1ST CONSTITUTION BANCORP
Form 10-Q
August 07, 2006

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

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2006

or

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ______ to ______

Commission file Number: 000-32891

1ST CONSTITUTION BANCORP

(Exact Name of Registrant as Specified in Its Charter)

New Jersey	22-3665653
(State of Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
2650 Route 130, P.O. Box 634, Cranbury, NJ	08512
(Address of Principal Executive Offices)	(Zip Code)

(609) 655-4500

(Issuer's Telephone Number, Including Area Code)

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

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

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. (Check one):

Large accelerated filer o Accelerated filer o Non-accelerated filer x

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

As of August 2, 2006, there were 3,453,674 shares of the registrant s common stock, no par value, outstanding.

1ST CONSTITUTION BANCORP

FORM 10-Q

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

1st Constitution Bancorp and Subsidiaries

Consolidated Balance Sheets

	June 30, 2006	December 31, 2005
ASSETS	**(unaudited)**	
CASH AND DUE FROM BANKS	$7,997,038	$9,394,929
FEDERAL FUNDS SOLD / SHORT-TERM INVESTMENTS	1,020,804	2,742,821
Total cash and cash equivalents	9,017,842	12,137,750
INVESTMENT SECURITIES:		
Available for sale, at fair value	64,660,336	69,236,658
Held to maturity (fair value of $16,892,486 and $21,521,026 in 2006 and 2005, respectively)	17,436,619	21,758,370
Total investment securities	82,096,955	90,995,028
LOANS HELD FOR SALE	12,950,636	16,757,734
LOANS	264,520,397	240,014,349
Less- Allowance for loan losses	(2,692,737)	(2,361,375)
Net loans	261,827,660	237,652,974
PREMISES AND EQUIPMENT, net	2,687,439	2,596,852
ACCRUED INTEREST RECEIVABLE	1,992,167	1,234,523
BANK OWNED LIFE INSURANCE	8,992,466	8,828,932
OTHER ASSETS	2,060,566	2,291,673
Total assets	$381,625,731	$372,495,466
LIABILITIES AND SHAREHOLDERS EQUITY		
LIABILITIES:		
Deposits		
Non-interest bearing	$64,384,645	$62,686,802
Interest bearing	229,540,724	243,122,665
Total deposits	293,925,369	305,809,467
OTHER BORROWINGS	28,400,000	28,500,000
REDEEMABLE SUBORDINATED DEBENTURES	23,712,000	5,155,000
ACCRUED INTEREST PAYABLE	1,628,711	1,288,040
ACCRUED EXPENSES AND OTHER LIABILITIES	2,251,791	1,946,092
Total liabilities	349,917,871	342,698,599
SHAREHOLDERS EQUITY:		
Common stock, no par value; 30,000,000 shares authorized; 3,490,535 shares issued and 3,443,240 and 3,436,995 outstanding as of June 30, 2006 and December 31, 2005, respectively	25,526,412	25,589,320
Retained earnings	8,593,824	5,981,803
Treasury Stock, shares at cost 47,295 shares and 53,540 at June 30, 2006 and December 31, 2005, respectively	(890,522)	(1,008,998)
Accumulated other comprehensive loss	(1,521,854)	(765,258)
Total shareholders equity	31,707,860	29,796,867
Total liabilities and shareholders equity	381,625,731	$372,495,466

See accompanying notes to consolidated financial statements

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1st Constitution Bancorp and Subsidiaries
Consolidated Statements of Income

	(Unaudited)			
	Three months ended June 30,		Six months ended June 30,	
INTEREST INCOME	2006	2005	2006	2005
Interest and fees on loans	$5,822,356	$4,126,583	$10,999,172	$8,038,521
Interest on securities				
Taxable	795,540	734,494	1,601,906	1,482,753
Tax-exempt	147,052	168,304	307,843	323,675
Interest on Federal funds sold and short-term investments	24,674	6,926	33,338	12,140
Total interest income	6,789,622	5,036,307	12,942,259	9,857,089
INTEREST EXPENSE				
Interest on deposits	1,524,009	968,462	2,874,339	1,921,652
Interest on securities sold under agreement to repurchase and other borrowed funds	490,796	351,863	957,133	603,789
Interest on redeemable subordinated debentures	165,708	85,269	267,552	160,269
Total interest expense	2,180,513	1,405,594	4,099,024	2,685,710
Net interest income	4,609,109	3,630,713	8,843,235	7,171,379
Provision for loan losses	170,000	135,000	340,000	195,000
Net interest income after provision for loan losses	4,439,109	3,495,713	8,503,235	6,976,379
NON-INTEREST INCOME				
Service charges on deposit accounts	167,042	170,385	353,601	329,245
Gain on sale of loans held for sale	174,930	460,303	493,619	750,266
Loss on sale of securities available for sale	(99,714)	-	(99,714)	-
Income on bank-owned life insurance	82,934	55,496	163,534	121,610
Other income	149,517	123,430	293,255	230,295
Total other income	474,709	809,614	1,204,295	1,431,416
NON-INTEREST EXPENSE				
Salaries and employee benefits	1,712,959	1,412,547	3,397,981	2,766,543
Occupancy expense	378,143	221,681	697,127	690,101
Other operating expenses	1,017,201	987,301	2,103,223	1,735,094
Total other expense	3,108,303	2,621,529	6,198,331	5,191,738
Income before income taxes	1,805,515	1,683,798	3,509,199	3,216,057
Income taxes	448,251	552,424	897,177	1,039,152
Net income	$1,357,264	$1,131,374	$2,612,022	$2,176,905
NET INCOME PER SHARE				
Basic	$0.39	$0.32	$0.76	$0.63
Diluted	$0.38	$0.31	$0.73	$0.60

See accompanying notes to consolidated financial statements

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1st Constitution Bancorp and Subsidiaries
Consolidated Statements Of Cash Flows

(**Unaudited**)

	Six months ended June 30, 2006	2005
OPERATING ACTIVITIES:		
Net income	$2,612,022	$2,176,905
Adjustments to reconcile net income to net cash provided by operating activities-		
Provision for loan losses	340,000	195,000
Depreciation and amortization	288,413	257,556
Net amortization of premiums on securities	29,515	81,640
Share-based compensation expense	46,084	-
Gain on sale of loans held for sale	(493,619)	(750,266)
Loss on sale of securities available for sale	99,714	-
Originations of loans held for sale	(26,714,241)	(29,439,737)
Income on Bank-owned life insurance	(163,534)	(121,610)
Proceeds from sales of loans held for sale	31,014,958	29,689,236
Decrease (increase) in accrued interest receivable	(757,644)	(129,819)
(Increase) decrease in other assets	411,674	278,644
Increase in accrued interest payable	340,671	148,148
Increase (decrease) in accrued expenses and other liabilities	305,699	773,310
Net cash provided by operating activities	7,359,712	3,159,007
INVESTING ACTIVITIES:		
Purchases of securities -		
Available for sale	(6,958,616)	-
Held to maturity	-	(4,169,000)
Proceeds from maturities and prepayments of securities -		
Available for sale	7,479,257	11,875,495
Held to maturity	4,311,655	102,787
Proceeds from sales of securities available for sale	2,899,385	-
Net increase in loans	(24,514,687)	(15,158,952)
Capital expenditures	(279,000)	(137,939)
Net cash used in investing activities	(17,062,006)	(7,487,609)
FINANCING ACTIVITIES:		
Issuance of common stock, net	44,956	69,070
Purchase of treasury stock	(35,472)	(1,184,528)
Net increase in demand, savings and time deposits	(11,884,098)	1,964,933
Proceeds from issuance of redeemable subordinated debentures	18,557,000	-
Net advances (repayments) in other borrowings	(100,000)	7,600,000
Net cash provided by financing activities	6,582,386	8,449,475
Increase (decrease) in cash and cash equivalents	(3,119,908)	4,120,873
CASH AND CASH EQUIVALENTS		
AT BEGINNING OF PERIOD	12,137,750	7,924,409
CASH AND CASH EQUIVALENTS		
AT END OF PERIOD	$9,017,842	$12,045,282

SUPPLEMENTAL DISCLOSURES

OF CASH FLOW INFORMATION:		
Cash paid during the period for -		
Interest	$3,758,353	$2,537,562
Income taxes	$0	$590,000

See accompanying notes to consolidated financial statements

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1st Constitution Bancorp and Subsidiaries

Notes To Consolidated Financial Statements

June 30, 2006 (Unaudited)

Summary of Significant Accounting Policies

The accompanying unaudited Consolidated Financial Statements herein have been prepared by 1st Constitution Bancorp (the Company), in accordance with accounting principles generally accepted in the United States of America and pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC). Certain information and footnote disclosures normally included in financial statements have been condensed or omitted pursuant to such rules and regulations. These Consolidated Financial Statements should be read in conjunction with the audited financial statements and the notes thereto included in the Company s Form 10-K for the year ended December 31, 2005, filed with the SEC on March 10, 2006.

In the opinion of the Company, all adjustments (consisting only of normal recurring accruals) which are necessary for a fair presentation of the operating results for the interim periods have been included. The results of operations for periods of less than a year are not necessarily indicative of results for the full year.

Net Income Per Common Share

Basic net income per common share is calculated by dividing net income by the weighted average number of shares outstanding during each period.

Diluted net income per common share is calculated by dividing net income by the weighted average number of shares outstanding, as adjusted for the assumed exercise of potential common stock options, using the treasury stock method. All share information has been restated for the effect of a 5% stock dividend declared on December 15, 2005 and paid on January 31, 2006 to shareholders of record on January 17, 2006.

The following (unaudited) tables illustrate the reconciliation of the numerators and denominators of the basic and diluted earnings per share (EPS) calculations.

	Three Months Ended June 30, 2006		
	Income	Weighted-average shares	Per share amount
Basic EPS			
Net income available to common stockholders	$1,357,264	3,443,419	$0.39
Effect of dilutive securities			
Options and Grants	-	118,013	(.01)
Diluted EPS			
Net income available to common stockholders plus assumed conversion	$1,357,264	3,561,432	$0.38

All options have been included in the computation of diluted earnings per share.

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	Three Months Ended June 30, 2005		
	Income	Weighted-average shares	Per share Amount
Basic EPS			
Net income available to common stockholders	$1,131,374	3,443,530	$0.32
Effect of dilutive securities			
Options and Grants	-	177,264	(0.01)
Diluted EPS			
Net income available to common stockholders plus assumed conversion	$1,131,374	3,620,794	$0.31

All options have been included in the computation of diluted earnings per share.

	Six Months Ended June 30, 2006		
	Income	Weighted-average shares	Per share Amount
Basic EPS			
Net income available to common stockholders	$2,612,022	3,440,625	$0.76
Effect of dilutive securities			
Options and Grants	-	118,162	(.03)
Diluted EPS			
Net income available to common stockholders plus assumed conversion	$2,612,022	3,558,787	$0.73

All options have been included in the computation of diluted earnings per share.

	Six Months Ended June 30, 2005		
	Income	Weighted-average shares	Per share Amount
Basic EPS			
Net income available to common stockholders	$2,176,905	3,447,042	$0.63
Effect of dilutive securities			
Options and Grants	-	178,340	(0.03)
Diluted EPS			
Net income available to common stockholders plus assumed conversion	$2,176,905	3,625,382	$0.60

All options have been included in the computation of diluted earnings per share.

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Share-based Compensation

Effective January 1, 2006, the Company has adopted FASB Statement No. 123 (R), Share-Based Payment . Statement 123 (R) requires that compensation cost relating to share-based payment transactions be recognized in financial statements. The cost is measured based on the fair value of the equity or liability instruments issued.

Statement 123 (R) covers a wide range of share-based compensation arrangements including share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans.

In addition to the accounting standard that sets forth the financial reporting objectives and related accounting principles, Statement 123 (R) includes an appendix of implementation guidance that provides expanded guidance on measuring the fair value of share-based payment awards.

Statement 123 (R) replaces FASB Statement No. 123, Accounting for Stock-Based Compensation and supersedes APB Opinion No. 25, Accounting For Stock Issued to Employees . Statement 123, as originally issued in 1995, established as preferable a fair-value-based method of accounting for share-based payment transactions with employees. However, that Statement permitted entities the option of continuing to apply the guidance in Opinion 25, as long as the footnotes to financial statements disclosed what net income would have been had the preferable fair-value-based method been used. The impact of Statement 123 (R), 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 was disclosed in the Company s Form 10-K for the fiscal year ended December 31, 2005.

Because the Company adopted Statement 123 (R) using the modified prospective transition method, prior periods have not been restated. Under this method, the Company is required to record compensation expense for all awards granted after the date of adoption and for the unvested portion of previously granted awards that remain outstanding as of the beginning of the period of adoption. The Company measured share-based compensation cost using the Black-Scholes option pricing model for stock option grants prior to January 1, 2006 and anticipates using this pricing mode for future grants. The Company did not grant options in the first quarter of 2006. Forfeitures did not affect the calculated expense based upon historical activities of option grantees.

At June 30, 2006, the Company has four stock-based employee compensation plans. Share-based compensation of $46,084 was recognized for the six months ended June 30, 2006, which related to the unvested portion of options to acquire shares of Company common stock granted prior to January 1, 2006. Reported net income, adjusting for share-based compensation that would have been recognized in the three month and six-month periods ended June 30, 2005 if Statement 123 (R) had been followed in that quarter, is presented in the following table:

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	Three months ended June 30, 2005	Six months ended June 30, 2005
Net income -		
As reported	$1,131,374	$2,176,905
Deduct: Share-based employee compensation determined under fair value based method for stock options, net of related tax effects	(6,385)	(12,770)
Pro forma	$1,124,989	$2,164,135
Net income per share -		
As reported -		
Basic	$0.32	$0.63
Diluted	$0.31	$0.60
Pro forma -		
Basic	$0.32	$0.63
Diluted	$0.31	$0.60

The adoption of Statement 123 (R) did not change the way that the Company has accounted for stock awards in prior periods and therefore no such change is reflected in the pro forma table above. The Company expenses the fair value of stock awards determined at the grant date on a straight-line basis over the vesting period of the award.

Redeemable Subordinated Debentures

On April 10, 2002, 1ST Constitution Capital Trust I (the Trust), a statutory business trust and a wholly owned subsidiary of the Company, issued $5.0 million of variable rate Trust Preferred Securities in a pooled institutional placement transaction maturing April 22, 2032. The Trust utilized the $5.0 million proceeds along with $155,000 invested in the Trust by the Company to purchase $5,155,000 of subordinated debentures issued by the Company. The Subordinated Debentures have terms that mirror the Trust Preferred Securities. The Trust exists for the sole purpose of issuing Trust Preferred Securities. These Subordinated Debentures constitute the sole assets of the Trust. These Subordinated Debentures are redeemable in whole or part prior to maturity after April 22, 2007. The Trust is obligated to distribute all proceeds of a redemption of these Subordinated Debentures, whether voluntary or upon maturity, to holders of the Trust Preferred Securities. The Company s obligation with respect to the Trust Preferred Securities and the Subordinated Debentures, when taken together, provides a full and unconditional guarantee on a subordinated basis by the Company of the obligations of the Trust to pay amounts when due on the Trust Preferred Securities.

On May 30, 2006, 1ST Constitution Bancorp established 1ST Constitution Capital Trust II, a Delaware business trust subsidiary (the Trust II), for the sole purpose of issuing $18 million of trust preferred securities (the Capital Securities). The Capital Securities were issued in connection with a pooled offering involving approximately 50 other financial institution holding companies. All of the Capital Securities were sold to a single pooling vehicle.

The proceeds from the sale of the Capital Securities were loaned to the Company under 30-year floating rate junior subordinated debentures issued to Trust II by the Company. The debentures are the only asset of Trust II. Interest payments on the debentures flow through Trust II to the pooling vehicle. Payments of distributions by Trust II to the pooling vehicle are guaranteed by the Company.

Variable Interest Entities

Management has determined that the 1ST Constitution Capital Trust I and the 1ST Constitution Capital Trust II (the Trusts) qualify as variable interest entities under FASB Interpretation 46 (FIN 46). The Trusts issued mandatorily redeemable preferred stock to investors and loaned the proceeds to the Company. Each of the Trusts holds, as its sole asset, subordinated debentures issued by the Company. Subsequent to the issuance of FIN 46 and prior to the establishment of Trust II, the FASB issued a revised interpretation, FIN 46(R), the provisions of which were required to be applied to certain variable interest entities, including Trust I, by March 31, 2004, at which time Trust I was deconsolidated.

In March 2005, the Federal Reserve Board adopted a final rule that would continue to allow the inclusion of trust preferred securities in Tier 1 capital, but with stricter quantitative limits. Under the final rule, after a five-year transition period, the aggregate amount of trust preferred securities and certain other capital elements would be limited to 25% of Tier 1 capital elements, net of goodwill. The amount of trust preferred securities and certain other elements in excess of the limit could be included in Tier 2 capital, subject to restrictions. Based on the final rule, the Company includes all of its $23.7 million in trust preferred securities in Tier 1 capital.

Segment Information

SFAS No. 131, *Segment Reporting*, establishes standards for public business enterprises to report information about operating segments in their annual financial statements and requires that those enterprises report selected information about operating segments in subsequent interim financial reports issued to shareholders. It also established standards for related disclosure about products and services, geographic areas, and major customers. Operating segments are components of an enterprise, which are evaluated regularly by the chief operating decision-maker in deciding how to allocate and assess resources and performance. The Company s chief operating decision-maker is the President and Chief Executive Officer. The Company has applied the aggregation criteria set forth in SFAS No. 131 for its operating segments to create one reportable segment, Community Banking.

The Company s community banking segment consists of construction, commercial, retail and mortgage banking. The community banking segment is managed as a single strategic unit, which generates revenue from a variety of products and services provided by the Company. For example, construction and commercial lending is dependent upon the ability of the Company 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 real estate lending.

Shareholders Equity

During the six months ended June 30, 2006 and 2005, the Company acquired 1,922 and 70,007 shares of its common stock for an aggregate purchase price of $35,472 and $1,184,528, respectively. All shares were acquired under the Company s authorized common stock repurchase programs. The Company also issued 8,167 and 8,017 shares of common stock in conjunction with stock option exercises during the six months ended June 30, 2006 and 2005, respectively. Additionally, during the six months ended June 30, 2006 and 2005, net unrealized losses on the Company s investment portfolio increased by $756,596 and $249,302, respectively.

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

The purpose of this discussion and analysis of the operating results and financial condition at June 30, 2006 is intended to help readers analyze the accompanying financial statements, notes and other supplemental information contained in this document. Results of operations for the three and six month periods ended June 30, 2006 are not necessarily indicative of results to be attained for any other period.

This discussion and analysis should be read in conjunction with the Consolidated Financial Statements, notes and tables included elsewhere in this report and Part II, Item 7 of the Company s Form 10-K (Management s Discussion and Analysis of Financial Condition and Results of Operations) for the year ended December 31, 2005, as filed with the SEC on March 10, 2006.

General

Throughout the following sections, the Company refers to 1st Constitution Bancorp and, as the context requires, its subsidiaries, 1st Constitution Bank, 1st Constitution Capital Trust I, and 1st Constitution Capital Trust II, the Bank refers to 1st Constitution Bank, and the Trusts refers to 1st Constitution Capital Trust I and 1st Constitution Capital Trust II, collectively.

The Company is a bank holding company registered under the Bank Holding Company Act of 1956, as amended. The Company was organized under the laws of the State of New Jersey in February 1999 for the purpose of acquiring all of the issued and outstanding stock of the Bank, a full service commercial bank which began operations in August 1989, and thereby enabling the Bank to operate within a bank holding company structure. The Company became an active bank holding company on July 1, 1999. The Bank is a wholly-owned subsidiary of the Company. Other than its ownership interest in the Bank, the Company currently conducts no other significant business activities.

The Bank operates nine branches, and manages an investment portfolio through its subsidiary, 1st Constitution Investment Company of Delaware, Inc. FCB Assets Holdings, Inc., a subsidiary of the Bank, is used by the Bank to manage and dispose of repossessed real estate.

The Trusts, subsidiaries of the Company, were created to issue trust preferred securities to assist the Company to raise additional regulatory capital.

Forward-Looking Statements

When used in this and in future filings by the Company with the SEC, in the Company s press releases and in oral statements made with the approval of an authorized executive officer of the Company, the words or phrases will, will likely result, could, anticipates, believes, conti expects, plans, will continue, is anticipated, estimated, project or outlook or similar expressions (including confirmations by an authori executive officer of the Company of any such expressions made by a third party with respect to the Company) are intended to identify forward-looking statements. The Company wishes to caution readers not to place undue reliance on any such forward-looking statements, each of which speak only as of the date made.

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Such statements are subject to certain risks and uncertainties that could cause actual results to differ materially from historical earnings and those presently anticipated or projected.

Factors that may cause actual results to differ from those results expressed or implied, include, but are not limited to, those listed under Business , Risk Factors and Management s Discussion and Analysis of Financial Condition and Results of Operations in the Company s Annual Report on Form 10-K filed with the SEC on March 10, 2006, such as the overall economy and the interest rate environment; the ability of customers to repay their obligations; the adequacy of the allowance for loan losses; competition; significant changes in accounting, tax or regulatory practices and requirements; certain interest rate risks; and risks associated with speculative construction lending. Although management has taken certain steps to mitigate any negative effect of the aforementioned items, significant unfavorable changes could severely impact the assumptions used and have an adverse effect on profitability. The Company has no obligation to publicly release the result of any revisions which may be made to any forward-looking statements to reflect anticipated or unanticipated events or circumstances occurring after the date of such statements.

Share-based Compensation

The Company adopted the provisions of SFAS 123 (R) during the first quarter of fiscal 2006 and accounts for share-based compensation in accordance with this statement. The Company elected the modified prospective transition method, under which prior periods are not restated. Under the fair value recognition provisions of this statement, share-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense on a straight-line basis over the requisite service period, which is the vesting period.

The Company currently uses the Black-Scholes option pricing model to determine the fair value of stock options and other share-based compensation. The determination of the fair value of share-based payment awards on the date of grant using an option-pricing model is affected by the Company s stock price as well as assumptions regarding a number of complex and subjective variables. These variables include the price of the underlying stock, the Company s expected stock price volatility over the expected term of the awards, actual and projected employee stock option exercise behaviors, risk-free interest rate and the expected annual dividend yield on the underlying stock.

The Company anticipates using historical information to estimate expected life and forfeitures within the valuation model, as permitted by the SEC s Staff Accounting Bulletin No. 107. The risk-free rate for periods within the expected life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. All share-based payment awards are amortized on a straight-line basis over the requisite service periods of the awards, which are generally the vesting periods. Expected volatility is based on historical volatility of the price of our common shares over the calculated expected life. The Company does not anticipate paying any cash dividends in the foreseeable future and therefore uses an expected dividend yield of zero in the option pricing model. Options granted to non-employee directors of the Company have been included in the calculations. The adoption of Statement 123 (R) did not change the way that the Company has accounted for stock awards in prior periods.

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Developing these assumptions requires significant judgment on the part of the Company and, generally, may involve analyzing all available historical data, considering whether historical data is relevant to predicting future behavior, making appropriate adjustments to historical data for future expectations, supplementing or replacing company-specific historical data with data from other supportable sources and appropriately weighting each of the inputs. These assumptions are evaluated at each grant date. If factors change and the Company employs different assumptions for estimating share-based compensation expense in future periods or if the Company decides to use a different valuation model, the future periods may differ significantly from what the Company has recorded in the current period and could materially affect operating income, net income and net income per share.

The Black-Scholes option-pricing model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable, characteristics not present in the Company s option grants and other share-based compensation. Existing valuation models, including the Black-Scholes and lattice binomial models, may not provide reliable measures of the fair values of the Company s share-based compensation. Consequently, there is a risk that the Company s estimates of the fair values of share-based compensation awards on the grant dates may bear little resemblance to the actual values realized upon the vesting, exercise, expiration, early termination or forfeiture of those share-based payments in the future. Certain share-based payments, such as employee stock options, may expire worthless or otherwise result in zero intrinsic value as compared to the fair values originally estimated on the grant date and reported in the Company s financial statements. Alternatively, value may be realized from these instruments that are significantly higher than the fair values originally estimated on the grant date and reported in the Company s financial statements. There currently is no market-based mechanism or other practical application to verify the reliability and accuracy of the estimates stemming from these valuation models, nor is there a means to compare and adjust the estimates to actual values.

The guidance in SFAS 123 (R) and SAB 107 is relatively new. The application of these principles may be subject to further interpretation and refinement over time. There are differences among valuation models, and there is a possibility that the Company will adopt different valuation models in the future. This may result in a lack of consistency in future periods and materially affect the fair value estimate of share-based payments. It may also result in a lack of comparability with other companies that use different models, methods and assumptions.

See Note 1 of the financial statements for further information regarding the SFAS 123 (R) disclosures.

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RESULTS OF OPERATIONS

Three Months Ended June 30, 2006 and June 30, 2005

Summary

The Company realized net income of $1,357,264 for the three months ended June 30, 2006, an increase of 20.0% from the $1,131,374 reported for the three months ended June 30, 2005. Diluted net income per share was $0.38 for the three months ended June 30, 2006 compared to $0.31 per diluted share for the three months ended June 30, 2005.

Key performance ratios continued to improve for 2006. Return on average assets and return on average equity were 1.45% and 17.69% for the three months ended June 30, 2006 compared to 1.34% and 16.75%, respectively, for the three months ended June 30, 2005.

All prior year share information has been restated for the effect of a 5% stock dividend declared on December 15, 2005 and paid on January 31, 2006 to shareholders of record on January 17, 2006.

A significant factor impacting the Company s net interest income has been the rising level of market interest rates that evolved during the latter half of 2004 and continued through the second quarter of 2006. The Federal Reserve Bank s Open Market Committee (FOMC) held eight meetings in 2004, eight meetings in 2005, and four meetings in the first and second quarters of 2006. Beginning with the June 30, 2004 meeting, the FOMC increased short-term interest rates by 25 basis points and continued with a series of 25 basis point increases in each of the next four meetings in 2004, each of the eight meetings in 2005 as well as in each of the four meetings in 2006. The immediate benefit of these interest rate increases to the Company s investment security purchases and floating rate assets resulted in a 117 basis point increase in the yield on total interest-earning assets. In addition, management s ability to lag the interest rate increases on deposits coupled with a tight discipline in deposit pricing resulting in a 52 basis point increase to the Company s net interest margin. Management expects the FOMC to continue its program of increasing the targeted Federal Funds rate over the next few months and has structured the Company s balance sheet to an asset sensitive position in order to continue to benefit from this rising market rates environment.

In June 2006, the Company added approximately $18 million in trust preferred securities, which accounted for the increase in subordinated debt from the second quarter of 2005.

Earnings Analysis

Interest Income

Interest income for the three months ended June 30, 2006 was $6,789,622, increasing by 34.8% from the $5,036,307 reported in the three months ended June 30, 2005. This is primarily attributable to the rising interest rate environment that evolved during the latter half of 2004 and continued through the first half of 2006. For the three months ended June 30, 2006, average interest earning assets increased $33,275,950 or 10.4%, to $352,241,613 compared to $318,965,663 for the three months ended June 30, 2005. The increase in interest

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income resulting from increases in earning asset volume was complemented by an increase in the average yield earned on these assets. For the three months ended June 30, 2006, the average yield on earning assets increased 138 basis points to 7.81% from 6.43% for the three months ended June 30, 2005.

Interest Expense

Interest expense for the three months ended June 30, 2006 was $2,180,513, an increase of $774,919 from $1,405,594 reported for the three months ended June 30, 2005. Total average interest bearing liabilities increased by $23,286,123 to $274,300,926 for the three months ended June 30, 2006 from $251,014,803 for the three months ended June 30, 2005. The average cost of interest bearing liabilities increased 94 basis points to 3.19% for the three months ended June 30, 2006 from 2.25% for the three months ended June 30, 2005, primarily as a result of an increase in market-driven rates paid on deposits and short-term borrowed funds.

Net Interest Income

The Company s net interest income for the three months ended June 30, 2006 was $4,609,109, an increase of 26.9% from the $3,630,713 reported for June 30, 2005. The net interest margin, on a fully taxable equivalent basis, increased 66 basis points to 5.33% for the three months ended June 30, 2006 from 4.67% for the three months ended June 30, 2005. The increase in the net interest margin was primarily the result of interest earning assets repricing faster than interest bearing liabilities in the rising current rate environment, combined with a lower level of net amortization of premiums on mortgage-backed investment securities. Net amortization expense decreased to $14,362 for the three months ended June 30, 2006 versus $35,025 for the three months ended June 30, 2005.

Provision for Loan Losses

The provision for loan losses was $170,000 for the three months ended June 30, 2006 and $135,000 for the three months ended June 30, 2005. Management considers a complete review of the following specific factors in determining the provision for loan losses: historical losses by loan category, non-accrual loans, problem loans as identified through internal classifications, collateral values, and the growth and size of the portfolio. In addition to these factors, management takes into consideration current economic conditions and local real estate market conditions. The increase in the provision for the three months ended June 30, 2006 compared to the provision for the three months ended June 30, 2005 was due principally to inherent risk related to growth, an increase in the amount of loans on the watch list from June 30, 2005, the balances in non-accrual loans and management s assessment of economic conditions in the Bank s marketplace. Net charge offs/recoveries amounted to $8,639 for the three months ended June 30, 2006 compared to no charge offs or recoveries for the three months ended June 30, 2005. See Allowance for Loan Losses on page 21.

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Non-Interest Income

Total non-interest income for the three months ended June 30, 2006 was $474,709, a decrease of $334,905, or 41.4%, from non-interest income of $809,614 for the three months ended June 30, 2005.

Service charges on deposit accounts represent a significant source of non-interest income. Service charge revenues decreased modestly to $167,042 for the three months ended June 30, 2006 compared to $170,385 for the three months ended June 30, 2005.

Gain on sale of loans held for sale decreased by $285,373, or 62.0%, to $174,930 for the three months ended June 30, 2006 when compared to $460,303 for the three months ended June 30, 2005. The rising rate environment that existed throughout 2005 and continued into the second quarter of 2006 has had a negative impact on the mortgage market and resultant secondary market loan sales.

Non-interest income also includes income from bank-owned life insurance (BOLI) which amounted to $82,934 for the three months ended June 30, 2006 compared to $55,496 for the three months ended June 30, 2005. The Bank purchased tax-free BOLI assets to partially offset the cost of employee benefit plans and reduced the Company s overall effective tax rate.

The Bank also generates non-interest income from a variety of fee-based services. These include safe deposit box rental, wire transfer service fees and Automated Teller Machine fees for non-Bank customers. Increased customer demand for these services contributed to the other income component of non-interest income amounting to $149,517 for the three months ended June 30, 2006, compared to $123,430 for the three months ended June 30, 2005.

Non-Interest Expense

Non-interest expenses increased by $486,774, or 18.6%, to $3,108,303 for the three months ended June 30, 2006 from $2,621,529 for the three months ended June 30, 2005. The following table presents the major components of non-interest expenses for the three months ended June 30, 2006 and 2005.

Non-interest Expenses

	Three months ended June 30,	
	2006	2005
Salaries and employee benefits	$1,712,959	$1,412,547
Occupancy expenses	378,143	221,681
Equipment expense	116,163	121,913
Marketing	65,100	82,061
Computer services	175,327	158,222
Regulatory, professional and other fees	290,178	269,577
Office expense	105,630	107,009
All other expenses	264,803	248,519
	$3,108,303	$2,621,529

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Salaries and employee benefits, which represent the largest portion of non-interest expenses, increased by $300,412, or 21.3%, to $1,712,959 for the three months ended June 30, 2006 compared to $1,412,547 for the three months ended June 30, 2005. Staffing levels overall increased to 93 full-time equivalent employees at June 30, 2006 as compared to 89 full-time equivalent employees at June 30, 2005. As the result of the adoption by the Company as of January 1, 2006 of Financial Accounting Standards Board Statement No. 123(R), *Share Based Payment*, management expects the expenses for employees will continue to increase in 2006. See Share-Based Compensation .

Occupancy expense increased by $156,462, or 70.6%, to $378,143 for the three months ended June 30, 2006 compared to $221,681 for the three months ended June 30, 2005. On June 10, 2006, the Bank opened the new Plainsboro branch which is now relocated in the new Plainsboro Village Center. This expanded location allows the Bank to offer drive-through banking plus ATM services that were not available at the previous location. The current period increase in occupancy costs is primarily attributable to this branch relocation project.

An important financial services industry productivity measure is the efficiency ratio. The efficiency ratio is calculated by dividing total operating expenses by net interest income plus non-interest income. An increase in the efficiency ratio indicates that more resources are being utilized to generate the same or greater volume of income, while a decrease would indicate a more efficient allocation of resources. The Bank s efficiency ratio increased modestly to 61.1% for the three months ended June 30, 2006, compared to 59.1% for the three months ended June 30, 2005.

Six Months Ended June 30, 2006 and June 30, 2005

Summary

The Company realized net income of $2,612,022 for the six months ended June 30, 2006, an increase of $435,117, or 20.0%, over the $2,176,905 realized for the six months ended June 30, 2005. Net income per diluted share was $0.73 for the six months ended June 30, 2006 compared to $0.60 per diluted share for the six months ended June 30, 2005.

Key performance ratios continued to improve during the six months ended June 30, 2006. Return on average assets and return on average equity were 1.42% and 17.31%, respectively, for the six months ended June 30, 2006 compared to 1.31% and 16.24%, respectively, for the six months ended June 30, 2005.

In June 2006, the Company added approximately $18 million in trust preferred securities, which accounted for the increase in subordinated debt from the first six months of 2005.

Earnings Analysis

Interest Income

For the six months ended June 30, 2006, total interest income was $12,942,259 an increase of $3,085,170 or 31.3%, compared to total interest income of $9,857,089 for the six months ended June 30, 2005. The following table sets forth the Company s consolidated average balances of assets, liabilities and shareholders equity as well as interest income and expense on related items, and the Company s average rate for the six month periods ended June 30, 2006 and 2005.

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Average Balance Sheets with Resultant Interest and Rates

(yields on a tax-equivalent basis)	Six months ended June 30, 2006			Six months ended June 30, 2005		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
Assets:						
Federal Funds Sold/Short-Term Investments	$882,764	$33,338	4.88%	$822,842	$12,140	2.98%
Securities:						
Collateralized Mortgage Obligations/ Mortgage Backed Securities	67,267,461	1,601,907	4.76%	78,188,981	1,482,753	3.82%
States and Political Subdivisions	16,826,536	455,607	5.42%	18,342,690	479,038	5.27%
Total	84,093,998	2,057,514	4.89%	96,531,671	1,961,791	4.10%
Loan Portfolio:						
Commercial	33,751,881	1,463,592	8.75%	34,715,326	1,233,274	7.16%
Installment	2,212,513	92,273	8.41%	2,378,152	99,508	8.44%
Commercial Mortgage	61,807,372	2,113,402	6.90%	55,856,858	1,945,530	7.02%
Construction Wholesale	118,763,546	5,162,332	8.77%	84,589,968	2,898,209	6.91%
Residential Mortgages	8,373,845	281,883	6.79%	9,322,166	292,390	6.32%
Construction Retail	3,312,979	145,893	8.88%	5,044,203	173,425	6.93%
Home Equity	14,349,464	510,640	7.18%	13,190,545	393,108	6.01%
SBA Loans	9,289,579	422,552	9.17%	5,407,559	208,565	7.78%
All Other Loans	13,071,426	806,606	12.44%	9,142,206	794,512	17.53%
Total	264,896,605	10,999,171	8.37%	219,646,984	8,038,521	7.38%

Total Interest-Earning Assets	**349,873,367**	**13,090,023**	**7.54%**	**317,001,497**	**10,012,452**	**6.37%**
Allowance for Loan Losses	(2,521,830)			(2,089,823)		
Cash and Due From Bank	9,192,148			8,589,865		
Other Assets	15,117,761			11,794,168		
Total Assets	**$371,661,446**			**$335,295,707**		
Interest-Bearing Liabilities:						
Money Market and NOW Accounts	91,223,484	680,438	1.50%	$103,936,299	$588,311	1.14%
Savings Accounts	43,010,509	369,525	1.73%	25,683,040	89,925	0.71%
Certificates of Deposit	95,281,466	1,824,376	3.86%	75,583,738	1,061,988	2.83%
Certificates of Deposit of $100,000 and Over	0	0	0.00%	12,256,921	181,428	2.98%
Federal Funds Purchased/Other Borrowed Funds	38,242,265	957,133	5.05%	28,435,260	603,789	4.28%
Redeemable Subordinated Debentures	6,591,160	267,552	8.12%	5,155,000	160,269	6.27%
Total Interest-Bearing Liabilities	**274,348,884**	**4,099,023**	**3.01%**	**251,050,258**	**2,685,710**	**2.16%**
Net Interest Spread			**4.53%**			**4.21%**
Demand Deposits	61,998,664			54,459,629		
Other Liabilities	4,882,757			2,759,437		
Total Liabilities	341,230,305			308,269,324		
Shareholders' Equity	30,431,141			27,026,383		
Total Liabilities and Shareholders' Equity	**371,661,446**			**335,295,707**		
Net Interest Margin		**$8,991,000**	**5.18%**		**$7,326,742**	**4.66%**

The current year increase in interest income resulted from a higher average balance in the loan portfolio combined with higher average yields earned on the securities and loan portfolios. Net amortization of premiums on mortgage-backed investment securities decreased to $29,515 for the six months ended June 30, 2006 compared to $81,640 for the six months ended June 30, 2005. Average loans increased $45,249,621, or 20.6%, to $264,896,605 for the six months ended June 30, 2006 from $219,646,984 for the six months ended June 30, 2005, while the yield on the portfolio increased 99 basis points to 8.37% for the six months ended June 30, 2006 from 7.38% for the six months ended June 30, 2005. The higher loan yield reflected the higher interest rate environment that evolved during the latter half of 2004 and continued through the first half of 2006.

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Average securities decreased $12,437,674, or 12.9%, from $96,531,671 for the six months ended June 30, 2005 to $84,093,997 for the six months ended June 30, 2006, while the yield on the securities portfolio increased to 4.89% for the six months ended June 30, 2006 from 4.10% for the six months ended June 30, 2005.

Overall, the yield on the Company s total interest-earning assets increased 117 basis points to 7.54% for the six months ended June 30, 2006 from 6.37% for the six months ended June 30, 2005.

Interest Expense

Total interest expense for the six months ended June 30, 2006 was $4,099,024, an increase of $1,413,314, or 52.6%, compared to $2,685,710 for the six months ended June 30, 2005. The increase in interest expense for the current period resulted primarily from the impact of higher levels of interest-bearing liabilities priced at higher market interest rate levels. The average rate paid on interest bearing liabilities for the six months ended June 30, 2006 increased 85 basis points to 3.01% from 2.16% for the six months ended June 30, 2005.

Net Interest Income

The Company s net interest income for the six months ended June 30, 2006 was $8,843,235, an increase of $1,671,856, or 23.3%, compared to $7,171,379 for the six months ended June 30, 2005. The net interest margin (on a tax-equivalent basis), which is net interest income divided by average interest-earning assets, was 5.18% for the six months ended June 30, 2006 compared to 4.66% for the six months ended June 30, 2005.

Provision for Loan Losses

Management maintains the allowance for loan losses at a level that is considered adequate to absorb losses on existing loans that may become uncollectible based upon an evaluation of known and inherent risks in the loan portfolio. Additions to the allowance are made by charges to the provision for loan losses. The evaluation considers a complete review of the following specific factors: historical losses by loan category, non-accrual loans, problem loans as identified through internal classifications, collateral values, and the growth and size of the portfolio. Additionally, current economic conditions and local real estate market conditions are considered. As a result of this evaluation process, the Company s provision for loan losses was $340,000 for the six months ended June 30, 2006 and $195,000 for the six months ended June 30, 2005.

Non-Interest Income

Total non-interest income for the six months ended June 30, 2006 was $1,204,295, a decrease of $227,121, or 15.9%, from non-interest income of $1,431,416 for the six months ended June 30, 2005.

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Gain on sale of loans held for sale represents the largest single source on non-interest income. Gain on sale of loans held for sale for the six months ended June 30, 2006 was $493,619 compared to $750,266 for the six months ended June 30, 2005. The current rising interest rate environment in 2006 has had a negative impact on the volume of mortgage loan originations and subsequent secondary market mortgage loan sales.

Service charges on deposit accounts were $353,601 for the six months ended June 30, 2006 compared to $329,245 for the six months ended June 30, 2005. Service charge income increased in 2006 principally due to management s actions to restructure service charged and fees based on the results of a comparative study of market fees performed in early 2005. This also resulted in an increase in the other income component of non-interest income to $293,255 for the six months ended June 30, 2006 compared to $230,295 for the six months ended June 30, 2005.

Income from Bank Owned Life Insurance (BOLI) amounted to $163,534 for the six months ended June 30, 2006, compared to $121,610 for the six months ended June 30, 2005. The Company owns $8.0 million in tax-free BOLI assets which partially offset the cost of employee benefit plans and reduced the Company s overall effective tax rate.

Non-Interest Expense

Total non-interest expense for the six months ended June 30, 2006 was $6,198,331, an increase of $1,006,593, or 19.4%, compared to non-interest expense of $5,191,738 for the six months ended June 30, 2005.

The following table presents the major components of non-interest expense for the six months ended June 30, 2006 and 2005.

Non-interest Expenses

	Six months ended June 30,	
	2006	2005
Salaries and employee benefits	$3,397,981	$2,766,543
Occupancy expense	697,127	690,101
Equipment expense	237,167	240,119
Marketing	174,198	170,122
Computer services	341,962	302,401
Regulatory, professional and other fees	681,569	480,445
Office expense	207,652	200,878
All other expenses	460,675	341,129
	$6,198,331	$5,191,738

Salaries and employee benefits increased $631,438, or 22.8%, to $3,397,981 for the six months ended June 30, 2006 compared to $2,766,543 for the six months ended June 30, 2005. This increase reflects the increase in staffing levels plus normal employee salary increases. As the result of the adoption by the Company as of January 1, 2006 of Financial Accounting Standards Board Statement No. 123(R), *Share Based Payment*, management expects the expenses for employees will continue to increase in 2006. See Share-Based Compensation .

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Regulatory, professional and other fees increased by $201,124, or 41.9%, to $681,569 for the six months ended June 30, 2006 compared to $480,445 for the six months ended June 30, 2005. The Company incurred increased consulting fees primarily as a result of preparations for internal control compliance requirements contained in Section 404 of the Sarbanes-Oxley Act for which the Company must be in compliance at December 31, 2007.

The Company s efficiency ratio increased modestly to 61.7% for the six months ended June 30, 2006 compared to a ratio of 60.3% for the six months ended June 30, 2005.

Financial Condition

June 30, 2006 Compared with December 31, 2005

Total consolidated assets at June 30, 2006 totaled $381,625,731, increasing by $9,130,265 from $372,495,466 at December 31, 2005.

Cash and Cash Equivalents

Cash and Cash Equivalents at June 30, 2006 totaled $9,017,842 compared to $12,137,750 at December 31, 2005. Cash and cash equivalents at June 30, 2006 consisted of cash and due from banks of $7,997,038 and Federal funds sold/short term investments of $1,020,804. The corresponding balances at December 31, 2005 were $9,394,929 and $2,742,821, respectively.

Securities

The Bank s investment securities represented 22.1% of total assets at June 30, 2006 and 24.4% of total assets at December 31, 2005. Total investment securities decreased $8,898,073, or 9.8%, at June 30, 2006 to $82,096,955 from $90,995,028 at December 31, 2005.

Investment Securities available for sale totaled $64,660,366 at June 30, 2006, a decrease of $4,576,322, or 6.6%, from $69,236,658 at December 31, 2005. During the first six months of 2006, $7,479,257 of securities available for sale matured (predominantly U.S. government agency securities) and, among other uses, assisted in funding the growth in the loan portfolio.

Investment Securities held to maturity totaled $17,436,619 at June 30, 2006, a decrease of $4,321,751, or 19.9%, from $21,758,370 at December 31, 2005.

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Loans

The loan portfolio, which represents the Bank s largest asset, is a significant source of both interest and fee income. Elements of the loan portfolio are subject to differing levels of credit and interest rate risk. The Company s primary lending focus continues to be construction loans, commercial loans, owner-occupied commercial mortgage loans and tenanted commercial real estate loans.

The following table sets forth the classification of loans by major category at June 30, 2006 and December 31, 2005.

Loan Portfolio Composition	June 30, 2006		December 31, 2005	
		%		%
Component	Amount	of total	Amount	of total
Construction loans	$128,870,184	49%	$109,862,614	46%
Residential real estate loans	7,882,038	3%	8,602,975	4%
Commercial and industrial loans	110,038,480	42%	104,448,196	43%
Loans to individuals	17,229,966	6%	16,441,994	7%
Lease financing	11,797	0%	21,073	0%
All other loans	487,932	0%	637,497	0%
	$264,520,397	100%	$240,014,349	100.0%

The loan portfolio increased $24,506,048, or 10.2%, at June 30, 2006 to $264,520,397 from $240,014,349 at December 31, 2005. The ability of the Company to enter into larger loan relationships and management s philosophy of relationship banking are key factors in the Company s strategy for loan growth. The ultimate collectability of the loan portfolio and the recovery of the carrying amount of real estate are subject to changes in the Company s market region's economic environment and real estate market.

Non-Performing Assets

Non-performing assets consist of non-performing loans and other real estate owned. Non-performing loans are composed of (1) loans on a non-accrual basis, (2) loans which are contractually past due 90 days or more as to interest and principal payments but have not been classified as non-accrual, and (3) loans whose terms have been restructured to provide a reduction or deferral of interest on principal because of a deterioration in the financial position of the borrower.

The Bank s policy with regard to non-accrual loans is that generally, loans are placed on a non-accrual status when they are 90 days past due unless these loans are well secured and in the process of collection or, regardless of the past due status of the loan, when management determines that the complete recovery of principal or interest is in doubt. Consumer loans are generally charged off after they become 120 days past due. Subsequent payments on loans in non-accrual status are credited to income only if collection of principal is not in doubt.

Non-accrual loans amounted to $827,904 at June 30, 2006, compared to $833,150 at December 31, 2005. Management believes that non-performing loans at June 30, 2006 are generally well collateralized and do not present a major risk of financial loss to the Company. The table below sets forth non-performing assets

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and risk elements in the Bank s portfolio by type at June 30, 2006 and December 31, 2005. As the table demonstrates, loan quality and ratios remain strong. This was accomplished through quality loan underwriting, a proactive approach to loan monitoring and aggressive workout strategies.

Management takes a proactive approach in addressing delinquent loans. The Company s President meets weekly with all loan officers to review the status of credits past-due ten days or more. An action plan is discussed for each of the loans to determine the steps necessary to induce the borrower to cure the delinquency and restore the loan to a current status. Also, delinquency notices are system generated when loans are five days past-due and again at fifteen days past-due.

In most cases, the Company s collateral is real estate and when the collateral is foreclosed upon, the real estate is carried at the lower of fair market value less estimated selling costs, or at cost. The amount, if any, by which the recorded amount of the loan exceeds the fair market value of the asset is a loss which is charged to the allowance for loan losses at the time of foreclosure or repossession. Resolution of a past-due loan can be delayed if the borrower files a bankruptcy petition because collection action cannot be continued unless the Company first obtains relief from the automatic stay provided by the bankruptcy code.

Non-Performing Assets and Loans	June 30 2006	December 31 2005
Non-Performing loans:		
Loans 90 days or more past due and still accruing	$-	$209
Non-accrual loans	827,904	833,150
Total non-performing loans	827,904	833,359
Other real estate owned	-	-
Total non-performing assets	$827,904	$833,359
Non-performing loans to total loans	0.30%	0.32%
Non-performing assets to total assets	0.22%	0.22%

The Company had no loans classified as restructured loans or potential problem loans at June 30, 2006 and December 31, 2005. Impaired loans totaled $827,904 at June 30, 2006 and $833,150 at December 31, 2005.

Allowance for Loan Losses

The allowance for loan losses is maintained at a level sufficient in the opinion of management to absorb estimated credit losses in the loan portfolio as of the date of the financial statements. The allowance for loan losses is a valuation reserve available for losses incurred or inherent in the loan portfolio and other extensions of credit. The determination of the adequacy of the allowance for loan losses is a critical accounting policy of the Company.

The Company s primary lending emphasis is the origination of commercial and commercial real estate loans, including construction loans. Based on the composition of the loan portfolio, the primary risks inherent in it are deteriorating credit quality, increases in interest rates, a decline in the economy, and a decline in New Jersey real estate market values. Any one or a combination of these events may adversely affect the loan portfolio and may result in increased delinquencies, loan losses and increased future provision levels.

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All, or part, of the principal balance of commercial and commercial real estate loans, and construction loans are charged off to the allowance as soon as it is determined that the repayment of all, or part, of the principal balance is unlikely. Consumer loans are generally charged off no later than 120 days past due on a contractual basis, earlier in the event of bankruptcy, or if there is an amount deemed uncollectible. Because all identified losses are immediately charged off, no portion of the allowance for loan and lease losses is restricted to any individual loan or groups of loans, and the entire allowance is available to absorb any and all loan and lease losses.

Management reviews the adequacy of the allowance on at least a quarterly basis to ensure that the provision for loan and lease losses has been charged against earnings in an amount necessary to maintain the allowance at a level that is adequate based on management s assessment of probable estimated losses. The Company s methodology for assessing the adequacy of the allowance for loan and lease losses consists of several key elements. These elements include a specific reserve for doubtful or high risk loans, an allocated reserve, and an unallocated portion. The Company consistently applies the following comprehensive methodology.

During the quarterly review of the allowance for loan and lease losses, management of the Company considers a variety of factors that include:

General economic conditions.

Trends in charge-offs.

Trends and levels of delinquent loans.

Trends and levels of non-performing loans, including loans over 90 days delinquent.

Trends in volume and terms of loans.

Levels of allowance for specific classified loans.

Credit concentrations.

The specific reserve for high risk loans is established for specific commercial loans, commercial real estate loans, and construction loans which have been identified by management as being high risk loan assets. These high risk loans are assigned a doubtful risk rating grade because the loan has not performed according to payment terms and there is reason to believe that repayment of the loan principal in whole, or part, is unlikely. The specific portion of the allowance is the total amount of potential unconfirmed losses for these individual doubtful loans. To assist in determining the fair value of loan collateral, the Company often utilizes independent third party qualified appraisal firms which in turn employ their own criteria and assumptions that may include occupancy rates, rental rates, and property expenses, among others.

The second category of reserves consists of the allocated portion of the allowance. The allocated portion of the allowance is determined by taking pools of loans outstanding that have similar characteristics and applying historical loss experience for each pool. This estimate represents the potential unconfirmed losses within the portfolio. Individual loan pools are created for commercial and commercial real estate loans, construction loans, and for the various types of loans to individuals. The historical estimation for each loan pool is then adjusted to account for current conditions, current loan portfolio performance, loan policy or management changes, or any other factor which may cause future losses to deviate from historical levels.

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The Company also maintains an unallocated allowance. The unallocated allowance is used to cover any factors or conditions which may cause a potential loan loss but are not specifically identifiable. It is prudent to maintain an unallocated portion of the allowance because no matter how detailed an analysis of potential loan losses is performed, these estimates by definition lack precision. Management must make estimates using assumptions and information which is often subjective and changing rapidly. At June 30, 2006, management believed that the allowance for loan losses and nonperforming loans was adequate.

The allowance for loan losses amounted to $2,692,737 at June 30, 2006, an increase of $331,361 from December 31, 2005. The ratio of the allowance for loan losses to total loans was 0.97% at June 30, 2006 and 0.92% at December 31, 2005, respectively. Management believes the quality of the loan portfolio remains strong and that the allowance for loan losses is adequate in relation to credit risk exposure levels.

The following table presents, for the periods indicated, an analysis of the allowance for loan losses and other related data.

Allowance for Loan Losses	June 30, 2006	December 31, 2005	June 30, 2005
Balance, beginning of period	$2,361,375	$2,005,169	$2,005,169
Provision charged to operating expenses	340,000	405,000	195,000
Loans charged off:			
Construction loans	-	-	-
Residential real estate loans	-	-	-
Commercial and commercial real estate	(11,154)	(39,150)	(3,543)
Loans to individuals	(285)	(13,653)	-
Lease financing	-	-	(6,639)
All other loans	-	-	-
	(11,439)	(52,803)	(10,182)
Recoveries:			
Construction loans	-	-	-
Residential real estate loans	-	-	-
Commercial and commercial real estate	-	1,498	-

Loans to individuals	2,800	2,511	-
Lease financing	-	-	749
All other loans	-	-	-
	2,800	4,009	749
Net (charge offs) / recoveries	(8,639)	(48,794)	(9,433)
Balance, end of period	$2,692,736	$2,361,375	$2,190,736
Loans:			
At period end	$277,471,033	$256,772,083	$236,231,218
Average during the period	264,896,605	231,418,672	219,646,984
Net charge offs to average loans outstanding	0.00%	(0.02%)	0.00%
Allowance for loan losses to:			
Total loans at period end	0.97%	0.92%	0.93%
Non-performing loans	325.25%	283.36%	182.46%

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Deposits

Deposits, which include demand deposits (interest bearing and non-interest bearing), savings and time deposits, are a fundamental and cost-effective source of funding. The Company offers a variety of products designed to attract and retain customers, with the Company s primary focus being on building and expanding long-term relationships.

Total deposits decreased $11,884,098, or 3.9%, to $293,925,369 at June 30, 2006 from $305,809,467 at December 31, 2005. This decrease in total deposits was primarily the result of a $13,581,941 decrease in interest bearing deposits of $243,122,665 at December 31, 2005 to $229,540,724 at June 30, 2006, which management believes is the result of depositors with maturing time deposits moving funds from the Bank to other alternatives yielding higher rates.

Other Borrowings

Other Borrowings are mainly comprised of fixed rate convertible advances from the Federal Home Loan Bank (FHLB) and federal funds purchased. These borrowings are primarily used to fund asset growth not supported by deposit generation. The balance of other borrowings at June 30, 2006 consisted of long-term FHLB borrowings of $23,500,000 and overnight funds purchases of $4,900,000. The balance of other borrowings at December 31, 2005 consisted of long-term FHLB borrowings of $23,500,000 and overnight funds purchased of $5,000,000. FHLB advances are fully secured by marketable securities.

Shareholders Equity And Dividends

Shareholders equity at June 30, 2006 totaled $31,707,860, an increase of $1,910,993, or 6.4%, from $29,796,867 at December 31, 2005. Book value per common share rose to $9.21 at June 30, 2006 from $8.67 at December 31, 2005.

The increase in shareholders equity and book value per share resulted primarily from net income of $2,612,022 less the combined effects of stock buybacks and the increase in unrealized holding losses on available for sale securities.

The Company s stock is listed for trading on the Nasdaq Global Market, under the symbol FCCY.

In July 2005, the Board of Directors authorized a common stock repurchase program that allows for the repurchase of a limited number of the Company s shares at management s discretion on the open market. The Company undertook this repurchase program in order to increase shareholder value. A table disclosing repurchases of Company shares made during the quarter ended June 30, 2006 is set forth under Part II, Item 2 of this report, *Unregistered Sales of Equity Securities and Use of Proceeds*.

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Actual capital amounts and ratios for the Company and the Bank as of June 30, 2006 and December 31, 2005 are as follows:

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provision	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of June 30, 2006 -						
Company						
Total Capital to Risk Weighted Assets	$55,860,451	18.42%	$24,261,200	>8%	$30,326,500	>10%
Tier 1 Capital to Risk Weighted Assets	44,306,714	14.61%	12,130,600	>4%	18,195,900	>6%
Tier 1 Capital to Average Assets	44,306,714	11.92%	14,866,440	>4%	18,583,050	>5%
Bank						
Total Capital to Risk Weighted Assets	$40,461,691	13.34%	$24,259,280	>8%	$30,324,100	>10%
Tier 1 Capital to Risk Weighted Assets	37,768,954	12.46%	12,129,640	>4%	18,194,460	>6%
Tier 1 Capital to Average Assets	37,768,954	10.10%	14,953,200	>4%	18,691,500	>5%
As of December 31, 2005 -						
Company						
Total Capital to Risk Weighted Assets	$37,923,500	13.30%	$22,817,040	>8%	$28,521,300	>10%
Tier 1 Capital to Risk Weighted Assets	35,562,125	12.47%	11,408,520	>4%	17,112,780	>6%
Tier 1 Capital to Average Assets	35,562,125	9.76%	14,580,112	>4%	18,225,140	>5%
Bank						
Total Capital to Risk Weighted Assets	$37,493,600	13.15%	$22,817,040	>8%	$28,521,300	>10%
Tier 1 Capital to Risk Weighted Assets	35,132,225	12.32%	11,408,520	>4%	17,112,780	>6%
Tier 1 Capital to Average Assets	35,132,225	9.64%	14,578,280	>4%	18,222,850	>5%

The minimum regulatory capital requirements for financial institutions require institutions to have a Tier 1 capital to average assets ratio of 4.0%, a Tier 1 capital to risk weighted assets ratio of 4.0% and a total capital to risk weighted assets ratio of 8.0%. To be considered well capitalized, an institution must have a minimum Tier 1 leverage ratio of 5.0%. At June 30, 2006, the ratios of the Company exceeded the ratios required to be considered well capitalized. It is management s goal to monitor and maintain adequate capital levels to continue to support asset growth and continue its status as a well-capitalized institution.

Liquidity

At June 30, 2006, the amount of liquid assets remained at a level management deemed adequate to ensure that contractual liabilities, depositors withdrawal requirements, and other operational and customer credit needs could be satisfied.

Liquidity measures the ability to satisfy current and future cash flow needs as they become due. Liquidity management refers to the Company s ability to support asset growth while satisfying the borrowing needs and deposit withdrawal requirements of customers. In addition to maintaining liquid assets, factors such as capital position, profitability, asset quality and availability of funding affect a bank s ability to meet its liquidity needs. On the asset side, liquid funds are maintained in the form of cash and cash equivalents, Federal funds sold, investment securities held to maturity maturing within one year, securities available for sale and loans held for sale. Additional asset-based liquidity is derived from scheduled loan repayments as well as investment

repayments of principal and interest from mortgage-backed securities. On the liability side, the primary source of liquidity is the ability to generate core deposits. Short-term borrowings are used as supplemental funding sources when growth in the core deposit base does not keep pace with that of earnings assets.

The Company has established a borrowing relationship with the FHLB which further supports and enhances liquidity.

The Consolidated Statements of Cash Flows present the changes in cash from operating, investing and financing activities. At June 30, 2006, the balance of cash and cash equivalents was $9,017,842.

Net cash provided by operating activities totaled $7,359,712 in the six months ended June 30, 2006 compared to $3,159,007 in the six months ended June 30, 2006. The primary sources of funds are net income from operations adjusted for provision for loan losses, depreciation expenses, and net proceeds from sales of loans held for sale.

Net cash used in investing activities totaled $17,062,006 in the six months ended June 30, 2006 compared to $7,487,609 used in investing activities in the six months ended June 30, 2005. The current period amount was the result of a $24,514,687 increase in the loan portfolio combines with $6,958,616 in available for sale security purchases for the six months ended June 30, 2006.

Net cash provided by financing activities amounted to $6,582,386 in the six months ended June 30, 2006 compared to $8,449,475 in the six months ended June 30, 2005. The current period amount resulted primarily from a decrease in deposits offset by the $18,557,000 proceeds from the issuance of redeemable subordinated debentures during the six months period ended June 30, 2006.

The securities portfolio is also a source of liquidity, providing cash flows from maturities and periodic repayments of principal. During the six months ended June 30, 2006, maturities and prepayments of investment securities totaled $11,790,912. Another source of liquidity is the loan portfolio, which provides a flow of payments and maturities.

Interest Rate Sensitivity Analysis

The largest component of the Company s total income is net interest income, and the majority of the Company s financial instruments are composed of interest rate-sensitive assets and liabilities with various terms and maturities. The primary objective of management is to maximize net interest income while minimizing interest rate risk. Interest rate risk is derived from timing differences in the repricing of assets and liabilities, loan prepayments, deposit withdrawals, and differences in lending and funding rates. Management actively seeks to monitor and control the mix of interest rate-sensitive assets and interest rate-sensitive liabilities.

The Company continually evaluates interest rate risk management opportunities, including the use of derivative financial instruments. Management believes that hedging instruments currently available are not cost-effective, and therefore, has focused its efforts on increasing the Company s spread by attracting lower-cost retail deposits.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

To measure the impacts of longer-term asset and liability mismatches beyond two years, the Company utilizes Modified Duration of Equity and Economic Value of Portfolio Equity (EVPE) models. The modified duration of equity measures the potential price risk of equity to changes in interest rates. A longer modified duration of equity indicates a greater degree of risk to rising interest rates. Because of balance sheet optionality, an EVPE analysis is also used to dynamically model the present value of asset and liability cash flows, with rates ranging up or down 200 basis points. The economic value of equity is likely to be different as interest rates change. Results falling outside prescribed ranges require action by management. At June 30, 2006 and December 31, 2005, the Company s variance in the economic value equity as a percentage of assets with an instantaneous and sustained parallel shift of 200 basis points is within the negative 3% guideline, as shown in the tables below.

The market capitalization of the Company should not be equated to the EVPE, which only deals with the valuation of balance sheet cash flows using conservative assumptions. Calculated core deposit premiums may be less than what is available in an outright sale. The model does not consider potential premiums on floating rate loan sales, the impact of overhead expense, non-interest income, taxes, industry market price multiples and other factors reflected in the market capitalization of a company.

The following tables set forth certain information relating to the Company s financial instruments that are sensitive to changes in interest rates, categorized by expected maturity or repricing and the instruments fair value at June 30, 2006 and December 31, 2005.

Market Risk Analysis

June 30, 2006

Change in Interest Rates	**Flat**	-200bp	+200bp
Economic Value of Portfolio Equity	$45,481,000	$46,114,000	$40,292,000
Change		$633,000	($5,190,000)
Change as a Percentage of Assets		0.17%	(1.36%)

December 31, 2005

Change in Interest Rates	**Flat**	-200bp	+200bp
Economic Value of Portfolio Equity	$44,923,000	$43,305,000	$42,049,000
Change		($1,617,000)	($2,873,000)
Change as a Percentage of Assets		(0.43%)	(0.77%)

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Item 4. Controls and Procedures.

The Company s chief executive officer and chief financial officer, with the assistance of other members of the Company s management, have evaluated the effectiveness of the design and operation of the Company s disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this quarterly report. Disclosure controls and procedures include those designed to ensure that information required to be disclosed is accumulated and communicated to the Company s management as appropriate to allow timely decisions regarding disclosure. Based upon such evaluation, the Company s chief executive officer and chief financial officer have concluded that the Company s disclosure controls and procedures are effective as of the end of the period covered by this quarterly report.

The Company s chief executive officer and chief financial officer have also concluded that there have not been any changes in the Company s internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

PART II. OTHER INFORMATION

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

Issuer Purchases of Equity Securities

On July 21, 2005, the Board of Directors authorized a common stock repurchase program under which the Company may purchase in open market or privately negotiated transactions up to 5% of its common shares outstanding on that date. The Company undertook these repurchase programs in an effort to increase shareholder value. The following table provides common stock repurchases made by or on behalf of the Company during the three months ended June 30, 2006.

Issuer Purchases of Equity Securities (1)

Period		**Total Number of Shares Purchased**	**Average Price Paid Per Share**	**Total Number of Shares Purchased As Part of Publicly Announced Plan or Program**	**Maximum Number of Shares That May Yet be Purchased Under the Plan or Program**
Beginning	Ending				
April 1, 2006	April 30, 2006	-	-	-	170,172
May 1, 2006	May 31, 2006	-	-	-	170,172
June 1, 2006	June 30, 2006	250	$18.75	250	169,922

Total	250	$18.75	250	169,922

(1) The Company s common stock repurchase program covers a maximum of 173,617 shares of common stock of the Company, representing 5% of the outstanding common stock of the Company on July 21, 2005, as adjusted for the 5% stock dividend paid January 31, 2006.

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Item 4. Submission of Matters to a Vote of Securities Holders.

The Company s Annual Meeting of Shareholders (the Annual Meeting) was held on May 18, 2006

There were present at the Annual Meeting in person or by proxy shareholders holding an aggregate of 3,149,987 shares of common stock of a total number of 3,445,162 shares of common stock issued, outstanding and entitled to vote at the Annual Meeting.

At the Annual Meeting, Charles S. Crow III and David C. Reed were re-elected as a Class I directors of the Company, with 3,132,867 shares votes cast for and 17,120 shares withheld. Directors whose term of office continued following the meeting were Frank E. Walsh, III, Robert F. Mangano, and William M. Rue.

A vote of the shareholders was taken at the Annual Meeting on the proposal to approve the adoption of the 1ST Constitution Bancorp 2006 Directors Stock Plan. The proposal was approved by the shareholders with 1,622,719 shares voting in favor of the proposal and 200,746 shares voting against the proposal. There were 1,621,697 abstentions and broker non-votes.

A vote of the shareholders was taken at the Annual Meeting on the proposal to approve and ratify the appointment of Grant Thornton LLP as the Company s independent auditor for the year ending December 31, 2006. The proposal was approved by the shareholders, with 3,129,713 shares voting in favor of the proposal, and 18,178 shares voting against the proposal. There were 297,271 abstentions and broker non-votes.

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Item 6. Exhibits.

3(i)		Certificate of Incorporation of the Company (incorporated by reference to Exhibit 3(i) to the Company s Form 10-K filed with the SEC on March 24, 2005)
3(ii)		Bylaws of the Company (incorporated by reference to Exhibit 3(ii) to the Company s Form 10-QSB filed with the SEC on May 14, 2003)
10.1		1st Constitution Bancorp 2006 Directors Stock Plan (incorporated by reference to Exhibit 10.1 to the Company s Form 8-K filed with the SEC on May 19, 2006)
10.2		Form of Nonqualified Stock Option Agreement under the 1st Constitution Bancorp 2006 Directors Stock Plan (incorporated by reference to Exhibit 10.2 to the Company s Form 8-K filed with the SEC on May 19, 2006)
10.3		Form of Restricted Stock Agreement under the 1st Constitution Bancorp 2006 Directors Stock Plan (incorporated by reference to Exhibit 10.3 to the Company s Form 8-K filed with the SEC on May 19, 2006)
10.4		Amended and Restated Declaration of Trust of 1st Constitution Capital Trust II, dated as of June 15, 2006, among 1st Constitution Bancorp, as sponsor, the Delaware and institutional trustee named therein, and the administrators named therein (incorporated by reference to Exhibit 10.1 to the Company s Form 8-K filed with the SEC on June 16, 2006)
10.5		Indenture, dated as of June 15, 2006, between 1st Constitution Bancorp, as issuer, and the trustee named therein, relating to the Floating Rate Junior Subordinated Debt Securities due 2036 (incorporated by reference to Exhibit 10.2 to the Company s Form 8-K filed with the SEC on June 16, 2006)
10.6		Guarantee Agreement, dated as of June 15, 2006, between 1st Constitution Bancorp and the guarantee trustee named therein (incorporated by reference to Exhibit 10.3 to the Company s Form 8-K filed with the SEC on June 16, 2006)
31.1	*	Certification of Robert F. Mangano, chief executive officer of the Company, pursuant to Securities Exchange Act Rule 13a-14(a)
31.2	*	Certification of Joseph M. Reardon, chief financial officer of the Company, pursuant to Securities Exchange Act Rule 13a-14(a)
32	*	Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of The Sarbanes-Oxley Act of 2002, signed by Robert F. Mangano, chief executive officer of

the Company, and Joseph M. Reardon, chief financial officer of the Company

* Filed herewith

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SIGNATURES

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

1ST CONSTITUTION BANCORP

Date: August 7, 2006

By: ROBERT F. MANGANO
Robert F. Mangano
President and Chief Executive Officer
(Principal Executive Officer)

Date: August 7, 2006

By: JOSEPH M. REARDON
Joseph M. Reardon
Senior Vice President and Treasurer
(Principal Accounting Officer)