

PEAPACK GLADSTONE FINANCIAL CORP  
Form 10-Q  
August 07, 2018  
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(MARK ONE)

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

For the Quarter Ended June 30, 2018

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. 001-16197

PEAPACK-GLADSTONE FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

New Jersey 22-3537895  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)

500 Hills Drive, Suite 300

Bedminster, New Jersey 07921-0700

(Address of principal executive offices, including zip code)

(908) 234-0700

(Registrant's telephone number, including area code)

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

Yes No .

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 or Regulations S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required

to submit and post such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer," "smaller reporting company", and "emerging growth company" in Rule 12b-2 of the Exchange Act (check one):

Large accelerated filer	Accelerated filer
Non-accelerated filer (do not check if a smaller reporting company)	Smaller reporting company
Emerging growth company	

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13 (a) of the Exchange Act.

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

Number of shares of Common Stock outstanding as of August 1, 2018:

19,011,212

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PEAPACK-GLADSTONE FINANCIAL CORPORATION

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## Item 1. Financial Statements (Unaudited)

## PEAPACK-GLADSTONE FINANCIAL CORPORATION

## CONSOLIDATED STATEMENTS OF CONDITION

(Dollars in thousands, except share and per share data)

	(unaudited) June 30, 2018	(audited) December 31, 2017
<b>ASSETS</b>		
Cash and due from banks	\$4,458	\$ 4,415
Federal funds sold	101	101
Interest-earning deposits	62,231	108,931
Total cash and cash equivalents	66,790	113,447
Securities available for sale	346,790	327,633
Equity security	4,710	—
FHLB and FRB stock, at cost	21,533	13,378
Loans held for sale, at fair value	996	984
Loans held for sale, at lower of cost or fair value	3,000	187
Loans	3,722,905	3,704,440
Less: Allowance for loan and lease losses	38,066	36,440
Net loans	3,684,839	3,668,000
Premises and equipment	28,404	29,476
Other real estate owned	1,608	2,090
Accrued interest receivable	7,202	9,452
Bank owned life insurance	44,980	44,586
Goodwill	17,107	17,107
Other intangible assets	6,370	6,729
Other assets	30,845	27,478
<b>TOTAL ASSETS</b>	<b>\$4,265,174</b>	<b>\$ 4,260,547</b>
<b>LIABILITIES</b>		
Deposits:		
Noninterest-bearing demand deposits	\$527,453	\$ 539,304
Interest-bearing deposits:		
Interest-bearing deposits checking	1,053,004	1,152,483
Savings	120,986	119,556
Money market accounts	1,051,893	1,091,385
Certificates of deposit - retail	431,679	344,652
Certificates of deposit - listing service	96,644	198,383
Subtotal deposits	3,281,659	3,445,763
Interest-bearing demand - brokered	180,000	180,000
Certificates of deposit - brokered	61,254	72,591
Total deposits	3,522,913	3,698,354
Overnight borrowings	127,350	—
Federal Home Loan Bank advances	52,898	37,898
Capital lease obligation	8,728	9,072
Subordinated debt, net	83,133	83,024

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Accrued expenses and other liabilities	33,133	28,521
<b>TOTAL LIABILITIES</b>	<b>3,828,155</b>	<b>3,856,869</b>
<b>SHAREHOLDERS' EQUITY</b>		
Preferred stock (no par value; authorized 500,000 shares; liquidation preference of \$1,000 per share)	—	—
Common stock (no par value; stated value \$0.83 per share; authorized 21,000,000 shares; issued shares, 19,415,490 at June 30, 2018 and 19,027,812 at December 31, 2017; outstanding shares, 19,007,312 at June 30, 2018 and 18,619,634 at December 31, 2017	16,183	15,858
Surplus	297,318	283,552
Treasury stock at cost, 408,178 shares at both June 30, 2018 and December 31, 2017	(8,988 )	(8,988 )
Retained earnings	135,260	114,468
Accumulated other comprehensive loss, net of income tax	(2,754 )	(1,212 )
<b>TOTAL SHAREHOLDERS' EQUITY</b>	<b>437,019</b>	<b>403,678</b>
<b>TOTAL LIABILITIES &amp; SHAREHOLDERS' EQUITY</b>	<b>\$4,265,174</b>	<b>\$ 4,260,547</b>

See accompanying notes to consolidated financial statements

## PEAPACK-GLADSTONE FINANCIAL CORPORATION

## CONSOLIDATED STATEMENTS OF INCOME

(Dollars in thousands, except share data)

(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30,	2017	June 30,	2017
	2018		2018	
<b>INTEREST INCOME</b>				
Interest and fees on loans	\$37,102	\$31,637	\$71,769	\$61,129
Interest on investments:				
Taxable	2,072	1,477	3,997	2,981
Tax-exempt	99	115	208	236
Interest on loans held for sale	6	7	16	11
Interest on interest-earning deposits	395	176	752	440
Total interest income	39,674	33,412	76,742	64,797
<b>INTEREST EXPENSE</b>				
Interest on savings and interest-bearing deposit accounts	4,416	2,320	8,135	4,132
Interest on certificates of deposit	2,330	1,650	4,479	3,220
Interest on borrowed funds	1,155	354	1,525	657
Interest on capital lease obligation	106	114	213	229
Interest on subordinated debt	1,221	783	2,442	1,566
Subtotal - interest expense	9,228	5,221	16,794	9,804
Interest on interest-bearing demand - brokered	804	726	1,484	1,446
Interest on certificates of deposits - brokered	399	493	828	984
Total Interest expense	10,431	6,440	19,106	12,234
<b>NET INTEREST INCOME BEFORE PROVISION FOR LOAN AND LEASE LOSSES</b>				
LEASE LOSSES	29,243	26,972	57,636	52,563
Provision for loan and lease losses	300	2,200	1,550	3,800
<b>NET INTEREST INCOME AFTER PROVISION FOR LOAN AND LEASE LOSSES</b>				
LEASE LOSSES	28,943	24,772	56,086	48,763
<b>OTHER INCOME</b>				
Wealth management fee income	8,126	5,086	16,493	9,904
Service charges and fees	873	815	1,704	1,586
Bank owned life insurance	345	350	681	672
Gains on loans held for sale at fair value (mortgage banking)	79	91	173	138
Fee income related to loan level, back-to-back swaps	900	1,291	1,152	1,747
Gain on sale of SBA loans	814	142	845	297
Other income	639	396	1,021	846
Securities losses, net	(36)	—	(114)	—
Total other income	11,740	8,171	21,955	15,190

## OPERATING EXPENSES

Compensation and employee benefits	15,826	12,751	30,405	24,664
Premises and equipment	3,406	3,033	6,676	5,849
FDIC insurance expense	625	602	1,205	1,288
Other operating expense	5,084	3,709	9,992	7,598
Total operating expenses	24,941	20,095	48,278	39,399
INCOME BEFORE INCOME TAX EXPENSE	15,742	12,848	29,763	24,554
Income tax expense	3,832	4,908	7,046	8,632
NET INCOME	\$11,910	\$7,940	\$22,717	\$15,922

## EARNINGS PER SHARE

Basic	\$0.63	\$0.45	\$1.21	\$0.92
Diluted	\$0.62	\$0.45	\$1.20	\$0.91

## WEIGHTED AVERAGE NUMBER OF SHARES

## OUTSTANDING

Basic	18,930,893	17,505,638	18,770,492	17,314,695
Diluted	19,098,838	17,756,390	18,996,979	17,588,816

See accompanying notes to consolidated financial statements

## PEAPACK-GLADSTONE FINANCIAL CORPORATION

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Dollars in thousands)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net income	\$11,910	\$7,940	\$22,717	\$15,922
Comprehensive income:				
Unrealized gains/(losses) on available for sale securities:				
Unrealized holding gains/(losses) arising during the period	(653 )	199	(3,587 )	835
Tax effect	159	(77 )	835	(316 )
Net of tax	(494 )	122	(2,752 )	519
Unrealized gains on cash flow hedges:				
Unrealized holding gains/(losses) arising during the period	828	(64 )	1,569	801
Reclassification adjustment for amounts included in net income	(31 )	—	(62 )	—
	797	(64 )	1,507	801
Tax effect	(215 )	26	(424 )	(327 )
Net of tax	582	(38 )	1,083	474
Total other comprehensive income/(loss)	88	84	(1,669 )	993
Total comprehensive income	\$11,998	\$8,024	\$21,048	\$16,915

See accompanying notes to consolidated financial statements



## PEAPACK-GLADSTONE FINANCIAL CORPORATION

## CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(Dollars in thousands)

(Unaudited)

Six Months Ended June 30, 2018

(In thousands, except per share data)	Common Stock	Surplus	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Loss	Total
Balance at January 1, 2018 common	18,619,634					
shares outstanding	\$ 15,858	\$ 283,552	\$ (8,988 )	\$ 114,468	\$ (1,212 )	\$ 403,678
Net income	—	—	—	22,717	—	22,717
Comprehensive loss	—	—	—	—	(1,669 )	(1,669 )
Cumulative adjustment for equity security (ASU						
2016-01)	—	—	—	(127 )	127	—
Restricted stock units issued 85,242 shares	71	(71 )	—	—	—	—
Restricted stock awards forfeitures, (94,034) shares	(78 )	78	—	—	—	—
Restricted stock units/awards repurchased on						
vesting to pay taxes, (40,457) shares	(33 )	(1,370 )	—	—	—	(1,403 )
Amortization of restricted stock awards/units	—	2,130	—	—	—	2,130
Cash dividends declared on common stock						
(\$0.10 per share)	—	—	—	(1,798 )	—	(1,798 )
Common stock options exercised, 10,683, net of						
2,374 used to exercise, 8,309 shares	9	93	—	—	—	102
Sales of shares (Dividend Reinvestment Program),						
392,302 shares	326	12,407	—	—	—	12,733
Issuance of shares for Employee Stock Purchase						
Plan, 15,490 shares	13	516	—	—	—	529
Issuance of common stock for acquisition 20,826	17	(17 )	—	—	—	—

shares

Balance at June 30, 2018 19,007,312  
common

shares outstanding	\$ 16,183	\$ 297,318	\$ (8,988 )	\$ 135,260	\$ (2,754	)	\$ 437,019
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See accompanying notes to consolidated financial statements

## PEAPACK-GLADSTONE FINANCIAL CORPORATION

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

(Unaudited)

	Six Months Ended June 30,	
	2018	2017
<b>OPERATING ACTIVITIES:</b>		
Net income	\$22,717	\$15,922
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	1,560	1,703
Amortization of premium and accretion of discount on securities, net	741	841
Amortization of restricted stock	2,130	1,671
Amortization of intangible assets	359	62
Amortization of subordinated debt costs	109	65
Provision of loan and lease losses	1,550	3,800
Provision for OREO losses	204	—
Deferred tax expense/(benefit)	1,429	(2,234 )
Stock-based compensation and employee stock purchase plan expense	112	79
Fair value adjustment for equity security	114	—
Loans originated for sale (1)	(25,418 )	(13,910 )
Proceeds from sales of loans held for sale (1)	23,609	13,233
Gain on loans held for sale (1)	(1,018 )	(435 )
Gain on OREO sold	(26 )	—
Gain on death benefit	—	(62 )
Increase in cash surrender value of life insurance, net	(394 )	(404 )
Decrease in accrued interest receivable	2,250	1,377
Decrease in other assets	4,496	8,843
(Decrease)/increase in accrued expenses, capital lease obligations and other liabilities	(3,167 )	743
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>31,357</b>	<b>31,294</b>
<b>INVESTING ACTIVITIES:</b>		
Principal repayments, maturities and calls of securities available for sale	40,189	32,337
Redemptions for FHLB & FRB stock	49,068	13,282
Purchase of securities available for sale	(68,547 )	(42,179 )
Purchase of FHLB & FRB stock	(57,223 )	(17,956 )
Net increase in loans, net of participations sold	(18,389 )	(352,270 )
Sale of other real estate owned	304	298
Purchase of premises and equipment	(488 )	(1,138 )
<b>NET CASH USED IN INVESTING ACTIVITIES</b>	<b>(55,086 )</b>	<b>(367,626)</b>
<b>FINANCING ACTIVITIES:</b>		
Net (decrease)/increase in deposits	(175,441)	169,416
Net increase in overnight borrowings	127,350	87,000
Proceeds from Federal Home Loan Bank advances	30,000	—
Repayments of Federal Home Loan Bank advances	(15,000 )	(3,000 )
Dividends paid on common stock	(1,798 )	(1,742 )

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Exercise of Stock Options, net of stock swaps	102	321
Restricted stock repurchased on vesting to pay taxes	(1,403 )	(1,415 )
Sales of common shares (Dividend Reinvestment Program)	12,733	16,473
Issuance of shares for employee stock purchase plan	529	408
<b>NET CASH (USED IN)/PROVIDED BY IN FINANCING ACTIVITIES</b>	<b>(22,928 )</b>	<b>267,461</b>
Net decrease in cash and cash equivalents	(46,657 )	(68,871 )
Cash and cash equivalents at beginning of period	113,447	162,691
Cash and cash equivalents at end of period	\$66,790	\$93,820
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION</b>		
Cash paid during the year for:		
Interest	\$18,086	\$12,028
Income tax, net	964	197
Transfer of loans to other real estate owned	—	137

(1) Includes mortgage loans originated with the intent to sell which are carried at fair value. In addition, this includes the guaranteed portion of SBA loans which are carried at the lower of cost or fair value.

See accompanying notes to consolidated financial statements

PEAPACK-GLADSTONE FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1.SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Certain information and footnote disclosures normally included in the audited consolidated financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. These unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Annual Report on Form 10-K for the period ended December 31, 2017 for Peapack-Gladstone Financial Corporation (the “Corporation” or the “Company”). In the opinion of the management of the Corporation, the accompanying unaudited Consolidated Interim Financial Statements contain all adjustments (consisting of normal recurring accruals) necessary to present fairly the financial position as of June 30, 2018, the results of operations and comprehensive income for the three and six months ended June 30, 2018 and 2017, shareholders’ equity for the six months ended June 30, 2018 and cash flow statements for the six months ended June 30, 2018 and 2017. The results of operations for the three and six months ended June 30, 2018 are not necessarily indicative of the results that may be expected for any future period.

**Principles of Consolidation and Organization:** The consolidated financial statements of the Company are prepared on the accrual basis and include the accounts of the Company and its wholly-owned subsidiary, Peapack-Gladstone Bank (the “Bank”). The consolidated statements also include the Bank’s wholly-owned subsidiaries, PGB Trust & Investments of Delaware, Peapack Capital Corporation (formed in the second quarter of 2017), Murphy Capital Management (“MCM”) (acquired in the third quarter of 2017), Quadrant Capital Management (“Quadrant”) (acquired in the fourth quarter of 2017), Peapack-Gladstone Mortgage Group, Inc. and Peapack-Gladstone Mortgage Group’s wholly-owned subsidiary, PG Investment Company of Delaware, Inc. and its wholly-owned subsidiary, Peapack-Gladstone Realty, Inc., a New Jersey real estate investment company. While the following footnotes include the collective results of the Company and the Bank, these footnotes primarily reflect the Bank’s and its subsidiaries’ activities. All significant intercompany balances and transactions have been eliminated from the accompanying consolidated financial statements.

**Basis of Financial Statement Presentation:** The consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles. In preparing the financial statements, Management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the statement of condition and revenues and expenses for that period. Actual results could differ from those estimates.

**Segment Information:** The Company’s business is conducted through two business segments: its banking subsidiary, which involves the delivery of loan and deposit products to customers and the Private Wealth Management Division, which includes asset management and other services provided for individuals and institutions. Management uses certain methodologies to allocate income and expense to the business segments.

The Banking segment includes commercial (includes C&I and equipment financing), commercial real estate, multifamily, residential and consumer lending activities; deposit generation; operation of ATMs; telephone and internet banking services; merchant credit card services and customer support services.

Peapack-Gladstone Bank’s Private Wealth Management Division includes: asset management services provided for individuals and institutions; personal trust services, including services as executor, trustee, administrator, custodian and guardian; corporate trust services including services as trustee for pension and profit sharing plans; and other financial planning and advisory services. This segment also includes the activities of PGB Trust and Investments of

Delaware, MCM and Quadrant. Income is recognized as it is earned.

Cash and Cash Equivalents: For purposes of the statements of cash flows, cash and cash equivalents include cash and due from banks, interest-earning deposits and federal funds sold. Generally, federal funds are sold for one-day periods. Cash equivalents are of original maturities of 90 days or less. Net cash flows are reported for customer loan and deposit transactions and overnight borrowings.

Interest-Earning Deposits in Other Financial Institutions: Interest-earning deposits in other financial institutions mature within one year and are carried at cost.

Securities: All securities are classified as available for sale and are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income, net of tax, with the exception of the Company's investment in a CRA investment fund, which is classified as an equity security. In accordance with ASU 2016-01, "Financial Instruments" (adopted January 1, 2018) unrealized holding gains and losses on equity securities are marked to market through the income statement.

Interest income includes amortization of purchase premiums and discounts. Premiums and discounts on securities are amortized on the level-yield method without anticipating prepayments, except for mortgage-backed securities where prepayments are anticipated and premiums on callable debt securities will be amortized to the earliest call date. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

Management evaluates securities for other-than-temporary impairment on at least a quarterly basis, and more frequently when economic or market conditions warrant. For securities in an unrealized loss position, Management considers the extent and duration of the unrealized loss and the financial condition and near-term prospects of the issuer. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) other-than-temporary impairment related to credit loss, which must be recognized in the income statement and 2) other-than-temporary impairment related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis.

Federal Home Loan Bank (FHLB) and Federal Reserve Bank (FRB) Stock: The Bank is a member of the FHLB system. Members are required to own a certain amount of FHLB stock, based on the level of borrowings and other factors. FHLB stock is carried at cost, classified as a restricted security and periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends are reported as income.

The Bank is also a member of the Federal Reserve Bank System and required to own a certain amount of FRB stock. FRB stock is carried at cost and classified as a restricted security. Both cash and stock dividends are reported as income.

Loans Held for Sale: Mortgage loans originated with the intent to sell in the secondary market are carried at fair value, as determined by outstanding commitments from investors.

Mortgage loans held for sale are generally sold with servicing rights released; therefore, no servicing rights are recorded. Gains and losses on sales of mortgage loans, shown as gain on sale of loans at fair value on the Statements of Income, are based on the difference between the selling price and the fair value of the related loan sold.

SBA loans originated with the intent to sell in the secondary market are carried at the lower of cost or fair value. SBA loans are generally sold with the servicing rights retained. Gains and losses on the sale of SBA loans are based on the difference between the selling price and the carrying value of the related loan sold. Total SBA loans serviced totaled \$27.8 million and \$20.1 million as of June 30, 2018 and December 31, 2017, respectively. SBA loans held for sale totaled \$3.0 million and \$187 thousand at June 30, 2018 and December 31, 2017, respectively.

Loans originated with the intent to hold and subsequently transferred to loans held for sale are carried at the lower of cost or fair value. These are loans that the Company no longer has the intent to hold for the foreseeable future.

Loans: Loans that Management has the intent and ability to hold for the foreseeable future or until maturity are stated at the principal amount outstanding. Interest on loans is recognized based upon the principal amount outstanding. Loans are stated at face value, less purchased premium and discounts and net deferred fees. Loan origination fees and

certain direct loan origination costs are deferred and recognized on a level-yield method, over the life of the loan as an adjustment to the loan's yield. The definition of recorded investment in loans includes accrued interest receivable and deferred fees/cost, however, for the Company's loan disclosures, accrued interest and deferred fees/cost was excluded as the impact was not material.

Loans are considered past due when they are not paid within 30 days in accordance with contractual terms. The accrual of income on loans, including impaired loans, is discontinued if, in the opinion of Management, principal or interest is not likely to be paid in accordance with the terms of the loan agreement, or when principal or interest is past due 90 days or more and collateral, if any, is insufficient to cover principal and interest. All interest accrued but not received for loans placed on nonaccrual are reversed against interest income. Payments received on nonaccrual loans are recorded as principal payments. A nonaccrual loan is returned to accrual status only when interest and principal payments are brought current and future payments are reasonably assured, generally when the Bank receives contractual payments for a minimum of six months. Commercial loans are generally charged off after an analysis is completed which indicates that collectability of the full principal balance is in doubt. Consumer loans are generally charged off after they become 120 days past due. Subsequent payments are credited to income only if collection of



principal is not in doubt. If principal and interest payments are brought contractually current and future collectability is reasonably assured, loans are returned to accrual status. Nonaccrual mortgage loans are generally charged off when the value of the underlying collateral does not cover the outstanding principal balance. The majority of the Company's loans are secured by real estate in New Jersey and New York.

**Allowance for Loan and Lease Losses:** The allowance for loan and lease losses is a valuation allowance for credit losses that is management's estimate of losses in the loan portfolio. The process to determine reserves utilizes analytic tools and management judgement and is reviewed on a quarterly basis. When Management is reasonably certain that a loan balance is not fully collectable, an impairment analysis is completed whereby a specific reserve may be established or a full or partial charge off is recorded against the allowance. Subsequent recoveries, if any, are credited to the allowance. Management estimates the allowance balance required using past loan loss experience, the size and composition of the portfolio, information about specific borrower situations, estimated collateral values, economic conditions and other factors. Allocations of the allowance may be made for specific loans via a specific reserve, but the entire allowance is available for any loan that, in Management's judgment, should be charged off.

The allowance consists of specific and general components. The specific component of the allowance relates to loans that are individually classified as impaired.

A loan is impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Factors considered by Management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

Loans are individually evaluated for impairment when they are classified as substandard by Management. If a loan is considered impaired, a portion of the allowance may be allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or if repayment is expected solely from the underlying collateral, the loan principal balance is compared to the fair value of collateral less estimated disposition costs to determine the need, if any, for a charge off.

A troubled debt restructuring ("TDR") is a modified loan with concessions made by the lender to a borrower who is experiencing financial difficulty. TDRs are impaired and are generally measured at the present value of estimated future cash flows using the loan's effective rate at inception. If a TDR is a collateral dependent loan, the loan is reported, net, of the fair value of the collateral, less estimated disposition costs. For TDRs that subsequently default, the Company determines the amount of reserve in accordance with the accounting policy for the allowance for loan and lease losses.

The general component of the allowance covers non-impaired loans and is based primarily on the Bank's historical loss experience adjusted for current factors. The historical loss experience is determined by portfolio segment and is based on the actual loss history experience by the Company on a weighted average basis over the previous three years. This actual loss experience is adjusted by other qualitative factors based on the risks present for each portfolio segment. These qualitative factors include consideration of the following: levels of and trends in delinquencies and impaired loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures and practices; ability and depth of lending management and other relevant staffing and experience; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations. For loans that are graded as non-impaired, the Company allocates a higher general reserve percentage than pass-rated loans using a multiple that is calculated annually through a migration analysis. At June 30, 2018 and at December 31, 2017, the multiple was 3.50 times for non-impaired substandard loans and 2.25 times for

non-impaired special mention loans.

In determining an appropriate amount for the allowance, the Bank segments and evaluates the loan portfolio based on Federal call report codes, which are based on collateral or purpose. The following portfolio classes have been identified:

**Primary Residential Mortgages.** The Bank originates one to four family residential mortgage loans in the Tri-State area (New York, New Jersey and Connecticut), Pennsylvania and Florida. Loans are secured by first liens on the primary residence or investment property. Primary risk characteristics associated with residential mortgage loans typically involve major living or lifestyle changes to the borrower, including unemployment or other loss of income; unexpected significant expenses, such as for major medical issues or catastrophic events; and divorce or death. In addition, residential mortgage loans that have adjustable rates could expose the borrower to higher debt service requirements in a rising interest rate environment. Further, real estate values could drop significantly and cause the value of the property to fall below the loan amount, creating additional potential exposure for the Bank.

**Home Equity Lines of Credit.** The Bank provides revolving lines of credit against one to four family residences in the Tri-State area. Primary risk characteristics associated with home equity lines of credit typically involve major living or lifestyle changes to the borrower, including unemployment or other loss of income; unexpected significant expenses, such as for major medical issues or catastrophic events; and divorce or death. In addition, home equity lines of credit typically are made with variable or floating interest rates, which could expose the borrower to higher debt service requirements in a rising interest rate environment. Further, real estate values could drop significantly and cause the value of the property to fall below the loan amount, creating additional potential exposure for the Bank.

**Junior Lien Loan on Residence.** The Bank provides junior lien loans (“JLL”) against one to four family properties in the Tri-State area. JLLs can be either in the form of an amortizing home equity loan or a revolving home equity line of credit. These loans are subordinate to a first mortgage which may be from another lending institution. Primary risk characteristics associated with JLLs typically involve major living or lifestyle changes to the borrower, including unemployment or other loss of income; unexpected significant expenses, such as for major medical issues or catastrophic events; and divorce or death. Further, real estate values could drop significantly and cause the value of the property to fall below the loan amount, creating additional potential exposure for the Bank.

**Multifamily and Commercial Real Estate Loans.** The Bank provides mortgage loans for multifamily properties (i.e. buildings which have five or more residential units) and other commercial real estate that is either owner occupied or managed as an investment property (non-owner occupied) in the Tri-State area and Pennsylvania. Commercial real estate properties primarily include retail buildings/shopping centers, hotels, office/medical buildings and industrial/warehouse space. Some properties are considered “mixed use” as they are a combination of building types, such as a building with retail space on the ground floor and either residential apartments or office suites on the upper floors. Multifamily loans are expected to be repaid from the cash flows of the underlying property so the collective amount of rents must be sufficient to cover all operating expenses, property management and maintenance, taxes and debt service. Increases in vacancy rates, interest rates or other changes in general economic conditions can have an impact on the borrower and its ability to repay the loan. Commercial real estate loans are generally considered to have a higher degree of credit risk than multifamily loans as they may be dependent on the ongoing success and operating viability of a fewer number of tenants who are occupying the property and who may have a greater degree of exposure to economic conditions.

**Commercial and Industrial Loans.** The Bank provides lines of credit and term loans to operating companies for business purposes. The loans are generally secured by business assets such as accounts receivable, inventory, business vehicles and equipment as well as the stock of the company if privately held. Commercial and industrial loans are typically repaid first by the cash flows generated by the borrower’s business operation. The primary risk characteristics are specific to the underlying business and its ability to generate sustainable profitability and resulting positive cash flow. Factors that may influence a business’s profitability include, but are not limited to, demand for its products or services, quality and depth of management, degree of competition, regulatory changes, and general economic conditions. Commercial and industrial loans are generally secured by business assets; however, the ability of the Bank to foreclose and realize sufficient value from the assets is often highly uncertain. To mitigate the risk characteristics of commercial and industrial loans, these loans often include commercial real estate as collateral to strengthen the Bank’s position and the Bank will often require more frequent reporting requirements from the borrower in order to better monitor its business performance.

**Leasing and Equipment Finance.** Peapack Capital Corporation (“PCC”), a subsidiary of the Bank, offers a range of finance solutions nationally. PCC provides term loans and leases secured by assets financed for U.S. based mid-size and large companies. Facilities tend to be fully drawn under fixed rate terms. PCC serves a broad range of industries including transportation, manufacturing, heavy construction and utilities.

Asset risk in PCC’s portfolio is generally recognized through changes to loan income, or though changes to lease related income streams due to fluctuations in lease rates. Changes to lease income can occur when the existing lease contract expires, the asset comes off lease or the business seeks to enter a new lease agreement. Asset risk may also

change depreciation, resulting from changes in the residual value of the operating lease asset or through impairment of the asset carrying value, which can occur at any time during the life of the asset.

Credit risk in PCC's portfolio generally results from the potential default of borrowers or lessees, which may be driven by customer specific or broader industry related conditions. Credit losses can impact multiple parts of the income statement including loss of interest/lease/rental income and/or via higher costs and expenses related to the repossession, refurbishment, re-marketing and or re-leasing of assets.

Consumer and Other. These are loans to individuals for household, family and other personal expenditures as well as obligations of states and political subdivisions in the U.S. This also represents all other loans that cannot be categorized in any of the previous mentioned loan segments.

Derivatives: At the inception of a derivative contract, the Company designates the derivative as one of three types based on the Company's intentions and belief as to likely effectiveness as a hedge. These three types are (1) a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment ("fair value hedge"), (2) a hedge of a forecasted transaction or the variability of cash flows to be received or paid related to a recognized asset or liability ("cash flow hedge"), or (3) an instrument with no hedging designation. For a fair value hedge, the gain or loss on the derivative, as well as the offsetting loss or gain on the hedged item, are recognized in current earnings as fair values change. For a cash flow hedge, the gain or loss on the derivative is reported in other comprehensive income and is reclassified into earnings in the same periods during which the hedged transaction affects earnings. For both types of hedges, changes in the fair value of derivatives that are not highly effective in hedging the changes in fair value or expected cash flows of the hedged item are recognized immediately in current earnings. Changes in the fair value of derivatives that do not qualify for hedge accounting are reported currently in earnings, as non-interest income.

Net cash settlements on derivatives that qualify for hedge accounting are recorded in interest income or interest expense, based on the item being hedged. Net cash settlements on derivatives that do not qualify for hedge accounting are reported in non-interest income. Cash flows on hedges are classified in the cash flow statement the same as the cash flows of the items being hedged.

The Company formally documents the relationship between derivatives and hedged items, as well as the risk-management objective and the strategy for undertaking hedge transactions at the inception of the hedging relationship. This documentation includes linking fair value or cash flow hedges to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions. The Company discontinues hedge accounting when it determines that the derivative is no longer effective in offsetting changes in the fair value or cash flows of the hedged item, the derivative is settled or terminated, a hedged forecasted transaction is no longer probable, a hedged firm commitment is no longer firm, or treatment of the derivative as a hedge is no longer appropriate or intended.

When hedge accounting is discontinued, subsequent changes in fair value of the derivative are recorded as non-interest income. When a cash flow hedge is discontinued but the hedged cash flows or forecasted transactions are still expected to occur, gains or losses that were accumulated in other comprehensive income are amortized into earnings over the same periods which the hedged transactions will affect earnings.

Stock-Based Compensation: The Company's 2006 Long-Term Stock Incentive Plan and 2012 Long-Term Stock Incentive Plan allow the granting of shares of the Company's common stock as incentive stock options, nonqualified stock options, restricted stock awards, restricted stock units and stock appreciation rights to directors, officers and employees of the Company and its subsidiaries. The options granted under these plans are, in general, exercisable not earlier than one year after the date of grant, at a price equal to the fair value of common stock on the date of grant, and expire not more than ten years after the date of grant. Stock options may vest during a period of up to five years after the date of grant. Some options granted to officers at or above the senior vice president level were immediately exercisable at the date of grant. The Company has a policy of using authorized but unissued shares to satisfy option exercises.

Upon adoption of Accounting Standards Update ("ASU") 2016-09, "Compensation - Stock Compensation (Topic 718), Improvements to Employee Share-Based Payment Accounting," the Company has elected to account for forfeitures as they occur, rather than estimate expected forfeitures.

For the three and six months ended June 30, 2018, there was no unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the Company's stock incentive plans. For the three months ended June 30, 2017, the Company recorded less than \$1 thousand of unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the Company's stock incentive plans. There was no recognized tax benefit for the quarter ended June 30, 2017. The Company recorded total compensation cost for stock options for the six months ended June 30, 2017 of \$6 thousand. There was no recognized tax benefit for the six months ended June 30, 2017.

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For the Company's stock option plans, changes in options outstanding during the six months ended June 30, 2018 were as follows:

	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (In thousands)
Balance, January 1, 2018	120,083	\$ 14.41		
Exercised during 2018	(10,683 )	17.25		
Expired during 2018	(415 )	24.99		
Forfeited during 2018	(3,475 )	24.33		
Balance, June 30, 2018	105,510	\$ 13.76	3.16 years	\$ 2,198
Vested and expected to vest	105,510	\$ 13.76	3.16 years	\$ 2,198
Exercisable at June 30, 2018	105,510	\$ 13.76	3.16 years	\$ 2,198

The aggregate intrinsic value represents the total pre-tax intrinsic value (the difference between the Company's closing stock price on the last trading day of the second quarter of 2018 and the exercise price, multiplied by the number of in-the-money options). The Company's closing stock price on June 30, 2018 was \$34.59.

There were no stock options granted in the three or six months ended June 30, 2018.

The Company has previously granted performance-based and service-based restricted stock awards/units. Service-based awards/units vest ratably over a , three or five-year period. There were 2,836 restricted stock units granted in the second quarter of 2018.

The performance-based awards that were granted in previous periods are dependent upon the Company meeting certain performance criteria and cliff vest at the end of the performance period. During the fourth quarter of 2015, the Company concluded that the performance targets will no longer be met. The Company did not meet the performance criteria by the end of the performance period at end of year 2017. Therefore, as of March 31, 2018, the Company forfeited 92,767 performance-based awards.

Changes in non-vested shares dependent on performance criteria for the six months ended June 30, 2018 were as follows:

	Number of Shares	Weighted Average Grant Date Fair Value
Balance, January 1, 2018	92,767	\$ 18.12
Forfeited during 2018	(92,767)	18.12
Balance, June 30, 2018	—	\$ —

Changes in service based restricted stock awards/units for the six months ended June 30, 2018 were as follows:

	Number of Shares	Weighted Average Grant Date Fair Value
Balance, January 1, 2018	308,625	\$ 23.96
Granted during 2018	228,697	35.12
Vested during 2018	(139,550)	21.85
Forfeited during 2018	(15,025 )	27.90
Balance, June 30, 2018	382,747	\$ 31.24



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As of June 30, 2018, there was \$293 thousand of total unrecognized compensation cost related to service-based awards. That cost is expected to be recognized over a weighted average period of 0.46 years. As of June 30, 2017, there was \$9.3 million of total unrecognized compensation cost related to service-based units. That cost is expected to be recognized over a weighted average period of 1.34 years. Stock compensation expense recorded for the second quarters of 2018 and 2017 totaled \$1.3 million and \$837 thousand, respectively. Stock compensation expense recorded for the six months ended June 30, 2018 and 2017 totaled \$2.4 million and \$1.7 million, respectively.

Employee Stock Purchase Plan (“ESPP”): The ESPP provides for the granting of rights to purchase up to 150,000 shares of Corporation common stock. Subject to certain eligibility requirements and restrictions, the ESPP allows employees to purchase shares during four three-month offering periods (“Offering Periods”). Each participant in the Offering Period is granted an option to purchase a number of shares and may contribute between 1% and 15% of their compensation. At the end of each Offering Period on the purchase date, the number of shares to be purchased by the employee is determined by dividing the employee’s contributions accumulated during the Offering Period by the applicable purchase price. The purchase price is an amount equal to 85% of the closing market price of a share of Company common stock on the purchase date. Participation in the ESPP is voluntary and employees can cancel their purchases at any time during the Offering Period without penalty. The fair value of each share purchase right is determined using the Black-Scholes option pricing model.

The Company recorded \$59 thousand and \$43 thousand of expense in salaries and employee benefits expense for the three months ended June 30, 2018 and 2017, respectively, related to the ESPP. Total shares issued under the ESPP during the second quarters of 2018 and 2017 were 9,127 and 7,499, respectively.

The Company recorded \$112 thousand and \$73 thousand of expense in salaries and employee benefits expense for the six months ended June 30, 2018 and 2017, respectively related to the ESPP. Total shares issued under the ESPP for the six months ended June 30, 2018 and 2017 were 15,490 and 12,833, respectively.

Earnings per share – Basic and Diluted: The following is a reconciliation of the calculation of basic and diluted earnings per share. Basic net income per share is calculated by dividing net income available to shareholders by the weighted average shares outstanding during the reporting period. Diluted net income per share is computed similarly to that of basic net income per share, except that the denominator is increased to include the number of additional shares that would have been outstanding utilizing the Treasury Stock Method if all shares underlying potentially dilutive stock options were issued and all restricted stock, stock warrants or restricted stock units were to vest during the reporting period.

	Three Months Ended June 30,		Six Months Ended June 30,	
(Dollars in thousands, except per share data)	2018	2017	2018	2017
Net income to shareholders	\$11,910	\$7,940	\$22,717	\$15,922
Basic weighted-average shares outstanding	18,930,893	17,505,638	18,770,492	17,314,695
Plus: common stock equivalents	167,945	250,752	226,487	274,121
Diluted weighted-average shares outstanding	19,098,838	17,756,390	18,996,979	17,588,816
Net income per share				
Basic	\$0.63	\$0.45	\$1.21	\$0.92
Diluted	0.62	0.45	1.20	0.91

As of June 30, 2018, and June 30, 2017, all stock options and warrants were included in the computation of diluted earnings per share because they were all dilutive, meaning that the exercise price of the stock option was greater than

the average market price for the period.

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

The Company recognizes deferred tax assets and liabilities for the expected future tax consequences of events that have been included in its financial statements or tax returns. The measurement of deferred tax assets and liabilities is based on the enacted tax rates. Such tax assets and liabilities are adjusted for the effect of a change in tax rates in the period of enactment.

The Company recognizes a tax position as a benefit only if it is “more likely than not” that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50 percent likely of being realized on examination. For tax positions not meeting the “more likely than not” test, no tax benefit is recorded.

The Company is no longer subject to examination by the U.S. Federal tax authorities for years prior to 2014 or by New Jersey tax authorities for years prior to 2013.

The Company recognizes interest and/or penalties related to income tax matters in income tax expense.

Loss Contingencies: Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe there are any such matters that will have a material effect on the financial statements.

Restrictions on Cash: Cash on hand or on deposit with the Federal Reserve Bank was required to meet regulatory reserve and clearing requirements.

Comprehensive Income: Comprehensive income consists of net income and the change during the period in the Company's net unrealized gains or losses on securities available for sale and unrealized gains and losses on cash flow hedge, net of tax, less adjustments for realized gains and losses.

Transfers of Financial Assets: Transfers of financial assets are accounted for as sales, when control over the assets has been relinquished. Control over transferred assets is deemed to be surrendered when the assets have been isolated from the Company, the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Goodwill and Other Intangible Assets: Goodwill is generally determined as the excess of the fair value of the consideration transferred, plus the fair value of any noncontrolling interests in the acquiree (if any), over the fair value of the net assets acquired and liabilities assumed as of the acquisition date. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but tested for impairment at least annually or more frequently if events and circumstances exist that indicate that a goodwill impairment test should be performed. The Company has selected September 30 as the date to perform the annual impairment test. Intangible assets with definite useful lives are amortized over their estimated useful lives to their estimated residual values. Goodwill and assembled workforce are the intangible assets with an indefinite life on our balance sheet.

Other intangible assets which primarily consist of customer relationship intangible assets arising from acquisition, are amortized on an accelerated method over their estimated useful lives, which range from 5 to 15 years.

## 2. INVESTMENT SECURITIES

A summary of amortized cost and approximate fair value of investment securities available for sale included in the consolidated statements of condition as of June 30, 2018 and December 31, 2017 follows:

(In thousands)	June 30, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government-sponsored agencies	\$68,418	\$ —	\$ (1,806)	\$66,612
Mortgage-backed securities –residential	258,406	391	(4,828)	253,969
SBA pool securities	4,705	—	(51)	4,654
State and political subdivisions	18,648	45	(187)	18,506

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Corporate bond	3,000	49	—	3,049
Total	\$353,177	\$ 485	\$ (6,872 )	\$346,790

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(In thousands)	December 31, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government-sponsored agencies	\$44,476	\$ —	\$ (775 )	\$43,701
Mortgage-backed securities – residential	244,913	583	(2,380 )	243,116
SBA pool securities	5,262	—	(57 )	5,205
State and political subdivisions	24,910	87	(129 )	24,868
Corporate bond	3,000	82	—	3,082
Single-issuer trust preferred security	2,999	—	(162 )	2,837
CRA investment fund	5,000	—	(176 )	4,824
Total	\$330,560	\$ 752		