operating earnings. Regulatory pressures to reclassify and charge off loans and to establish additional loan loss reserves can have the effect of reducing current operating earnings and thus impacting an institution's ability to pay dividends. Further, as described herein, the regulatory authorities have established guidelines with respect to the maintenance of appropriate levels of capital by a bank or bank holding company under their jurisdiction. Compliance with the standards set forth in these policy statements and guidelines could limit the amount of dividends which the Company and Lakeland may pay. Under the Federal Deposit Insurance Corporation Improvement Act of 1991 ( FDICIA ), banking institutions which are deemed to be undercapitalized will, in most instances, be prohibited from paying dividends. See FDICIA . See also Note 18 - Regulatory Matters of the Notes to Consolidated Financial Statements for further information regarding dividends.

### **Capital Adequacy Guidelines**

The Federal Reserve Board has adopted Risk-Based Capital Guidelines. These guidelines establish minimum levels of capital and require capital adequacy to be measured in part upon the degree of risk associated with certain assets. Under these guidelines all banks and bank holding companies must have a core or tier 1 capital to risk-weighted assets ratio of at least 4% and a total capital to risk-weighted assets ratio of at least 8%. At December 31, 2005, the Company's Tier 1 capital to risk-weighted assets ratio and total capital to risk-weighted assets ratio were 11.51% and 12.47%, respectively.

In addition, the Federal Reserve Board and the FDIC have approved leverage ratio guidelines (Tier I capital to average quarterly assets, less goodwill) for bank holding companies such as the Company. These guidelines provide for a minimum leverage ratio of 3% for bank holding companies that meet certain specified criteria, including that they have the highest regulatory rating. All other holding companies are required to maintain a leverage ratio of 3% plus an additional cushion of at least 100 to 200 basis points. The Company's leverage ratio was 7.49% at December 31, 2005.

Under FDICIA, federal banking agencies have established certain additional minimum levels of capital which accord with guidelines established under that act. See FDICIA .

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### **FDICIA**

Enacted in December 1991, FDICIA substantially revised the bank regulatory provisions of the Federal Deposit Insurance Act and several other federal banking statutes. Among other things, FDICIA requires federal banking agencies to broaden the scope of regulatory corrective action taken with respect to banks that do not meet minimum capital requirements and to take such actions promptly in order to minimize losses to the FDIC. Under FDICIA, federal banking agencies were required to establish minimum levels of capital (including both a leverage limit and a risk-based capital requirement) and specify for each capital measure the levels at which depository institutions will be considered well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized or critically undercapitalized.

Under regulations adopted under these provisions, for an institution to be well capitalized it must have a total risk-based capital ratio of at least 10%, a Tier I risk-based capital ratio of at least 6% and a Tier I leverage ratio of at least 5% and not be subject to any specific capital order or directive. For an institution to be adequately capitalized it must have a total risk-based capital ratio of at least 8%, a Tier I risk-based capital ratio of at least 4% and a Tier I leverage ratio of at least 4% (or in some cases 3%). Under the regulations, an institution will be deemed to be undercapitalized if it has a total risk-based capital ratio that is less than 8%, a Tier I risk-based capital ratio that is less than 4%, or a Tier I leverage ratio of less than 4% (or in some cases 3%). An institution will be deemed to be significantly undercapitalized if it has a total risk-based capital ratio that is less than 6%, a Tier I risk-based capital ratio that is less than 3%, or a leverage ratio that is less than 3% and will be deemed to be critically undercapitalized if it has a ratio of tangible equity to total assets that is equal to or less than 2%. An institution may be deemed to be in a capitalization category that is lower than is indicated by its actual capital position if it receives an unsatisfactory examination rating or is deemed to be in an unsafe or unsound condition or to be engaging in unsafe or unsound practices. As of December 31, 2005, the Company and Lakeland met all regulatory requirements for classification as well capitalized under the regulatory framework for prompt corrective action.

In addition, FDICIA requires banking regulators to promulgate standards in a number of other important areas to assure bank safety and soundness, including internal controls, information systems and internal audit systems, credit underwriting, asset growth, compensation, loan documentation and interest rate exposure.

### **Deposit Insurance and Premiums**

Lakeland's deposits are insured by the Bank Insurance Fund (BIF) that is administered by the FDIC up to a maximum of \$100,000 per depositor. The amount of the premium is determined by the FDIC's risk-based insurance assessment system in which each insured bank is placed in one of nine assessment risk classifications based on the FDIC's evaluation. There is a 27 basis point range between the highest and lowest assessment rate. Banks classified as strongest by the FDIC were subject in 2005 to a 0.00% assessment. Lakeland was placed in this category and, therefore, had a 0.00% assessment rate in 2005.

In addition to this assessment, Lakeland and all other members of the BIF are required to help fund interest payment obligations that the Financing Corporation (FICO) has assumed to recapitalize the Savings Association Insurance Fund (SAIF). During 2005, a FICO premium of approximately two basis points was charged on BIF deposits. Based on this premium, the Company paid a FICO premium of \$235,000 in 2005.

### **Proposed Legislation**

From time to time proposals are made in the United States Congress, the New Jersey Legislature, and before various bank regulatory authorities, which would alter the powers of, and place restrictions on, different types of banking organizations. It is impossible to predict the impact, if any, of potential legislative trends on the business of the Company and its subsidiaries.

In accordance with federal law providing for deregulation of interest on all deposits, banks and thrift organizations are now unrestricted by law or regulation from paying interest at any rate on most time deposits. It is not clear whether deregulation and other pending changes in certain aspects of the banking industry will result in further increases in the cost of funds in relation to prevailing lending rates.

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### **ITEM 1A - Risk Factors.**

Our business, financial condition, operating results and cash flows can be affected by a number of factors, including, but not limited to, those set forth below, any one of which could cause our actual results to vary materially from recent results or from our anticipated future results.

#### **We are subject to interest rate risk and variations in interest rates may negatively affect our financial performance.**

We are unable to predict actual fluctuations of market interest rates. Rate fluctuations are influenced by many factors, including:

inflation or recession;

a rise or fall in unemployment;

tightening or expansion of the money supply;

domestic and international disorder; and

instability in domestic and foreign financial markets.

Both increases and decreases in the interest rate environment may reduce our profits. We expect that we will continue to realize income from the difference or spread between the interest we earn on loans, securities and other interest-earning assets, and the interest we pay on deposits, borrowings and other interest-bearing liabilities. Our net interest spreads are affected by the differences between the maturities and repricing characteristics of our interest-earning assets and interest-bearing liabilities. Our interest-earning assets may not reprice as slowly or rapidly as our interest-bearing liabilities. Changes in market interest rates could materially and adversely affect our net interest spread, asset quality, levels of prepayments, cash flows, the market value of our securities portfolio, loan and deposit growth, costs and yields on loans and deposits and our overall profitability.

#### **Lakeland's ability to pay dividends is subject to regulatory limitations which, to the extent that our holding company requires such dividends in the future, may affect our holding company's ability to pay its obligations and pay dividends to shareholders.**

As a bank holding company, the Company is a separate legal entity from Lakeland and its subsidiaries, and we do not have significant operations of our own. We currently depend on Lakeland's cash and liquidity to pay our operating expenses and dividends to shareholders. The availability of dividends from Lakeland is limited by various statutes and regulations. The inability of the Company to receive dividends from Lakeland could adversely affect our financial condition, results of operations, cash flows and prospects.

#### **Lakeland's allowance for loan and lease losses may not be adequate to cover actual losses.**

Like all commercial banks, we maintain an allowance for loan and lease losses to provide for loan and lease defaults and non-performance. If Lakeland's allowance for loan and lease losses is not adequate to cover actual loan and lease losses, we may be required to significantly increase future provisions for loan and lease losses, which could materially and adversely affect our operating results. Our allowance for loan and lease losses is determined by analyzing historical loan and lease losses, current trends in delinquencies and charge-offs, plans for problem loan and lease resolution, the opinions of Lakeland's regulators, changes in the size and composition of the loan and lease portfolio and industry information. We also consider the possible effects of economic events, which are difficult to predict. The amount of future losses is affected by changes in economic, operating and other conditions, including changes in interest rates, many of which are beyond our control. These losses may exceed our current estimates. Federal regulatory agencies, as an integral part of their examination process, review Lakeland's loans and the allowance for loan and lease losses. While we





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believe that our allowance for loan and lease losses in relation to our current loan portfolio is adequate to cover current losses, we cannot assure you that we will not need to increase our allowance for loan and lease losses or that regulators will not require us to increase this allowance. An increase in our allowance for loan and lease losses could materially and adversely affect our earnings and profitability.

**Lakeland is subject to various lending and other economic risks that could adversely affect our results of operations and financial condition.**

Economic, political and market conditions, trends in industry and finance, legislative and regulatory changes, changes in governmental monetary and fiscal policies and inflation affect our business. These factors are beyond our control. A deterioration in economic conditions, particularly in New Jersey, could have the following consequences, any of which could materially adversely affect our business:

loan and lease delinquencies may increase;

problem assets and foreclosures may increase;

demand for our products and services may decrease; and

collateral for loans made by Lakeland may decline in value, in turn reducing the borrowing ability of Lakeland's customers.

A downturn in the real estate market, particularly in New Jersey, could hurt our business. If there is a significant decline in real estate values in New Jersey, Lakeland's ability to recover on defaulted loans by selling the underlying real estate would be reduced, and Lakeland would be more likely to suffer losses on defaulted loans.

**Lakeland may suffer losses in its loan portfolio despite its underwriting practices.**

Lakeland seeks to mitigate the risks inherent in its loan portfolio by adhering to specific underwriting practices. Although we believe that Lakeland's underwriting criteria are appropriate for the various kinds of loans that it makes, Lakeland may incur losses on loans that meet its underwriting criteria, and these losses may exceed the amounts set aside as reserves in its allowance for loan and lease losses.

**Lakeland faces strong competition from other financial institutions, financial service companies and other organizations offering services similar to the services that Lakeland provides.**

Many competitors offer the types of loans and banking services that Lakeland offers. These competitors include other state and national banks, savings associations, regional banks and other community banks. Lakeland also faces competition from many other types of financial institutions, including finance companies, brokerage firms, insurance companies, credit unions, mortgage banks and other financial intermediaries. Many of Lakeland's competitors have greater financial resources than we do, which may enable them to offer a broader range of services and products, and to advertise more extensively, than we do. Our inability to compete effectively would adversely affect our business.

**If we do not successfully integrate any banks that we may acquire in the future, the combined company may be adversely affected.**

If we make acquisitions in the future, we will need to integrate the acquired entities into our existing business and systems. We may experience difficulties in accomplishing this integration or in effectively managing the combined company after any future acquisition. Any actual cost savings or revenue enhancements that we may anticipate from a future acquisition will depend on future expense levels and operating results, the timing of certain events and general industry, regulatory and business conditions. Many of these events will be beyond our control, and we cannot provide assurances that if we make any acquisitions in the future, we will be successful in integrating those businesses into our own.

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**ITEM 1B - Unresolved Staff Comments**

Not Applicable.

**ITEM 2 - Properties**

The Company's principal office is located at 250 Oak Ridge Road, Oak Ridge, New Jersey 07438. It also maintains an operations center in Branchville, New Jersey.

The Company operates 47 banking locations in Passaic, Morris, Sussex, Bergen, Essex and Warren Counties, New Jersey. The following chart provides information about the Company's leased offices:

<b>Location</b>	<b>Lease Expiration Date</b>
Wantage	April 30, 2006
Rockaway	August 15, 2008
Newton*	August 31, 2006
Wharton	July 24, 2010
Ringwood	February 28, 2008
Fairfield	February 28, 2007
Vernon	September 30, 2006
Bristol Glen	December 31, 2006
Hampton	September 30, 2018
Little Falls	November 30, 2010
Pompton Plains	March 31, 2008
Cedar Crest	August 19, 2011
Sussex/Wantage	July 31 2012
Park Ridge	December 31, 2009
Hackensack	September 1, 2008
Morristown	August 31, 2009
Caldwell	April 30, 2024
Andover*	December 31, 2006
Sparta*	March 31, 2007

\* While these branches were consolidated with other branches in November 2005, the Company remains liable under the applicable leases. For information regarding all of the Company's rental obligations, see Notes to Consolidated Financial Statements.

All other offices of the Company and Lakeland are owned and are unencumbered.

**ITEM 3 - Legal Proceedings**

As the Company has disclosed in its periodic reports filed with the SEC, the Company was involved in legal proceedings concerning four separate portfolios of predominantly commercial leases which Lakeland purchased from Commercial Money Center, Inc. ( CMC ). CMC obtained surety bonds from three surety companies to guarantee each lessee's performance. Relying on these bonds, the Company and other investors purchased the leases and CMC's right to payment under the various surety bonds. CMC (and a related entity, Commercial Servicing Corp. ( CSC )) eventually stopped forwarding to the Company the required amounts.



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On July 20, 2005, Lakeland entered into a settlement agreement with RLI Insurance Company and one remaining party in Lakeland's claims related to the CMC matter. Pursuant to the settlement agreements Lakeland was paid an aggregate of \$3,315,000 and the parties executed mutual releases. As a result of the settlements, Lakeland's nonperforming assets were reduced by \$6.4 million and no additional loan loss provision was required. A charge-off of \$3.0 million was recorded.

A complaint captioned Ronnie Clayton dba Clayton Trucking, et al v. Ronald Fisher, et al was filed in the Los Angeles County Superior Court against Lakeland and others. Plaintiffs are certain of the lessees who had entered into leases with CMC. Plaintiffs allege, among other things, that these leases are not true leases but are instead loans which charge usurious interest rates. They further allege that because of various California Financial Code violations by CMC, the lease instruments are either void or must be reformed and all amounts paid by the lessees must be returned to them. The action against Lakeland has been stayed while an appeal by plaintiffs is pending concerning the dismissal of certain of plaintiffs' claims against defendants.

From time to time, the Company and its subsidiaries are defendants in legal proceedings relating to their respective businesses. While the ultimate outcome of any pending matter cannot be determined at this time, management does not believe that the outcome of any pending legal proceeding will materially affect the consolidated financial position of the Company, but could possibly be material to the consolidated results of operations of any one period.

**ITEM 4 - Submission of Matters to a Vote of Security Holders**

There were no matters submitted to a vote of security holders of the Company during the fourth quarter of 2005.

**ITEM 4A - Executive Officers of the Registrant**

The following table sets forth the name and age of each executive officer of the Company. Each officer is appointed by the Company's Board of Directors. Unless otherwise indicated, the persons named below have held the position indicated for more than the past five years.

Name and Age	Officer of The Company Since	Position with the Company, its Subsidiary	
		Banks, and Business Experience	
Roger Bosma Age 63	1999	President and Chief Executive Officer of the Company (June, 1999 - Present); President and Chief Executive Officer of Lakeland Bank (January 2002 to Present)	
Robert A. Vandenberg Age 54	1999	Executive Vice President and Chief Lending Officer of the Company (October, 1999 - Present); President, NBSC (November, 1998 - June, 2001)	

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<b>Name and Age</b>	<b>Officer of The Company Since</b>	<b>Position with the Company, its Subsidiary</b>	
		<b>Banks, and Business Experience</b>	
Joseph F. Hurley Age 55	1999	Executive Vice President and Chief Financial Officer of the Company (November, 1999 Present)	
Jeffrey J. Buonforte Age 54	1999	Executive Vice President and Chief Retail Officer of the Company (November, 1999 Present)	
Louis E. Luddecke Age 59	1999	Executive Vice President and Chief Operations Officer of the Company (October, 1999 Present)	
Steven Schachtel Age 48	2000	President, Lakeland Bank Equipment Leasing Division (April, 2000 Present)	
James R. Noonan Age 54	2003	Executive Vice President and Chief Credit Officer of the Company (December, 2003 Present); Senior Vice President and Chief Credit Officer of the Company (March, 2003 December, 2003); Senior Credit Officer, Fleet National Bank (prior years March, 2003)	

**Table of Contents****PART II****ITEM 5 - MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

Shares of the Common Stock of Lakeland Bancorp, Inc. have been traded under the symbol LBAI on the Nasdaq National Market since February 22, 2000 and in the over the counter market prior to this date. As of December 31, 2005, there were 3,899 shareholders of record of Common Stock. The following table sets forth the range of the high and low daily closing prices of the Common Stock as provided by Nasdaq and dividends declared for the periods presented. Prices and dividends have been adjusted to reflect the Company's 5% stock dividend paid on August 15, 2005.

	<b>Dividends</b>		
	<b>High</b>	<b>Low</b>	<b>Declared</b>
<b>Year ended December 31, 2005</b>			
First Quarter	\$ 17.03	\$ 14.56	\$ 0.095
Second Quarter	15.76	13.44	0.095
Third Quarter	16.31	14.75	0.100
Fourth Quarter	16.34	14.29	0.100
			<b>Dividends</b>
<b>Year ended December 31, 2004</b>			
First Quarter	\$ 16.52	\$ 14.90	\$ 0.095
Second Quarter	16.14	14.68	0.095
Third Quarter	16.30	14.82	0.095
Fourth Quarter	17.57	15.24	0.095

Dividends on the Company's Common Stock are within the discretion of the Board of Directors of the Company and are dependent upon various factors, including the future earnings and financial condition of the Company and Lakeland and bank regulatory policies.

The Bank Holding Company Act of 1956 restricts the amount of dividends the Company can pay. Accordingly, dividends should generally only be paid out of current earnings, as defined.

The New Jersey Banking Act of 1948 restricts the amount of dividends paid on the capital stock of New Jersey chartered banks. Accordingly, no dividends shall be paid by such banks on their capital stock unless, following the payment of such dividends, the capital stock of the bank will be unimpaired and the bank will have a surplus of not less than 50% of its capital stock, or, if not, the payment of such dividend will not reduce the surplus of the bank. Under this limitation, approximately \$134.2 million was available for the payment of dividends from Lakeland to the Company as of December 31, 2005.

Capital guidelines and other regulatory requirements may further limit the Company's and Lakeland's ability to pay dividends. See Item 1 Business - Supervision and Regulation - Dividend Restrictions.

**Table of Contents****Equity Compensation Plan Information**

The following table gives information about the Company's Common Stock that may be issued upon the exercise of options under the Company's Stock Option Plan, as of December 31, 2005. This plan was Lakeland's only equity compensation plan in existence as of December 31, 2005. No warrants or rights may be granted, or are outstanding, under the Stock Option Plan.

	(a)	(b)	(c)
Plan Category	Number Of Securities To Be Issued Upon Exercise Of Outstanding Options, Warrants and Rights	Weighted-Average Exercise Price Of Outstanding Options, Warrants and Rights	Number Of Securities Remaining Available For Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected In Column (a))
Equity Compensation Plans Approved by Shareholders	1,160,237	\$ 13.46	708,585
Equity Compensation Plans Not Approved by Shareholders			
<b>TOTAL</b>	<b>1,160,237</b>	<b>\$ 13.46</b>	<b>708,585</b>

The following table provides information about purchases made by the Company of its Common Stock during the quarter ended December 31, 2005.

	(a)	(b)	(c)	(d)
Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum No. of Shares that May Yet Be Purchased Under the Plans or Programs
October 2005	7,000	\$ 15.00	7,000	460,648
November 2005	49,500	\$ 15.78	49,500	411,148
December 2005	24,750	\$ 15.04	24,750	386,398

On June 10, 2005, the Company announced a stock repurchase program for the purchase of up to 787,500 shares of the Company's Common Stock over the next year. Under the 2005 plan, the Company purchased 401,102 shares of its outstanding Common Stock at an average price of \$15.18 per share for an aggregate cost of \$6.1 million.

In January 2004, the Company announced a stock repurchase program for the purchase of up to 262,500 shares of the Company's Common Stock over the next year. On July 15, 2004, the amount of shares purchasable in the stock buyback plan was increased to 525,000 shares to be purchased over the following year. During 2004, the Company purchased 265,650 shares of its outstanding Common Stock at an average price of \$16.61 per share for an aggregate cost of \$4.4 million. During 2005, the Company completed purchasing the shares purchasable in the 2004 plan by purchasing 270,888 shares of its outstanding Common Stock at an average price of \$14.80 per share for an aggregate price of \$4.0 million.



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Any purchases under the Company's stock repurchase program may be made from time-to-time in the open market, through block trades or otherwise. Depending on market conditions and other factors, these purchases may be commenced or suspended at any time or from time-to-time without prior notice.

**ITEMS 6 - Selected Financial Data****SELECTED CONSOLIDATED FINANCIAL DATA**

(Not covered by Report of Independent Registered Public Accounting Firm)

Years Ended December 31	2005	2004 <sup>(2)</sup>	2003 <sup>(3)</sup>	2002	2001
	(in thousands except per share data)				
Interest income	\$ 103,839	\$ 83,319	\$ 66,922	\$ 65,520	\$ 63,323
Interest expense	33,632	21,817	16,224	17,346	22,831
Net interest income	70,207	61,502	50,698	48,174	40,492
Provision for loan and lease losses	1,555	3,602	3,000	10,500	1,600
Noninterest income	15,128	12,761	10,926	9,001	8,347
Gains (losses) on sales of investment securities	(583)	638	1,857	876	(57)
Noninterest expenses	53,392	47,185	38,287	33,587	31,206
Income before income taxes	29,805	24,114	22,194	13,964	15,976
Income tax provision	9,584	7,619	7,087	3,887	4,953
Net income	\$ 20,221	\$ 16,495	\$ 15,107	\$ 10,077	\$ 11,023
<b>Per-Share Data<sup>(1)</sup></b>					
Weighted average shares outstanding:					
Basic	21,439	19,329	16,045	15,788	15,895
Diluted	21,601	19,567	16,268	16,082	16,089
Earnings per share:					
Basic	\$ 0.94	\$ 0.85	\$ 0.94	\$ 0.64	\$ 0.70
Diluted	\$ 0.94	\$ 0.84	\$ 0.93	\$ 0.63	\$ 0.69
Cash dividend per common share	\$ 0.39	\$ 0.38	\$ 0.36	\$ 0.32	\$ 0.28
Book value per common share	\$ 9.08	\$ 8.96	\$ 6.63	\$ 5.79	\$ 5.41
<b>At December 31</b>					
Investment securities available for sale	\$ 515,903	\$ 582,106	\$ 557,402	\$ 361,760	\$ 273,082
Investment securities held to maturity	154,569	162,922	43,009	46,083	70,259
Loans, net of deferred fees	1,312,767	1,176,005	851,536	719,658	601,959
Goodwill and other identifiable intangible assets	93,395	94,119	27,609	3,020	3,149
Total assets	2,206,033	2,141,021	1,585,290	1,207,105	1,044,338
Total deposits	1,798,160	1,726,804	1,325,682	1,059,092	912,110
Total core deposits	1,350,567	1,360,980	1,038,195	807,747	677,346
Long-term borrowings	101,764	98,991	89,500	31,000	21,004
Total stockholders' equity	191,781	194,548	110,951	90,767	85,567
<b>Performance ratios</b>					
Return on Average Assets	0.94%	0.90%	1.10%	0.89%	1.14%
Return on Average Equity	10.55%	10.79%	15.45%	11.29%	13.37%
Efficiency ratio	59.76%	60.70%	60.32%	57.23%	61.72%
Net Interest Margin (tax equivalent basis)	3.73%	3.82%	4.12%	4.75%	4.69%
<b>Capital ratios</b>					
Tier 1 leverage ratio	7.49%	7.71%	7.84%	7.01%	7.86%

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Total risk-based capital ratio	<b>12.47%</b>	13.27%	15.96%	12.20%	13.61%
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- (1) Restated for 5% stock dividends in 2005, 2003, 2002, and 2001.
- (2) The results of operations include Newton Trust Company from July 1, 2004 forward.
- (3) The results of operations include Community State Bank for the period August 25, 2003 forward.

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**ITEMS 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations**

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

This section presents a review of Lakeland Bancorp, Inc.'s consolidated results of operations and financial condition. You should read this section in conjunction with the selected consolidated financial data that is presented on the preceding page as well as the accompanying financial statements and notes to financial statements. As used in the following discussion, the term "Company" refers to Lakeland Bancorp, Inc. and "Lakeland" refers to the Company's wholly owned banking subsidiary Lakeland Bank. The Newton Trust Company (Newton) was merged into Lakeland on November 4, 2005. Newton Financial Corporation ("NFC"), the parent company of Newton, was merged into the Company on July 1, 2004. Community State Bank (CSB) was merged into Lakeland on August 25, 2003, and The National Bank of Sussex County (NBSC) was merged into Lakeland on June 29, 2001.

***Statements Regarding Forward-Looking Information***

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

In addition to the factors disclosed by the Company elsewhere in this document, the following factors, among others, could cause the Company's actual results to differ materially and adversely from such forward-looking statements: pricing pressures on loan and deposit products; competition; changes in economic conditions nationally, regionally and in the Company's markets; the extent and timing of actions of the Federal Reserve Board; changes in levels of market interest rates; clients' acceptance of the Company's products and services; credit risks of lending activities and competitive factors; changes in the conditions of the capital markets in general and in the capital markets for financial institutions in particular and the impact of the war in Iraq on such markets; and the extent and timing of legislative and regulatory actions and reforms.

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

***Significant Accounting Policies, Judgments and Estimates***

The accounting and reporting policies of the Company and Lakeland conform with accounting principles generally accepted in the United States of America and predominant practices within the banking industry. The consolidated financial statements include the accounts of the Company, Lakeland, Lakeland Investment Corp, and Lakeland NJ Investment Corp. All intercompany balances and transactions have been eliminated.

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. These estimates and assumptions also affect reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates. Significant estimates implicit in these financial statements are as follows.

The principal estimates that are particularly susceptible to significant change in the near term relate to the allowance for loan and lease losses, the Company's deferred tax asset and the analysis of goodwill impairment. The evaluation of the adequacy of the allowance for loan and lease losses includes, among other factors, an analysis of historical loss rates, by category, applied to current loan totals. However, actual losses may be higher or lower than historical trends, which vary. Actual losses on specified problem loans, which also are provided for in the evaluation, may vary from estimated loss percentages, which are established based upon a limited number of potential loss classifications.

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The allowance for loan and lease losses is established through a provision for loan and lease losses charged to expense. Loan principal considered to be uncollectible by management is charged against the allowance for loan and lease losses. The allowance is an amount that management believes will be adequate to absorb losses on existing loans that may become uncollectible based upon an evaluation of known and inherent risks in the loan portfolio. The evaluation takes into consideration such factors as changes in the nature and size of the loan portfolio, overall portfolio quality, specific problem loans, and current economic conditions which may affect the borrowers' ability to pay. The evaluation also details historical losses by loan category, the resulting loss rates for which are projected at current loan total amounts. Loss estimates for specified problem loans are also detailed. All of the factors considered in the analysis of the adequacy of the allowance for loan and lease losses may be subject to change. To the extent actual outcomes differ from management estimates, additional provisions for loan losses may be required that would adversely impact earnings in future periods.

The Company accounts for impaired loans in accordance with SFAS No. 114, *Accounting by Creditors for Impairment of a Loan*, as amended by SFAS No. 118, *Accounting by Creditors for Impairment of a Loan - Income Recognition and Disclosures*. Impairment is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, except that as a practical expedient, a creditor may measure impairment based on a loan's observable market price, or the fair value of the collateral if the loan is collateral-dependent. Regardless of the measurement method, a creditor must measure impairment based on the fair value of the collateral when the creditor determines that foreclosure is probable.

The Company accounts for income taxes under the liability method of accounting for income taxes. Deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities as measured by the enacted tax rates that will be in effect when these differences reverse. Deferred tax expense is the result of changes in deferred tax assets and liabilities. The principal types of differences between assets and liabilities for financial statement and tax return purposes are allowance for loan and lease losses, core deposit intangible, deferred loan fees, deferred compensation and securities available for sale.

The Company accounts for goodwill and other identifiable intangible assets in accordance with SFAS No. 142, *Goodwill and Intangible Assets*. SFAS No. 142 includes requirements to test goodwill and indefinite lived intangible assets for impairment rather than amortize them. The Company tests goodwill for impairment annually at the reporting unit level using various market valuation methodologies. The Company has tested the goodwill as of December 31, 2005 and has determined that it is not impaired.

### ***Financial Overview***

The year ended December 31, 2005 represented a year of continued growth and consolidation for the Company. In November 2005, the Company merged Newton into Lakeland and closed three branches—two of Newton and one of Lakeland. In 2005 the Company opened two new branches in towns where Lakeland did not previously have a presence. As discussed in this management's discussion and analysis:

Net income increased \$3.7 million or 23% from 2004 to 2005.

Total loans increased by \$139.6 million or 12%.

Non-performing assets decreased \$9.8 million from December 31, 2004 to December 31, 2005 which reflected the settlement between Lakeland and the remaining surety company which issued surety bonds to guarantee the income stream of several commercial lease pools. For more information see Note 15—Commitments and Contingencies—Litigation.

Lakeland expensed \$225,000 related to the merger of Newton into Lakeland.

Lakeland terminated its post retirement benefit plan and thereby reduced its benefit expense by \$750,000.

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Lakeland sold \$80.4 million in securities in 2005 for a loss of \$583,000 to position its portfolio to take advantage of higher yielding bonds.

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Net income for 2005 was \$20.2 million or \$0.94 per diluted share compared to net income of \$16.5 million and \$0.84 per diluted share in 2004. For 2005, Return on Average Assets was 0.94% and Return on Average Equity was 10.55%. For 2004, Return on Average Assets was 0.90% and Return on Average Equity was 10.79%.

In 2003, net income was \$15.1 million or \$0.93 per diluted share with a Return on Average Assets of 1.10% and a Return on Average Equity of 15.45%. The decline in earnings per share from 2003 to 2004 resulted from the increased average shares outstanding from the NFC acquisition.

### ***Net interest income***

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

Net interest income for 2005 on a tax equivalent basis was \$72.2 million, representing an increase of \$8.9 million or 14% from the \$63.2 million earned in 2004. Net interest income for 2003 on a tax equivalent basis was \$52.3 million. The increase in net interest income from 2004 to 2005 resulted from an increase in average interest-earning assets of \$279.3 million partially offset by a \$257.7 million increase in interest-bearing liabilities and a 47 basis point increase in the cost of funds. The increase in net interest income in 2004 from 2003 resulted from an increase in earning assets of \$389.5 million partially offset by a 30 basis point decline in the net interest margin. Factors contributing to the decline in the net interest margin will be discussed in further detail below.

**Interest income and expense volume/rate analysis.** The following table shows the impact that changes in average balances of the Company's assets and liabilities and changes in average interest rates have had on the Company's net interest income over the past three years. This information is presented on a tax equivalent basis assuming a 35% tax rate. If a change in interest income or expense is attributable to a change in volume and a change in rate, the amount of the change is allocated proportionately.

**Table of Contents****INTEREST INCOME AND EXPENSE VOLUME/RATE ANALYSIS**

(tax equivalent basis, in thousands)

	2005 vs. 2004			Total Increase	2004 vs. 2003		Total Increase
	Increase (Decrease) Due to Change in:		(Decrease)		Increase (Decrease) Due to Change in:		
	Volume	Rate			Volume	Rate	
<b>Interest Income</b>							
Loans	\$ 13,722	\$ 3,714	\$ 17,436	\$ 14,096	\$ (3,281)	\$ 10,815	
Taxable investment securities	1,700	491	2,191	5,382	(157)	5,225	
Tax-exempt investment securities	801	(162)	639	664	(195)	469	
Federal funds sold	(14)	492	478	(3)	55	52	
<b>Total interest income</b>	<b>16,209</b>	<b>4,535</b>	<b>20,744</b>	20,139	(3,578)	16,561	
<b>Interest Expense</b>							
Savings deposits	85	236	321	290	(337)	(47)	
Interest-bearing transaction accounts	1,183	3,649	4,832	2,067	77	2,144	
Time deposits	2,241	1,911	4,152	611	(447)	164	
Borrowings	2,645	(135)	2,510	2,961	371	3,332	
<b>Total interest expense</b>	<b>6,154</b>	<b>5,661</b>	<b>11,815</b>	5,929	(336)	5,593	
<b>NET INTEREST INCOME (TAX EQUIVALENT BASIS)</b>	<b>\$ 10,055</b>	<b>\$ (1,126)</b>	<b>\$ 8,929</b>	\$ 14,210	\$ (3,242)	\$ 10,968	

The following table reflects the components of the Company's net interest income, setting forth for the years presented, (1) average assets, liabilities and stockholders' equity, (2) interest income earned on interest-earning assets and interest expense paid on interest-bearing liabilities, (3) average yields earned on interest-earning assets and average rates paid on interest-bearing liabilities, (4) the Company's net interest spread (i.e., the average yield on interest-earning assets less the average cost of interest-bearing liabilities) and (5) the Company's net interest margin. Rates are computed on a tax equivalent basis assuming a 35% tax rate.

**Table of Contents****CONSOLIDATED STATISTICS ON A TAX EQUIVALENT BASIS**

	2005			2004			2003		
	Average Balance	Interest Income/ Expense	Average rates earned/ paid	Average Balance	Interest Income/ Expense	Average rates earned/ paid	Average Balance	Interest Income/ Expense	Average rates earned/ paid
	(dollars in thousands)								
<b>Assets</b>									
Interest-earning assets:									
Loans (A)	\$ 1,222,084	\$ 76,388	6.25%	\$ 999,865	\$ 58,952	5.90%	\$ 763,607	\$ 48,137	6.30%
Taxable investment securities	593,789	23,027	3.88%	549,728	20,836	3.79%	407,684	15,611	3.83%
Tax-exempt securities	99,110	5,631	5.68%	84,889	4,992	5.88%	73,361	4,523	6.17%
Federal funds sold (B)	21,798	764	3.50%	23,034	286	1.24%	23,321	234	1.00%
Total interest-earning assets	1,936,781	105,810	5.46%	1,657,516	85,066	5.13%	1,267,973	68,505	5.40%
Noninterest earning assets:									
Allowance for loan and lease losses	(15,513)			(18,150)			(18,284)		
Other assets	232,455			191,100			122,459		
<b>TOTAL ASSETS</b>	<b>\$ 2,153,723</b>			<b>\$ 1,830,466</b>			<b>\$ 1,372,148</b>		
<b>Liabilities and Stockholders Equity</b>									
Interest-bearing liabilities:									
Savings accounts	\$ 343,219	\$ 2,084	0.61%	\$ 327,965	\$ 1,763	0.54%	\$ 279,084	\$ 1,810	0.65%
Interest-bearing transaction accounts	695,415	11,707	1.68%	602,575	6,875	1.14%	421,307	4,731	1.12%
Time deposits	411,704	11,041	2.68%	319,808	6,889	2.15%	266,512	6,725	2.52%
Borrowings	191,807	8,800	4.59%	134,082	6,290	4.69%	70,228	2,958	4.21%
Total interest-bearing liabilities	1,642,145	33,632	2.05%	1,384,430	21,817	1.58%	1,037,131	16,224	1.56%
Noninterest-bearing liabilities:									
Demand deposits	308,025			284,638			231,116		
Other liabilities	11,945			8,503			6,140		
Stockholders equity	191,608			152,895			97,761		
<b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b>	<b>\$ 2,153,723</b>			<b>\$ 1,830,466</b>			<b>\$ 1,372,148</b>		
Net interest income/spread Tax equivalent basis adjustment		72,178	3.42%		63,249	3.56%		52,281	3.84%
		1,971			1,747			1,583	
<b>NET INTEREST INCOME</b>		<b>\$ 70,207</b>			<b>\$ 61,502</b>			<b>\$ 50,698</b>	
Net interest margin (C)			3.73%			3.82%			4.12%

(A) Includes non-accrual loans, the effect of which is to reduce the yield earned on loans, and deferred loan fees.



- (B) Includes interest-bearing cash accounts.
- (C) Net interest income divided by interest-earning assets.

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Total interest income on a tax equivalent basis increased from \$85.1 million in 2004 to \$105.8 million in 2005, an increase of \$20.7 million. The increase in interest income in 2005 was primarily due to a \$279.3 million increase in interest-earning assets due to growth in the loan and investment portfolios resulting from a full year's impact of the Newton merger as well as from growth generated internally. The increase in interest income was also due to a 33 basis point increase in the average yield on earning assets due to the increasing rate environment and to a shift in the Company's mix in earning assets from lower yielding investment securities and federal funds sold to higher yielding loans. Loans as a percent of average interest-earning assets increased from 60% in 2004 to 63% in 2005.

The increase in interest income from \$68.5 million in 2003 to \$85.1 million in 2004 resulted from a \$389.5 million increase in average interest-earning assets offset by a 27 basis point decrease in the yield on average interest-earning assets reflecting loan and investment prepayments being reinvested at lower rates.

Total interest expense increased from \$21.8 million in 2004 to \$33.6 million in 2005 as a result of an increase in the volume of interest-bearing liabilities of \$257.7 million. Interest expense also increased due to an increase in the Company's cost of funds from 1.58% in 2004 to 2.05% in 2005. A change in the mix of the deposits also had the effect of increasing the Company's cost of funds. Average savings and interest-bearing transaction accounts decreased from 67% of total interest-bearing liabilities in 2004 to 63% in 2005. Higher yielding time deposits increased from 23% of interest-bearing liabilities in 2004 to 25% of total deposits in 2005. Average borrowings which have an average rate paid of 4.59% in 2005 increased from 10% of interest-bearing liabilities in 2004 to 12% in 2005. Interest expense increased from \$16.2 million in 2003 to \$21.8 million in 2004 due to the increase in the

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volume of interest-bearing liabilities of \$347.3 million. The cost of funds remained relatively stable at 1.58% resulting from an increase in average savings and interest bearing transaction accounts as a percent of total deposits and a decline in higher yielding time deposits as a percent of total deposits. The cost of funds in 2004 was impacted by the Company's trust preferred offerings of \$30 million completed in June of 2003 and \$25 million completed in December of 2003. The trust preferred securities have a weighted average rate of 6.78%. For more information see Note 7 Debt Subordinated Debentures.

***Net Interest Margin***

Net interest margin is calculated by dividing net interest income on a fully taxable equivalent basis by average interest-earning assets. The Company's net interest margin was 3.73%, 3.82% and 4.12% for 2005, 2004 and 2003, respectively. The decrease in the net interest margin from 2004 to 2005 resulted from deposits repricing faster than interest earning assets and from a shift in interest-bearing liabilities from core deposits to time deposits and borrowings. The 33 basis point increase in the average yield on interest-earning assets and the 47 basis point increase in the average rate paid on interest-bearing liabilities resulted in a lower net interest spread and a lower net interest margin. The decrease in the net interest margin from 2003 to 2004 resulted from a decline in the average yield earned on interest-earning assets due to investment and loan prepayments being reinvested in lower yielding assets.

***Provision for Loan and Lease Losses***

In determining the provision for loan and lease losses, management considers national and local economic conditions; trends in the portfolio including orientation to specific loan types or industries; experience, ability and depth of lending management in relation to the complexity of the portfolio; adequacy and adherence to policies, procedures and practices; levels and trends in delinquencies, impaired loans and net charge-offs and the results of independent third party loan review. The provision for loan and lease losses at \$1.6 million in 2005 decreased from \$3.6 million in 2004 due to management's evaluation of the loan portfolio. For more information, see Financial Condition Risk Elements below. Net charge-offs decreased from \$6.2 million in 2004 to \$5.0 million in 2005. Charge-offs in 2005 and 2004 included charge-offs of \$3.0 million and \$3.4 million, respectively, in two of the commercial lease pools due to the settlement with two of the surety companies which issued surety bonds to guarantee the income stream of several commercial lease pools. Net charge-offs as a percent of average loans outstanding decreased from 0.62% in 2004 to 0.41% in 2005. Without the impact of the commercial lease pool charge-offs, net charge-offs as a percentage of average loans outstanding would have been 0.16% and 0.41% for 2005 and 2004, respectively.

The 2004 provision for loan and lease losses at \$3.6 million increased from \$3.0 million in 2003 due to management's evaluation of the loan portfolio including its evaluation of the risk in the commercial lease pools discussed above. Net charge-offs were \$4.9 million in 2003 including a \$2.1 million charge-off in one of the commercial lease pools due to a settlement with one of the surety companies which issued surety bonds to guarantee the income stream of several commercial lease pools. The ratio of net charge-offs to average loans outstanding was 0.64%. Without the impact of the commercial lease pool charge-off in 2003, the ratio of net-charge-offs to average loans outstanding would have been 0.37%.

***Noninterest Income***

Noninterest income increased \$1.1 million or 9% to \$14.5 million in 2005 from \$13.4 million in 2004 and represented 17.2% of total revenue for 2005. (Total revenue is defined as net interest income plus noninterest income.) A primary source of this increase in revenue was an increase in service charges on demand deposit accounts from \$7.8 million in 2004 to \$9.6 million in 2005, a \$1.8 million or 23% increase. This increase resulted from fee income generated by Lakeland's overdraft protection program implemented in second quarter of 2005 and a full year of income from the Newton branches. Gains (losses) on sales of securities decreased from a gain of \$638,000 in 2004 to a loss of \$583,000 in 2005 as a result of a decline in the market value of securities due to the interest rate environment and from a sale of securities so that Lakeland could position its portfolio to take advantage of higher yielding bonds. Income from bank owned life insurance (BOLI) increased as a result of a full year of income earned on \$5.5 million in BOLI policies acquired in the Newton acquisition. Other income increased from \$803,000 in 2004 to \$1.2 million in 2005 as a result of leasing income.

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Noninterest income increased \$616,000 or 5% from \$12.8 million in 2003 to \$13.4 million in 2004 and represented 17.9% of total revenue for 2004. Noninterest income increased from 2003 to 2004 primarily as a result of increases in service charges on demand deposit accounts generated by the Newton branches purchased on July 1, 2004, and increased ATM income. Gains on sales of securities decreased from \$1.9 million in 2003 to \$638,000 in 2004 because Lakeland sold less securities in 2004 than 2003. Commissions and fees increased from \$2.5 million in 2003 to \$3.0 million in 2004, an increase of \$466,000 or 18% due to increased loan volumes, increased prepayment fees on commercial loans and increased investment services brokerage income. Income from bank owned life insurance (BOLI) increased as a result of income earned on \$7.0 million in BOLI policies purchased in the second quarter of 2003 and income earned from BOLI policies acquired in the Newton and CSB acquisitions. Other income increased from \$389,000 in 2003 to \$803,000 in 2004 as a result of gains on sales of leases and income received on the Company's investment in the common stock of the trusts that are described in further detail in Note 1 under Variable Interest Entities.

***Noninterest Expense***

Noninterest expense increased from \$47.2 million in 2004 to \$53.4 million in 2005, a \$6.2 million or 13% increase. Salaries and benefits, the largest component of noninterest expense, increased by \$3.4 million or 13%. A full year of the salaries paid to Newton's 119 employees contributed to this increase as well as normal salary and benefit increases. Occupancy expense increased from \$4.4 million in 2004 to \$5.4 million in 2005 as a result of expenses related to the ten branches and one administration center acquired in the Newton acquisition. Occupancy expense also included \$161,000 in expenses relating to the closing of three branch offices. Furniture and equipment expenses increased \$373,000 or 9% due to costs related to upgrading the Company's computer system as well as additional costs incurred from the acquisition of the Newton branches. Stationery, supplies and postage increased \$254,000 or 16% from 2004 to 2005 as a result of expenses related to the Newton merger as well as expenses related to internal growth. Marketing expense increased from \$1.5 million in 2004 to \$1.6 million in 2005 primarily as a result of expenses related to the merger of Newton into Lakeland and related to the opening of two new branches. Core deposit intangible expense increased from \$810,000 in 2004 to \$1.2 million in 2005 resulting from a full year's amortization of core deposit intangible acquired in the Newton acquisition. Other expenses increased from \$8.1 million in 2004 to \$9.6 million in 2005, a \$1.4 million or 18% increase. Other expenses included a \$408,000 increase in director fees which included a full year of fees related to Newton, costs related to the merger of Newton to Lakeland, and costs related to the increased size of the Company's Board of Directors in connection with the merger of NFC. Other expenses also included a \$200,000 increase in telecommunications expense, and a \$139,000 increase in expenses related to personnel recruitment. The remainder of the increase in other expenses resulted from a full year of expenses related to Newton and expense related to our increased customer base.

Noninterest expense in 2004 increased \$8.9 million or 23% over 2003. This increase included a \$4.5 million or 22% increase in salary expense due to the 119 employees added from the Newton acquisition, a full year of salary paid to the 34 employees added from the CSB acquisition and normal increases. Occupancy expense increased from \$3.7 million in 2003 to \$4.4 million in 2004 as a result of expenses related to four branches acquired in the CSB acquisition and the ten branches and one administration center acquired in the Newton acquisition. Furniture and equipment expenses increased \$714,000 or 21% due to costs related to upgrading the Company's computer system as well as additional costs incurred from the acquisition of the Newton branches. Stationery, supplies and postage increased \$185,000 or 14% from 2003 to 2004 as a result of expenses related to the Newton merger as well as expenses related to internal growth. Marketing expense increased from \$1.1 million in 2003 to \$1.5 million in 2004 primarily as a result of expenses incurred in Bergen County, the market area the Company entered as a result of the CSB acquisition. The Newton acquisition also contributed to the increased marketing expense. Core deposit intangible expense increased \$588,000 from \$222,000 in 2003 to \$810,000 in 2004 resulting from the Newton and CSB mergers. Other expenses increased from \$6.3 million in 2003 to \$8.1 million in 2004, a \$1.8 million or 29% increase. Other expenses included \$885,000 resulting from the addition of the Newton offices beginning July 1, 2004, and a \$311,000 increase in audit fees resulting from costs incurred to comply with the Sarbanes-Oxley Act. Also included in other expenses was a \$200,000 writedown of other real estate owned property in fourth quarter 2004. The remainder of the increase in other expenses resulted from expense related to our increased customer base.

The efficiency ratio expresses the relationship between non-interest expense (excluding other real estate expense and core deposit amortization) to total tax-equivalent revenue (excluding gains (losses) on sales of securities). In 2005, the Company's efficiency ratio on a tax equivalent basis decreased to 59.8% from 60.7% in 2004. The efficiency ratio was 60.3% in 2003.

**Table of Contents****Income Taxes**

The Company's effective income tax rate was 32.2%, 31.6% and 31.9%, in the years ended December 31, 2005, 2004 and 2003, respectively.

**Financial Condition**

Total assets increased from \$2.141 billion on December 31, 2004 to \$2.206 billion on December 31, 2005, an increase of \$65.0 million, or 3%. Total assets at year-end 2004 increased \$555.7 million or 35% from year-end 2003, including \$316.4 million from the Newton acquisition.

**Loans**

Lakeland primarily serves Northern New Jersey and the surrounding areas. All of its borrowers are U.S. residents or entities.

Total loans increased from \$1.18 billion on December 31, 2004 to \$1.32 billion on December 31, 2005, an increase of \$139.6 million or 12%. The increase in loans occurred in all major loan categories. Commercial loans increased from \$602.1 million to \$691.1 million, an increase of \$89.0 million or 15%. Commercial loans included \$23.7 million in growth in leases from the Company's leasing division. The home equity and consumer installment portfolio increased from \$289.9 million in 2004 to \$302.2 million in 2005, an increase of \$12.3 million or 4%. The residential real estate mortgage portfolio also increased \$32.7 million or 15%. Real estate construction loans, which include both residential and commercial construction loans, increased from \$62.7 million in 2004 to \$68.3 million in 2005, an increase of \$5.6 million or 9%. In 2004, total loans increased from \$852.4 million to \$1.18 billion including \$201.5 million from the Newton acquisition. The majority of the growth was in the commercial loan portfolio which increased \$202.6 million or 51% including \$138.4 million from the Newton acquisition.

The following table sets forth the classification of the Company's loans by major category as of December 31 for each of the last five years:

	2005	2004	December 31, 2003			2002	2001
			(in thousands)				
Commercial	\$ 691,054	\$ 602,062	\$ 399,468	\$ 303,381	\$ 251,821		
Real estate mortgage	256,621	223,936	178,404	161,469	156,251		
Real estate construction	68,325	62,687	20,476	19,567	15,598		
Home equity and consumer installment	302,236	289,920	254,039	234,259	176,404		
	<b>\$ 1,318,236</b>	<b>\$ 1,178,605</b>	<b>\$ 852,387</b>	<b>\$ 718,676</b>	<b>\$ 600,074</b>		

The following table shows the percentage distributions of loans by category as of December 31 for each of the last five years.

	2005	2004	December 31, 2003			2002	2001
Commercial	52.4%	51.1%	46.9%	42.2%	42.0%		
Real estate mortgage	19.5%	19.0%	20.9%	22.5%	26.0%		
Real estate construction	5.2%	5.3%	2.4%	2.7%	2.6%		
Home equity and consumer installment	22.9%	24.6%	29.8%	32.6%	29.4%		
	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>		

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At December 31, 2005, there were no concentrations of loans exceeding 10% of total loans outstanding other than loans that are secured by real estate. Loan concentrations are considered to exist when there are amounts loaned to a multiple number of borrowers engaged in similar activities which would cause them to be similarly impacted by economic or other related conditions.

The following table sets forth certain categories of loans as of December 31, 2005, in terms of contractual maturity date:

	Within one year	After one but within five years (in thousands)	After five years	Total
<b>Types of Loans:</b>				
Commercial	\$ 94,478	\$ 181,144	\$ 415,432	\$ 691,054
Real Estate construction	35,097	11,302	21,926	68,325
<b>Total</b>	<b>\$ 129,575</b>	<b>\$ 192,446</b>	<b>\$ 437,358</b>	<b>\$ 759,379</b>
<b>Amount of such loans with:</b>				
Predetermined rates	\$ 37,759	\$ 152,368	\$ 120,006	\$ 310,133
Floating or adjustable rates	91,816	40,078	317,352	449,246
<b>Total</b>	<b>\$ 129,575</b>	<b>\$ 192,446</b>	<b>\$ 437,358</b>	<b>\$ 759,379</b>

**Risk Elements**

Commercial loans are placed on a non-accrual status with all accrued interest and unpaid interest reversed if (a) because of the deterioration in the financial position of the borrower they are maintained on a cash basis (which means payments are applied when and as received rather than on a regularly scheduled basis), (b) payment in full of interest or principal is not expected, or (c) principal and interest has been in default for a period of 90 days or more unless the obligation is both well secured and in process of collection. Residential mortgage loans are placed on non-accrual status at the time when foreclosure proceedings are commenced except where there exists sufficient collateral to cover the defaulted principal and interest payments, and management's knowledge of the specific circumstances warrant continued accrual. Consumer loans are generally charged off when principal and interest payments are four months in arrears unless the obligations are well secured and in the process of collection. Interest thereafter on such charged-off consumer loans is taken into income when received only after full recovery of principal.

The following schedule sets forth certain information regarding the Company's non-accrual, past due and renegotiated loans and other real estate owned as of December 31, for each of the last five years:

	2005	2004	December 31, 2003 (in thousands)	2002	2001
<b>Non-performing assets:</b>					
Non-accrual loans	<b>3,907</b>	13,017	16,653	19,985	1,985
Other real estate owned		650			513
<b>TOTAL NON-PERFORMING ASSETS</b>	<b>\$ 3,907</b>	\$ 13,667	\$ 16,653	\$ 19,985	\$ 2,498
<b>Non-performing assets as a percent of total assets</b>	<b>0.18%</b>	0.64%	1.05%	1.66%	0.24%
Past due loans*	<b>\$ 5,127</b>	\$ 2,347	\$ 1,248	\$ 1,342	\$ 1,370

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Represents loans as to which payments of interest or principal are contractually past due ninety days or more, but which are currently accruing income at the contractually stated rates. A determination is made to continue accruing income on such loans only if collection of the debt is proceeding in due course and collection efforts are reasonably expected to result in repayment of the debt or in its restoration to a current status.

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Non-accrual loans decreased from \$13.0 million at December 31, 2004 to \$3.9 million on December 31, 2005 primarily as a result of a settlement with the one remaining surety company which had guaranteed the income stream of \$6.4 million of the commercial lease pools. Lakeland received \$3.3 million in the settlement. The remaining \$3.0 million of the loan was charged-off. Excluding the impact of the settlement of the lease pools, non-accrual loans decreased \$2.7 million from 2004 to 2005. In 2004, non-accruals decreased \$3.7 million from the prior year resulting primarily from the settlement with one of the surety companies that guaranteed the income stream of \$4.0 million of commercial lease pools. The settlement included a \$1.9 million principal payment and a charge-off of the remaining \$2.1 million. Included in 2004 non-accrual loans are \$2.7 million in non-accrual loans from Newton. Other real estate owned increased to \$650,000 in 2004, resulting from the Newton acquisition. All non-accrual loans are in various stages of litigation, foreclosure, or workout.

For 2005, the gross interest income that would have been recorded, had the loans classified at year-end as non-accrual been performing in conformance with their original loan terms, is approximately \$661,000. The amount of interest income actually recorded on those loans for 2005 was \$323,000. The resultant income loss of \$338,000 for 2005 compares to losses of \$1.3 million and \$1.6 million for 2004 and 2003, respectively.

Loans specifically evaluated are deemed impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreements. Loans which are in process of collection will not be classified as impaired. A loan is not impaired during the process of collection of payment if the Company expects to collect all amounts due, including interest accrued at the contractual interest rate. All commercial loans identified as impaired in excess of \$250,000 are evaluated by an independent loan review consultant. The Company aggregates consumer loans and residential mortgages for evaluation purposes.

The Company's policy concerning commercial non-accrual loans states that, except for loans which are considered to be fully collectible by virtue of collateral held and in the process of collection, loans are placed on a non-accrual status when payments are 90 days delinquent or more. It is possible for a loan to be on non-accrual status and not be classified as impaired if the balance of such loan is relatively small and, therefore, that loan has not been specifically reviewed for impairment.

Loans, or portions thereof, are charged off in the period that the loss is identified. Until such time, an allowance for loan loss is maintained for estimated losses. With regard to interest income recognition for payments received on impaired loans, as well as all non-accrual loans, the Company follows regulatory guidelines, which apply any payments to principal as long as there is doubt as to the collectibility of the loan balance.

As of December 31, 2005, based on the above criteria, the Company had impaired loans totaling \$3.7 million (including \$3.4 million in non-accrual loans). The impairment of these loans is based on the fair value of the underlying collateral for these loans. Based upon such evaluation, \$953,000 has been allocated to the allowance for loan and lease losses for impairment. At December 31, 2005, the Company also had \$11.4 million in loans that were rated substandard that were not classified as non-performing or impaired.

There were no loans at December 31, 2005, other than those designated non-performing, impaired, or substandard where the Company was aware of any credit conditions of any borrowers that would indicate a strong possibility of the borrowers not complying with the present terms and conditions of repayment and which may result in such loans being included as non-accrual, past due or renegotiated at a future date.

The following table sets forth for each of the five years ended December 31, 2005, the historical relationships among the amount of loans outstanding, the allowance for loan and lease losses, the provision for loan and lease losses, the amount of loans charged off and the amount of loan recoveries:



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	2005	2004	December 31, 2003 (in thousands)	2002	2001
Balance of the allowance at the beginning of the year	\$ 16,638	\$ 16,899	\$ 17,940	\$ 8,220	\$ 8,890
Loans charged off:					
Commercial	4,350	4,964	4,100	501	2,248
Home equity and consumer	1,923	1,718	1,817	926	398
Real estate mortgage					4
Total loans charged off	6,273	6,682	5,917	1,427	2,650
Recoveries:					
Commercial	753	145	653	446	245
Home equity and consumer	499	363	350	195	124
Real estate mortgage	1	10	1	6	11
Total Recoveries	1,253	518	1,004	647	380
Net charge-offs:	5,020	6,164	4,913	780	2,270
Addition related to acquisitions		2,301	872		
Provision for loan and lease losses charged to operations	1,555	3,602	3,000	10,500	1,600
Ending balance	\$ 13,173	\$ 16,638	\$ 16,899	\$ 17,940	\$ 8,220
Ratio of net charge-offs to average loans outstanding	0.41%	0.62%	0.64%	0.12%	0.41%
Ratio of allowance at end of year as a percentage of year-end total loans	1.00%	1.41%	1.98%	2.49%	1.37%

The ratio of the allowance for loan and lease losses to loans outstanding reflects management's evaluation of the underlying credit risk inherent in the loan portfolio. The determination of the adequacy of the allowance for loan and lease losses and the periodic provisioning for estimated losses included in the consolidated financial statements is the responsibility of management. The evaluation process is undertaken on a quarterly basis.

Methodology employed for assessing the adequacy of the allowance consists of the following criteria:

The establishment of reserve amounts for all specifically identified classified loans that have been designated as requiring attention by the Company's external loan review consultant.

The establishment of reserves for pools of homogeneous types of loans not subject to specific review, including 1-4 family residential mortgages, and consumer loans.

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

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

Based upon the process employed and giving recognition to all accompanying factors related to the loan portfolio, management considers the allowance for loan and lease losses to be adequate at December 31, 2005. The preceding statement constitutes a forward-looking statement under the Private Securities Litigation Reform Act of 1995.



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The following table shows how the allowance for loan and lease losses is allocated among the various types of loans that the Company has outstanding. This allocation is based on management's specific review of the credit risk of the outstanding loans in each category as well as historical trends.

	At December 31,				
	2005	2004	2003	2002	2001
	(in thousands)				
Commercial	\$ 9,821	\$ 13,598	\$ 14,036	\$ 16,086	\$ 6,308
Home equity and consumer	2,592	2,411	2,117	1,109	1,173
Real estate - construction	350	146	54	54	54
Real estate - mortgage	410	483	692	691	685
	<b>\$ 13,173</b>	<b>\$ 16,638</b>	<b>\$ 16,899</b>	<b>\$ 17,940</b>	<b>\$ 8,220</b>

**Investment Securities**

The Company has classified its investment securities into the available for sale and held to maturity categories pursuant to SFAS No. 115 Accounting for Certain Investments in Debt and Equity Securities.

The following table sets forth the carrying value of the Company's investment securities, both available for sale and held to maturity, as of December 31 for each of the last three years. Investment securities available for sale are stated at fair value while securities held for maturity are stated at cost, adjusted for amortization of premiums and accretion of discounts.

	December 31,		
	2005	2004	2003
	(in thousands)		
U.S. Treasury and U.S. government agencies	\$ 195,914	\$ 194,378	\$ 169,826
Obligations of states and political subdivisions	109,862	101,023	82,139
Mortgage-backed securities	335,081	403,150	332,904
Equity securities	19,067	18,352	10,874
Other debt securities	10,548	28,125	4,668
	<b>\$ 670,472</b>	<b>\$ 745,028</b>	<b>\$ 600,411</b>

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The following table sets forth the maturity distribution and weighted average yields (calculated on the basis of the stated yields to maturity, considering applicable premium or discount), on a fully taxable equivalent basis, of investment securities available for sale as of December 31, 2005:

Available for sale	Within one year	Over one but within five years	Over five but within ten years	After ten years	Total
	(dollars in thousands)				
U.S. Treasury and U.S. government agencies					
Amount	\$ 10,546	\$ 117,044	\$ 25,980	\$ 3,812	\$ 157,382
Yield	3.86%	3.85%	3.97%	4.72%	3.89%
Obligations of states and political subdivisions					
Amount	3,860	17,671	22,718	1,470	45,719
Yield	5.58%	5.75%	5.54%	5.67%	5.63%
Mortgage-backed securities					
Amount	102	18,022	45,514	222,166	285,804
Yield	4.48%	3.71%	3.88%	4.16%	4.09%
Other debt securities					
Amount		1,162		6,769	7,931
Yield	%	3.87%	%	6.68%	6.27%
Other equity securities					
Amount	19,067				19,067
Yield	%	%	%	%	%
Total securities					
Amount	\$ 33,575	\$ 153,899	\$ 94,212	\$ 234,217	\$ 515,903
Yield	1.87%	4.05%	4.30%	4.25%	4.05%

The following table sets forth the maturity distribution and weighted average yields (calculated on the basis of the stated yields to maturity, considering applicable premium or discount), on a fully taxable equivalent basis, of investment securities held to maturity as of December 31, 2005:

Held to maturity	Within one year	Over one but within five years	Over five but within ten years	After ten years	Total
	(dollars in thousands)				
U.S. Treasury and U.S. government agencies					
Amount	\$ 308	\$ 28,445	\$ 9,779	\$	\$ 38,532
Yield	1.85%	3.87%	4.68%	%	4.06%
Obligations of states and political subdivisions					
Amount	18,020	7,924	25,887	12,312	64,143
Yield	4.60%	5.28%	4.92%	5.47%	4.98%
Mortgage-backed securities					
Amount	183	4,888	4,547	39,659	49,277
Yield	4.53%	4.03%	3.79%	4.24%	4.18%
Other debt securities					
Amount	1,002		509	1,106	2,617
Yield	4.64%	%	5.00%	5.45%	5.05%
Total securities					
Amount	\$ 19,513	\$ 41,257	\$ 40,722	\$ 53,077	\$ 154,569
Yield	4.56%	4.16%	4.74%	4.55%	4.50%



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**Deposits**

Total deposits increased from \$1.727 billion on December 31, 2004 to \$1.798 billion on December 31, 2005, an increase of \$71.4 million, or 4%. The major factor driving deposit growth in 2005 was a growth in time deposits which increased from \$365.8 million at December 31, 2004 to \$447.6 million at December 31, 2005, an increase of \$81.8 million or 22% as customers moved their funds from transaction and savings accounts to higher yielding time deposits. The growth in time deposits included \$58.3 million in certificates of deposits over \$100,000 which included municipal deposits. Total noninterest bearing demand accounts decreased from \$319.4 million to \$312.5 million, a \$6.8 million or 2% decrease. Total core deposits, which are defined as noninterest bearing deposits and savings and interest-bearing transaction accounts, decreased from \$1.361 billion on December 31, 2004 to \$1.351 billion on December 31, 2005, a decrease of \$10.4 million or 1%. Total deposits in 2004 increased \$401.1 million or 30% from December 31, 2003, including \$266.9 million from the Newton acquisition.

The average amount of deposits and the average rates paid on deposits for the years indicated are summarized in the following table:

	Year Ended December 31, 2005		Year Ended December 31, 2004		Year Ended December 31, 2003	
	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Average Rate
	(Dollars in thousands)					
Noninterest-bearing demand deposits	\$ 308,025	%	\$ 284,638	%	\$ 231,116	%
Interest-bearing transaction accounts	695,415	1.68%	602,575	1.14%	421,307	1.12%
Savings	343,219	0.61%	327,965	0.54%	279,084	0.65%
Time deposits	411,704	2.68%	319,808	2.15%	266,512	2.52%
<b>Total</b>	<b>\$ 1,758,363</b>	<b>1.41%</b>	<b>\$ 1,534,986</b>	<b>1.01%</b>	<b>\$ 1,198,019</b>	<b>1.11%</b>

As of December 31, 2005, the aggregate amount of outstanding time deposits issued in amounts of \$100,000 or more, broken down by time remaining to maturity, was as follows (in thousands):

<b>Maturity</b>	
Within 3 months	\$ 69,530
Over 3 through 6 months	34,571
Over 6 through 12 months	24,616
Over 12 months	25,583
<b>Total</b>	<b>\$ 154,300</b>

**Liquidity**

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

Lakeland funds loan demand and operation expenses from four sources:

Net income.

Deposits. Lakeland can offer new products or change its rate structure in order to increase deposits. In 2005, the Company generated \$71.4 million in deposit growth.

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Sales of securities and overnight funds. At year-end 2005, the Company had \$515.9 million in securities designated available for sale.

Overnight credit lines. Lakeland is a member of the Federal Home Loan Bank of New York (FHLB). One membership benefit is that members can borrow overnight funds. Lakeland has overnight credit lines of \$100 million available for it to borrow from the FHLB. Lakeland also has overnight federal funds lines available for it to borrow up to \$85 million.

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The Company's management believes that its current level of liquidity is sufficient to meet its current and anticipated operational needs including current loan commitments, deposit maturities and other obligations. This constitutes a forward-looking statement under the Private Securities Litigation Reform Act of 1995. Actual results could differ materially from anticipated results due to a variety of factors, including uncertainties relating to general economic conditions; unanticipated decreases in deposits; changes in or failure to comply with governmental regulations; and uncertainties relating to the analysis of the Company's assessment of rate sensitive assets and rate sensitive liabilities and relating to the extent to which market factors indicate that a financial institution such as Lakeland should match such assets and liabilities.

The following table sets forth contractual obligations and other commitments representing required and potential cash outflows as of December 31, 2005:

(dollars in thousands)	Total	Within			
		one year	three years	five years	five years
			After one but within three years	After three but within five years	After five years
Minimum annual rentals or noncancellable operating leases	\$ 6,623	\$ 1,084	\$ 1,528	\$ 1,057	\$ 2,954
Benefit plan commitments	2,565	35	220	370	1,940
Remaining contractual maturities of time deposits	447,593	349,719	93,045	3,426	1,403
Subordinated debentures	56,703				56,703
Loan commitments	351,418	306,916	20,956	2,978	20,568
Long-term borrowed funds	45,061	3,355	11,706	10,000	20,000
Standby letters of credit	11,842	11,458	384		
Total	\$ 921,805	\$ 672,567	\$ 127,839	\$ 17,831	\$ 103,568

**Interest Rate Risk**

Closely related to the concept of liquidity is the concept of interest rate sensitivity (i.e., the extent to which assets and liabilities are sensitive to changes in interest rates). Interest rate sensitivity is often measured by the extent to which mismatches or gaps occur in the repricing of assets and liabilities within a given time period. Gap analysis is utilized to quantify such mismatches. A positive gap results when the amount of earning assets repricing within a given time period exceeds the amount of interest-bearing liabilities repricing within that time period. A negative gap results when the amount of interest-bearing liabilities repricing within a given time period exceeds the amount of earning assets repricing within such time period.

In general, a financial institution with a positive gap in relevant time periods will benefit from an increase in market interest rates and will experience erosion in net interest income if such rates fall. Likewise, a financial institution with a negative gap in relevant time periods will normally benefit from a decrease in market interest rates and will be adversely affected by an increase in rates. By maintaining a balanced interest rate sensitivity position, where interest rate sensitive assets roughly equal interest sensitive liabilities in relevant time periods, interest rate risk can be limited.

As a financial institution, the Company's potential interest rate volatility is a primary component of its market risk. Fluctuations in interest rates will ultimately impact the level of income and expense recorded on a large portion of the Company's assets and liabilities, and the market value of all interest-earning assets, other than those



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which possess a short term to maturity. Based upon the Company's nature of operations, the Company is not subject to foreign currency exchange or commodity price risk. The Company does not own any trading assets and does not have any hedging transactions in place, such as interest rate swaps and caps.

The Company's Board of Directors has adopted an Asset/Liability Policy designed to stabilize net interest income and preserve capital over a broad range of interest rate movements. This policy outlines guidelines and ratios dealing with, among others, liquidity, volatile liability dependence, investment portfolio composition, loan portfolio composition, loan-to-deposit ratio and gap analysis ratio. The Company's performance as compared to the Asset/Liability Policy is monitored by its Board of Directors. In addition, to effectively administer the Asset/Liability Policy and to monitor exposure to fluctuations in interest rates, the Company maintains an Asset/Liability Committee, consisting of the Chief Executive Officer, Chief Financial Officer, Chief Lending Officer, Chief Retail Officer, Chief Credit Officer, certain other senior officers and certain directors. This committee meets quarterly to review the Company's financial results and to develop strategies to implement the Asset/Liability Policy and to respond to market conditions.

The Company monitors and controls interest rate risk through a variety of techniques, including use of traditional interest rate sensitivity analysis (also known as gap analysis) and an interest rate risk management model. With the interest rate risk management model, the Company projects future net interest income, and then estimates the effect of various changes in interest rates and balance sheet growth rates on that projected net interest income. The Company also uses the interest rate risk management model to calculate the change in net portfolio value over a range of interest rate change scenarios. Traditional gap analysis involves arranging the Company's interest-earning assets and interest-bearing liabilities by repricing periods and then computing the difference (or interest rate sensitivity gap) between the assets and liabilities that are estimated to reprice during each time period and cumulatively through the end of each time period.

Both interest rate sensitivity modeling and gap analysis are done at a specific point in time and involve a variety of significant estimates and assumptions. Interest rate sensitivity modeling requires, among other things, estimates of how much and when yields and costs on individual categories of interest-earning assets and interest-bearing liabilities will respond to general changes in market rates, future cash flows and discount rates.

Gap analysis requires estimates as to when individual categories of interest-sensitive assets and liabilities will reprice, and assumes that assets and liabilities assigned to the same repricing period will reprice at the same time and in the same amount. Gap analysis does not account for the fact that repricing of assets and liabilities is discretionary and subject to competitive and other pressures.

The following table sets forth the estimated maturity/repricing structure of the Company's interest-earning assets and interest-bearing liabilities at December 31, 2005. Except as stated below, the amounts of assets or liabilities shown which reprice or mature during a particular period were determined in accordance with the contractual terms of each asset or liability. The majority of interest-bearing demand deposits and savings deposits are assumed to be core deposits, or deposits that will generally remain at the Company regardless of market interest rates. Therefore, 13% of the core interest-bearing deposits, 20% of core savings deposits and 35% of money market deposit accounts are shown as maturing or repricing within three months. The remainder is divided between the after 1 but within 5 years column and the after 5 years column. Interest-bearing transaction accounts held by states and municipalities are seen to be more sensitive than personal interest-bearing transaction accounts. Therefore, 50% of public interest-bearing transaction accounts are shown as repricing within three months. The table does not assume any prepayment of fixed-rate loans.

The table does not necessarily indicate the impact of general interest rate movements on the Company's net interest income because the repricing of certain categories of assets and liabilities, for example, prepayments of loans and withdrawal of deposits, is beyond the Company's control. As a result, certain assets and liabilities indicated as repricing within a stated period may in fact reprice at different times and at different rate levels.

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December 31, 2005	Maturing or Repricing				Total
	Within three months	but within 1 year	After 3 months After 1 but within 5 years	After 5 Years	
	(dollars in thousands)				
<b>Interest-earning assets:</b>					
Loans	\$ 291,081	\$ 111,015	\$ 566,247	\$ 344,424	\$ 1,312,767
Investment securities	48,774	95,679	375,577	150,442	670,472
Interest-bearing cash accounts	10,176				10,176
<b>Total interest-earning assets</b>	<b>350,031</b>	<b>206,694</b>	<b>941,824</b>	<b>494,866</b>	<b>1,993,415</b>
<b>Interest-bearing liabilities:</b>					
<b>Deposits:</b>					
Interest-bearing demand	188,682		321,487	192,156	702,325
Savings accounts	65,563		120,067	150,083	335,713
Time deposits	136,898	213,022	96,270	1,403	447,593
<b>Total interest-bearing deposits</b>	<b>391,143</b>	<b>213,022</b>	<b>537,824</b>	<b>343,642</b>	<b>1,485,631</b>
<b>Borrowings:</b>					
Fed funds purchased and securities sold under agreements to repurchase	78,199	25,000			103,199
Long-term debt	2,906	451	41,704	0	45,061
Subordinated debentures			30,929	25,774	56,703
<b>Total borrowings</b>	<b>81,105</b>	<b>25,451</b>	<b>72,633</b>	<b>25,774</b>	<b>204,963</b>
<b>Total interest-bearing liabilities</b>	<b>472,248</b>	<b>238,473</b>	<b>610,457</b>	<b>369,416</b>	<b>1,690,594</b>
Interest rate sensitivity gap	\$ (122,217)	\$ (31,779)	\$ 331,367	\$ 125,450	\$ 302,821
Cumulative rate sensitivity gap	\$ (122,217)	\$ (153,996)	\$ 177,371	\$ 302,821	

Changes in estimates and assumptions made for interest rate sensitivity modeling and gap analysis could have a significant impact on projected results and conclusions. Therefore, these techniques may not accurately reflect the impact of general interest rate movements on the Company's net interest income or net portfolio value.

Because of the limitations in the gap analysis discussed above, members of the Company's Asset/Liability Management Committee believe that the interest sensitivity modeling more accurately reflects the effects and exposure to changes in interest rates. Net interest income simulation considers the relative sensitivities of the balance sheet including the effects of interest rate caps on adjustable rate mortgages and the relatively stable aspects of core deposits. As such, net interest income simulation is designed to address the probability of interest rate changes and the behavioral response of the balance sheet to those changes. Market Value of Portfolio Equity represents the fair value of the net present value of assets, liabilities and off-balance-sheet items.

The starting point (or base case) for the following table is an estimate of the Company's net portfolio value at December 31, 2005 using current discount rates, and an estimate of net interest income for 2006 assuming that both interest rates and the Company's interest-sensitive assets and liabilities remain at December 31, 2005 levels. The information provided for the net portfolio value assumes fluctuations or rate shocks of plus 200 basis points and minus 200 basis points. Rate shocks assume that current interest rates change immediately. The information provided for net interest income for 2006 assumes that changes in interest rates of plus 200 basis points and minus 200 basis points change gradually in equal increments over the twelve month period. The information set forth in the following table is based on significant estimates and assumptions, and constitutes a forward-looking statement under the Private Securities Litigation Reform Act of 1995.



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Rate Scenario	Net Portfolio Value at December 31, 2005		Net interest income for 2006	
	Amount	Percent Change From Base Case (dollars in thousands)	Amount	Percent Change From Base Case
+200 basis points	\$ 292,451	(11.7)%	\$ 67,380	(3.3)%
Base Case	331,370	%	69,680	%
-200 basis points	340,049	2.6%	72,035	3.4%

**Capital Resources**

Stockholders' equity decreased \$2.8 million to \$191.8 million at December 31, 2005, from \$194.5 million at December 31, 2004, reflecting net income during the year of \$20.2 million, cash dividends to stockholders of \$8.3 million, an unrealized securities loss, net of deferred income taxes, of \$5.2 million, purchases of treasury stock of \$10.1 million and a net change from the exercise of stock options of \$608,000.

Book value per share (total stockholders' equity divided by the number of shares outstanding) increased from \$8.96 on December 31, 2004 to \$9.08 on December 31, 2005 as a result of increased income and a decrease in shares outstanding resulting from the buyback of shares under the stock repurchase program. Book value per share was \$6.63 on December 31, 2003.

The FDIC's risk-based capital policy statement imposes a minimum capital standard on insured banks. The minimum ratio of risk-based capital to risk-weighted assets (including certain off-balance sheet items, such as standby letters of credit) is 8%. At least half of the total capital is to be comprised of common stock equity and qualifying perpetual preferred stock, less goodwill (Tier I capital). The remainder (Tier II capital) may consist of mandatory convertible debt securities, qualifying subordinated debt, other preferred stock and a portion of the allowance for loan and lease losses. The Federal Reserve Board has adopted a similar risk-based capital guideline for the Company which is computed on a consolidated basis.

In addition, the bank regulators have adopted minimum leverage ratio guidelines (Tier I capital to average quarterly assets, less goodwill) for financial institutions. These guidelines provide for a minimum leverage ratio of 3% for financial institutions that meet certain specified criteria, including that they have the highest regulatory rating. All other holding companies are required to maintain a leverage ratio of 3% plus an additional cushion of at least 100 to 200 basis points.

The following table reflects capital ratios of the Company and its subsidiaries as of December 31, 2005 and 2004:

Capital Ratios:	Tier 1 Capital to Total Average Assets Ratio December 31,		Tier 1 Capital to Risk-Weighted Assets Ratio December 31,		Total Capital to Risk-Weighted Assets Ratio December 31,	
	2005	2004	2005	2004	2005	2004
The Company	7.49%	7.71%	11.51%	12.02%	12.47%	13.27%
Lakeland Bank	6.86%	6.11%	10.57%	9.78%	11.53%	11.03%
Newton Trust Company	N/A	10.36%	N/A	14.52%	N/A	15.38%
Well capitalized institution under FDIC Regulations	5.00%	5.00%	6.00%	6.00%	10.00%	10.00%

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***Recent Accounting Pronouncements***

In November 2005, FASB Staff Position 115-1 and 124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments* (FSP 115-1) was issued. FSP 115-1 replaced the guidance in paragraphs 10-18 of EITF Issue 03-1 with references to existing other-than-temporary impairment guidance, such as SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, Staff Accounting Bulletin 59, *Accounting for Noncurrent Marketable Equity Securities*, and APB Opinion 18, *The Equity Method of Accounting for Investments in Common Stock*. FSP 115-1 codified the guidance set forth in EITF Topic D-44 and clarified that an investor should recognize an impairment loss no later than when the impairment is considered other-than-temporary, even if a decision to sell has not been made. FSP 115-1 also includes language from EITF Issue 03-1 regarding the accounting for debt securities subsequent to an other-than-temporary impairment.

The Company has evaluated its investments under EITF 03-1 and FSP 115-1. Because it has concluded that none of its securities have impairments that are other-than-temporary, the impact of these pronouncements have not had a material impact on the Company's financial statements.

In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123(R), *Share-Based Payment*, that addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for (a) equity instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. Under SFAS No. 123(R), all forms of share-based payments to employees, including employee stock options, would be treated the same as other forms of compensation by recognizing the related cost in the income statement. The expense of the award would generally be measured at fair value at the grant date. Current accounting guidance requires that the expense relating to employee stock options only be disclosed in the footnotes to the financial statements. SFAS No. 123(R) eliminates the ability to account for share-based compensation transactions using APB Opinion No. 25, *Accounting for Stock Issued to Employees*. SFAS No. 123(R) is effective for public companies as of the beginning of the first fiscal year that begins after June 15, 2005. All public companies that used the fair-value-based method for either recognition or disclosure under SFAS No. 123 will apply SFAS No. 123(R) using a modified method of prospective application. Under this transition method, compensation cost is recognized on or after the required effective date for the portion of outstanding awards for which the requisite service has not yet been rendered based on the grant-date fair value of those awards calculated under SFAS No. 123 for either recognition or pro forma disclosures. The impact of this new standard, if it had been in effect, on the net earnings and related per share amounts for the years ended December 31, 2005, 2004 and 2003 is disclosed in Note 1-Summary of Accounting Policies - Stock-Based Compensation.

On March 29, 2005, the SEC released Staff Accounting Bulletin 107, *Share Based Payments* (SAB 107). The interpretations in SAB 107 express views of the SEC staff regarding the application of SFAS No. 123(R). Among other things, SAB 107 provides interpretive guidance related to the interaction between Statement 123(R) and certain SEC rules and regulations, as well as provides the staff's views regarding the valuation of share-based payment arrangements for public companies. Since all of the Company's stock options outstanding at December 31, 2005 are vested, management does not believe that the implementation of SAB 107 and SFAS No. 123(R) will have an immediate impact on its earnings. The Company will implement SAB 107 and SFAS No. 123(R) using a modified method of prospective application. The Company is evaluating the impact that the implementation of SAB 107 and SFAS No. 123 (R) will have on future option, restricted stock, or other potential grants.

***Effects of Inflation***

The impact of inflation, as it affects banks, differs substantially from the impact on non-financial institutions. Banks have assets which are primarily monetary in nature and which tend to move with inflation. This is especially true for banks with a high percentage of rate sensitive interest-earning assets and interest-bearing liabilities. A bank can further reduce the impact of inflation with proper management of its rate sensitivity gap. This gap represents the difference between interest rate sensitive assets and interest rate sensitive liabilities. Lakeland attempts to structure its assets and liabilities and manages its gap to protect against substantial changes in interest rate scenarios, in order to minimize the potential effects of inflation.

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**ITEM 7A - Quantitative and Qualitative Disclosures About Market Risk**

See Management's Discussion and Analysis of Financial Condition and Results of Operations

**Table of Contents****ITEM 8 - Financial Statements and Supplementary Data****Lakeland Bancorp, Inc. and Subsidiaries****CONSOLIDATED BALANCE SHEETS**

	December 31, 2005      2004 (dollars in thousands)	
<b>ASSETS</b>		
Cash	\$ 42,639	\$ 47,981
Interest-bearing deposits due from banks	10,176	7,365
Total cash and cash equivalents	52,815	55,346
Investment securities available for sale	515,903	582,106
Investment securities held to maturity; fair value of \$151,637 in 2005 and \$162,926 in 2004	154,569	162,922
Loans, net of deferred fees	1,312,767	1,176,005
Less: allowance for loan and lease losses	13,173	16,638
Net loans	1,299,594	1,159,367
Premises and equipment - net	32,428	31,749
Accrued interest receivable	8,851	8,002
Goodwill and other identifiable intangible assets	93,395	94,119
Bank owned life insurance	35,479	34,240
Other assets	12,999	13,170
<b>TOTAL ASSETS</b>	<b>\$ 2,206,033</b>	<b>\$ 2,141,021</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
<b>LIABILITIES:</b>		
Deposits:		
Noninterest bearing	\$ 312,529	\$ 319,359
Savings and interest-bearing transaction accounts	1,038,038	1,041,621
Time deposits under \$100 thousand	293,293	269,820
Time deposits \$100 thousand and over	154,300	96,004
Total deposits	1,798,160	1,726,804
Federal funds purchased and securities sold under agreements to repurchase	103,199	110,830
Long-term debt	45,061	42,288
Subordinated debentures	56,703	56,703
Other liabilities	11,129	9,848
<b>TOTAL LIABILITIES</b>	<b>2,014,252</b>	<b>1,946,473</b>
Commitments and contingencies		
Stockholders equity:		
Common stock, no par value; authorized shares, 40,000,000; issued shares, 22,442,337 at December 31, 2005 and 22,443,298 at December 31, 2004; outstanding shares, 21,121,923 at December 31, 2005 and 21,714,968 at December 31, 2004	226,322	208,933
Accumulated Deficit	(9,514)	(3,847)
Treasury stock, at cost, 1,320,414 shares in 2005 and 728,330 in 2004	(20,176)	(10,878)
Accumulated other comprehensive income (loss)	(4,851)	340

<b>TOTAL STOCKHOLDERS EQUITY</b>	<b>191,781</b>	194,548
<b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b>	<b>\$ 2,206,033</b>	\$ 2,141,021

See accompanying notes to consolidated financial statements



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

	Years Ended December 31,		
	2005	2004	2003
	(In thousands, except per share data)		
<b>INTEREST INCOME</b>			
Loans and fees	\$ 76,388	\$ 58,952	\$ 48,137
Federal funds sold and interest-bearing deposits with banks	764	286	234
Taxable investment securities	23,027	20,835	15,611
Tax-exempt investment securities	3,660	3,246	2,940
<b>TOTAL INTEREST INCOME</b>	<b>103,839</b>	<b>83,319</b>	<b>66,922</b>
<b>INTEREST EXPENSE</b>			
Deposits	24,832	15,527	13,266
Federal funds purchased and securities sold under agreements to repurchase	3,026	589	223
Long-term debt	5,774	5,701	2,735
<b>TOTAL INTEREST EXPENSE</b>	<b>33,632</b>	<b>21,817</b>	<b>16,224</b>
<b>NET INTEREST INCOME</b>	<b>70,207</b>	<b>61,502</b>	<b>50,698</b>
Provision for loan and lease losses	1,555	3,602	3,000
<b>NET INTEREST INCOME AFTER PROVISION FOR LOAN AND LEASE LOSSES</b>	<b>68,652</b>	<b>57,900</b>	<b>47,698</b>
<b>NONINTEREST INCOME</b>			
Service charges on deposit accounts	9,633	7,823	7,089
Commissions and fees	3,074	3,001	2,535
Gains (losses) on the sales of investment securities	(583)	638	1,857
Income on bank owned life insurance	1,210	1,134	913
Other income	1,211	803	389
<b>TOTAL NONINTEREST INCOME</b>	<b>14,545</b>	<b>13,399</b>	<b>12,783</b>
<b>NONINTEREST EXPENSE</b>			
Salaries and employee benefits	28,511	25,128	20,676
Net occupancy expense	5,416	4,365	3,665
Furniture and equipment	4,453	4,080	3,366
Stationery, supplies and postage	1,806	1,552	1,367
Legal fees	811	1,655	1,605
Marketing expense	1,625	1,473	1,081
Core deposit intangible amortization	1,212	810	222
Other expenses	9,558	8,122	6,305
<b>TOTAL NONINTEREST EXPENSE</b>	<b>53,392</b>	<b>47,185</b>	<b>38,287</b>
Income before provision for income taxes	29,805	24,114	22,194
Provision for income taxes	9,584	7,619	7,087
<b>NET INCOME</b>	<b>\$ 20,221</b>	<b>\$ 16,495</b>	<b>\$ 15,107</b>
<b>EARNINGS PER SHARE</b>			

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Basic	\$	<b>0.94</b>	\$	0.85	\$	0.94
Diluted	\$	<b>0.94</b>	\$	0.84	\$	0.93

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

	Years Ended December 31,		
	2005	2004	2003
	(in thousands)		
NET INCOME	<b>\$ 20,221</b>	\$ 16,495	\$ 15,107
OTHER COMPREHENSIVE INCOME NET OF TAX:			
Unrealized securities gains (losses) arising during period	<b>(5,587)</b>	678	(3,059)
Less: reclassification for gains (losses) included in net income	<b>(396)</b>	436	1,263
Other Comprehensive Income (Loss)	<b>(5,191)</b>	242	(4,322)
TOTAL COMPREHENSIVE INCOME	<b>\$ 15,030</b>	\$ 16,737	\$ 10,785

See accompanying notes to consolidated financial statements

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

## CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY

For the years ended December 31, 2005, 2004 and 2003

	Common stock		Accumulated		Other Comprehensive	
	Number of		Accumulated	Treasury	Income	Total
	Shares	Amount	Deficit (dollars in thousands)	Stock	(Loss)	
BALANCE DECEMBER 31, 2002	14,671,097	\$ 101,664	\$ (9,436)	\$ (5,881)	\$ 4,420	\$ 90,767
Net Income 2003			15,107			15,107
Other comprehensive loss, net of tax					(4,322)	(4,322)
Exercise of stock options		(210)		680		470
Shares issued for the purchase of CSB Financial Corp.	1,028,492	16,742				16,742
Stock dividend	783,962	12,920	(12,920)			
Cash dividends			(5,731)			(5,731)
Purchase of treasury stock				(2,082)		(2,082)
BALANCE DECEMBER 31, 2003	16,483,551	131,116	(12,980)	(7,283)	98	110,951
Net Income 2004			16,495			16,495
Other comprehensive income, net of tax					242	242
Exercise of stock options		264		818		1,082
Shares issued for the purchase of Newton Financial Corp.	4,891,019	77,553				77,553
Cash dividends			(7,362)			(7,362)
Purchase of treasury stock				(4,413)		(4,413)
BALANCE DECEMBER 31, 2004	21,374,570	208,933	(3,847)	(10,878)	340	194,548
Net Income 2005			20,221			20,221
Other comprehensive loss net of tax					(5,191)	(5,191)
Exercise of stock options		(192)		800		608
Stock dividend	1,067,767	17,581	(17,581)			
Cash dividends			(8,307)			(8,307)
Purchase of treasury stock				(10,098)		(10,098)
BALANCE DECEMBER 31, 2005	22,442,337	\$ 226,322	\$ (9,514)	\$ (20,176)	\$ (4,851)	\$ 191,781

See accompanying notes to consolidated financial statements

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

## CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31,		
	2005	2004	2003
	(in thousands)		
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Net income	\$ 20,221	\$ 16,495	\$ 15,107
Adjustments to reconcile net income to net cash provided by operating activities:			
Net amortization of premiums, discounts and deferred loan fees and costs	4,593	3,978	5,821
Depreciation and amortization	3,532	3,189	2,621
Amortization of intangible assets	1,212	810	222
Provision for loan and lease losses	1,555	3,602	3,000
Provision for losses on other real estate		200	
(Gains) losses on sales of securities	583	(637)	(1,857)
Deferred income tax	1,524	1,330	803
(Increase) decrease in other assets	(1,851)	39	(2,482)
Increase in other liabilities	1,428	661	1,427
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>32,797</b>	<b>29,667</b>	<b>24,662</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Cash equivalents in excess of cash paid for business acquired		1,067	1,720
Proceeds from repayments on and maturity of securities:			
Available for sale	122,326	153,537	180,459
Held to maturity	32,326	43,244	19,327
Proceeds from sales of securities:			
Available for sale	80,380	32,708	80,727
Held to maturity	715		701
Purchase of securities:			
Available for sale	(146,359)	(171,400)	(439,789)
Held to maturity	(25,058)	(122,965)	(17,098)
Purchase of Asset Based Lending portfolio		(25,524)	
Net increase in loans	(144,652)	(104,430)	(51,374)
Purchase of bank owned life insurance			(7,000)
Proceeds from dispositions of premises and equipment	135	44	265
Capital expenditures	(4,345)	(3,682)	(2,023)
Net decrease in other real estate owned	650		
<b>NET CASH USED IN INVESTING ACTIVITIES</b>	<b>(83,882)</b>	<b>(197,401)</b>	<b>(234,085)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Net increase in deposits	71,356	134,229	140,936
Increase (decrease) in federal funds purchased and securities sold under agreements to repurchase	(7,631)	59,407	31,449
Proceeds from long-term debt	10,000		
Repayments of long-term debt	(7,227)	(5,521)	
Issuance of subordinated debentures			55,000
Purchase of treasury stock	(10,098)	(4,413)	(2,082)
Exercise of stock options	461	656	470
Dividends paid	(8,307)	(7,362)	(5,731)
<b>NET CASH PROVIDED BY FINANCING ACTIVITIES</b>	<b>48,554</b>	<b>176,996</b>	<b>220,042</b>

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Net increase (decrease) in cash and cash equivalents	(2,531)	9,262	10,619
Cash and cash equivalents, beginning of year	55,346	46,084	35,465
CASH AND CASH EQUIVALENTS, END OF YEAR	\$ 52,815	\$ 55,346	\$ 46,084

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See accompanying notes to consolidated financial statements

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**Lakeland Bancorp, Inc. and Subsidiaries**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - SUMMARY OF ACCOUNTING POLICIES

Lakeland Bancorp, Inc. (the Company) is a bank holding company whose principal activity is the ownership and management of its wholly owned subsidiary, Lakeland Bank (Lakeland). The Newton Trust Company (Newton), was merged into Lakeland on November 4, 2005 and Community State Bank (CSB) was merged into Lakeland on August 25, 2003. Lakeland generates commercial, mortgage and consumer loans and receives deposits from customers located primarily in Northern New Jersey. They also provide securities brokerage services, including mutual funds and variable annuities. Lakeland operates under a state bank charter and provides full banking services and, as a state bank, is subject to regulation by the New Jersey Department of Banking and Insurance.

Lakeland operates as a commercial bank offering a wide variety of commercial loans and leases and, to a lesser degree, consumer credits. Its primary future strategic aim is to establish a reputation and market presence as the small and middle market business bank in its principal markets. Lakeland funds its loans primarily by offering time, savings and money market, and demand deposit accounts to both commercial enterprises and individuals. Additionally, it originates residential mortgage loans, and services such loans which are owned by other investors. Lakeland also has a leasing division which provides equipment lease financing to small and medium sized business clients and an asset based lending department which specializes in utilizing particular assets to fund the working capital needs of borrowers.

The Company and Lakeland are subject to regulations of certain state and federal agencies and, accordingly, are periodically examined by those regulatory authorities. As a consequence of the extensive regulation of commercial banking activities, Lakeland's business is particularly susceptible to being affected by state and federal legislation and regulations.

*Basis of Financial Statement Presentation*

The accounting and reporting policies of the Company and Lakeland and its subsidiaries conform with accounting principles generally accepted in the United States of America and predominant practices within the banking industry. The consolidated financial statements include the accounts of the Company, Lakeland, Lakeland Investment Corp. and Lakeland NJ Investment Corp. All intercompany balances and transactions have been eliminated.

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. These estimates and assumptions also affect reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates. Significant estimates implicit in these financial statements are as follows.

The principal estimates that are particularly susceptible to significant change in the near term relate to the allowance for loan and lease losses and the evaluation of goodwill impairment.

The evaluation of the adequacy of the allowance for loan and lease losses includes, among other factors, an analysis of historical loss rates, by category, applied to current loan totals. However, actual losses may be higher or lower than historical trends, which vary. Actual losses on specified problem loans, which also are provided for in the evaluation, may vary from estimated loss percentages, which are established based upon a limited number of potential loss classifications.

The Company provides disclosures under Statement of Financial Accounting Standards (SFAS) No. 131, Disclosures about Segments of an Enterprise and Related Information. Operating segments are components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and assess performance.

The Company has one operating segment and accordingly one reportable segment, Community Banking. All of the Company's activities are interrelated, and each activity is dependent and assessed based on how each of the activities of the Company supports the others. For example, commercial lending is dependent upon the ability of Lakeland to fund itself with retail deposits and other borrowings and to manage interest rate and credit risk. This situation is also similar for consumer and residential mortgage lending. Accordingly, all significant operating decisions are based upon analysis of the Company as one operating segment or unit.



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**Table of Contents***Investment Securities*

The Company accounts for its investment securities in accordance with SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. Investments in securities are classified in one of three categories: held to maturity, trading, or available for sale. Investments in debt and equity securities, for which management has both the ability and intent to hold to maturity, are carried at cost, adjusted for the amortization of premiums and accretion of discounts computed by the interest method. Investments in debt and equity securities, which management believes may be sold prior to maturity due to changes in interest rates, prepayment risk, liquidity requirements, or other factors, are classified as available for sale. Net unrealized gains and losses for such securities, net of tax effect, are reported as other comprehensive income (loss) and excluded from the determination of net income. The Company does not engage in security trading. Gains or losses on disposition of investment securities are based on the net proceeds and the adjusted carrying amount of the securities sold using the specific identification method.

In November 2005, FASB Staff Position 115-1 and 124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments* (FSP 115-1) was issued. FSP 115-1 replaced the guidance in paragraphs 10-18 of EITF Issue 03-1 with references to existing other-than-temporary impairment guidance, such as SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, Staff Accounting Bulletin 59, *Accounting for Noncurrent Marketable Equity Securities*, and APB Opinion 18, *The Equity Method of Accounting for Investments in Common Stock*. FSP 115-1 codified the guidance set forth in EITF Topic D-44 and clarified that an investor should recognize an impairment loss no later than when the impairment is considered other-than-temporary, even if a decision to sell has not been made. FSP 115-1 also includes language from EITF Issue 03-1 regarding the accounting for debt securities subsequent to an other-than-temporary impairment.

The Company has evaluated its investments under EITF 03-1 and FSP 115-1. Because it has concluded that none of its securities have impairments that are other-than-temporary, the impact of these pronouncements have not had a material impact on the Company's financial statements.

*Loans and Allowance for Loan and Lease Losses*

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are stated at the amount of unpaid principal and are net of unearned discount, unearned loan fees and an allowance for loan and lease losses. The allowance for loan and lease losses is established through a provision for loan and lease losses charged to expense. Loan principal considered to be uncollectible by management is charged against the allowance for loan and lease losses. The allowance is an amount that management believes will be adequate to absorb losses on existing loans that may become uncollectible based upon an evaluation of known and inherent risks in the loan portfolio. The evaluation takes into consideration such factors as changes in the nature and size of the loan portfolio, overall portfolio quality, specific problem loans, and current economic conditions which may affect the borrowers' ability to pay. The evaluation also details historical losses by loan category, the resulting loss rates for which are projected at current loan total amounts. Loss estimates for specified problem loans are also detailed.

Interest income is accrued as earned on a simple interest basis. Accrual of interest is discontinued on a loan when management believes, after considering economic and business conditions and collection efforts, that the borrower's financial condition is such that collection of interest is doubtful. When a loan is placed on such non-accrual status, all accumulated accrued interest receivable is reversed out of current period income. Commercial loans 90 days or more past due and still accruing interest must have both principal and accruing interest adequately secured and must be in the process of collection. Residential mortgage loans are placed on non-accrual status at the time when foreclosure proceedings are commenced except where there exists sufficient collateral to cover the defaulted principal and interest payments, and management's knowledge of the specific circumstances warrant continued accrual. Consumer loans are generally charged off when principal and interest payments are four months in arrears unless the obligations are well secured and in the process of collection. Interest thereafter on such charged-off consumer loans is taken into income when received only after full recovery of principal.

The Company accounts for impaired loans in accordance with SFAS No. 114, *Accounting by Creditors for Impairment of a Loan*, as amended by SFAS No. 118, *Accounting by Creditors for Impairment of a Loan - Income Recognition and Disclosures*. Impairment is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, except that as a practical expedient, Lakeland may measure impairment based on a loan's observable market price, or the fair value of the collateral if the loan is collateral-dependent. Regardless of the measurement method, a creditor must measure impairment based on the fair value of the collateral when the creditor determines that foreclosure is probable.

In October 2003, the AICPA issued SOP 03-3 *Accounting for Loans or Certain Debt Securities Acquired in a*





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Transfer. SOP 03-3 applies to a loan with the evidence of deterioration of credit quality since origination acquired by completion of a transfer for which it is probable at acquisition, that the Company will be unable to collect all contractually required payments receivable. SOP 03-3 requires that the Company recognize the excess of all cash flows expected at acquisition over the investor's initial investment in the loan as interest income on a level-yield basis over the life of the loan as the accretable yield. The loan's contractual required payments receivable in excess of the amount of its cash flows expected at acquisition (nonaccretable difference) should not be recognized as an adjustment to yield, a loss accrual or a valuation allowance for credit risk. SOP 03-3 is effective for loans acquired in fiscal years beginning after December 31, 2004. The Company adopted this statement on January 1, 2005. The adoption of this statement did not have a material impact on the financial condition or results of operations of the Company. Management will continue to evaluate the effects of this statement when it subsequently evaluates loans and securities acquired in a transfer.

*Bank Premises and Equipment*

Bank premises and equipment, including leasehold improvements, are stated at cost less accumulated depreciation. Depreciation expense is computed on the straight-line method over the estimated useful lives of the assets. Leasehold improvements are depreciated over the shorter of the estimated useful lives of the improvements or the terms of the related leases.

*Other Real Estate Owned*

Other real estate owned (OREO), representing property acquired through foreclosure, is carried at the lower of the principal balance of the secured loan or fair value less estimated disposal costs of the acquired property. Costs relating to holding the assets are charged to expense. An allowance for OREO has been established, through charges to OREO expense, to maintain properties at the lower of cost or fair value less estimated costs to sell. Operating results of OREO, including rental income, operating expenses and gains and losses realized from the sale of properties owned, are included in other expenses.

*Mortgage Servicing*

The Company performs various servicing functions on loans owned by others. A fee, usually based on a percentage of the outstanding principal balance of the loan, is received for these services. At December 31, 2005 and 2004, Lakeland was servicing approximately \$17.1 million and \$17.2 million, respectively, of loans for others.

The Company accounts for its transfers and servicing of financial assets in accordance with SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. The Company originates mortgages under a definitive plan to sell or securitize those loans and service the loans owned by the investor. Upon the transfer of the mortgage loans in a sale or a securitization, the Company records the servicing assets retained in accordance with SFAS No. 140. The Company records mortgage servicing rights and the loans based on relative fair values at the date of origination.

Mortgage loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or estimated fair value. Gains and losses on sales of loans are also accounted for in accordance with SFAS No. 134, *Accounting for Mortgage Securities Retained after the Securitizations of Mortgage Loans Held for Sale by a Mortgage Banking Enterprise*. This statement requires that an entity engaged in mortgage banking activities classify the retained mortgage-backed security or other interest, which resulted from the securitization of a mortgage loan held for sale, based upon its ability and intent to sell or hold these investments.

*Restrictions On Cash And Due From Banks*

Lakeland is required to maintain reserves against customer demand deposits by keeping cash on hand or balances with the Federal Reserve Bank of New York in a noninterest bearing account. The amounts of those reserves and cash balances at December 31, 2005 and 2004 were approximately \$2.9 million and \$6.6 million, respectively.

*Earnings Per Share*

The Company follows the provisions of SFAS No. 128, *Earnings Per Share*, which requires presentation of basic and diluted earnings per share in conjunction with the disclosure of the methodology used in computing such earnings per share. Basic earnings per share excludes dilution and is computed by dividing income available to common shareholders by the weighted average common shares outstanding during the period. Diluted earnings per share takes into account the potential dilution that could occur if securities or other contracts to issue common stock were exercised and converted into common stock. All weighted average, actual shares or per share information in the financial statements have been adjusted retroactively for the effect of stock dividends.



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*Employee Benefit Plans*

The Company has certain employee benefit plans covering substantially all employees. The Company accrues such costs as incurred.

The Company follows the disclosure provisions of SFAS No. 132, *Employers' Disclosures about Pensions and Other Postretirement Benefits*, which was revised in December 2003. SFAS No. 132, as revised, requires additional employers' disclosures about pension and other postretirement benefit plans. Certain disclosures related to estimated future benefit payments are effective for fiscal years ending after June 14, 2004. Net pension expense consists of service cost, interest cost, return on pension assets and amortization of unrecognized initial net assets. The Company accrues its post retirement benefit costs and other benefit plan costs as incurred.

*Stock-Based Compensation*

The Company follows the provisions of SFAS No. 123, *Accounting for Stock-Based Compensation*, which contains a fair value-based method for valuing stock-based compensation that entities may use, which measures compensation cost at the grant date based on the fair value of the award. Compensation is then recognized over the service period, which is usually the vesting period. Alternatively, the standard permits entities to continue accounting for employee stock options and similar equity instruments under Accounting Principles Board (APB) Opinion No. 25,

*Accounting for Stock Issued to Employees*. Entities that continue to account for stock options using APB Opinion No. 25 are required to make pro forma disclosures of net income and earnings per share, as if the fair value-based method of accounting defined in SFAS No. 123 had been applied.

At December 31, 2005, the Company had stock-based employee compensation plans, which are more fully described in Note 14. The Company accounts for these plans under the recognition and measurement principles of APB No. 25, *Accounting for Stock Issued to Employees*, and related interpretations. Stock-based employee compensation costs are not reflected in net income, as all options granted under the plans had an exercise price equal to the market value of the underlying common stock on the date of grant.

In December 2004, the Company granted options to purchase 158,162 shares of common stock to key employees at an exercise price of \$16.39. Included in this grant were 61,561 options which were subject to shareholder approval of an increase in authorized shares. Such shareholder approval was received at the Company's annual meeting on May 10, 2005. The fair market value of the Company's stock on the date of shareholder approval was less than it was on the date of grant; therefore, no compensation expense was recorded.

On May 13, 2005, the Company accelerated the vesting of 460,774 stock options, representing all unvested stock options on such date which had exercise prices in excess of the market value of the Company's common stock on May 13, 2005. The Company's decision to accelerate the vesting of these options was part of a review by the Board of Directors of the Company's incentive compensation program and also on upcoming changes in the accounting for stock options. The acceleration of the stock options had the effect of reducing pro forma earnings by \$1.3 million, and pro forma earnings per share by \$0.06 for the year ended December 31, 2005. The acceleration of the vesting, however, did not have any impact on reported earnings.

During 2005, the Company granted options to purchase 156,484 shares of common stock to key employees at an exercise price of \$15.69 per share. These options vested immediately and the corresponding fair value of these options is included in the table below.

The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS No. 123, *Accounting for Stock-Based Compensation*, to stock-based employee compensation (in thousands, except per share amounts).

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	Years Ended December 31,		
	2005	2004	2003
Net income, as reported	\$ 20,221	\$ 16,495	\$ 15,107
Deduct: Stock-based compensation costs determined under fair value based method for all awards	2,888	769	638
Pro forma net income	\$ 17,333	\$ 15,726	\$ 14,469
Earnings per share:			
Basic, as reported	\$ 0.94	\$ 0.85	\$ 0.94
Basic, pro forma	\$ 0.80	\$ 0.81	\$ 0.81
Diluted, as reported	\$ 0.94	\$ 0.84	\$ 0.93
Diluted, pro forma	\$ 0.80	\$ 0.80	\$ 0.89

The fair value of each option grant is estimated on the date of grant using the Black-Scholes options-pricing model with the following weighted average assumptions used for grants in 2005, 2004 and 2003: dividend rate of 2%; expected volatility of 30%, 31% and 35%, risk-free interest rate of 4.28%, 3.98% and 3.39%, and expected lives of 7 years for all periods.

In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123(R), Share-Based Payment, that addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for (a) equity instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. Under SFAS No. 123(R), all forms of share-based payments to employees, including employee stock options, would be treated the same as other forms of compensation by recognizing the related cost in the income statement. The expense of the award would generally be measured at fair value at the grant date. Current accounting guidance requires that the expense relating to employee stock options only be disclosed in the footnotes to the financial statements. SFAS No. 123(R) eliminates the ability to account for share-based compensation transactions using APB Opinion No. 25, Accounting for Stock Issued to Employees. SFAS No. 123(R) is effective for public companies as of the beginning of the first fiscal year that begins after June 15, 2005. All public companies that used the fair-value-based method for either recognition or disclosure under SFAS No. 123 will apply SFAS No. 123(R) using a modified method of prospective application. Under this transition method, compensation cost is recognized on or after the required effective date for the portion of outstanding awards for which the requisite service has not yet been rendered based on the grant-date fair value of those awards calculated under SFAS No. 123 for either recognition or pro forma disclosures. The impact of this new standard, if it had been in effect, on the net earnings and related per share amounts for the years ended December 31, 2005, 2004 and 2003 is disclosed in the table above.

On March 29, 2005, the SEC released Staff Accounting Bulletin 107, Share Based Payments (SAB 107). The interpretations in SAB 107 express views of the SEC staff regarding the application of SFAS No. 123(R). Among other things, SAB 107 provides interpretive guidance related to the interaction between Statement 123(R) and certain SEC rules and regulations, as well as provides the staff's views regarding the valuation of share-based payment arrangements for public companies. Since all of the Company's stock options outstanding at December 31, 2005 are vested, management does not believe that the implementation of SAB 107 and SFAS No. 123(R) will have an immediate impact on its earnings. The Company will implement SAB 107 and SFAS No. 123(R) using a modified method of prospective application. The Company is evaluating the impact that the implementation of SAB 107 and SFAS No. 123(R) will have on future option, restricted stock, or other potential grants.

*Statement Of Cash Flows*

Cash and cash equivalents are defined as cash on hand, cash items in the process of collection, amounts due from banks and federal funds sold with an original maturity of three months or less. Cash paid for income taxes was \$7.8 million, \$6.7 million and \$6.5 million in 2005, 2004 and 2003, respectively. Cash paid for interest was \$32.6 million, \$21.4 million and \$15.8 million in 2005, 2004 and 2003, respectively.

	2005	2004	2003
	(in thousands)		
Supplemental schedule of noncash investing and financing activities:			
Transfer of loans receivable to other real estate owned	\$	\$	\$ 325

**Table of Contents***Comprehensive Income*

The Company follows the disclosure provisions of SFAS No. 130, Reporting Comprehensive Income. SFAS No. 130 requires the reporting of comprehensive income in addition to net income from operations. Comprehensive income is a more inclusive financial reporting methodology that includes disclosure of certain financial information that historically has not been recognized in the calculation of net income.

	December 31, 2005 (in thousands)		
	Before tax amount	Tax benefit	Net of tax amount
<b>Unrealized loss on investment securities</b>			
<b>Unrealized holding losses arising during the period</b>	\$ (8,503)	\$ 2,916	\$ (5,587)
<b>Less: reclassification adjustment for losses realized in net income</b>	(583)	187	(396)
<b>Other comprehensive loss, net</b>	\$ (7,920)	\$ 2,729	\$ (5,191)

	December 31, 2004 (in thousands)		
	Before tax amount	Tax expense	Net of tax amount
<b>Unrealized gain on investment securities</b>			
<b>Unrealized holding gains arising during the period</b>	\$ 991	\$ (313)	\$ 678
<b>Less: reclassification adjustment for gains realized in net income</b>	638	(202)	436
<b>Other comprehensive gain, net</b>	\$ 353	\$ (111)	\$ 242

	December 31, 2003 (in thousands)		
	Before tax amount	Tax (expense) benefit	Net of tax amount
<b>Unrealized loss on investment securities</b>			
<b>Unrealized holding losses arising during the period</b>	\$ (5,021)	\$ 1,962	\$ (3,059)
<b>Less: reclassification adjustment for gains realized in net income</b>	1,857	(594)	1,263
<b>Other comprehensive loss, net</b>	\$ (6,878)	\$ 2,556	\$ (4,322)

*Goodwill and Other Identifiable Intangible Assets*

The Company accounts for goodwill and other identifiable intangible assets in accordance with SFAS No. 142, Goodwill and Intangible Assets. The Company tests goodwill for impairment annually at the reporting unit level using various market valuation methodologies. The Company has tested the goodwill and other identifiable intangible assets as of December 31, 2005 and has determined that they are not impaired.

Goodwill and core deposit intangible resulting from the Newton acquisition totaled \$61.2 million and \$5.7 million, respectively. Goodwill and core deposit intangible resulting from the acquisition of CSB totaled \$23.7 million and \$2.2 million, respectively, and is included in goodwill and other identifiable intangible assets. Total goodwill was \$87.1 million and \$86.6 million for the years ended December 31, 2005 and 2004, respectively. Core deposit



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intangible was \$6.3 million and \$7.5 million for the years ended December 31, 2005 and 2004, respectively. Amortization expense of core deposit intangible was \$1.2 million, \$810,000 and \$222,000 for the years ended December 31, 2005, 2004 and 2003, respectively.

*Bank Owned Life Insurance*

The Company invests in bank owned life insurance (BOLI). BOLI involves the purchasing of life insurance by the Company on a chosen group of employees. The Company is owner and beneficiary of the policies. At December 31, 2005 and 2004, Lakeland had \$35.5 million and \$34.2 million, respectively, in BOLI. Income earned on BOLI was \$1.2 million, \$1.1 million and \$913,000 for the years ended December 31, 2005, 2004 and 2003, respectively.

*Income Taxes*

The Company accounts for income taxes under the liability method of accounting for income taxes. Deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities as measured by the enacted tax rates that will be in effect when these differences reverse. Deferred tax expense is the result of changes in deferred tax assets and liabilities. The principal types of differences between assets and liabilities for financial statement and tax return purposes are allowance for loan and lease losses, core deposit intangible, deferred loan fees, deferred compensation and securities available for sale.

*Variable Interest Entity*

Management has determined that Lakeland Bancorp Capital Trust I, Lakeland Bancorp Capital Trust II and Lakeland Bancorp Capital Trust III (collectively, the Trusts ) qualify as a variable interest entities under FIN 46. The Trusts issued mandatorily redeemable preferred stock to investors and loaned the proceeds to the Company. The Trusts hold, as their sole asset, subordinated debentures issued by the Company.

The Federal Reserve has issued guidance on the regulatory capital treatment for the trust preferred securities issued by the Trusts as a result of the adoption of FIN 46(R). The rule retains the current maximum percentage of total capital permitted for trust preferred securities at 25%, but enacts other changes to the rules governing trust preferred securities that affect their use as part of the collection of entities known as restricted core capital elements. The rule took effect April 11, 2005; however, a five year transition period starting March 31, 2004 and leading up to March 31, 2009 allows bank holding companies to continue to count trust preferred securities as Tier 1 Capital after applying FIN 46(R). Management has evaluated the effects of the rule and anticipates that its ratios would still exceed the minimum ratios required to qualify as a well-capitalized institution. This constitutes a forward-looking statement under the Private Securities Litigation Act of 1995.

*Reclassifications*

Certain reclassifications have been made to the prior period financial statements to conform to the 2005 presentation.

**NOTE 2 - ACQUISITIONS**

On August 25, 2003, the Company and Lakeland completed a merger with CSB Financial Corp. and its subsidiary Community State Bank pursuant to which CSB Financial Corp. and Community were merged into the Company and Lakeland. Subject to specified allocation procedures in the merger agreement, CSB shareholders had the right to elect to receive shares of the Company's common stock or cash in the merger. Under the terms of the merger, each of the 577,513 shares of CSB stock was exchanged for 1.781 shares (1.964 restated<sup>^</sup>) of Lakeland Bancorp common stock for a total issuance of 1,028,492 shares (1,133,912 restated) of stock. The remaining 577,514 shares of CSB stock were exchanged for a cash payment of \$29 per share for a total of \$16.7 million. Remaining stock options of 55,325 were paid at a rate of \$29 per share less the exercise price of the options for a total cash payment of \$856,000. The transaction was accounted for under the purchase method of accounting and the results of operations include CSB's results from August 25, 2003 forward. The acquisition resulted in the recording of approximately \$25.9 million of goodwill and other intangible assets. The Company acquired assets, loans and deposits of \$141.2 million, \$87.2 million and \$125.7 million, respectively.

<sup>^</sup>Restated for the 5% stock dividend payable on October 15, 2003 to shareholders of record on September 30, 2003, and for the 5% stock dividend payable on August 16, 2005 to shareholders of record on July 29, 2005.

On July 1, 2004, the Company completed the acquisition of Newton Financial Corp. ( NFC ) pursuant to which NFC was merged into the Company. NFC shareholders had the right to elect stock and/or cash in the merger





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subject to certain allocation provisions. NFC shareholders who received stock received 4.5 shares (4.725 restated\*) of the Company's stock for each of their NFC shares. NFC shareholders who received cash received \$72.08 per share. Under the terms of the merger, 1,086,922 shares of NFC stock were exchanged for a total issuance of 4,891,119 shares (5,135,674 restated\*) of Lakeland Bancorp stock. The remaining 270,526 shares of NFC stock were exchanged for a total of \$19.5 million. NFC stock options of 13,591 were exchanged for Company stock options of 61,160 (64,218 restated\*) and were fully vested at the time of the merger. As a result of the acquisition, the Company recorded \$67.0 million in goodwill and other intangible assets. In 2005, an unasserted legal claim was identified related to loan payments previously made to Newton prior to Lakeland's acquisition. The unasserted legal claim of approximately \$460,000 was recorded in goodwill during the first quarter of 2005 and was settled in the second quarter of 2005. The transaction was accounted for under the purchase method of accounting. The results of operations include Newton's results of operations from July 1, 2004 forward.

\* Restated for the 5% stock dividend payable on August 16, 2005 to shareholders of record on July 29, 2005.

The following condensed consolidated balance sheet of NFC discloses the amounts assigned to each major asset and liability caption at the acquisition date, July 1, 2004.

	(dollars in thousands)	
<b>Assets:</b>		
Cash and due from banks	\$	1,067
Investment securities		80,803
Net loans		200,084
Premises and Equipment		3,790
Goodwill and core deposit intangible		66,502
Other assets		7,389
Total assets	\$	359,635
 <b>Liabilities</b>		
Total deposits	\$	(266,894)
Borrowings		(13,309)
Other liabilities		(1,879)
Total liabilities assumed		(282,082)
Net assets acquired	\$	77,553

The following represents the unaudited pro forma financial information of Lakeland Bancorp as if the acquisition occurred on the first date of the period indicated. The pro forma financial information should be read in conjunction with the related historical information and is not necessarily indicative of the results that would have been attained had the transaction actually taken place.

	For the year ended December 31, 2004 (in thousands)	
Interest income	\$	90,826
Interest expense		23,300
Net interest income		67,526
Provision for loan losses		4,038
Non-interest income		14,065
Non-interest expense		51,959

Net Income	\$	17,592
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NOTE 3 - INVESTMENT SECURITIES

The amortized cost, gross unrealized gains and losses, and the fair value of the Company's available for sale and held to maturity securities are as follows:

**AVAILABLE FOR SALE**

	Amortized Cost	December 31, 2005		Fair Value	Amortized Cost	December 31, 2004		Fair Value
		Gross Unrealized Gains (in thousands)	Gross Unrealized Losses (in thousands)			Gross Unrealized Gains (in thousands)	Gross Unrealized Losses (in thousands)	
U.S. Treasury and U.S. government agencies	\$ 160,421	\$	\$ (3,039)	\$ 157,382	\$ 156,250	\$ 46	\$ (1,867)	\$ 154,429
Mortgage-backed securities	293,179	27	(7,402)	285,804	342,022	831	(2,383)	340,470
Obligations of states and political subdivisions	45,396	549	(226)	45,719	44,418	1,513	(10)	45,921
Other debt securities	8,084	13	(166)	7,931	22,891	53	(10)	22,934
Equity securities	16,231	3,069	(233)	19,067	16,013	2,354	(15)	18,352
	<b>\$ 523,311</b>	<b>\$ 3,658</b>	<b>\$ (11,066)</b>	<b>\$ 515,903</b>	<b>\$ 581,594</b>	<b>\$ 4,797</b>	<b>\$ (4,285)</b>	<b>\$ 582,106</b>

**HELD TO MATURITY**

	Amortized Cost	December 31, 2005		Fair Value	Amortized Cost	December 31, 2004		Fair Value
		Gross Unrealized Gains (in thousands)	Gross Unrealized Losses (in thousands)			Gross Unrealized Gains (in thousands)	Gross Unrealized Losses (in thousands)	
U.S. Treasury and U.S. government agencies	\$ 38,532	\$	\$ (834)	\$ 37,698	\$ 39,949	\$ 41	\$ (144)	\$ 39,846
Mortgage-backed securities	49,277	13	(1,111)	48,179	62,680	276	(287)	62,669
Obligations of states and political subdivisions	64,143	142	(1,116)	63,169	55,102	305	(178)	55,229
Other debt securities	2,617		(26)	2,591	5,191	4	(13)	5,182
	<b>\$ 154,569</b>	<b>\$ 155</b>	<b>\$ (3,087)</b>	<b>\$ 151,637</b>	<b>\$ 162,922</b>	<b>\$ 626</b>	<b>\$ (622)</b>	<b>\$ 162,926</b>

The following table lists contractual maturities of investment securities classified as available for sale and held to maturity. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	December 31, 2005			
	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(in thousands)			
Due in one year or less	\$ 14,458	\$ 14,406	\$ 19,330	\$ 19,236
Due after one year through five years	137,488	135,877	36,369	35,548
Due after five years through ten years	49,579	48,698	36,175	35,471
Due after ten years	12,376	12,051	13,418	13,203
	213,901	211,032	105,292	103,458
Mortgage-backed securities	293,179	285,804	49,277	48,179
Equity securities	16,231	19,067		

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Total securities	\$ 523,311	\$ 515,903	\$ 154,569	\$ 151,637
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	Years ended December 31,		
	2005	2004	2003
	(in thousands)		
Sale proceeds	<b>\$ 81,095</b>	\$ 32,708	\$ 81,428
Gross gains	<b>343</b>	678	1,900
Gross losses	<b>(926)</b>	(440)	(43)

In 2005 and 2003, the Company sold approximately \$715,000 and \$701,000, respectively, in investment securities classified as held to maturity because over 85% of the original principal acquired on these securities had been paid by the sale date. There was a gain of \$23,000 on the 2005 sale of held to maturity securities and a loss of \$1,000 on the sale in 2003.

Securities with a carrying value of approximately \$255.3 million and \$298.9 million at December 31, 2005 and 2004, respectively, were pledged to secure public deposits and for other purposes required by applicable laws and regulations.

The following table indicates the length of time individual securities have been in a continuous unrealized loss position at December 31, 2005 and 2004:

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December 31, 2005	Less than 12 months		12 months or longer		Number of securities	Total	
	Fair value	Unrealized Losses	Fair value	Unrealized Losses		Fair value	Unrealized Losses
(dollars in thousands)							
<b>AVAILABLE FOR SALE</b>							
U.S. Treasury and U.S. government agencies	\$ 53,718	\$ 340	\$ 103,664	\$ 2,699	55	\$ 157,382	\$ 3,039
Mortgage-backed securities	101,212	1,720	168,724	5,682	136	269,936	7,402
Obligations of states and political subdivisions	16,923	204	767	22	38	17,690	226
Other debt securities	5,452	149	568	17	4	6,020	166
Equity securities	7,862	233			6	7,862	233
	\$ 185,167	\$ 2,646	\$ 273,723	\$ 8,420	239	\$ 458,890	\$ 11,066
<b>HELD TO MATURITY</b>							
U.S. Treasury and U.S. government agencies	\$ 14,830	\$ 252	22,868	\$ 582	16	\$ 37,698	\$ 834
Mortgage-backed securities	18,904	277	27,388	834	22	46,292	1,111
Obligations of states and political subdivisions	38,825	649	2,523	467	131	41,348	1,116
Other debt securities	2,038	24	553	2	4	2,591	26
	\$ 74,597	\$ 1,202	\$ 53,332	\$ 1,885	173	\$ 127,929	\$ 3,087
<b>December 31, 2004</b>							
December 31, 2004	Less than 12 months		12 months or longer		Number of securities	Total	
	Fair value	Unrealized Losses	Fair value	Unrealized Losses		Fair value	Unrealized Losses
(dollars in thousands)							
<b>AVAILABLE FOR SALE</b>							
U.S. Treasury and U.S. government agencies	\$ 91,237	\$ 706	\$ 39,149	\$ 1,161	58	\$ 130,386	\$ 1,867
Mortgage-backed securities	161,152	975	72,178	1,408	112	233,330	2,383
Obligations of states and political subdivisions	2,049	10			6	2,049	10
Other debt securities	1,528	10			2	1,528	10
Equity securities	5,113	15			1	5,113	15
	\$ 261,079	\$ 1,716	\$ 111,327	\$ 2,569	179	\$ 372,406	\$ 4,285
<b>HELD TO MATURITY</b>							
U.S. Treasury and U.S. government agencies	\$ 25,709	\$ 144	\$	\$	11	\$ 25,709	\$ 144
Mortgage-backed securities	34,352	287			10	34,352	287
Obligations of states and political subdivisions	19,972	141	1,513	37	60	21,485	178
Other debt securities	557	13			1	557	13
	\$ 80,590	\$ 585	\$ 1,513	\$ 37	82	\$ 82,103	\$ 622

Management has evaluated the securities in the above table and has concluded that none of these securities has impairments that are other-than-temporary. In its evaluation, management considered the types of securities including if the securities were US government issued, and what the credit rating was on the securities. Most of the securities that are in an unrealized loss position are in a loss position because of changes in interest rates since the securities were purchased. The securities that have been in an unrealized loss position for 12 months or longer include US government agency securities and mortgage backed securities whose market values are sensitive to interest rates. The corporate securities and the obligations of state and political subdivisions listed in the above table all are investment grade securities.

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## NOTE 4 - LOANS

	December 31,	
	2005	2004
	(in thousands)	
Commercial	\$ 691,054	\$ 602,062
Real estate-mortgage	256,621	223,936
Real estate-construction	68,325	62,687
Home Equity and Consumer	302,236	289,920
<b>Total loans</b>	<b>1,318,236</b>	<b>1,178,605</b>
Less: deferred fees	5,469	2,600
<b>Loans net of deferred fees</b>	<b>\$ 1,312,767</b>	<b>\$ 1,176,005</b>

Changes in the allowance for loan and lease losses are as follows:

	Years ended December 31,		
	2005	2004	2003
	(in thousands)		
Balance at beginning of year	\$ 16,638	\$ 16,899	\$ 17,940
Provision for loan and lease losses	1,555	3,602	3,000
Addition related to acquisitions		2,301	872
Loans charged off	(6,273)	(6,682)	(5,917)
Recoveries	1,253	518	1,004
<b>Balance at end of year</b>	<b>\$ 13,173</b>	<b>\$ 16,638</b>	<b>\$ 16,899</b>

The balance of impaired loans was \$3.7 million and \$12.2 million at December 31, 2005 and 2004, respectively. Lakeland identifies a loan as impaired when it is probable that interest and principal will not be collected according to the contractual terms of the loan agreements. The allowance for loan and lease losses associated with impaired loans was \$953,000 and \$4.6 million at December 31, 2005 and 2004, respectively. The average recorded investment on impaired loans was \$8.2 million, \$15.3 million and \$18.3 million during 2005, 2004 and 2003, respectively, and the income recognized, primarily on the cash basis, on impaired loans was \$323,000, \$190,000 and \$218,000 during 2005, 2004 and 2003, respectively. Interest which would have been accrued on impaired loans during 2005, 2004 and 2003 was \$661,000, \$1.5 million and \$1.8 million, respectively. Lakeland's policy for interest income recognition on impaired loans is to recognize income on restructured loans under the accrual method. Lakeland recognizes income on non-accrual loans under the cash basis when the loans are both current and the collateral on the loan is sufficient to cover the outstanding obligation to Lakeland; if these factors do not exist, Lakeland will not recognize income.

Loans past due 90 days or more and still accruing are those loans as to which payment of interest or principal is in arrears for a period of 90 days or more but is adequately collateralized as to interest and principal or is in the process of collection. Non-performing loans consist of non-accrual loans and renegotiated loans. Non-accrual loans are those on which income under the accrual method has been discontinued with subsequent interest payments credited to interest income when received, or if ultimate collectibility of principal is in doubt, applied as principal reductions. Renegotiated loans are loans whose contractual interest rates have been reduced or where other significant modifications have been made due to borrowers' financial difficulties. Interest on these loans is either accrued or credited directly to interest income. Loans past due 90 days or more and non-performing loans were as follows:

	December 31,		
	2005	2004	2003
	(in thousands)		
Loans past due 90 days or more and still accruing	\$ 5,127	\$ 2,347	\$ 1,248



Non-accrual loans

**\$ 3,907** \$ 13,017 \$ 16,653

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The impact of the above non-performing loans on interest income is as follows:

December 31,	2005	2004	2003
	(in thousands)		
Interest income if performing in accordance with original terms	\$ 661	\$ 1,476	\$ 1,811
Interest income actually recorded	323	217	218
	<b>\$ 338</b>	<b>\$ 1,259</b>	<b>\$ 1,593</b>

Lakeland has entered into lending transactions in the ordinary course of business with directors, executive officers, principal stockholders and affiliates of such persons on the same terms as those prevailing for comparable transactions with other borrowers. These loans at December 31, 2005, were current as to principal and interest payments, and do not involve more than normal risk of collectibility. At December 31, 2005, loans to these related parties amounted to \$29.7 million. There were new loans of \$25.8 million to related parties and repayments of \$15.1 million from related parties in 2005.

## NOTE 5 - PREMISES AND EQUIPMENT

	Estimated	December 31,	
	useful lives	2005	2004
		(in thousands)	
Land	Indefinite	\$ 5,698	\$ 5,698
Buildings and building improvements	10 to 50 years	29,615	28,107
Leasehold improvements	10 to 25 years	1,855	1,978
Furniture, fixtures and equipment	2 to 30 years	21,823	22,713
		<b>58,991</b>	58,496
Less accumulated depreciation and amortization		<b>26,563</b>	26,747
		<b>\$ 32,428</b>	<b>\$ 31,749</b>

## NOTE 6 - DEPOSITS

At December 31, 2005, the schedule of maturities of certificates of deposit is as follows (in thousands):

Year	
2006	\$ 349,719
2007	82,049
2008	10,996
2009	2,996
2010	430
Thereafter	1,403
	<b>\$ 447,593</b>

## NOTE 7 - Debt

*Lines of Credit*

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As of December 31, 2005, the Company had approved overnight borrowing capacity with the Federal Home Loan Bank (FHLB) of New York of \$100 million. Borrowings under this arrangement have an interest rate that fluctuates based on market conditions and customer demand. As of December 31, 2005 there were outstanding borrowings against this line of \$20 million at an interest rate of 4.23%. As of December 31, 2005, the Company also had overnight federal funds lines available for it to borrow \$85.0 million. The Company borrowed \$16.3 million against these lines with a weighted average rate of 4.30% as of December 31, 2005.

### *Securities Sold Under Agreements to Repurchase and Federal Funds Purchased*

Borrowed money at December 31, 2005 and 2004 consisted of short-term securities sold under agreements to

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repurchase and federal funds purchased. Securities underlying the agreements were under Lakeland's control. The following table summarizes information relating to lines of credit, securities sold under agreements to repurchase and federal funds purchased for 2005, 2004 and 2003. For purposes of the table, the average amount outstanding was calculated based on a daily average.

	2005	2004	2003
	(dollars in thousands)		
Balance at December 31	\$ 103,199	\$ 110,830	\$ 51,423
Interest rate at December 31	3.98%	2.30%	1.01%
Maximum amount outstanding at any month-end during the year	\$ 157,133	\$ 110,830	\$ 51,423
Average amount outstanding during the year	\$ 95,439	\$ 38,894	\$ 20,601
Weighted average interest rate during the year	3.18%	1.51%	1.08%

*Long-Term Debt**FHLB Debt*

At December 31, 2005, advances from the FHLB totaling \$45.1 million will mature within one to seven years and are reported as long-term borrowings. These advances are collateralized by certain securities and first mortgage loans. The advances had a weighted average interest rate of 4.66%.

Outstanding borrowings mature as follows: (in thousands)

Year	
2006	\$ 3,355
2007	10,851
2008	855
2009	
2010	10,000
Thereafter	20,000
	\$ 45,061

*Subordinated Debentures*

On December 15, 2003, the Company issued \$25.8 million of junior subordinated debentures due January 7, 2034 to Lakeland Bancorp Capital Trust III, a Delaware business trust, which is a wholly-owned subsidiary of the Company. The distribution rate on these securities is 7.535% for 10 years and float at LIBOR plus 285 basis points thereafter. The debentures are the sole asset of the Trust. The Trust issued 25,000 shares of trust preferred securities, \$1,000 face value, for total proceeds of \$25.0 million. The Company's obligations under the debentures and related documents, taken together, constitute a full, irrevocable and unconditional guarantee on a subordinated basis by the Company of the Trust's obligations under the preferred securities. The preferred securities are callable by the Company on or after January 7, 2009, or earlier if the deduction of related interest for federal income taxes is prohibited, treatment as Tier I capital is no longer permitted, or certain other contingencies arise. The preferred securities must be redeemed upon maturity of the debentures in 2034.

On June 18, 2003, the Company issued \$10.3 million of junior subordinated debentures due July 7, 2033 to Lakeland Bancorp Capital Trust I, a Delaware business trust, which is a wholly-owned subsidiary of the Company. The distribution rate on these securities is 6.20% for 7 years and float at LIBOR plus 310 basis points thereafter. The debentures are the sole asset of the Trust. The Trust issued 10,000 shares of trust preferred securities, \$1,000 face value, for total proceeds of \$10.0 million. The Company's obligations under the debentures and related documents, taken together, constitute a full, irrevocable and unconditional guarantee on a subordinated basis by the Company of the Trust's obligations under the preferred securities. The preferred securities are callable by the Company on or after July 7, 2010, or earlier if the deduction of related interest for federal income taxes is prohibited, treatment as Tier I capital is no longer permitted, or certain other contingencies arise. The preferred securities must be redeemed upon maturity of the debentures in 2033.

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On June 18, 2003, the Company also issued \$20.6 million of junior subordinated debentures due June 30, 2033 to Lakeland Bancorp Capital Trust II, a Delaware business trust, which is a wholly-owned subsidiary of the Company. The distribution rate on these securities is 5.71% for 5 years and float at LIBOR plus 310 basis points thereafter. The debentures are the sole asset of the Trust. The Trust issued 20,000 shares of trust preferred securities, \$1,000

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face value, for total proceeds of \$20.0 million. The Company's obligations under the debentures and related documents, taken together, constitute a full, irrevocable and unconditional guarantee on a subordinated basis by the Company of the Trust's obligations under the preferred securities. The preferred securities are callable by the Company on or after June 30, 2008, or earlier if the deduction of related interest for federal income taxes is prohibited, treatment as Tier I capital is no longer permitted, or certain other contingencies arise. The preferred securities must be redeemed upon maturity of the debentures in 2033.

**NOTE 8 - STOCKHOLDERS' EQUITY**

On June 10, 2005, the Company announced a stock repurchase program for the purchase of up to 787,500 shares of the Company's common stock over the next year. Under the 2005 plan, the Company purchased 401,102 shares of its outstanding common stock at an average price of \$15.18 per share for an aggregate cost of \$6.1 million.

On July 13, 2005, the Company's Board of Directors authorized a 5% stock dividend which was distributed on August 15, 2005.

In January 2004, the Company announced a stock repurchase program for the purchase of up to 262,500 shares of the Company's common stock over the next year. On July 15, 2004, the amount of shares purchasable in the stock buyback plan was increased to 525,000 shares to be purchased over the following year. During 2004, the Company purchased 265,650 shares of its outstanding common stock at an average price of \$16.61 per share for an aggregate cost of \$4.4 million. During 2005, the Company completed purchasing the shares purchasable in the 2004 plan by purchasing 270,888 shares of its outstanding common stock at an average price of \$14.80 per share for an aggregate price of \$4.0 million.

On September 10, 2003, the Company's Board of Directors authorized a 5% stock dividend which was distributed on October 15, 2003.

In January 2003, the Company announced a stock repurchase program for the purchase of up to 275,625 shares of the Company's common stock over the next year. During 2003, the Company purchased 137,812 shares of its outstanding common stock at an average price of \$15.11 per share for an aggregate cost of \$2.1 million. In January 2004, the 2003 program expired and was replaced by the 2004 stock repurchase program.

**NOTE 9 - SHAREHOLDER PROTECTION RIGHTS PLAN**

The Company adopted a Shareholder Rights Plan (the "Rights Plan") in 2001 to protect shareholders from attempts to acquire control of the Company at an inadequate price. Under the Rights Plan, the Company distributed a dividend of one right to purchase a unit of preferred stock on each outstanding common share of the Company. The rights are not currently exercisable or transferable, and no separate certificates evidencing such rights will be distributed, unless certain events occur. The rights have an expiration date of September 4, 2011.

After the rights become exercisable, under certain circumstances, the rights (other than rights held by a 15.0% beneficial owner or an "adverse person") will entitle the holders to purchase the Company's common shares at a substantially reduced price.

The Company is generally entitled to redeem the rights at \$0.001 per right at any time before the Rights become exercisable. Rights are not redeemable following an "adverse person" determination.

The Rights Plan was not adopted in response to any specific effort to acquire control of the Company. The issuance of rights had no dilutive effect, did not affect the Company's reported earnings per share, and was not taxable to the Company or its shareholders.

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## NOTE 10 - INCOME TAXES

The components of income taxes are as follows:

	Years Ended December 31,		
	2005	2004	2003
	(in thousands)		
Current tax provision	\$ 8,060	\$ 6,289	\$ 6,285
Deferred tax provision	1,524	1,330	802
<b>Total provision for income taxes</b>	<b>\$ 9,584</b>	<b>\$ 7,619</b>	<b>\$ 7,087</b>

The income tax provision reconciled to the income taxes that would have been computed at the statutory federal rate is as follows:

	Years Ended December 31,		
	2005	2004	2003
	(in thousands)		
Federal income tax, at statutory rates	\$ 10,432	\$ 8,442	\$ 7,768
Increase (deduction) in taxes resulting from:			
Non-taxable interest income	(1,730)	(1,507)	(1,329)
State income tax, net of federal income tax effect	823	622	500
Other, net	59	62	148
<b>Provision for income taxes</b>	<b>\$ 9,584</b>	<b>\$ 7,619</b>	<b>\$ 7,087</b>

The net deferred tax asset consisted of the following:

	2005	2004
	(in thousands)	
Deferred tax assets:		
Allowance for loan and lease losses	\$ 5,382	\$ 6,797
Valuation reserves for land held for sale and other real estate	679	787
Non-accrued interest	243	1,079
Depreciation	68	156
Deferred compensation	974	808
Unrealized loss on securities available for sale	2,557	
Other, net	240	82
<b>Deferred tax assets</b>	<b>10,143</b>	<b>9,709</b>
Deferred tax liabilities:		
Core deposit intangible from acquired companies	2,466	2,909
Deferred loan costs	963	839
Prepaid expenses	264	329
Unrealized gain on securities available for sale		172
Fair market value adjustments	217	429
Other	574	577
<b>Deferred tax liabilities</b>	<b>4,484</b>	<b>5,255</b>

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Net deferred tax assets, included in other assets

\$ 5,659 \$ 4,454

As a result of the acquisition of Newton, the Company recorded a net deferred tax liability of \$1.8 million in 2004 which included \$126,000 in unrealized holding losses. As a result of the acquisition of CSB, the Company recorded a net deferred tax liability of \$496,000, which included \$93,000 in unrealized holding gains in 2003. An \$876,000 tax liability for CSB's core deposit intangible was recorded in 2004 as an adjustment to goodwill.

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## NOTE 11 EARNINGS PER SHARE

The Company's calculation of earnings per share in accordance with SFAS No. 128 is as follows:

	Year ended December 31, 2005		
	Income (numerator) (in thousands except per share amounts)	Shares (denominator)	Per share amount
<b>Basic earnings per share</b>			
Net income available to common shareholders	\$ 20,221	21,439	\$ 0.94
Effect of dilutive securities			
Stock options		162	(0.00)
<b>Diluted earnings per share</b>			
Net income available to common shareholders plus assumed conversions	\$ 20,221	21,601	\$ 0.94

Options to purchase 521,597 shares of common stock at a weighted average of \$16.16 per share were outstanding during 2005. They were not included in the computation of diluted earnings per share because the option exercise price was greater than the average market price.

	Year ended December 31, 2004		
	Income (numerator) (in thousands except per share amounts)	Shares (denominator)	Per share amount
<b>Basic earnings per share</b>			
Net income available to common shareholders	\$ 16,495	19,329	\$ 0.85
Effect of dilutive securities			
Stock options		238	(0.01)
<b>Diluted earnings per share</b>			
Net income available to common shareholders plus assumed conversions	\$ 16,495	19,567	\$ 0.84

Options to purchase 227,165 shares of common stock at a weighted average of \$16.71 per share were outstanding during 2004. They were not included in the computation of diluted earnings per share because the option exercise price was greater than the average market price.

	Year ended December 31, 2003		
	Income (numerator) (in thousands except per share amounts)	Shares (denominator)	Per share amount
<b>Basic earnings per share</b>			
Net income available to common shareholders	\$ 15,107	16,045	\$ 0.94
Effect of dilutive securities			
Stock options		223	(0.01)
<b>Diluted earnings per share</b>			
Net income available to common shareholders plus assumed conversions	\$ 15,107	16,268	\$ 0.93

Options to purchase 133,540 shares of common stock at \$16.96 per share were outstanding during 2003. They were not included in the computation of diluted earnings per share because the option exercise price was greater than the average market price.



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## NOTE 12 - EMPLOYEE BENEFIT PLANS

*Profit Sharing Plan*

The Company has a profit sharing plan for all its eligible employees. The Company's annual contribution to the plan is determined by its Board of Directors. Annual contributions are allocated to participants on a point basis with accumulated benefits payable at retirement, or, at the discretion of the plan committee, upon termination of employment. Contributions made by the Company were approximately \$755,000 for 2005, \$625,000 for 2004 and \$500,000 for 2003.

*Salary Continuation Agreements*

The National Bank of Sussex County (NBSC) entered into a salary continuation agreement during 1996 with its former Chief Executive Officer and its President which entitle them to certain payments upon their retirement. As part of the merger of the Company and NBSC's parent (High Point Financial Corp.) in July 1999, Lakeland placed in trusts amounts equal to the present value of the amounts that would be owed to them in their retirement. These amounts were \$722,000 for the Chief Executive Officer and \$381,000 for the President. Lakeland has no further obligation to pay additional amounts pursuant to these agreements.

*Former CEO Retirement Benefits*

Metropolitan State Bank entered into an agreement in January 1997 with its former Chief Executive Officer (CEO), which provides for an annual retirement benefit of \$35,000 for a fifteen year period. In February 1999, the Company entered into an additional agreement with this CEO. Such agreement provides for an additional retirement benefit of \$35,000 per annum for a fifteen year period as well as certain retiree medical benefits. The present value of this obligation was charged to operations. During 2005, 2004 and 2003, \$9,000, \$15,000 and \$27,000 respectively, was charged to operations related to these obligations.

*Retirement Savings Plans (401K plans)*

Beginning in January 2002, the Company began contributing to its 401(k) plan. All eligible employees can contribute a portion of their annual salary with the Company matching up to 40% of the employee's contributions. The Company's contributions in 2005, 2004 and 2003 totaled \$321,000, \$240,000 and \$150,000, respectively.

*Pension Plan*

Newton had a defined benefit pension plan. As of March 31, 2004, Newton's Board of Directors elected to freeze the benefits of the pension plan. All participants of the plan ceased accruing benefits as of that date. As a result, Newton's pension plan recognized a curtailment gain of \$1.1 million.

The investment policy and strategy of the Plan and its advisors includes target portfolio allocations of approximately 60% in equities and 40% in debt securities. Based on historical performance, the Plan assumes that the long term equity securities have earned a rate of return of approximately 10% and fixed income securities have earned a return of between 1% and 5%. The composition of plan assets at December 31, 2005 was as follows:

<b>Asset Category</b>	
Equity securities	66%
Debt securities	33%
Other securities	1%

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The accumulated benefit obligation as of December 31, 2005 and 2004, is as follows:

(in thousands)	2005	2004
Accumulated postretirement benefit obligation, January 1, 2005 and July 1, 2004	<b>\$ 1,481</b>	\$ 1,526
Interest Cost	<b>105</b>	53
Actuarial loss	<b>237</b>	27
Estimated benefit payments	<b>(323)</b>	(125)
<b>Total accumulated postretirement benefit obligation</b>	<b>1,500</b>	1,481
Fair value of plan assets beginning of period	<b>1,619</b>	1,672
Return on plan assets	<b>64</b>	62
Benefits paid	<b>(323)</b>	(125)
Asset gain	<b>0</b>	9
Fair value of plan assets at end of year	<b>1,360</b>	1,618
Funded status	<b>(140)</b>	137
Unrecognized net actuarial loss	<b>304</b>	18
<b>Prepaid benefit</b>	<b>\$ 164</b>	\$ 155
<b>Accumulated benefit obligation</b>	<b>\$ 1,500</b>	\$ 1,481

The components of net periodic pension cost are as follows:

(in thousands)	2005	2004
Amortization of actuarial loss	<b>\$ 4</b>	\$ 0
Interest cost on APBO	<b>105</b>	53
Expected return on plan assets	<b>(117)</b>	(62)
<b>Net periodic postretirement cost</b>	<b>\$ (8)</b>	\$ (9)

The benefits expected to be paid in each of the next five years and the aggregate for the five fiscal years thereafter are as follows (in thousands):

2006	\$ 16
2007	22
2008	68
2009	63
2010	65
2011 - 2015	300

The assumptions used to determine the pension obligation and the net periodic pension cost were as follows:

	2005	2004
Discounted rate	<b>6.00%</b>	6.25%
Expected return on plan assets	<b>7.25%</b>	7.25%
Rate of compensation	<b>4.00%</b>	4.00%

There is no expected contribution for 2006.

*Employee Stock Ownership Plan*

NBSC had an Employee Stock Ownership Plan ( ESOP ). No contributions have been made to this plan for the years ended December 31, 2005, 2004 and 2003.

**Table of Contents***Postretirement Health Care Benefits*

In 2000, the Company instituted postretirement health care benefits and life insurance coverage to its employees who meet certain predefined criteria. The expected cost of these benefits is charged to expense during the years that eligible employees render service. In December 2005, the Company terminated this plan recording a curtailment gain of \$675,000 and a settlement gain of \$197,000.

The accumulated postretirement benefit obligations (APBO s) as of December 31, 2005 and 2004 were as follows:

(in thousands)	2005	2004
Accumulated postretirement benefit obligation, January 1	\$ 660	\$ 595
Service cost	62	66
Interest Cost	41	36
Amendments	(204)	
Effect of Settlement	(30)	
Effect of Curtailment	(512)	
Actuarial (gain) loss	15	(23)
Estimated benefit payments	(32)	(14)
<b>Total accumulated postretirement benefit obligation</b>	<b>0</b>	<b>660</b>
Unrecognized net gain due to past experience different from that assumed and effects of changes in assumptions made		191
Unrecognized prior service cost		(26)
Unamortized transition obligation		(46)
<b>Accrued accumulated postretirement benefit obligation</b>	<b>\$</b>	<b>\$ 779</b>

The measurement date for the APBO was December 31 for each year presented.

The components of net periodic postretirement benefit cost are as follows:

(in thousands)	2005	2004	2003
Service cost, benefits attributed to employee service during the year	\$ 62	\$ 66	\$ 66
Interest cost on APBO	41	36	37
Amortization of prior service cost	26	47	46
Amortization of transition obligation	6	6	6
Amortization of gains	(9)	(7)	(2)
Net periodic postretirement cost before accounting for settlement and curtailment	\$ 126	\$ 148	\$ 153
Curtailment gain	(675)		
Settlement gain	(197)		
<b>Net periodic postretirement benefit cost</b>	<b>\$ (746)</b>	<b>\$</b>	<b>\$</b>

Because the Company terminated the postretirement benefit expense, there will be no contribution in 2006.

The discount rate used to determine the Company s APBO was 6.0% for 2005 and 6.25% in 2004 and 2003.

*Deferred Compensation Arrangements*

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High Point Financial Corp. had established deferred compensation arrangements for certain directors and executives of High Point Financial Corp. and NBSC. The deferred compensation plans differ, but generally provide for annual payments for ten to fifteen years following retirement. The Company's liabilities under these arrangements are being accrued from the commencement of the plans over the participants remaining periods of service. The Company intends to fund its obligations under the deferred compensation arrangements with the increase in cash surrender value of life insurance policies that it has purchased on the respective participants. The deferred compensation plans do not hold any assets. For the years ended December 31, 2005, 2004 and 2003, \$25,000, \$3,000 and \$26,000, respectively, was charged to operations related to these obligations. As of December 31, 2005 and 2004, the accrued liability for these plans was \$208,000 and \$187,000, respectively.

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**Table of Contents***Supplemental Executive Retirement Plan*

In 2003, the Company began contributing to a supplemental executive retirement plan for its Chief Executive Officer that provides annual retirement benefits of \$150,000 a year for a 15 year period when the chief executive officer reaches the age of 65. The Company intends to fund its obligations under the deferred compensation arrangements with the increase in cash surrender value of bank owned life insurance policies purchased in 2003. In 2005, 2004 and 2003, the Company expensed \$331,000, \$308,000 and \$129,000, respectively, for this plan.

**NOTE 13 - DIRECTORS RETIREMENT PLAN**

The Company provides a plan that any director who completes five years of service may retire and continue to be paid for a period of ten years at a rate ranging from \$5,000 through \$17,500 per annum, depending upon years of credited service. This plan is unfunded. The following tables present the status of the plan and the components of net periodic plan cost for the years then ended. The measurement date for the accumulated benefit obligation is December 31 of the years presented.

	December 31, 2005      2004 (in thousands)	
Actuarial present value of benefit obligation		
Vested	\$ 543	\$ 531
Nonvested	86	67
Accumulated benefit obligation	\$ 629	\$ 598
Projected benefit obligation	825	795
Unrecognized net loss	(113)	(116)
Unrecognized prior service cost being amortized over fifteen years	(258)	(304)
Accrued plan cost included in other liabilities	\$ 454	\$ 375

	Years ended December 31, 2005      2004      2003 (in thousands)		
Net periodic plan cost included the following components:			
Service cost	\$ 21	\$ 18	\$ 6
Interest cost	48	49	35
Amortization of prior service cost	47	46	33
	\$ 116	\$ 113	\$ 74

Discount rates of 6.0% and 6.25% were assumed in the plan valuation for 2005 and 2004, respectively. As the benefit amount is not dependent upon compensation levels, a rate of increase in compensation assumption was not utilized in the plan valuation.

The director's retirement plan holds no plan assets. The benefits expected to be paid in each of the next five years and in aggregate for the five years thereafter are as follows (in thousands):

2006	\$ 42
2007	54
2008	55
2009	72



2010	72
2011 - 2015	362

The Company expects its contribution to the director s retirement plan to be \$42,000 in 2006.

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NOTE 14 - STOCK-BASED COMPENSATION

*Employee Stock Option Plans*

The Company established the 2000 Equity Compensation Program which authorizes the granting of incentive stock options and supplemental stock options to employees of the Company which includes those employees serving as officers and directors of the Company. The plan originally authorized options to purchase up to 1,212,466 shares of common stock of the Company. At the 2005 Annual Shareholders meeting, the shareholders voted to increase the authorized shares by an additional 835,034 shares.

During 2004 the Company granted options to purchase 105,000 shares to new non-employee directors of the Company. The directors' options were exercisable in five equal installments beginning on the date of grant and continuing on the next four anniversaries of the date of grant. The vesting of these shares were accelerated in 2005 as further discussed below. As of December 31, 2005 and 2004, 281,107 and 351,730 options granted to directors were outstanding, respectively.

During 2005, the Company granted options to purchase 156,484 shares of common stock to key employees at an exercise price of \$15.69 per share. These options vested immediately. During 2004, the Company granted options to purchase 158,162 shares of common stock to key employees at an exercise price of \$16.39, 61,562 of which were subject to shareholder approval of the increase of authorized shares. As of December 31, 2005 and 2004, outstanding options to purchase common stock granted to key employees were 826,901 and 632,629 (excluding the 61,562 referred to above), respectively.

On May 13, 2005, the Company accelerated 460,774 stock options representing all unvested stock options on such date which had exercise prices in excess of the market value of the Company's common stock on that date.

In addition to the 2000 Equity Compensation program, the Company has assumed the outstanding options granted under three employee stock option plans established by High Point (the High Point Plans). As of December 31, 2005 and 2004, 1,532 and 18,975 options were outstanding under the High Point Plans. The Company has also assumed outstanding options granted under Newton Financial Corp.'s 1999 Stock Option Plan (the Newton Plan). As of December 31, 2005 and 2004, 50,697 and 60,408 options, respectively, were outstanding under the Newton Plan.

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A summary of the status of the Company's option plans as of December 31, 2005, 2004 and 2003 and the changes during the years ending on those dates is represented below. The following table includes those 61,562 shares issued in 2004 subject to shareholder approval of the authorized shares in the 2005 grants:

	2005		2004		2003	
	Number of shares	Weighted average exercise price	Number of shares	Weighted average exercise price	Number of shares	Weighted average exercise price
Outstanding, beginning of year	1,062,744	\$ 12.45	911,918	\$ 11.55	824,041	\$ 10.54
Granted	218,046	15.89	201,600	15.84	162,146	14.75
Options granted in acquisition	0	0.00	64,218	6.30	0	0.00
Exercised	(90,543)	6.84	(104,236)	7.18	(65,565)	7.17
Forfeited	(30,010)	15.41	(10,756)	13.59	(8,704)	8.73
Outstanding, end of year	1,160,237	\$ 13.46	1,062,744	\$ 12.45	911,918	\$ 11.55
Options exercisable at year-end	1,160,237		649,776		452,237	
Weighted average fair value of options granted during the year		\$ 4.72		\$ 5.00		\$ 4.99

The following table summarizes information about options outstanding at December 31, 2005:

Range of Exercise Prices	Options outstanding			Options exercisable		
	Number outstanding at December 31, 2005	Weighted average remaining contractual life (years)	Weighted average exercise price	Number outstanding at December 31, 2005	Weighted average exercise price	
\$ 6.02 - 7.33	50,699	5.19	\$ 6.28	50,699	\$ 6.28	
7.34 - 8.44	238,892	4.43	7.80	238,892	7.80	
8.45 - 12.47	30,388	5.78	11.51	30,388	11.51	
12.48 - 14.52	160,622	5.96	14.45	160,622	14.45	
14.53 - 16.96	679,636	8.52	15.83	679,636	15.83	
	1,160,237			1,160,237		

**NOTE 15 - COMMITMENTS AND CONTINGENCIES**

*Lease Obligations*

Rentals under long-term operating leases amounted to approximately \$1,186,000, \$878,000 and \$701,000 for the years ended December 31, 2005, 2004 and 2003, respectively, including rent expense to related parties of \$197,000 in 2005, \$183,000 in 2004 and \$181,000 in 2003. At December 31, 2005, the minimum commitments, which include rental, real estate tax and other related amounts, under all noncancellable leases with remaining terms of more than one year and expiring through 2025 are as follows (in thousands):

December 31, 2006	\$ 1,084
2007	853
2008	675

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2009	582
2010	475
Thereafter	2,954
	\$ 6,623

**Table of Contents***Litigation*

As the Company has disclosed in its periodic reports filed with the SEC, the Company was involved in legal proceedings concerning four separate portfolios of predominately commercial leases which Lakeland purchased from Commercial Money Center, Inc. ( CMC ). CMC obtained surety bonds from three surety companies to guarantee each lessee's performance. Relying on these bonds, the Company and other investors purchased the leases and CMC's right to payment under the various surety bonds. CMC (and a related entity, Commercial Servicing Corp. ( CSC )) eventually stopped forwarding to the Company the required amounts.

On July 20, 2005, Lakeland entered into a settlement agreement with RLI Insurance Company and one remaining party in Lakeland's claims related to the CMC matter. Pursuant to the settlement agreements Lakeland was paid an aggregate of \$3,315,000 and the parties executed mutual releases. As a result of the settlements, Lakeland's nonperforming assets were reduced by \$6.4 million and no additional loan loss provision was required. A charge-off of \$3.0 million was recorded.

A complaint captioned Ronnie Clayton dba Clayton Trucking, et al v. Ronald Fisher, et al was filed in the Los Angeles County Superior Court against Lakeland and others. Plaintiffs are certain of the lessees who had entered into leases with CMC. Plaintiffs allege, among other things, that these leases are not true leases but are instead loans which charge usurious interest rates. They further allege that because of various California Financial Code violations by CMC, the lease instruments are either void or must be reformed and all amounts paid by the lessees must be returned to them. The action against Lakeland has been stayed while an appeal by plaintiffs is pending concerning the dismissal of certain of plaintiffs' claims against defendants.

From time to time, the Company and its subsidiaries are defendants in legal proceedings relating to their respective businesses. While the ultimate outcome of these matters cannot be determined at this time, management does not believe that the outcome of any pending legal proceeding will materially affect the consolidated financial position of the Company, but could possibly be material to the results of operations of any one period.

**NOTE 16 - FINANCIAL INSTRUMENTS WITH OFF-BALANCE-SHEET RISK AND CONCENTRATIONS OF CREDIT RISK**

Lakeland is party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Such financial instruments are recorded in the financial statements when they become payable. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets. The contract or notional amounts of those instruments reflect the extent of involvement Lakeland has in particular classes of financial instruments.

Lakeland's exposure to credit loss in the event of non-performance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual or notional amount of those instruments. Lakeland uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

Lakeland generally requires collateral or other security to support financial instruments with credit risk. The approximate contract amounts are as follows:

	<b>December 31,</b>	
	<b>2005</b>	<b>2004</b>
	<b>(in thousands)</b>	
<b>Financial instruments whose contract amounts represent credit risk</b>		
Commitments to extend credit	\$ 351,418	\$ 257,161
Standby letters of credit and financial guarantees written	11,842	10,058

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Lakeland evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by Lakeland upon extension of credit, is based on management's credit evaluation.

Standby letters of credit are conditional commitments issued by Lakeland to guarantee the payment by or performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers.

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Lakeland holds deposit accounts, residential or commercial real estate, accounts receivable, inventory and equipment as collateral to support those commitments for which collateral is deemed necessary. The extent of collateral held for those commitments at December 31, 2005 and 2004 varies based on Lakeland's credit evaluation.

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The Company follows the provisions of FASB Interpretation 45 (FIN 45) Guarantor's Accounting and Disclosure Requirements for Guarantees, including Indirect Guarantees of Indebtedness of Others. FIN 45 requires a guarantor entity, at the inception of a guarantee covered by the measurement provisions of the interpretation, to record a liability for the fair value of the obligation undertaken in issuing the guarantee. The Company has financial and performance letters of credit. Financial letters of credit require the Company to make payment if the customer fails to make payment, as defined in the agreements. Performance letters of credit require the Company to make payments if the customer fails to perform certain non-financial contractual obligations. The Company defines the initial fair value of these letters of credit as the fees received from the customer. The Company records these fees as a liability when issuing the letters of credit and amortizes the fee over the life of the letter of credit.

The maximum potential undiscounted amount of future payments of these letters of credit as of December 31, 2005 is \$11.8 million and they expire through 2008. Lakeland's exposure under these letters of credit would be reduced by actual performance, subsequent termination by the beneficiaries and by any proceeds that the Company obtained in liquidating the collateral for the loans, which varies depending on the customer.

As of December 31, 2005, the Company had \$351.4 million in loan commitments, with \$306.9 million maturing within one year, \$20.9 million maturing after one year but within three years, \$3.0 million maturing after three years but within five years, and \$20.6 million maturing after five years. As of December 31, 2005, the Company had \$11.8 million in standby letters of credit, with \$11.5 million maturing within one year and \$383,000 maturing after one year but within three years.

Lakeland grants loans primarily to customers in its immediately adjacent suburban counties which include Bergen, Morris, Passaic, Sussex, Warren and Essex counties in Northern New Jersey and surrounding areas. Certain of Lakeland's consumer loans and lease customers are more diversified nationally. Although Lakeland has a diversified loan portfolio, a large portion of its loans are secured by commercial or residential real property. Although Lakeland has a diversified loan portfolio, a substantial portion of its debtors' ability to honor their contracts is dependent upon the economy. Commercial and standby letters of credit were granted primarily to commercial borrowers.

**NOTE 17 - ESTIMATED FAIR VALUE OF FINANCIAL INSTRUMENTS**

SFAS No. 107 requires disclosure of the estimated fair value of an entity's assets and liabilities considered to be financial instruments. For the Company, as for most financial institutions, the majority of its assets and liabilities are considered financial instruments as defined in SFAS No. 107. However, many such instruments lack an available trading market, as characterized by a willing buyer and seller engaging in an exchange transaction. Also, it is the Company's general practice and intent to hold its financial instruments to maturity and not to engage in trading or sales activities, except for certain loans. Therefore, the Company had to use significant estimations and present value calculations to prepare this disclosure.

Changes in the assumptions or methodologies used to estimate fair values may materially affect the estimated amounts. Also, management is concerned that there may not be reasonable comparability between institutions due to the wide range of permitted assumptions and methodologies in the absence of active markets. This lack of uniformity gives rise to a high degree of subjectivity in estimating financial instrument fair values.

Estimated fair values have been determined by the Company using the best available data and an estimation methodology suitable for each category of financial instruments. The estimation methodologies used, the estimated fair values, and recorded book balances at December 31, 2005 and 2004 are outlined below.

For cash and cash equivalents and interest-bearing deposits with banks, the recorded book values approximate fair values. The estimated fair values of investment securities are based on quoted market prices, if available. Estimated fair values are based on quoted market prices of comparable instruments if quoted market prices are not available.

The net loan portfolio at December 31, 2005 and 2004 has been valued using a present value discounted cash flow where market prices were not available. The discount rate used in these calculations is the estimated current market rate adjusted for credit risk. The carrying value of accrued interest approximates fair value.

The estimated fair values of demand deposits (i.e. interest (checking) and non-interest bearing demand accounts, savings and certain types of money market accounts) are, by definition, equal to the amount payable on demand at

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the reporting date (i.e. their carrying amounts). The carrying amounts of variable rate accounts approximate their fair values at the reporting date. For fixed maturity certificates of deposit, fair value was estimated using the rates currently offered for deposits of similar remaining maturities. The carrying amount of accrued interest payable approximates its fair value.

The fair value of securities sold under agreements to repurchase and long-term debt are based upon discounted value of contractual cash flows. The Company estimates the discount rate using the rates currently offered for similar borrowing arrangements.

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

The carrying values and estimated fair values of the Company's financial instruments are as follows:

	2005		December 31, 2004	
	Carrying Value	Estimated fair value	Carrying Value	Estimated fair value
(in thousands)				
<b>Financial Assets:</b>				
Cash and cash equivalents	\$ 52,815	\$ 52,815	\$ 55,346	\$ 55,346
Investment securities available for sale	515,903	515,903	582,106	582,106
Investment securities held to maturity	154,569	151,637	162,922	162,926
Loans	1,312,767	1,314,884	1,176,005	1,176,936
<b>Financial Liabilities:</b>				
Deposits	1,798,160	1,794,444	\$ 1,726,804	1,726,027
Federal funds purchased and securities sold under agreements to repurchase	103,199	103,139	110,830	110,830
Long-term debt	45,061	45,822	42,288	44,641
Subordinated debentures	56,703	51,838	56,703	52,497
<b>Commitments:</b>				
Standby letters of credit		23		28
NOTE 18 - REGULATORY MATTERS				

The Bank Holding Company Act of 1956 restricts the amount of dividends the Company can pay. Accordingly, dividends should generally only be paid out of current earnings, as defined.

The New Jersey Banking Act of 1948 restricts the amount of dividends paid on the capital stock of New Jersey chartered banks. Accordingly, no dividends shall be paid by such banks on their capital stock unless, following the payment of such dividends, the capital stock of Lakeland will be unimpaired, and: (1) Lakeland will have a surplus, as defined, of not less than 50% of its capital, or, if not, (2) the payment of such dividend will not reduce the surplus, as defined, of Lakeland. Under these limitations, approximately \$134.2 million was available for payment of dividends from Lakeland to the Company as of December 31, 2005.

The Company and Lakeland are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's and Lakeland's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company must meet specific capital guidelines that involve quantitative measures of the Company's and Lakeland's assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The Company's and Lakeland's capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulations to ensure capital adequacy require the Company and Lakeland to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets, and of Tier 1 capital to average assets. Management believes, as of December 31, 2005, that the Company and Lakeland met all capital adequacy requirements to which they are subject.





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As of December 31, 2005, the most recent notification from the Federal Reserve Bank of New York and the FDIC categorized the Company and Lakeland as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Company and Lakeland must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the institutions' category.

As of December 31, 2005 and 2004, the Company, Lakeland and Newton (as of December 31, 2004) have the following capital ratios:

	Actual		For capital adequacy purposes		To be well capitalized under prompt corrective action provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>As of December 31, 2005</b>						
<b>Total capital (to risk-weighted assets)</b>						
Company	\$ 171,409	12.47%	≥\$ 109,970	≥ 8.00%	N/A	N/A
Lakeland	157,805	11.53	109,489	8.00	≥\$ 136,862	≥ 10.00%
<b>Tier I capital (to risk-weighted assets)</b>						
Company	\$ 158,236	11.51%	≥\$ 54,984	≥ 4.00%	N/A	N/A
Lakeland	144,632	10.57	54,745	4.00	≥\$ 82,117	≥ 6.00%
<b>Tier I capital (to average assets)</b>						
Company	\$ 158,236	7.49%	≥\$ 84,542	≥ 4.00%	N/A	N/A
Lakeland	144,632	6.86	84,274	4.00	≥\$ 105,342	5.00%

	Actual		For capital adequacy purposes		To be well capitalized under prompt corrective action provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>As of December 31, 2004</b>						
<b>Total capital (to risk-weighted assets)</b>						
Company	\$ 171,218	13.27%	≥\$ 103,194	≥ 8.00%	N/A	N/A
Lakeland	117,273	11.03	85,064	8.00	≥\$ 106,330	≥ 10.00%
Newton	33,600	15.38	17,482	8.00	\$ 21,853	10.00%
<b>Tier I capital (to risk-weighted assets)</b>						
Company	\$ 155,088	12.02%	≥\$ 51,596	≥ 4.00%	N/A	N/A
Lakeland	103,963	9.78	42,532	4.00	≥\$ 63,798	≥ 6.00%
Newton	31,734	14.52	8,741	4.00	13,112	6.00%
<b>Tier I capital (to average assets)</b>						
Company	\$ 155,088	7.71%	≥\$ 80,503	≥ 4.00%	N/A	N/A
Lakeland	103,963	6.11	68,032	4.00	≥\$ 85,039	5.00%
Newton	31,734	10.36	12,254	4.00	15,318	5.00%

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## NOTE 19 - QUARTERLY FINANCIAL DATA (UNAUDITED)

The following represents summarized quarterly financial data of the Company, which in the opinion of management reflected all adjustments, consisting only of nonrecurring adjustments, necessary for a fair presentation of the Company's results of operations.

	Quarter ended			
	March 31, 2005	June 30, 2005	September 30, 2005	December 31, 2005
	(in thousands, except per share amounts)			
<b>Total interest income</b>	<b>\$ 24,640</b>	<b>\$ 25,064</b>	<b>\$ 26,486</b>	<b>\$ 27,649</b>
<b>Total interest expense</b>	<b>7,032</b>	<b>7,637</b>	<b>8,759</b>	<b>10,204</b>
<b>Net interest income</b>	<b>17,608</b>	<b>17,427</b>	<b>17,727</b>	<b>17,445</b>
<b>Provision for loan and lease losses</b>	<b>783</b>	<b>327</b>	<b>304</b>	<b>141</b>
<b>Noninterest income</b>	<b>3,501</b>	<b>3,624</b>	<b>3,978</b>	<b>4,025</b>
<b>Gains (losses) on sales of investment securities</b>	<b>28</b>	<b>100</b>	<b>4</b>	<b>(715)</b>
<b>Noninterest expense</b>	<b>13,673</b>	<b>13,233</b>	<b>13,410</b>	<b>13,076</b>
<b>Income before taxes</b>	<b>6,681</b>	<b>7,591</b>	<b>7,995</b>	<b>7,538</b>
<b>Income taxes</b>	<b>2,113</b>	<b>2,454</b>	<b>2,637</b>	<b>2,380</b>
<b>Net income</b>	<b>\$ 4,568</b>	<b>\$ 5,137</b>	<b>\$ 5,358</b>	<b>\$ 5,158</b>
<b>Earnings per share</b>				
<b>Basic</b>	<b>\$ 0.21</b>	<b>\$ 0.24</b>	<b>\$ 0.25</b>	<b>\$ 0.24</b>
<b>Diluted</b>	<b>\$ 0.21</b>	<b>\$ 0.24</b>	<b>\$ 0.25</b>	<b>\$ 0.24</b>

	Quarter ended			
	March 31, 2004	June 30, 2004	September 30, 2004	December 31, 2004
	(in thousands, except per share amounts)			
<b>Total interest income</b>	<b>\$ 18,456</b>	<b>\$ 18,313</b>	<b>\$ 22,778</b>	<b>\$ 23,772</b>
<b>Total interest expense</b>	<b>4,898</b>	<b>4,717</b>	<b>5,756</b>	<b>6,446</b>
<b>Net interest income</b>	<b>13,558</b>	<b>13,596</b>	<b>17,022</b>	<b>17,326</b>
<b>Provision for loan and lease losses</b>	<b>875</b>	<b>875</b>	<b>926</b>	<b>926</b>
<b>Noninterest income</b>	<b>2,873</b>	<b>2,915</b>	<b>3,421</b>	<b>3,552</b>
<b>Gains on sales of investment securities</b>	<b>3</b>	<b>413</b>	<b>204</b>	<b>18</b>
<b>Noninterest expense</b>	<b>10,311</b>	<b>10,578</b>	<b>13,006</b>	<b>13,290</b>
<b>Income before taxes</b>	<b>5,248</b>	<b>5,471</b>	<b>6,715</b>	<b>6,680</b>
<b>Income taxes</b>	<b>1,679</b>	<b>1,753</b>	<b>2,163</b>	<b>2,024</b>
<b>Net income</b>	<b>\$ 3,569</b>	<b>\$ 3,718</b>	<b>\$ 4,552</b>	<b>\$ 4,656</b>
<b>Earnings per share</b>				
<b>Basic</b>	<b>\$ 0.21</b>	<b>\$ 0.22</b>	<b>\$ 0.21</b>	<b>\$ 0.21</b>
<b>Diluted</b>	<b>\$ 0.20</b>	<b>\$ 0.22</b>	<b>\$ 0.21</b>	<b>\$ 0.21</b>

During the fourth quarter of 2005, the Company recorded a \$750,000 reduction of benefit expense related to the termination of its post-retirement benefit plan.



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NOTE 20 - CONDENSED FINANCIAL INFORMATION PARENT COMPANY ONLY:

## BALANCE SHEETS

## CONDENSED BALANCE SHEETS

	December 31, 2005      2004 (in thousands)	
<b>ASSETS</b>		
Cash and due from banks	\$ 4,288	\$ 11,458
Investment securities available for sale	5,378	5,447
Investment in bank subsidiaries	231,326	228,215
Land held for sale	1,402	1,527
Other assets	7,523	6,156
<b>TOTAL ASSETS</b>	<b>\$ 249,917</b>	<b>\$ 252,803</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Other liabilities	\$ 1,433	\$ 1,552
Guaranteed preferred beneficial interests in the Company's subordinated debentures	56,703	56,703
Stockholders' equity	191,781	194,548
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$ 249,917</b>	<b>\$ 252,803</b>

## CONDENSED STATEMENTS OF OPERATIONS

	Years Ended December 31, 2005      2004      2003 (in thousands)		
<b>INCOME</b>			
Dividends from subsidiaries	\$ 14,850	\$ 12,635	\$ 10,747
Other income	241	748	526
<b>TOTAL INCOME</b>	<b>15,091</b>	<b>13,383</b>	<b>11,273</b>
<b>EXPENSE</b>			
Interest on subordinated debentures	3,842	3,845	1,062
Noninterest expenses	724	641	493
<b>TOTAL EXPENSE</b>	<b>4,566</b>	<b>4,486</b>	<b>1,555</b>
Income before benefit for income taxes	10,525	8,897	9,718
Benefit for income taxes	(1,514)	(1,438)	(357)
Income before equity in undistributed income of subsidiaries	12,039	10,335	10,075
Equity in undistributed income of subsidiaries	8,182	6,160	5,032
<b>NET INCOME</b>	<b>\$ 20,221</b>	<b>\$ 16,495</b>	<b>\$ 15,107</b>



**Table of Contents****CONDENSED STATEMENTS OF CASH FLOWS**

	Years Ended December 31,		
	2005	2004	2003
	(in thousands)		
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Net income	\$ 20,221	\$ 16,495	\$ 15,107
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Gain on sale of securities		(576)	(456)
Increase in other assets	(1,095)	(1,619)	(855)
Increase (decrease) in other liabilities	(52)	747	83
Equity in undistributed income of subsidiaries	(8,182)	(6,160)	(5,032)
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>10,892</b>	8,887	8,847
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Purchases of securities	(118)	(12)	(447)
Proceeds from sale of securities available for sale		954	1,449
Purchase of banks		(19,342)	(20,806)
Contribution to subsidiary			(6,000)
<b>NET CASH USED IN INVESTING ACTIVITIES</b>	<b>(118)</b>	(18,400)	(25,804)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Cash dividends paid on common stock	(8,307)	(7,362)	(5,731)
Purchase of treasury stock	(10,098)	(4,413)	(2,082)
Proceeds from issuance of subordinated debentures			55,000
Exercise of stock options	461	656	470
<b>NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES</b>	<b>(17,944)</b>	(11,119)	47,657
Net increase (decrease) in cash and cash equivalents	(7,170)	(20,632)	30,700
Cash and cash equivalents, beginning of year	11,458	32,090	1,390
<b>CASH AND CASH EQUIVALENTS, END OF YEAR</b>	<b>\$ 4,288</b>	\$ 11,458	\$ 32,090

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Board of Directors

Lakeland Bancorp, Inc.

We have audited the accompanying consolidated balance sheets of Lakeland Bancorp, Inc. and subsidiaries (a New Jersey corporation) as of December 31, 2005 and 2004, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2005. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Lakeland Bancorp, Inc. and subsidiaries as of December 31, 2005 and 2004, and the consolidated results of its operations and its cash flows for the each of the three years in the period ended December 31, 2005, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Lakeland Bancorp, Inc.'s internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated March 3, 2006 expressed an unqualified opinion on management's assessment of the effectiveness of internal controls over financial reporting and an unqualified opinion on the effectiveness of internal control over financial reporting.

/s/ GRANT THORNTON LLP

Philadelphia, Pennsylvania

March 3, 2006



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**ITEM 9 Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

Not Applicable

**ITEM 9A Controls and Procedures**

**Evaluation of Disclosure Controls and Procedures**

As of the end of the period covered by this Annual Report on Form 10-K, the Company's management, including the Chief Executive Officer and Chief Financial Officer, evaluated the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) related to the recording, processing, summarization, and reporting of information in the Company's periodic reports that the Company files with the SEC.

Based on their evaluation as of December 31, 2005, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) are effective to ensure that the information required to be disclosed by the Company in the reports that the Company files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms.

**Changes in Internal Controls Over Financial Reporting**

There have been no changes in the Company's internal control over financial reporting that occurred during the last fiscal quarter to which this Annual Report on Form 10-K relates that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**Management's Report on Internal Control Over Financial Reporting**

The management of Lakeland Bancorp, Inc. and its subsidiaries (the Company) is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934.

The Company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

Pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company;

Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and the board of directors of the Company; and

Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to risk that controls may become inadequate because of changes in conditions or because of declines in the degree of compliance with policies or procedures.

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The Company's management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2005. In making this assessment, the Company's management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ( COSO ) in Internal Control-Integrated Framework.

As of December 31, 2005, based on management's assessment, the Company's internal control over financial reporting was effective.

Grant Thornton LLP, the Company's independent registered public accounting firm, has issued an audit report on our assessment of the Company's internal control over financial reporting. See Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting below.

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Board of Directors and Shareholders

Lakeland Bancorp, Inc.

We have audited management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting, that Lakeland Bancorp, Inc. and its subsidiaries (a New Jersey Corporation) maintained effective internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Lakeland Bancorp, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Lakeland Bancorp, Inc. maintained effective internal control over financial reporting as of December 31, 2005, is fairly stated, in all material respects, based on criteria

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established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also in our opinion, Lakeland Bancorp, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2004 based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Lakeland Bancorp, Inc. and subsidiaries as of December 31, 2005 and 2004, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2005 and our report dated March 3, 2006 expressed an unqualified opinion on those financial statements.

/s/ GRANT THORNTON LLP  
Philadelphia, Pennsylvania  
March 3, 2006  
**ITEM 9B Other Information**

None.

## **PART III**

### **ITEM 10 - Directors and Executive Officers of the Registrant**

The Company responds to this Item by incorporating by reference the material responsive to this Item in the Company's definitive proxy statement for its 2006 Annual Meeting of Shareholders.

### **ITEM 11 - Executive Compensation**

The Company responds to this Item by incorporating by reference the material responsive to this Item in the Company's definitive proxy statement for its 2006 Annual Meeting of Shareholders.

### **ITEM 12 - Security Ownership of Certain Beneficial Owners and Management**

The Company responds to this Item by incorporating by reference the material responsive to this Item in the Company's definitive proxy statement for its 2006 Annual Meeting of Shareholders.

### **ITEM 13 - Certain Relationships and Related Transactions**

The Company responds to this Item by incorporating by reference the material responsive to this Item in the Company's definitive proxy statement for its 2006 Annual Meeting of Shareholders.

### **ITEM 14 - Principal Accountant Fees and Services**

The Company responds to this Item by incorporating by reference the material responsive to this Item in the Company's definitive proxy statement for its 2006 Annual Meeting of Shareholders.

## **PART IV**

### **ITEM 15 - Exhibits and Financial Statement Schedules**

(a) 1. The following portions of the Company's consolidated financial statements are set forth in Item 8 of this Annual Report:

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- (i) Consolidated Balance Sheets as of December 31, 2005 and 2004.
- (ii) Consolidated Statements of Income for each of the three years in the period ended December 31, 2005.
- (iii) Consolidated Statements of Changes in Stockholders' Equity for each of the three years in the period ended December 31, 2005.
- (iv) Consolidated Statements of Cash Flows for each of the three years in the period ended December 31, 2005.

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(v) Notes to Consolidated Financial Statements.

(vi) Report of Independent Registered Public Accounting Firm.

(a) 2. Financial Statement Schedules

All financial statement schedules are omitted as the information, if applicable, is presented in the consolidated financial statements or notes thereto.

(a) 3. Exhibits

- 2.1 Agreement and Plan of Merger, dated as of March 31, 2003, among the Registrant, Lakeland Bank, CSB Financial Corp. and Community State Bank, is incorporated by reference to Exhibit 2.1 to the Registrant's Current Report on Form 8-K filed with the SEC on April 3, 2003.
- 2.2 Agreement and Plan of Merger, dated as of October 24, 2003, between the Registrant and Newton Financial Corporation, is incorporated by reference to Exhibit 2.1 to the Registrant's Current Report on Form 8-K filed with the SEC on October 29, 2003.
- 3.1 Certificate of Incorporation of the Registrant, as amended, is incorporated by reference to Exhibit 3.1 to Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 1999.
- 3.2 By-Laws of the Registrant, as amended, are incorporated by reference to Exhibit 3.2 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2003.
- 10.1 Lakeland Bancorp, Inc. Amended and Restated 2000 Equity Compensation Program is incorporated by reference to Appendix A to the Registrant's definitive proxy materials for its 2005 Annual Meeting of Shareholders.
- 10.2 Employment Agreement Change in Control, Severance and Employment Agreement for Roger Bosma, dated as of January 1, 2000, among Lakeland Bancorp, Inc., Lakeland Bank and Roger Bosma, is incorporated by reference to Exhibit 10.6 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 1999.
- 10.3 Change of Control Agreement dated March 1, 2001, among Lakeland Bancorp, Inc., Lakeland Bank and Joseph F. Hurley is incorporated by reference to Exhibit 10.8 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2000.
- 10.4 Change of Control Agreement dated March 1, 2001, among Lakeland Bancorp, Inc., Lakeland Bank and Robert A. Vandenberg is incorporated by reference to Exhibit 10.9 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2000.
- 10.5 Change of Control Agreement dated March 6, 2001, among Lakeland Bancorp, Inc., Lakeland Bank and Louis E. Luddecke is incorporated by reference to Exhibit 10.10 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2000.
- 10.6 Change of Control Agreement dated March 7, 2001, among Lakeland Bancorp, Inc. Lakeland Bank and Jeffrey J. Buonforte is incorporated by reference to Exhibit 10.11 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2000.
- 10.7 Amendments to Change of Control Agreements, dated March 10, 2003, among Lakeland Bancorp, Inc., Lakeland Bank and each of Joseph F. Hurley, Robert A. Vandenberg, Louis E. Luddecke and Jeffrey J. Buonforte are incorporated by reference to Exhibit 10.13 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2002.
- 10.8 Change of Control Agreement dated April 7, 2004, among Lakeland Bancorp, Inc. Lakeland Bank and James R. Noonan is incorporated by reference to Exhibit 10.11 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2004.
- 10.9 Lakeland Bancorp, Inc. Directors' Deferred Compensation Plan, as amended June 9, 2004, is incorporated by reference to Exhibit 10.10 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2004.
- 21.1 Subsidiaries of Registrant.

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- 23.1 Consent of Independent Registered Public Accounting Firm.
- 24.1 Power of Attorney.
- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

LAKELAND BANCORP, INC.

Dated: March 16, 2006

By: /s/ Roger Bosma  
 Roger Bosma  
 President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<b>Signature</b>	<b>Capacity</b>	<b>Date</b>
/s/ Roger Bosma	Director, Chief Executive Officer, and President	March 16, 2006
Roger Bosma		
/s/ Bruce G. Bohuny*	Director	March 16, 2006
Bruce G. Bohuny		
/s/ Mary Ann Deacon*	Director	March 16, 2006
Mary Ann Deacon		
/s/ John W. Fredericks*	Director	March 16, 2006
John W. Fredericks		
/s/ Mark J. Fredericks*	Director	March 16, 2006
Mark J. Fredericks		
/s/ George H. Guptill, Jr.*	Director	March 16, 2006

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George H. Guptill, Jr.

/s/ Janeth C. Hendershot\*

Director

March 16, 2006

Janeth C. Hendershot

/s/ Paul P. Lubertazzi\*

Director

March 16, 2006

Paul P. Lubertazzi

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/s/ Robert E. McCracken\* Director March 16, 2006

Robert E. McCracken

/s/ Robert B. Nicholson, III\* Director March 16, 2006

Robert B. Nicholson, III

/s/ Joseph P. O Dowd\* Director March 16, 2006

Joseph P. O Dowd

/s/ Stephen R. Tilton, Sr.\* Director March 16, 2006

Stephen R. Tilton, Sr.

/s/ Paul G. Viall, Jr.\* Director March 16, 2006

Paul. G. Viall, Jr.

/s/ Arthur L. Zande\* Director March 16, 2006

Arthur L. Zande

/s/ Joseph F. Hurley Executive Vice President and Chief Financial Officer March 16, 2006

Joseph F. Hurley

\*By: /s/ Roger Bosma  
 Roger Bosma  
 Attorney-in-Fact