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SUSSEX BANCORP
Form 10QSB
August 10, 2001

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549

FORM 10-QSB

(Mark One)

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

For the quarterly period ended June 30, 2001

or

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

For the transition period from _____ to _____

Commission file number 0-29030

SUSSEX BANCORP.

(Exact name of registrant as specified in its charter)

New Jersey

22-3475473

(State of other jurisdiction of
incorporation or organization)

(I. R. S. Employer
Identification No.)

399 Route 23, Franklin, New Jersey

07416

(Address of principal executive offices)

(Zip Code)

Issuer's telephone number, including area code) (973) 827-2914

(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 and 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

As of August 6, 2001 there were 1,649,209 shares of common stock, no par value,
outstanding.

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SUSSEX BANCORP FORM 10-QSB

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PART I - FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

SUSSEX BANCORP CONSOLIDATED BALANCE SHEETS (in Thousands, Except Share Data) (Unaudited)

| | June 30, 2001 ----- | December 31, ----- |
|--|------------------------|-----------------------|
| ASSETS | | |
| ----- | | |
| Cash and Due from Banks | \$ 6,475 | \$ 4 |
| Federal Funds Sold | 14,545 | 8 |
| Interest Bearing Deposits | 0 | |
| | ----- | ----- |
| Total Cash and Cash Equivalents | 21,020 | 12 |
| Time Deposits in Other Banks | 7,100 | |
| Securities available for sale, at estimated fair value | 42,795 | 33 |
| Securities held to maturity, estimated fair value of \$5,800 in 2001 and \$6,393 in 2000 | 5,733 | 6 |

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| | | |
|---|------------|--------|
| Total Securities | 48,528 | 39 |
| Loans Held for Sale | 136 | |
| Loans (Net of Unearned Income) | 100,566 | 101 |
| Less: Allowance for Possible Loan Losses | 1,030 | |
| Net Loans | 99,536 | 100 |
| Other Real Estate Owned | 185 | |
| Premises and Equipment, Net | 4,778 | 4 |
| Federal Home Loan Bank Stock | 693 | |
| Intangible Assets | 493 | |
| Accrued Interest Receivable | 1,045 | |
| Other Assets | 1,772 | 1 |
| Total Assets | \$ 185,286 | \$ 161 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Liabilities: | | |
| Deposits: | | |
| Demand | \$ 25,086 | \$ 24 |
| Savings | 70,861 | 63 |
| Time | 49,269 | 42 |
| Time of \$100 and over | 17,245 | 9 |
| Total Deposits | 162,461 | 140 |
| Federal Home Loan Bank Advances | 10,000 | 10 |
| Other Liabilities | 809 | |
| Total Liabilities | 173,270 | 151 |
| Stockholders' Equity: | | |
| Common Stock, No Par Value Authorized 5,000,000 Shares, Issued 1,662,896 in 2001 and 1,511,567 in 2000 | 7,640 | 6 |
| Retained Earnings | 4,362 | 4 |
| Treasury Stock, 13,687 Shares in 2001 and 13,216 in 2000 | (126) | |
| Accumulated other comprehensive income (loss), net of income tax | 140 | |
| Total Stockholders' Equity | 12,016 | 10 |
| Total Liabilities and Stockholders' Equity | \$ 185,286 | \$ 161 |

See Notes to Consolidated Financial Statements

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| | Three Months Ended June 30, | | Six |
|---|--------------------------------|-----------|---------|
| | 2001 | 2000 | 2001 |
| | ----- | ----- | ----- |
| INTEREST INCOME | | | |
| Interest and Fees on Loans | \$ 2,037 | \$ 1,829 | \$ 4,1 |
| Interest on Time Deposits | 46 | 20 | |
| Interest on Securities: | | | |
| Taxable | 595 | 544 | 11 |
| Exempt from Federal Income Tax | 66 | 75 | 1 |
| Interest on Federal Funds Sold | 220 | 54 | 4 |
| | ----- | ----- | ----- |
| Total Interest Income | 2,964 | 2,522 | 5,9 |
| INTEREST EXPENSE | | | |
| Interest on Deposits: | 1,356 | 1,091 | 2,7 |
| Interest Expense on Federal Funds Purchased | 0 | 49 | |
| Interest Expense on FHLB Advances | 125 | 0 | 2 |
| | ----- | ----- | ----- |
| Total Interest Expense | 1,481 | 1,140 | 2,9 |
| Net Interest Income | 1,483 | 1,382 | 2,9 |
| Provision for Possible Loan Losses | 63 | 63 | 1 |
| | ----- | ----- | ----- |
| Net Interest Income After Provision for Loan Losses | 1,420 | 1,319 | 2,8 |
| NON-INTEREST INCOME | | | |
| Service charges on Deposit Accounts | 139 | 114 | 2 |
| Other Income | 206 | 95 | 3 |
| | ----- | ----- | ----- |
| Total Non-Interest Income | 345 | 209 | 5 |
| NON-INTEREST EXPENSE | | | |
| Salaries and Employee Benefits | 755 | 673 | 14 |
| Occupancy Expense, Net | 112 | 113 | 2 |
| Furniture and Equipment Expense | 129 | 138 | 2 |
| Data Processing Expense | 29 | 20 | |
| Stationary and Supplies | 28 | 23 | |
| Advertising and Promotion | 57 | 40 | 1 |
| Audit and Exams | 32 | 26 | |
| Amortization of Intangibles | 21 | 21 | |
| Other Expenses | 255 | 234 | 4 |
| | ----- | ----- | ----- |
| Total Non-Interest Expense | 1,418 | 1,288 | 2,7 |
| Income Before Provision for Income Taxes | 347 | 240 | 6 |
| Provision for Income Taxes | 107 | 56 | 1 |
| | ----- | ----- | ----- |
| Net Income | \$ 240 | \$ 184 | \$ 4 |
| | ===== | ===== | ===== |
| Net Income Per Common Share-Basic | \$ 0.15 | \$ 0.13 | \$ 0. |
| | ===== | ===== | ===== |
| Net Income Per Common Share-Diluted | \$ 0.14 | \$ 0.12 | \$ 0. |
| | ===== | ===== | ===== |
| Weighted Average Shares Outstanding-Basic | 1,645,443 | 1,494,298 | 1,631,5 |

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Weighted Average Shares Outstanding-Diluted 1,663,374 1,504,241 1,649,5

See Notes to Consolidated Financial Statements

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SUSSEX BANCORP
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In Thousands)
(Unaudited)

| | Three Months Ended June 30, | | Six M J |
|---|--------------------------------|--------------|--------------|
| | 2001 ---- | 2000 ---- | 2001 ---- |
| Net Income | \$ 240 | \$ 184 | \$ 450 |
| Other comprehensive income, net of tax | | | |
| Unrealized gain (loss) on available for sale securities | 54 | (30) | 320 |
| Comprehensive income (loss) | \$ 294 | \$ 154 | \$ 770 |

See Notes to Consolidated Financial Statements

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SUSSEX BANCORP
CONSOLIDATED STATEMENT OF CHANGES IN
STOCKHOLDERS' EQUITY
(In Thousands)
(Unaudited)

| | Common Stock ----- | Retained Earnings ----- | Treasury Stock ----- |
|---|--------------------------|-------------------------------|----------------------------|
| Balance December 31, 2000 | \$ 6,385 | \$ 4,027 | (\$ 122) |
| Net Income for the Period | | 450 | |
| Cash Dividend | | (115) | |
| Sale of Common Stock | 1160 | | |
| Stock Options Exercised | 24 | | |
| Shares Issued Through Dividend Reinvestment Plan | 71 | | |
| Treasury Stock Purchased | | | (4) |
| Change in Unrealized Gain on Securities, Available for Sale | | | |

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Balance June 30, 2001

 \$ 7,640 \$ 4,362 (\$ 126)
 =====

See Notes to Consolidated Financial Statements

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CONSOLIDATED STATEMENTS
 OF CASH FLOWS
 (Unaudited)

| | Six 2001 ---- |
|---|---------------------|
| Cash Flows from Operating Activities: | |
| Net Income | \$ 45 |
| Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities: | |
| Depreciation and Amortization of Premises and Equipment | 21 |
| Amortization of Intangible Assets | 4 |
| Premium Amortization of Securities, net | 9 |
| Provision for Possible Loan Losses | 12 |
| Loss on Sale of Securities, Available for Sale | |
| Amortization of Loan Origination and Commitment Fees, net | (2) |
| Decrease in Loans Held for Sale | 16 |
| Increase in Deferred Federal Income Tax | |
| (Increase) Decrease in Accrued Interest Receivable | (6) |
| Increase in Cash Value of Life Insurance Policy | (2) |
| Increase in Other Assets | (18) |
| Increase (Decrease) in Accrued Interest and Other Liabilities | 15 |
| | ----- |
| Net Cash (Used In) Provided by Operating Activities | \$ 93 |
| | ----- |
| Cash Flow from Investing Activities: | |
| Securities Available for Sale: | |
| Proceeds from Maturities and Paydowns | 6,78 |
| Proceeds from Sales/Calls Prior to Maturity | 6,27 |
| Purchases | (22,20) |
| Securities Held to Maturity: | |
| Proceeds from Maturities | 1,21 |
| Purchases | (53) |
| (Purchases) Maturities of Time Deposits on Other Banks | (7,00) |
| Net (Increase) Decrease in Loans Outstanding | 55 |
| Increase in Other Real Estate Owned | (18) |
| Capital Expenditures | (47) |
| | ----- |
| Net Cash (Used In) Investing Activities | (\$15,57) |
| | ----- |
| Cash Flows from Financing Activities: | |
| Net Increase in Total Deposits | 21,60 |

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| | |
|--|----------|
| Net Increase in Federal Funds Purchased | |
| Exercise of Stock Options | 2 |
| Purchase of Treasury Stock | (|
| Sale of Common Stock | 1,16 |
| Payment of Dividends Net of Reinvestment | (4 |
| | ----- |
| Net Cash Provided by Financing Activities | \$ 22,73 |
| | ----- |
| Net Increase (Decrease) in Cash and Cash Equivalents | \$ 8,10 |
| Cash and Cash Equivalents, Beginning of Period | 12,92 |
| | ----- |
| Cash and Cash Equivalents, End of Period | \$ 21,02 |
| | ===== |

See Notes to Consolidated Financial Statements

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SUSSEX BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. Basis of Presentation

Sussex Bancorp ("the Company"), a one-bank holding company, was incorporated in January, 1996 to serve as the holding company for the Sussex County State Bank ("the Bank"). The Bank is the only active subsidiary of the Company at June 30, 2001. The Bank operates eight banking offices all located in Sussex County. The Company is subject to the supervision and regulation of the Board of Governors of the Federal Reserve System (the "FRB"). The Bank's deposits are insured by the Bank Insurance Fund ("BIF") of the Federal Deposit Insurance Corporation ("FDIC") up to applicable limits. The operations of the Company and the Bank are subject to the supervision and regulation of the FRB, FDIC and the New Jersey Department of Banking and Insurance (the "Department").

The consolidated financial statements included herein have been prepared without audit in accordance with the rules and regulations of the Securities and Exchange Commission and reflect all adjustments which, in the opinion of management, are necessary for a fair statement of the results for interim periods. All adjustments made were of a normal recurring nature. These consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto that are included in the Company's Annual Report on Form 10-KSB for the fiscal period ended December 31, 2000.

2. Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash and due from banks and federal funds sold. Generally, federal funds are sold for a one day period.

3. Securities

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The amortized cost and approximate market value of securities are summarized as follows (in thousands):

| | June 30, 2001 | | December 31, 2000 | |
|--|---------------------------|--------------------------|---------------------------|--------------------------|
| | Amortized Cost ---- | Market Value ----- | Amortized Cost ---- | Market Value ----- |
| Available For Sale | | | | |
| US Treasury securities | \$ 2,014 | \$ 2,049 | \$ 4,043 | \$ 4,033 |
| US Government Mortgage Backed | 36,062 | 36,245 | 25,116 | 24,880 |
| Corporate Bonds | 3,631 | 3,691 | 3,477 | 3,469 |
| Equity Securities | 850 | 810 | 850 | 804 |
| | ----- | ----- | ----- | ----- |
| Total | \$42,557 | \$42,795 | \$33,486 | \$33,186 |
| | ===== | ===== | ===== | ===== |
| Held to maturity | | | | |
| Obligations of State and Political subdivisions | \$ 5,733 | \$ 5,800 | \$ 6,431 | \$ 6,393 |
| | ----- | ----- | ----- | ----- |
| Total | \$ 5,733 | \$ 5,800 | \$ 6,431 | \$ 6,393 |
| | ===== | ===== | ===== | ===== |
| Total Securities | \$48,290 | \$48,595 | \$39,917 | \$39,579 |
| | ===== | ===== | ===== | ===== |

4. Net Income Per Common Share

Basic net income per share of common stock is calculated by dividing net income by the weighted average number of shares of common stock outstanding during the period. Diluted net income per share is calculated by dividing net income by the weighted average number of shares of common stock outstanding during the period plus the potential dilutive effect of outstanding stock options. On June 21, 2000 the Company declared a 5% stock dividend. Share and per share information for 2000 has therefore been restated.

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ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

RESULTS OF OPERATIONS

Three and Six Months ended June 30, 2001 and June 30, 2000.

OVERVIEW

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The Company realized net income of \$240 thousand for the second quarter of 2001, an increase of \$56 thousand over the \$184 thousand reported for the same period in 2000. Basic earnings per share increased from \$0.13 in the second quarter of 2000 to \$0.15 for the second quarter of 2001. Diluted earnings per share increased from \$0.12 in the second quarter of 2000 to \$0.14 per share in the quarter ended June 30, 2001.

For the six months ended June 30, 2001, net income was \$450 thousand, an increase of \$66 thousand from the \$384 thousand reported for the same period in 2000. Basic and diluted earnings per share were \$.26 for the six months ended June 30, 2000 compared to basic earnings per share of \$0.28 and diluted earnings per share of \$0.27 for the six months ended June 30, 2001.

RESULTS OF OPERATIONS

Interest Income. Total interest income increased \$442 thousand, or 17.5%, to \$3.0 million for the quarter ended June 30, 2001 from \$2.5 million for the same period in 2000. This increase was primarily attributable to an increase in average interest earning assets of \$34.3 million, or 24.5%, from \$139.9 million for the second quarter of 2000 to \$174.2 million in the second quarter of 2001. An increase in interest and fees on loans of \$208 thousand and an increase of \$166 thousand in interest earned on federal funds sold were the largest components of this change. The yield on average interest-earning assets on a fully taxable equivalent basis decreased 44 basis points from 7.31% for the second quarter of 2000 to 6.87% for the second quarter of 2001, reflecting both market changes in interest rates and larger average balances in lower yielding federal funds sold and time deposits in other banks.

For the six months ended June 30, 2001, interest income increased \$908 thousand, or 18.2%, to \$5.9 million from the \$5.0 million reported for the same period in 2000. This growth in interest income is the result of a \$28.3 million, or 20.2% increase in the average balance of interest-earning assets over the comparable period last year. The average balance in the loan portfolio increased \$13.3 million and other interest bearing assets increased \$14.8 million during the first six months of 2001 over the same period in 2000. As the result of changing market rates and growth in earning assets, the average yield on interest earning assets on a fully taxable equivalent basis decreased 13 basis points from 7.24% from the first half of 2000 to 7.11% for the same period of 2001.

Interest Expense. The Company's interest expense for the second quarter of 2001 increased \$341 thousand, or 29.9% to \$1.5 million from \$1.2 million as the average balance of interest bearing liabilities increased \$32.2 million, or 27.7% from the same period last year. The largest component of the increase was in time deposits, which increased \$20.7 million, or 45.4% in the second quarter of 2001 compared to the same period in 2000. The Company had promoted higher yielding time deposits during the first three months of 2001 to meet anticipated loan demand. The Company's average borrowed funds increased \$7.0 million from second quarter 2000 compared to the second quarter of 2001. The Company entered into three ten year callable Federal Home Loan Bank advances totaling \$10 million in December 2000 compared to overnight borrowed funds of \$3.0 million in the second quarter of 2000. The FHLB advances were an investment strategy used to payoff overnight borrowings and to have liquidity available to purchase investments. Money market, savings and NOW deposits combined showed an aggregate increase of \$4.4 million, or 6.5%, in average balances during the second quarter of 2001 from the second quarter of 2000. The Company's average cost of funds increased 6 basis points to 4.01% for the second quarter of 2001 from 3.95% for the second quarter in 2000. This net increase in the average cost of funds was the combination of the Company decreasing its rates of interest paid on NOW, savings and money market accounts offset by a higher cost of funds on time deposits from the Company's first quarter promotion.

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For the six months ended June 30, 2001 interest expense increased \$702 thousand, or 31.0%, to \$3.0 million from \$2.3 million for the same period last year. This increase was largely due to an increase in interest expense on time deposits of \$603 thousand, or 53.0%, from \$1.1 million for the first half of 2000 to \$1.7 million during the same period in 2001. In the first six months of 2001, the average balance in time deposit accounts increased \$18.3 million, or 40.4%, over the average balance for the six months ended June 30, 2000. The Company's borrowed funds increased \$6.3 million from \$3.7 million during the first six months of 2000 to \$10 million in the first six months of 2001. As the Company moved from overnight funding to long term funding, the average rate paid on these borrowed funds decreased 117 basis points. The average rate paid on the additional \$18.3 million in time deposits increased 47 basis points from 5.04% for the six months ending June 30, 2000 to 5.51% for the six months ending June 30, 2001. The average rate paid on total interest bearing liabilities increased 27 basis points from 3.90% in the first six months of 2000 to 4.17% during the same period in 2001. The average balance of non-interest bearing demand deposits increased by \$1.8 million to \$24.8 million for the first six months of 2001 from \$23.0 million for the same period in 2000.

The following table presents, on a tax equivalent basis, a summary of the Company's interest-earning assets and their average yields, and interest-bearing liabilities and their average costs and shareholders' equity for the six months ended June 30, 2001 and 2000. The average balance of loans includes non-accrual loans, and associated yields include loan fees, which are considered adjustment to yields.

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Comparative Average Balance Sheets Six Months Ended June 30,

| | 2001 | | Average Rates Earned/ Paid | |
|--|--------------------|--------------------------------|-------------------------------------|------------------------|
| | Average Balance | Interest Income/ Expense | ----- ----- ---- | ----- ----- ---- |
| | | | | |
| | | | | (Dollars in Thousands) |
| Assets | | | | |
| Interest Earning Assets: | | | | |
| Taxable Loans (net of unearned income) | \$ 102,519 | \$ 4,111 | 8.09% | \$ |
| Tax Exempt Securities | 6,596 | 170 | 5.20% | |
| Taxable Investment Securities | 38,155 | 1,134 | 5.99% | |
| Other (1) | 21,278 | 530 | 5.02% | |
| | ----- | ----- | | ----- |
| Total Earning Assets | \$ 168,548 | \$ 5,945 | 7.11% | \$ 1 |
| Non-Interest Earning Assets | \$ 13,119 | | | \$ |
| Allowance for Possible Loan Losses | (\$ 1,010) | | | (\$ |
| | ----- | | | ----- |
| Total Assets | \$ 180,657 | | | \$ 1 |
| | ===== | | | ===== |

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| | | | | |
|--|------------|----------|-------|------|
| Liabilities and Shareholders' Equity | | | | |
| Interest Bearing Liabilities: | | | | |
| NOW Deposits | \$ 15,113 | \$ 104 | 1.39% | \$ |
| Savings Deposits | 47,178 | 754 | 3.22% | |
| Money Market Deposits | 7,542 | 118 | 3.16% | |
| Time Deposits | 63,683 | 1,740 | 5.51% | |
| Borrowed Funds | 10,000 | 249 | 4.96% | |
| | ----- | | | |
| Total Interest Bearing Liabilities | \$ 143,516 | \$ 2,965 | 4.17% | \$ 1 |
| Non-Interest Bearing Liabilities: | | | | |
| Demand Deposits | \$ 24,832 | | | \$ |
| Other Liabilities | 819 | | | |
| | ----- | | | |
| Total Non-Interest Bearing Liabilities | \$ 25,651 | | | \$ |
| Shareholders' Equity | \$ 11,490 | | | \$ |
| | ----- | | | |
| Total Liabilities and Shareholders' Equity | \$ 180,657 | | | \$ 1 |
| | ===== | | | |
| Net Interest Differential | | \$ 2,980 | | |
| Net Interest Margin | | | 2.95% | |
| Net Yield on Interest-Earning Assets | | | 3.57% | |

(1) Includes FHLB stock, federal funds sold, interest-bearing deposits, and time deposits

Net-Interest Income. The net interest income for the second quarter of 2001 increased \$101 thousand, or 7.3%, compared to the second quarter of 2000. The net interest margin, on a fully taxable equivalent basis, decreased 50 basis points and the net yield on interest earning assets decreased 58 basis points from the same period last year. This decrease was due to an increase in the cost of funds on interest bearing liabilities from the time deposit promotion and a decrease in the average yield earned on interest bearing assets. The funds brought in from the time deposit promotion were not immediately needed to fund loan demand, and are presently invested in lower yielding federal funds. Although new loan demand remains strong, loan payoffs have exceeded expectations in the current declining interest rate environment.

Net interest income for the six months ended June 30, 2001 increased \$702 thousand, or 31.0%, over the same period last year. The net interest spread decreased, on a fully taxable equivalent basis, 39 basis points and the net yield on interest-bearing assets declined by 42 basis points between the first six month periods of 2000 and 2001. This comparison displays an increase the average balance in lower yielding federal funds brought in through an increase in the average balance in time deposits. Due to the declining market rates of interest during the first six months of 2001, the Company's anticipated increase in loan average balances has slowed down as new loan originations have not kept the pace with loan payoffs.

Provision for Loan Losses. For the three months ended June 30, 2001 and 2000, the provision for possible loan losses was \$63 thousand. The provision for

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possible loan losses was \$126 thousand for the six months ended June 30, 2001 as compared to \$111 thousand for the same period last year. The provision for loan losses over the three and six month periods reflects management's judgment concerning the risks inherent in the Company's existing loan portfolio and the size of the allowance necessary to absorb the risks, as well as in the average balance of the portfolio over both periods. Management reviews the adequacy of its allowance on an ongoing basis and will provide for additional provision in future periods, as management may deem necessary.

Non-Interest Income. For the second quarter of 2001, total non-interest income increased \$136 thousand, or 65.1%, from the same period in 2000. Service charges on deposit accounts increased \$25 thousand in the second quarter of 2001 compared to the three months ended June 30, 2000. Other income increased \$111 thousand, or 116.8%, in the second quarter of 2001 from the same period in 2000. This increase was mostly the result of an increase of \$32 thousand in fees generated by the non-deposit investment products offered by our third party provider, IBFS, and an increase of \$42 thousand in commission income from Sussex Bancorp Mortgage Company, our mortgage banking subsidiary in the second quarter of 2001 over the second quarter of 2000.

For the six months ended June 30, 2001, non-interest income increased \$195 thousand, or 48.9%, from the same period in 2000. Service charges on deposit accounts increased \$37 thousand for the six month period ending June 30, 2001 over the same period in 2000. This increase was largely due to increased fees charged on deposit accounts which became effective on April 1, 2001. Other income increased \$158 thousand, or 90.3%, from June 30, 2000 to June 30, 2001. The components of this increase were a \$50 thousand increase in commission income from Sussex Bancorp Mortgage Company, a \$49 thousand increase in the fees generated from non-deposit investment products offered through IBFS and other increases of \$55 thousand cumulatively collected from various other services. In the first six months of 2001, a \$4 thousand gain on the sale of fixed assets was recorded compared to an \$8 thousand loss in available for sale securities during the first six months of 2000.

Non-Interest Expense. For the quarter ended June 30, 2001, non-interest expense increased \$130 thousand from the same period last year. Salaries and employee benefits increased \$82 thousand, or 12.2%, as salaries increased \$66 thousand and employee benefits increased \$16 thousand, with a \$10 thousand increase in medical claim expenses. Other larger notable increases from second quarter 2000 to second quarter 2001 were data processing expenses of \$9 thousand, advertising and promotions of \$17 thousand and audits and exams of \$6 thousand.

For the six months ended June 30, 2001, non-interest expense increased \$245 thousand, or 9.7%, from the same period last year. Salaries and employee benefits increased \$149 thousand, or 11.1%, occupancy expense increased \$26 thousand, or 11.8%, while furniture and fixture expense decreased \$16 thousand, or 5.9%. Data processing expenses have increased \$14 thousand, advertising and promotions increased \$16 thousand and audits and exams increased \$12 thousand during the first six month of 2001 as compared to the first six months of 2000. These increases in operating expenses reflect normal expenditures relative to the growth of the Company.

Income Taxes. Income tax expense increased \$51 thousand to \$107 thousand for the three months ended June 30, 2001 as compared to \$56 thousand for the same period in 2000. Income taxes also increased for the six months ended June 30, 2001 to \$189 thousand as compared to \$114 thousand for the six months ended June 30, 2000. The increase in income taxes resulted from a higher level of income before income taxes in combination with a reduced level of tax-exempt income.

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FINANCIAL CONDITION

June 30, 2001 as compared to December 31, 2000

Total assets increased to \$185.3 million at June 30, 2001, a \$23.7 million increase from total assets of \$161.6 million at December 31, 2000. Increases in total assets included increases of \$8.1 million in cash and cash equivalents, \$8.9 million in total securities and \$7.0 million in time deposits in other banks, while total loans, net of unearned income, decreased \$600 thousand. This net increase in assets was funded by an increase in total deposits of \$21.6 million from \$140.9 million at year-end 2000 to \$162.5 million on June 30, 2001 and an increase in total stockholder's equity of \$1.9 million from \$10.1 million at December 31, 2000 to \$12.1 million at June 30, 2001, reflecting both the Company's retained earnings for the first six months of 2001 and the investment of \$1.1 million in the Company's common stock by Lakeland Bancorp in January 2001.

Total loans at June 30, 2001 decreased \$600 thousand to \$100.6 million from year-end 2000. The decrease reflects loan payoffs in excess of new originations during a period of declining market rates. The Company operates in a highly competitive market, and must frequently compete with larger institutions. These competitors often devote greater resources to marketing and customer acquisition than can the Company. In addition, the Company is emphasizing the origination of commercial, industrial, and construction loans to increase the yield in its loan portfolio and reduce its dependence on loans secured by 1-4 family properties. These factors are evident in the loan portfolio balances at June 30, 2001 compared to December 31, 2000. Residential real estate loans decreased \$3.2 million, other loans decreased \$477 thousand and consumer loans decreased \$84 thousand, while commercial and industrial loans, increased \$2.2 million, construction loans increased \$490 thousand and non-residential real estate loans increased \$443 thousand.

The following schedule presents the components of loans, net of unearned income, for each period presented:

| | June 30 2001 | | December 31 2000 | |
|-------------------------------------|-----------------|-----------------------------------|---------------------|---------|
| | Amount | Percent (Dollars in Thousands) | Amount | Percent |
| Commercial and industrial | \$ 7,159 | 7.12% | \$ 4,968 | 4.91% |
| Real Estate-Non Residential | 27,972 | 27.81% | 27,529 | 27.21% |
| Residential Properties (1-4 Family) | 52,066 | 51.77% | 55,229 | 54.59% |
| Construction | 9,450 | 9.40% | 8,960 | 8.86% |
| Consumer | 2,696 | 2.68% | 2,780 | 2.75% |
| Other Loans | 1,223 | 1.22% | 1,700 | 1.68% |
| | ----- | ----- | ----- | ----- |
| Total Loans, Net of Unearned Income | \$100,566 | 100.00% | \$101,166 | 100.00% |
| | ===== | ===== | ===== | ===== |

Federal funds sold increased by \$6.5 million to \$14.5 million at June 30, 2001 from \$8 million on December 31, 2000 and time deposits in other banks increased \$7 million from \$100 thousand at year-end 2000 to \$7.1 million on June 30, 2001. Due to the promotion of time deposits during the first quarter of 2001, time

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deposits at June 30, 2001 increased \$13.8 million to \$66.5 million from \$52.7 million at year end 2000. As deposits increased faster than investment opportunities, the excess funds were invested in short-term federal funds and time deposits in other banks. These funds will be used to fund future loan demand, with excess liquidity used to purchase investment securities.

Total investment securities increased \$8.9 million, or 22.5%, from \$39.6 million at year-end 2000 to \$48.5 million on June 30, 2001. Securities, available for sale, at market value, increased \$9.6 million, or 29.0%, from \$33.2 million on December 31, 2000 to \$42.8 million on June 30, 2001. The Company purchased \$22.2 million in new securities in the first six months of 2001 and \$13.1 million in available for sale securities matured, were called and were repaid. There were \$538 thousand in recorded unrealized gains in the available of sale portfolio during the first six months of 2001. Held to maturity securities decreased to \$5.7 million at June 30, 2001 from \$6.4 million at year-end 2000. There were \$532 thousand in held to maturity purchases and \$1.2 million in maturing securities in the held to maturity portfolio during the first six months of 2001.

Total year to date average deposits increased \$19.9 million, or 14.4%, to \$158.3 million during the first half of 2001 from the twelve-month average of \$138.4 million for the year ended December 31, 2000. Average time deposits increased by \$16.0 million, savings deposits increased by \$1.3 million, money market deposits increased by \$913 thousand, NOW deposits increased by \$852 thousand and demand deposits increased by \$817 thousand. As discussed earlier, the increase in time deposits was due to an aggressive promotion of higher yielding time deposits and the Company's decision to compete for the deposits on the basis of rate. Management continues to monitor the shift in deposits through its Asset/Liability Committee.

The following schedule presents the components of deposits, for each period presented.

| | Six Months Ended June 30, 2001 | | Twelve Months Ended December 31, 2000 | |
|-------------------------|-----------------------------------|---------------------|--|---------------------|
| | Average Balance | Percent of Total | Average Balance | Percent of Total |
| Deposits: | | | | |
| NOW Deposits | \$ 15,113 | 9.54% | \$ 14,261 | 10.30% |
| Savings Deposits | 47,178 | 29.79% | 45,853 | 33.13% |
| Money Market Deposits.. | 7,542 | 4.76% | 6,629 | 4.79% |
| Time Deposits | 63,683 | 40.22% | 47,656 | 34.43% |
| Demand Deposits | 24,832 | 15.68% | 24,015 | 17.35% |
| | | | ----- | |
| Total Deposits . | \$158,348 | 100.00% | \$138,414 | 100.00% |
| | ===== | ===== | ===== | ===== |

ASSET QUALITY

At June 30, 2001, non-performing loans decreased \$174 thousand to \$377 thousand, as compared to \$552 thousand at December 31, 2000. Management continues to

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monitor the Company's asset quality.

The following table provides information regarding risk elements in the loan portfolio:

| | June 30 2001 ---- | December 31 2000 ---- |
|---|-------------------------|-----------------------------|
| Non-accrual loans | \$ 377 | \$ 552 |
| Non-accrual loans to total loans | 0.38% | 0.55% |
| Non-performing loans to total assets | 0.30% | 0.34% |
| Allowance for possible loan losses as a percentage of non-performing loans | 272.49% | 176.27% |
| Allowance for possible loan losses to total loans | 1.02% | 0.96% |

ALLOWANCE FOR POSSIBLE LOAN LOSSES

The allowance for possible loan losses is maintained at a level considered adequate to provide for potential loan losses. The level of the allowance is based on management's evaluation of potential losses in the portfolio, after consideration of risk characteristics of the loans and prevailing and anticipated economic conditions. The allowance for possible loan losses is increased by provisions charged to expense and reduced by charge-offs, net of recoveries. Although management strives to maintain an allowance it deems adequate, future economic changes, deterioration of borrowers' credit worthiness, and the impact of examinations by regulatory agencies all could cause changes to the Company's allowance for possible loan losses.

At June 30, 2001, the allowance for possible loan losses was \$1.0 million, up 5.6% from the \$973 thousand at year-end 2000. There were \$68 thousand in charge offs and no recoveries reported in the first half of 2001. The allowance for possible loan losses as a percentage of total loans was 1.02% at June 30, 2001 compared to 0.96% on December 31, 2000.

LIQUIDITY MANAGEMENT

At June 30, 2001, 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.

At June 30, 2001, liquid investments totaled \$21 million, and all mature within 30 days.

It is management's intent to fund future loan demand primarily with deposits. In addition, the Bank is a member of the Federal Home Loan Bank of New York and as of June 30, 2001, had the ability to borrow a total of \$24.2 million against its one to four family mortgages as collateral for long term advances. The Bank also has available an overnight line of credit in the amount of \$7.8 million. In December of 2000 the Company borrowed against its one to four family mortgages and entered into three long term FHLB advances totaling \$10 million. The three borrowings, which have an average interest rate of 4.96%, mature on December 21, 2010, but are callable beginning in December 2001, 2002 and 2003, respectively. These borrowings were used to restructure maturing short-term debt of \$4 million and make available funds to purchase higher yielding investments.

CAPITAL RESOURCES

Total stockholders' equity increased \$1.9 million to \$12.0 million at June 30,

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2001 from the \$10.1 million at year-end 2000. The increase was due to the sale of common stock of \$1.2 million, net income of \$450 thousand, shares issued through the dividend reinvestment plan of \$71 thousand, stock options exercised of \$24 thousand and an increase in the net unrealized gain on securities available for sale of \$320 thousand. Decreases to stockholders' equity were a cash dividend of \$115 thousand and purchases of \$4 thousand in treasury stock. On January 17, 2001 the Company sold 9.9% of its outstanding stock to Lakeland Bancorp, a New Jersey based bank holding company, at a price of \$8.50 per share. Lakeland purchased 139,906 shares for approximately \$1.1 million. As of June 30, 2001 Lakeland Bancorp's stock holdings represented 8.5% of the Company's outstanding stock.

At June 30, 2001, each of the Company and the Bank exceeded each of the regulatory capital requirements applicable to it. The table below presents the capital ratios at June 30, 2001 for both the Company and the Bank as well as the minimum regulatory requirements.

| | Amount ----- | Ratio ----- | Amount ----- | Minimum Ratio ----- |
|---------------------|-----------------|----------------|-----------------|------------------------|
| The Company | | | | |
| Leverage Capital | \$11,356 | 6.11% | \$ 7,432 | 4% |
| Tier 1 - Risk Based | 11,356 | 10.81% | 4,201 | 4% |
| Total Risk-Based | 12,386 | 11.79% | 8,401 | 8% |
| The Bank | | | | |
| Leverage Capital | 10,418 | 5.61% | 7,429 | 4% |
| Tier 1 Risk-Based | 10,418 | 9.94% | 4,194 | 4% |
| Total Risk-Based | 11,448 | 10.92% | 8,387 | 8% |

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NEW ACCOUNTING PRONOUNCEMENTS

The adoption of SFAS No. 138 on January 1, 2001, "Accounting for Certain Derivative Instruments and Certain Hedging Activities, an amendment of FASB Statement No. 133" did not have a material impact on the financial condition or results of operations of the Company.

On June 29, 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 141, Business Combinations, which supersedes APB Opinion No. 16, Business Combinations, and FASB Statement No. 38, Accounting for Preacquisition Contingencies of Purchased Enterprises. All business combinations in the scope of this Statement are to be accounted for using the purchase method of accounting. The provisions of this Statement apply to all business combinations initiated after June 30, 2001. The Company will apply this new pronouncement on a prospective basis.

On June 29, 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 142, Goodwill and Other Intangible Assets. This Statement supersedes APB Opinion No. 17, Intangible Assets. Under the new standard goodwill will no longer be subject to amortization over its estimated useful life. Rather goodwill will be subject to at least an annual assessment for impairment by applying a fair value test. An acquired intangible asset would be separately recognized if the benefit of the intangible asset is obtained through contractual or other legal rights, or if the intangible asset can be sold, transferred, licensed, rented or exchanged regardless of the acquirers intent to do so. All of the provisions of this

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Statement should be applied in fiscal years beginning after December 15, 2001, to all goodwill and other intangible assets recognized in an entity's statement of financial position at the beginning of that fiscal year, regardless of when those previously recognized assets were initially recognized. The Company does not expect that the adoption of this new pronouncement will have a material impact on its financial position or results of operations.

Part II Other Information

Item 1. Legal Proceedings

The Company and the Bank are periodically involved in various legal proceedings as a normal incident to their businesses. In the opinion of management, no material loss is expected from any such pending lawsuit.

Item 2. Changes in Securities

Not applicable

Item 3. Defaults Upon Served Securities

Not applicable

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

On April 25, 2001, the Registrant held its annual meeting of shareholders to elect members of the Company's Board of Directors whose terms expired. Nominees for election to the Board of Directors received the following votes:

| Nominees: ----- | For --- | Withhold Authority ----- |
|--------------------|------------|-----------------------------|
| Irvin Ackerson | 1,399,325 | 17,736 |
| William E. Kulsar | 1,396,538 | 20,522 |
| Terry H. Thompson | 1,399,325 | 17,736 |

Approval of the Sussex Bancorp 2001 Stock Option Plan:

| For --- | Against ----- |
|------------|------------------|
| 938,322 | 129,055 |

Item 5. Other Information

Not applicable.

Item 6. Exhibits and Report on form 8-K

(a). Exhibits

None

(b). Reports on Form 8-K

| Filing Date ----- | Item Number ----- | Description ----- |
|----------------------|----------------------|--|
| April 6, 2001 | 4 | The Registrant announced that it had replaced Radics & Co., LLC as its independent auditors with Arthur Andersen, LLP. |

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SIGNATURE

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.

SUSSEX BANCORP

Date:

By: /s/ Candace A. Leatham

CANDACE A. LEATHAM
Senior Vice President and
Chief Financial Officer

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