

UNITY BANCORP INC /NJ/
Form 10-Q
August 10, 2007

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR
15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR
THE QUARTERLY PERIOD ENDED JUNE 30, 2007**

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 1-12431

Unity Bancorp, Inc.

(Exact Name of Registrant as Specified in Its Charter)

New Jersey

(State or Other Jurisdiction
of Incorporation or Organization)

22-3282551

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

64 Old Highway 22, Clinton, NJ

(Address of Principal Executive Offices)

08809

(Zip Code)

Registrant's Telephone Number, Including Area Code **(908) 730-7630**

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, as amended, during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Exchange Act Rule 12b-2) Large accelerated filer Accelerated filer Non-accelerated filer

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

The number of shares outstanding of each of the registrant's classes of common equity stock, as of August 1, 2007 common stock, no par value:
6,872,290 shares outstanding

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Part 1.-Consolidated Financial Information

Item 1.-Consolidated Financial Statements (unaudited)

Unity Bancorp, Inc.

Consolidated Balance Sheets

(unaudited)

(In thousands)	06/30/07	12/31/06	06/30/06
Assets			
Cash and due from banks	\$ 14,696	\$ 14,727	\$ 13,709
Federal funds sold and interest bearing deposits	51,063	40,709	42,631
Securities:			
Available for sale	66,199	65,595	68,104
Held to maturity (market value of \$35,523, \$42,449 and \$39,700, respectively)	36,531	42,815	40,875
Total securities	102,730	108,410	108,979
Loans:			
SBA held for sale	8,914	12,273	24,384
SBA held to maturity	66,634	66,802	59,111
Commercial	342,328	312,195	297,826
Residential mortgage	69,417	63,493	55,966
Consumer	54,092	52,927	47,335
Total loans	541,385	507,690	484,622
Less: Allowance for loan losses	7,997	7,624	7,257
Net loans	533,388	500,066	477,365
Premises and equipment, net	11,614	11,610	10,954
Bank owned life insurance	5,467	5,372	5,279
Accrued interest receivable	3,687	3,926	3,460
Loan servicing asset	2,289	2,294	2,424
Goodwill and other intangibles	1,596	1,603	1,611
Other assets	5,873	5,389	4,458
Total assets	\$ 732,403	\$ 694,106	\$ 670,870
Liabilities and Shareholders Equity			
Liabilities:			
Deposits			
Noninterest bearing demand deposits	\$ 74,731	\$ 79,772	\$ 81,721
Interest bearing checking	84,107	105,382	116,497
Savings deposits	218,273	205,919	187,841
Time deposits, under \$100,000	138,440	111,070	124,652
Time deposits, \$100,000 and over	80,542	64,322	65,665
Total deposits	596,093	566,465	576,376
Borrowed funds	60,000	55,000	40,000
Subordinated debentures	24,744	24,744	9,279
Accrued interest payable	595	475	313
Accrued expense and other liabilities	2,729	1,194	1,948
Total liabilities	684,161	\$ 647,878	\$ 627,916
Commitments and contingencies			
Shareholders equity			
Common stock, no par value, 12,500 shares authorized	49,087	44,343	43,866
Retained earnings	1,435	2,951	1,063
Treasury stock (102 shares at June 30, 2007 and 24 shares at December 31, 2006 and June 30, 2006)	(1,121)	(242)	(242)
Accumulated other comprehensive loss	(1,159)	(824)	(1,733)
Total Shareholders Equity	48,242	46,228	42,954
Total Liabilities and Shareholders Equity	\$ 732,403	\$ 694,106	\$ 670,870

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Issued common shares	7,122	6,973	6,932
Outstanding common shares	7,020	6,949	6,908

See Accompanying Notes to the Consolidated Financial Statements

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Unity Bancorp

Consolidated Statements of Income

(unaudited)

(In thousands, except per share amounts)	For the three months ended June 30,		For the six months ended June 30,	
	2007	2006	2007	2006
Interest income:				
Fed funds sold and interest on deposits	\$ 221	\$ 354	\$ 483	\$ 561
Securities:				
Available for sale	778	709	1,558	1,417
Held to maturity	478	467	1,018	943
Total securities	1,256	1,176	2,576	2,360
Loans:				
SBA loans	2,202	2,179	4,542	4,332
Commercial loans	6,378	5,368	12,366	10,260
Residential mortgage loans	967	788	1,855	1,608
Consumer loans	951	779	1,855	1,523
Total loan interest income	10,498	9,114	20,618	17,723
Total interest income	11,975	10,644	23,677	20,644
Interest expense:				
Interest-bearing demand deposits	477	653	1,029	1,347
Savings deposits	2,122	1,704	4,293	2,896
Time deposits	2,153	1,671	4,123	3,170
Borrowed funds and subordinated debentures	1,136	583	2,126	1,145
Total interest expense	5,888	4,611	11,571	8,558
Net interest income	6,087	6,033	12,106	12,086
Provision for loan losses	350	250	550	550
Net interest income after provision for loan losses	5,737	5,783	11,556	11,536
Noninterest Income:				
Service charges on deposit accounts	339	409	688	842
Service and loan fee income	380	406	746	801
Gain on sales of SBA loans, net	824	558	1,503	1,258
Gain on sales of mortgage loans	19	110	28	172
Gain on sales of other loans				82
Net security gains			10	
Bank owned life insurance	46	47	95	94
Other income	140	117	357	400
Total noninterest income	1,748	1,647	3,427	3,649
Noninterest expense:				
Compensation and benefits	2,723	2,664	5,678	5,389
Occupancy	644	646	1,317	1,294
Processing and communications	563	553	1,113	1,080
Furniture and equipment	394	381	794	774
Professional services	162	151	298	283
Loan servicing costs	169	55	259	156
Advertising	105	148	199	318
Deposit insurance	16	16	34	33
Other expenses	491	387	992	930
Total noninterest expense	5,267	5,001	10,684	10,257
Net income before provision for income taxes	2,218	2,429	4,299	4,928
Provision for income taxes	676	792	1,306	1,634
Net income	\$ 1,542	\$ 1,637	\$ 2,993	\$ 3,294
Net income per common share - Basic	\$ 0.22	\$ 0.24	\$ 0.43	\$ 0.48
Net income per common share - Diluted	0.21	0.23	0.41	0.45
Weighted average shares outstanding Basic	6,985	6,903	6,981	6,893

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Weighted average shares outstanding	Diluted	7,295	7,250	7,298	7,246
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See Accompanying Notes to the Unaudited Consolidated Financial Statements

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Unity Bancorp, Inc.

Consolidated Statements of Changes in Shareholders Equity

For the six months ended June 30, 2007 and 2006

(unaudited)

(In thousands)	Outstanding Shares	Common Stock	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Loss	Total Shareholders Equity
Balance, December 31, 2005	6,863	\$ 38,423	\$ 3,897	\$ (242)	\$ (1,149)	\$ 40,929
Cumulative effect of adjustments resulting from the adoption of SAB No. 108, net of tax			(492)			(492)
Adjusted balance at December 31, 2005	6,863	\$ 38,423	\$ 3,405	\$ (242)	\$ (1,149)	\$ 40,437
Comprehensive income:						
Net Income			3,294			3,294
Unrealized holding loss on securities arising during the period, net of tax benefit of \$358					(584)	
Net unrealized holding loss on securities arising during the period, net of tax benefit of \$358					(584)	(584)
Total comprehensive income						2,710
Cash dividends declared on common stock of \$.10 per share			(644)			(644)
5% Stock Dividend, including cash-in-lieu of fractional shares		4,987	(4,992)			(5)
Issuance of common stock:						
Employee benefit plans	45	456				456
Balance, June 30, 2006	6,908	\$ 43,866	\$ 1,063	\$ (242)	\$ (1,733)	\$ 42,954

(In thousands)	Outstanding Shares	Common Stock	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Loss	Total Shareholders Equity
Balance, December 31, 2006	6,949	\$ 44,343	\$ 2,951	\$ (242)	\$ (824)	\$ 46,228
Comprehensive income:						
Net Income			2,993			2,993
Unrealized holding gain on securities arising during the period, net of tax benefit of \$202					(328)	
Less: Reclassification adjustment for gains included in net income, net of tax of \$3					7	
Net unrealized holding gain on securities arising during the period, net of tax benefit of \$205					(335)	(335)
Total comprehensive income						2,658
Cash dividends declared on common stock of \$.10 per share			(686)			(686)
Treasury stock purchased	(78)			(879)		(879)
5% Stock Dividend, including cash-in-lieu of fractional shares		3,820	(3,823)			(3)
Issuance of common stock:						
Employee benefit plans	149	924				924

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Balance, June 30, 2007	7,020	\$ 49,087	\$ 1,435	\$ (1,121)	\$ (1,159)	\$ 48,242
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See Accompanying Notes to the Unaudited Consolidated Financial Statements.

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Unity Bancorp, Inc.

Consolidated Statements of Cash Flows

(unaudited)

(In thousands)	For the six months ended June 30,	
	2007	2006
Operating activities:		
Net income	\$ 2,993	\$ 3,294
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	550	550
Depreciation and amortization	387	425
Decrease in deferred income taxes	(341)	(91)
Net gain on sale of securities	(10))
Gain on sale of SBA loans held for sale	(1,503)	(1,258)
Gain on sale of mortgage loans	(28)	(172)
Gain on sale of other loans		(82)
Origination of mortgage loans held for sale	(1,614)	(11,237)
Origination of SBA loans held for sale	(21,894)	(18,514)
Proceeds from the sale of mortgage loans held for sale	1,642	11,409
Proceeds from the sale of SBA loans	26,756	18,455
Net change in other assets and liabilities	2,168	(54)
Net cash provided by operating activities	9,106	2,725
Investing activities:		
Purchases of securities held to maturity		(4,360)
Purchases of securities available for sale	(6,104)	(7,808)
Maturities and principal payments on securities held to maturity	6,264	4,182
Maturities and principal payments on securities available for sale	4,953	4,309
Proceeds from the sale of other real estate owned	267	239
Net increase in loans	(37,472)	(35,107)
Purchases of premises and equipment	(529)	(855)
Net cash used in investing activities	(32,620)	(39,400)
Financing activities:		
Net increase in deposits	29,628	54,516
Proceeds from new borrowings	15,000	
Repayments of borrowings	(10,000))
Proceeds from the issuance of common stock	756	370
Purchase of treasury stock	(879))
Dividends paid	(668)	(630)
Net cash provided by financing activities	33,837	54,256
Increase in cash and cash equivalents	10,323	17,581
Cash and cash equivalents at beginning of year	55,436	38,759
Cash and cash equivalents at end of period	\$ 65,759	\$ 56,340
Supplemental disclosures:		
Cash:		
Interest paid	\$ 11,451	\$ 8,519
Income taxes paid	1,839	2,462
Non-Cash investing activities:		
Transfer of loan to Other Real Estate Owned	423	61

See Accompanying Notes to the Consolidated Financial Statements.

Unity Bancorp, Inc.

Notes to the Consolidated Financial Statements (Unaudited)

June 30, 2007

NOTE 1. Summary of Significant Accounting Policies

The accompanying consolidated financial statements include the accounts of Unity Bancorp, Inc. (the Parent Company) and its wholly-owned subsidiary, Unity Bank (the Bank , or when consolidated with the Parent Company, the Company), and reflect all adjustments and disclosures which are generally routine and recurring in nature, in the opinion of management, necessary for a fair presentation of interim results. Unity Investment Services, Inc. a wholly-owned subsidiary of the Bank, is used to hold part of the Bank's investment portfolio. Unity Participation Company, Inc. a wholly-owned subsidiary of the Bank is used to hold part of the Bank's loan portfolio. All significant inter-company balances and transactions have been eliminated in consolidation. Certain reclassifications have been made to prior period amounts to conform to the current year presentation. The financial information has been prepared in accordance with U.S. generally accepted accounting principles and has not been audited. In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the dates of the statements of financial condition and revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Estimates that are particularly susceptible to significant changes relate to the determination of the allowance for loan losses. Management believes that the allowance for loan losses is adequate. While management uses available information to recognize losses on loans, future additions to the allowance for loan losses may be necessary based on changes in economic conditions in the market. The interim unaudited consolidated financial statements included herein have been prepared in accordance with instructions for Form 10-Q and the rules and regulations of the Securities and Exchange Commission (SEC). The results of operations for the three months and six months ended June 30, 2007 are not necessarily indicative of the results which may be expected for the entire year. As used in this Form 10-Q, we and us and our refer to Unity Bancorp, Inc. and its consolidated subsidiary, Unity Bank, depending on the context. Interim financial statements should be read in conjunction with the Company's consolidated financial statements and notes thereto for the year ended December 31, 2006, included in the Company's Annual Report on Form 10-K for the year ended December 31, 2006.

Stock-Based Compensation

On April 26, 2007, the Company announced a 5 percent stock dividend, which was paid on June 29, 2007 to all shareholders of record as of June 15, 2007 and accordingly, all share amounts have been restated to include the effect of the distribution.

Option Plans

As of January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123R, Share-Based Payment (Statement 123R) using the modified prospective application. Statement 123R requires public companies to recognize compensation expense related to stock-based compensation awards over the period during which an employee is required to provide service for the award. The provisions apply to all awards granted after the required effective date including existing awards not vested, modified, repurchased or canceled. Prior to January 1, 2006, the Company applied Accounting Principles Board Opinion 25 and related Interpretations in accounting for its Option Plans. No stock-based compensation cost was reflected in net income, as all options granted under those plans had an exercise price equal to the market value of their underlying common stock on the date of grant.

The Company has incentive and non-qualified option plans, which allow for the grant of options to officers, employees and members of the Board of Directors. The period during which the option is vested is generally 3 years, but no option may be exercised after 10 years from the date of the grant. The exercise price of each option is the market price on the date of grant. As of June 30, 2007, 1,448,123 shares have been reserved for issuance upon the exercise of options, 704,335 option grants are outstanding, and 535,089 option grants have been exercised, forfeited or expired leaving 208,699 shares available for grant.

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Compensation expense related to stock-based compensation awards totaled \$28 thousand and \$6 thousand for the three months ended June 30, 2007 and 2006, respectively and \$57 thousand and \$12 thousand for the six months ended June 30, 2007 and 2006, respectively. The following table presents the impact of SFAS 123R on the Company's financial statements for the quarter and six month periods ended June 30, 2007.

Under SFAS 123R	Quarter	YTD
Net income before provision for income taxes	\$ 2,218	\$ 4,299
Net income	1,542	2,993
Net income per common share Basic	0.22	0.43
Net income per common share Diluted	0.21	0.41

During the six months ended June 30, 2007 and 2006, the fair value of the options granted during each period was estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

	Six Months Ended	
	June 30, 2007	2006
Number of Shares Granted	63,788	16,538
Weighted Average Exercise Price	\$ 13.19	\$ 12.70
Weighted Average Fair Value	\$ 3.62	\$ 2.84
Expected life	4.01	4.19
Expected volatility	29.72	% 23.50
Risk-free interest rate	4.86	% 3.99
Dividend yield	1.45	% 1.36

There were no stock options granted during the quarters ended June 30, 2007 and 2006.

Transactions under the Company's stock option plans during the six months ended June 30, 2007 are summarized as follows:

	Number of Shares	Exercise Price per Share		Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value
Outstanding at December 31, 2006	766,646	\$ 2.20	14.71	\$ 5.80		
Options Granted	63,788	11.81	13.25	13.19		
Options Exercised	(119,420)	2.84	9.30	4.93		
Options Expired	(6,679)	10.79	13.25	12.75		
Outstanding at June 30, 2007	704,335	\$ 2.20	14.71	\$ 6.55	5.37	\$ 3,621,222
Exercisable at June 30, 2007	619,980	\$ 2.20	12.70	\$ 5.63	4.82	\$ 3,619,141

The following table summarizes nonvested stock option activity for the six months ended June 30, 2007:

	Shares	Average Grant Date Fair Value
Nonvested stock options at December 31, 2006	36,501	\$ 3.18
Granted	63,788	3.62
Vested	(9,255)	2.28
Forfeited	(6,679)	3.45
Nonvested stock options at June 30, 2007	84,355	3.59

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As of June 30, 2007, there was approximately \$243 thousand of unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the Company's stock incentive plans. This cost is expected to be recognized over a weighted-average period of 1.3 years.

The total intrinsic value (spread between the market value and exercise price) of the stock options exercised during the three months ended June 30, 2007 and 2006 was \$331 thousand and \$38 thousand, respectively. The total intrinsic value of the stock options exercised during the six months ended June 30, 2007 and 2006 was \$420 thousand and \$122 thousand, respectively.

Restricted Stock Awards

In addition, restricted stock is issued under the stock bonus program to reward employees and directors and to retain them by distributing stock over a period of time. These shares vest over a period of 4 years and are recognized as compensation to the employees over the vesting period. Restricted stock awards during the first six months of 2007 and 2006 were as follows:

	Three Months Ended		Six Months Ended	
	June 30, 2007	2006	June 30, 2007	2006
Number of Shares Granted	500	0	18,613	8,655
Weighted Average Fair Market Value	\$ 11.63	\$ 0.00	\$ 13.17	\$ 13.45
Vested as of Period End	8,677	1,734	8,677	1,734

Compensation expense related to the restricted stock awards totaled \$52 thousand and \$17 thousand for the three months ended June 30, 2007 and 2006, respectively. Compensation expense related to the restricted stock awards totaled \$88 thousand and \$41 thousand for the six months ended June 30, 2007 and 2006, respectively. As of June 30, 2007, 115,763 shares of restricted stock were reserved for issuance, of which 53,895 shares are outstanding, 1,200 shares have been issued and 60,668 shares are available for grant.

Transactions under the Company's restricted stock award plans during the six months ended June 30, 2007 are summarized as follows:

	Number of Shares	Price per Share	Weighted Average Price	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value
Outstanding at December 31, 2006	37,473	\$ 11.13 14.71	\$ 12.53		
Granted	18,613	11.63 - 13.52	13.17		
Issued	(1,200)	11.13 13.45	11.88		
Canceled	(991)	11.13 13.45	12.10		
Outstanding at June 30, 2007	53,895	\$ 11.13 14.71	\$ 12.77	8.85	\$ 1,650
Vested at June 30, 2007	8,677	\$ 11.13 13.45	\$ 12.27	8.27	\$ 733

Income Taxes

The Company accounts for income taxes according to the asset and liability method. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using the enacted tax rates applicable to taxable income for the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Valuation reserves are established against certain deferred tax assets when it is more likely than not that the deferred tax assets will not be realized. Increases or decreases in the valuation reserve are charged or credited to the income tax provision.

When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that ultimately would be sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more-likely-than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. The evaluation of a tax position taken is

considered by itself and not offset or aggregated with other positions. Tax positions that meet the more-likely-than not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination. Interest and penalties associated with unrecognized tax benefits are recognized in income tax expense on the income statement.

NOTE 2. Litigation

From time to time, the Company is subject to legal proceedings and claims in the ordinary course of business. The Company currently is not aware of any such legal proceedings or claims that it believes will have, individually or in the aggregate, a material adverse effect on the business, financial condition, or the results of the operation of the Company.

NOTE 3. Earnings per share

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

(In thousands, except per share data)	Three Months ended June 30,		Six Months ended June 30,	
	2007	2006	2007	2006
Net Income to common shareholders	\$ 1,542	\$ 1,637	\$ 2,993	\$ 3,294
Basic weighted-average common shares outstanding	6,985	6,903	6,981	6,893
Plus: Common stock equivalents	310	347	317	353
Diluted weighted average common shares outstanding	7,295	7,250	7,298	7,246
Net Income per Common share:				
Basic	\$ 0.22	\$ 0.24	\$ 0.43	\$ 0.48
Diluted	0.21	0.23	0.41	0.45
Return on average assets	0.89	% 1.03	% 0.88	% 1.05
Return on average common equity	13.14	% 15.39		