

1ST CONSTITUTION BANCORP  
Form 10-Q  
May 15, 2008

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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 March 31, 2008

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: 000-32891

1ST CONSTITUTION BANCORP

(Exact Name of Registrant as Specified in Its Charter)

New Jersey  
(State of Other Jurisdiction  
of Incorporation or Organization)

22-3665653  
(I.R.S. Employer Identification  
No.)

2650 Route 130, P.O. Box 634, Cranbury,  
NJ  
(Address of Principal Executive Offices)

08512  
(Zip Code)

(609) 655-4500  
(Issuer's Telephone Number, Including Area Code)

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

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

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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 the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	<input type="radio"/>	Accelerated filer	<input type="radio"/>
Non-accelerated filer	<input type="radio"/>	Smaller reporting company	<input checked="" type="radio"/>

(Do not check if a smaller reporting company)

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

As of May 9, 2008, there were 3,989,428 shares of the registrant's common stock, no par value, outstanding.

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## 1ST CONSTITUTION BANCORP

## FORM 10-Q

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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

1st Constitution Bancorp and Subsidiaries  
Consolidated Balance Sheets

	March 31, 2008 (unaudited)	December 31, 2007
<b>ASSETS</b>		
CASH AND DUE FROM BANKS	\$ 11,650,085	\$ 7,517,158
FEDERAL FUNDS SOLD / SHORT-TERM INVESTMENTS	11,148	30,944
Total cash and cash equivalents	11,661,233	7,548,102
<b>INVESTMENT SECURITIES:</b>		
Available for sale, at fair value	71,055,792	75,192,137
Held to maturity (fair value of \$16,499,376 and \$23,411,269 in 2008 and 2007, respectively)	16,486,512	23,512,346
Total investment securities	87,542,304	98,704,483
LOANS HELD FOR SALE	13,569,983	10,322,005
LOANS	344,583,370	294,760,718
Less- Allowance for loan losses	(3,513,080)	(3,348,080)
Net loans	341,070,290	291,412,638
PREMISES AND EQUIPMENT, net	2,656,900	2,760,203
ACCRUED INTEREST RECEIVABLE	2,060,607	2,495,732
BANK-OWNED LIFE INSURANCE	9,642,179	9,550,352
OTHER REAL ESTATE OWNED	4,305,293	2,960,727
OTHER ASSETS	3,770,844	3,397,297
Total assets	\$ 476,279,633	\$ 429,151,539
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>LIABILITIES:</b>		
Deposits		
Non-interest bearing	\$ 73,111,552	\$ 59,055,803
Interest bearing	305,597,937	270,276,565
Total deposits	378,709,489	329,332,368
BORROWINGS	31,800,000	35,600,000
REDEEMABLE SUBORDINATED DEBENTURES	18,557,000	18,557,000
ACCRUED INTEREST PAYABLE	2,018,045	1,992,187
ACCRUED EXPENSES AND OTHER LIABILITIES	3,547,274	2,696,667
Total liabilities	434,631,808	388,178,222

## COMMITMENTS AND CONTINGENCIES

## SHAREHOLDERS' EQUITY:

Common stock, no par value; 30,000,000 shares authorized; 3,992,339 and 3,993,905 shares issued and 3,989,428 and 3,992,715 shares outstanding as of March 31, 2008 and December 31, 2007, respectively	32,547,049	32,514,936
Retained earnings	9,482,446	9,009,955
Treasury Stock, shares at cost, 2,911 and 1,190 shares at March 31, 2008 and December 31, 2007, respectively	(46,583)	(18,388)
Accumulated other comprehensive loss	(335,087)	(533,186)
Total shareholders' equity	41,647,825	40,973,317
Total liabilities and shareholders' equity	\$ 476,279,633	\$ 429,151,539

See accompanying notes to consolidated financial statements

1st Constitution Bancorp and Subsidiaries  
Consolidated Statements of Income  
(unaudited)

Three Months Ended March 31,  
2008  
2007  
(restated)

<b>INTEREST INCOME:</b>		
Loans, including fees	\$ 6,009,100	\$ 6,167,725
<b>Securities:</b>		
Taxable	975,401	992,327
Tax-exempt	145,599	206,568
Federal funds sold and short-term investments	36,956	22,544
<b>Total interest income</b>	<b>7,167,056</b>	<b>7,389,164</b>
<b>INTEREST EXPENSE:</b>		
Deposits	2,538,093	2,216,085
Securities sold under agreements to repurchase and other borrowed funds	376,027	286,339
Redeemable subordinated debentures	249,806	429,067
<b>Total interest expense</b>	<b>3,163,926</b>	<b>2,931,491</b>
<b>Net interest income</b>	<b>4,003,130</b>	<b>4,457,673</b>
<b>PROVISION FOR LOAN LOSSES</b>	<b>165,000</b>	<b>40,000</b>
<b>Net interest income after provision for loan losses</b>	<b>3,838,130</b>	<b>4,417,673</b>
<b>NON-INTEREST INCOME:</b>		
Service charges on deposit accounts	185,888	149,855
Gain on sales of loans	310,044	231,777
Income on Bank-owned life insurance	91,827	90,348
Other income	198,618	171,761
<b>Total non-interest income</b>	<b>786,377</b>	<b>643,741</b>
<b>NON-INTEREST EXPENSE:</b>		
Salaries and employee benefits	1,978,061	1,863,252
Occupancy expense	432,015	393,491
Data processing expenses	211,781	197,076
Other operating expenses	792,493	620,405
<b>Total non-interest expenses</b>	<b>3,414,350</b>	<b>3,074,224</b>
<b>Income before income taxes</b>	<b>1,210,157</b>	<b>1,987,190</b>
<b>INCOME TAXES</b>	<b>407,960</b>	<b>661,296</b>
<b>Net income</b>	<b>\$ 802,197</b>	<b>\$ 1,325,894</b>
<b>NET INCOME PER SHARE:</b>		
Basic	\$ 0.20	\$ 0.33
Diluted	\$ 0.20	\$ 0.33

See accompanying notes to consolidated financial statements.



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1st Constitution Bancorp and Subsidiaries

Consolidated Statements of Changes in Shareholders' Equity

For the Three Months Ended March 31, 2008 and 2007

Restated for the period ended March 31, 2007

(unaudited)

	Common Stock	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
BALANCE, January 1, 2007 (restated)	\$ 28,886,105	\$ 7,010,211	\$ (3,545)	\$ (945,726)	\$ 34,947,045
FAS 123R share-based compensation	32,852				32,852
<b>Comprehensive Income:</b>					
Net Income for the three months ended March 31, 2007 (restated)	-	1,325,894	-	-	1,325,894
Unrealized gain on securities available for sale net of tax of \$172,448 (restated)	-	-	-	366,453	366,453
Comprehensive Income (restated)	-	-	-	-	1,692,347
Balance, March 31, 2007 (restated)	\$ 28,918,957	\$ 8,336,105	\$ (3,545)	\$ (579,273)	\$ 36,672,244
Balance, January 1, 2008	\$ 32,514,936	\$ 9,009,955	\$ (18,388)	\$ (533,186)	\$ 40,973,317
Adjustment to initially apply EITF 06-4	-	(329,706)	-	-	(329,706)
FAS 123R share-based compensation	32,113	-	-	-	32,113
Treasury stock, shares acquired at cost	-		(28,195)		(28,195)
<b>Comprehensive Income:</b>					
Net Income for the three months ended March 31, 2008	-	802,197	-	-	802,197
Unrealized gain on securities available for sale net of tax of \$326,666	-	-	-	634,517	634,517
Unrealized loss on interest rate swap contract net of tax of \$289,860	-	-	-	(436,418)	(436,418)
Comprehensive Income	-	-	-	-	1,000,296
BALANCE, March 31, 2008	\$ 32,547,049	\$ 9,482,446	\$ (46,583)	\$ (335,087)	\$ 41,647,825

See accompanying notes to consolidated financial statements





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1st Constitution Bancorp and Subsidiaries

Consolidated Statements of Cash Flows  
(unaudited)

Three months ended March 31,  
2008  
2007  
(restated)

OPERATING ACTIVITIES:

Net income	\$	802,197	\$	1,325,894
Adjustments to reconcile net income to net cash provided by operating activities-				
Provision for loan losses		165,000		40,000
Depreciation and amortization		173,960		180,573
Net (accretion) amortization of premiums on securities		(3,229)		11,378
Gain on sales of loans held for sale		(310,044)		(231,777)
Originations of loans held for sale		(19,388,430)		(14,001,050)
Proceeds from sales of loans held for sale		16,450,496		17,177,599
Income on Bank – owned life insurance		(91,827)		(90,348)
Share-based compensation expense		32,113		32,852
Decrease (increase) in accrued interest receivable		435,125		(161,158)
(Increase) decrease in other assets		(419,531)		407,620
Increase in accrued interest payable		25,858		48,313
(Decrease) increase in accrued expenses and other liabilities		(205,377)		799,204
Net cash (used in) provided by operating activities		(2,333,689)		5,539,100
INVESTING ACTIVITIES:				
Purchases of securities -				
Available for sale		(3,020,614)		(11,920,653)
Held to maturity		-		(7,677,917)
Proceeds from maturities and prepayments of securities -				
Available for sale		8,128,985		2,871,299
Held to maturity		7,018,220		342,556
Net increase in loans		(50,832,012)		(4,799,001)
Additional investment in other real estate owned		(335,206)		-
Capital expenditures		(61,479)		(186,161)
Cash consideration paid to acquire branch		-		(747,330)
Cash and cash equivalents acquired from branch		-		19,514,239
Net cash used in investing activities		(39,102,106)		(2,602,968)

<b>FINANCING ACTIVITIES:</b>			
Purchase of treasury stock		(28,195)	-
Net increase in demand, savings and time deposits		49,377,121	8,542,984
Net repayments in other borrowings		(3,800,000)	(1,700,000)
Net cash provided by financing activities		45,548,926	6,842,984
Increase in cash and cash equivalents		4,113,131	9,779,116
<b>CASH AND CASH EQUIVALENTS</b>			
AT BEGINNING OF PERIOD		7,548,102	10,361,812
<b>CASH AND CASH EQUIVALENTS</b>			
AT END OF PERIOD	\$	11,661,233	\$ 20,140,928
<b>SUPPLEMENTAL DISCLOSURES</b>			
<b>OF CASH FLOW INFORMATION:</b>			
Cash paid during the period for -			
Interest	\$	3,138,068	\$ 2,883,178
Income taxes		1,051,040	325,000
Non-cash investing activities			
Real estate acquired in full satisfaction of loans in foreclosure		1,009,360	-
	See accompanying notes to consolidated financial statements.		

1st Constitution Bancorp and Subsidiaries  
Notes To Consolidated Financial Statements  
March 31, 2008 (Unaudited)

## (1) Summary of Significant Accounting Policies

The accompanying unaudited Consolidated Financial Statements include 1st Constitution Bancorp (the “Company”), its wholly-owned subsidiary, 1st Constitution Bank (the “Bank”), and the Bank’s wholly-owned subsidiaries, 1st Constitution Investment Company of Delaware, Inc., FCB Assets Holdings, Inc. and 1st Constitution Title Agency, LLC. 1st Constitution Capital Trust II, a subsidiary of the Company, and 1st Constitution Capital Trust I, which was a subsidiary of the Company until April 2007, are not included in the Company’s consolidated financial statements as they are variable interest entities and the Company is not the primary beneficiary. All significant intercompany accounts and transactions have been eliminated in consolidation and certain prior period amounts have been reclassified to conform to current year presentation. The accounting and reporting policies of the Company and its subsidiaries conform to accounting principles generally accepted in the United States and pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”). Certain information and footnote disclosures normally included in financial statements have been condensed or omitted pursuant to such rules and regulations. These Consolidated Financial Statements should be read in conjunction with the audited consolidated financial statements and the notes thereto included in the Company’s Form 10-K for the year ended December 31, 2007, filed with the SEC on April 15, 2008.

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

## Net Income Per Common Share

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

Diluted net income per share is calculated by dividing net income by the weighted average number of shares outstanding, as adjusted for the assumed exercise of common shares related to stock options and unvested stock awards, using the treasury stock method. All share information has been restated for the effect of a 6% stock dividend declared December 20, 2007 and paid on February 6, 2008 to shareholders of record on January 23, 2008.

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

	Three Months Ended March 31, 2008		
	Income	Weighted- average shares	Per share amount
<b>Basic EPS</b>			
Net income available to common shareholders	\$ 802,197	3,989,428	\$ 0.20
<b>Effect of dilutive securities</b>			
Stock options and unvested stock awards	-	54,934	-
<b>Diluted EPS</b>			
Net income available to common shareholders	\$ 802,197	4,044,362	\$ 0.20

plus assumed conversion

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Three Months Ended March 31, 2007

	Income	(restated) Weighted- average shares	Per share Amount
<b>Basic EPS</b>			
Net income available to common shareholders	\$ 1,325,894	3,967,179	\$ 0.33
<b>Effect of dilutive securities</b>			
Stock options and unvested stock awards	-	63,411	-
<b>Diluted EPS</b>			
Net income available to common shareholders plus assumed conversion	\$ 1,325,894	4,030,590	\$ 0.33

### Share-Based Compensation

Share-based compensation is accounted for in accordance with Statement of Financial Accounting Standards (“SFAS”) No. 123 (revised 2004) (“SFAS No. 123R”), Share-Based Payment. The Company adopted SFAS No. 123R on January 1, 2006 using the modified prospective approach. The Company establishes fair value for its equity awards to determine its cost and the Company recognizes the related expense for stock options over the vesting period using the straight-line method. The grant date fair value for stock options is calculated using the Black-Scholes option valuation model.

The Company’s stock plans authorize the issuance of shares of common stock pursuant to awards that may be granted in the form of stock options to purchase common stock (“options”) and awards of shares of common stock (“stock awards”). The purpose of the Company’s stock plans is to attract and retain personnel for positions of substantial responsibility and to provide additional incentive to certain officers, directors, employees and other persons to promote the success of the Company. Under the Company’s stock plans, options expire no later than ten years after the date of grant. Options are granted with an exercise price set at no less than the fair market value of the Company’s stock on the date of the grant. The grant date fair value of the stock options is calculated using the Black-Scholes option valuation model.

Stock-based compensation expense related to stock options was \$32,113 and \$32,852 for the three months ended March 31, 2008 and 2007, respectively.

Stock options granted under the Company’s stock plans during the three months ended March 31, 2008 are summarized as follows:

Stock Options	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Outstanding at January 1, 2008	156,838	\$ 10.43		
Options Granted	-	-		
Options Exercised	-	-		
Options Forfeited	-	-		
Options Expired	-	-		

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Outstanding at March 31, 2008	156,838	\$	10.43	5.1	\$	588,611
Exercisable at March 31, 2008	121,066	\$	8.94	4.0	\$	493,681

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Stock awards generally vest over a four-year service period on the anniversary of the grant date. Once vested, stock awards are irrevocable. The product of the number of shares granted and the grant date market price of the Company's common stock determine the fair value of shares covered by the stock award under the Company's stock plans. Management recognizes compensation expense for the fair value of the shares covered by the stock award on a straight-line basis over the requisite service period.

The following table summarizes the non-vested portion of stock awards outstanding at March 31, 2008:

Stock Awards	Number of Shares	Average Grant Date Fair Value
Non-vested stock awards at January 1, 2008	47,993	\$ 15.35
Shares granted	-	-
Shares vested	-	-
Shares forfeited	-	-
Non-vested stock awards at March 31, 2008	47,993	\$ 15.35

As of March 31, 2008, there was approximately \$525,090 of unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the Company's stock plans. That cost is expected to be recognized over the next four years.

#### Benefit Plans

The Company provides certain retirement benefits to employees under a 401(k) plan. The Company's contributions to the 401(k) plan are expensed as incurred.

The Company also provides retirement benefits to certain employees under a supplemental executive retirement plan. The plan is unfunded and the Company accrues actuarial determined benefit costs over the estimated service period of the employees in the plan. The Company follows SFAS No. 132, as revised in December 2003, "Employers' Disclosures about Pensions and Other Post-retirement Benefits" and SFAS No. 158, "Employers Accounting for Defined Benefit Pension and Other Post-retirement Plans-an amendment of FASB Statements No. 87, 88, 106 and 132(R). SFAS No. 132 revised employers' disclosures about pension and other post-retirement benefit plans. It requires additional information about changes in the benefit obligation and the fair values of plan assets. It also standardized the requirements for pensions and other postretirement benefit plans to the extent possible, and illustrates combined formats for the presentation of pension plan and other post-retirement benefit plan disclosures. SFAS 158 requires an employer to recognize the over funded or under funded status of a defined benefit postretirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income.

The components of net periodic expense for the Company's supplemental executive retirement plan for the quarters ended March 31, 2008 and 2007 are as follows:

	2008	March 31, 2007 (restated)
Service cost	\$ 57,637	\$ 56,791
Interest cost	39,830	32,889
Actuarial loss recognized	15,375	6,217
Prior service cost recognized	24,858	24,858
	\$ 137,700	\$ 120,755





In September 2006, the FASB Emerging Issues Task Force finalized Issue No. 06-4, Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-dollar Life Insurance Arrangements, or EITF 06-4. EITF 06-4 requires that a liability be recorded during the service period when a split-dollar life insurance agreement continues after participants' employment or retirement. The required accrued liability is based on either the post-employment benefit cost for the continuing life insurance or based on the future death benefit depending on the contractual terms of the underlying agreement. The Company adopted EITF 06-4 on January 1, 2008, and recorded a cumulative effect adjustment of \$329,706 as a reduction of retained earnings effective January 1, 2008. Total compensation expense for 2008 is projected to increase by approximately \$16,120 as a result of the adoption of EITF 06-4.

#### Recent Accounting Pronouncements

In March 2008, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 161 ("SFAS No. 161"), "Disclosures about Derivative Instruments and Hedging Activities - an amendment of FASB Statement No. 133". SFAS No. 161 gives financial statement users better information about the reporting entity's hedges by providing for qualitative disclosures about the objectives and strategies for using derivatives, quantitative data about the fair value of and gains and losses on derivative contracts, and details of credit-risk-related contingent features in their hedged positions. The standard is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged, but not required. We do not anticipate the adoption of SFAS No. 161 will have a material effect on the Company's financial statements.

In December 2007, the FASB issued SFAS No. 141(R), "Business Combinations (revised 2007)." FAS 141(R) will significantly change how entities apply the acquisition method to business combinations. The new standard requires the acquiring entity in a business combination to recognize all (and only) the assets acquired and liabilities assumed in the transaction; establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed; and requires the acquirer to disclose to investors and other users all of the information they need to evaluate and understand the nature and financial effect of the business combination. This Statement is broader than SFAS 141, which only applied to business combinations in which control was obtained by transferring consideration. SFAS 141(R) applies to all transactions or other events in which an entity (the acquirer) obtains control of one or more businesses including combinations achieved without the transfer of consideration. SFAS 141(R) requires an acquirer to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date, measured at their fair values as of that date, with limited exceptions specified in the Statement. This replaces SFAS 141's cost allocation process, which required the cost of an acquisition to be allocated to the individual assets acquired and liabilities assumed based on their estimated fair values. SFAS 141 required the acquirer to include the costs incurred to effect the acquisition (acquisition-related costs) in the cost of the acquisition that was allocated to the assets acquired and the liabilities assumed. SFAS 141 (R) requires those costs to be recognized separately from the acquisition. In accordance with SFAS 141, restructuring costs that the acquirer expected but was not obligated to incur were recognized as if they were a liability assumed at the acquisition date. SFAS 141(R) requires the acquirer to recognize those restructuring costs that do not meet the criteria in SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" as an expense as incurred. Acquisition related transaction costs will be expensed as incurred. SFAS 141(R) requires an acquirer to recognize assets or liabilities arising from all other contingencies (contractual contingencies) as of the acquisition date, measured at their acquisition-date fair values only if it is more likely than not that they meet the definition of an asset or a liability on the acquisition date. Under SFAS 141(R), changes in deferred tax asset valuation allowances and acquired income tax uncertainties in a business combination after the measurement period will impact income tax expense. Additionally, under SFAS 141(R), the allowance for loan losses of an acquiree will not be permitted to be recognized by the acquirer. SFAS 141(R) is effective for fiscal years beginning after December 15, 2008. This new pronouncement will impact the Company's accounting for business combinations beginning January 1, 2009.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interest in Consolidated Financial Statements—an amendment of Accounting Research Bulletin No. 51, "Consolidated Financial Statements." FAS 160 requires all entities to report noncontrolling (minority) interests in subsidiaries as equity in the consolidated financial statements. Its intention is to eliminate the diversity in practice regarding the accounting for transactions between an entity and noncontrolling interests. SFAS 160 is effective for fiscal years beginning after December 15, 2008. The Company is currently assessing the impact of the adoption of SFAS 160 on its financial statements.

In November 2007, the SEC issued SAB 109, "Written Loan Commitments Recorded at Fair Value through Earnings." SAB 109 revises and rescinds portions of SAB 105, "Application of Accounting Principles to Loan Commitments." The SEC staff's current view is that the expected net future cash flows related to the associated servicing of a loan should be included in the measurement of derivative and other written loan commitments that are accounted for at fair value through earnings. That view is consistent with the guidance in Financial Accounting Standards Board (FASB) No. 156, "Accounting for Servicing of Financial Assets" and FASB No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities." SAB 109 retains the view expressed in SAB 105 that internally developed intangible assets should not be recorded as part of the fair value of a derivative loan commitment. The guidance in SAB 109 is effective for derivative loan commitments issued or modified in fiscal quarters beginning after December 15, 2007. The adoption of SAB 109 did not have a material impact on the Company's financial statements.

## (2) Fair Value Measurements

Effective January 1, 2008, the Company adopted the provisions of SFAS No. 157, "Fair Value Measurements," for financial assets and financial liabilities ("SFAS No. 157"). In accordance with Financial Accounting Standards Board Staff Position (FSP) No. 157-2, "Effective Date of FASB Statement no. 157," the Company will delay application of SFAS No. 157 for non-financial assets and non-financial liabilities, until January 1, 2009. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurement.

SFAS No. 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets and liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are (i) independent, (ii) knowledgeable, (iii) able to transact and (iv) willing to transact.

SFAS No. 157 requires the use of valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities. The income approach uses valuation techniques to convert future amounts, such as cash flows or earnings, to a single present amount on a discounted basis. The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (replacement cost). Valuation techniques should be consistently applied. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. In that regard, SFAS No. 157 establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

- Level 1 Inputs – Unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.
- Level 2 Inputs – Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted

prices that are observable for the asset or liability (such as interest rates, volatilities, prepayment speeds, credit risks, etc). or inputs that are derived principally from or corroborated by market data by correlation or other means.

- Level 3 Inputs – Unobservable inputs for determining the fair values of assets or liabilities that reflect an entity’s own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below. These valuation methodologies were applied to all of the Company’s financial assets and financial liabilities carried at fair value effective January 1, 2008.

In general, fair value is based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon internally developed models that primarily use, as inputs, observable market-based parameters. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments may include amounts to reflect counterparty credit quality, the Company’s creditworthiness, among other things, as well as unobservable parameters. Any such valuation adjustments are applied consistently over time. The Company’s valuation methodologies may produce a fair value calculation that may not be indicative of net realizable value or reflective of future values. While management believes the Company’s valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

**Securities Available for Sale.** Securities classified as available for sale are reported at fair value utilizing Level 2 inputs. For these securities, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade executive data, market consensus prepayments speeds, credit information and the bond’s terms and conditions, among other things.

**Derivatives.** Derivatives are reported at fair value utilizing Level 2 inputs. The Company obtains dealer quotations to value its interest rate swap.

The following table summarizes financial assets and financial liabilities measured at fair value on a recurring basis as of March 31, 2008, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
Securities available for sale	\$ -	\$ 71,055,792	\$ -	\$ 71,055,792
Derivative liabilities	-	825,491	-	825,491

Certain financial assets and financial liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). Financial assets and financial liabilities measured at fair value on a non-recurring basis were not significant at March 31, 2008.

Certain non-financial assets and non-financial liabilities measured at fair value on a recurring basis include reporting units measured at fair value in the first step of a goodwill impairment test. Certain non-financial assets measured at fair value on a non-recurring basis include non-financial assets and non-financial liabilities measured at fair value in the second step of a goodwill impairment test, as well as intangible assets and other non-financial long-lived assets measured at fair value for impairment assessment. As stated above, SFAS No. 157 will be applicable to these fair value measurements beginning January 1, 2009.



Effective January 1, 2008, the Company adopted the provisions of SFAS No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities – Including an amendment of FASB Statement No. 115” (“SFAS No. 159”). SFAS No. 159 permits the Company to choose to measure eligible items at fair value at specified election dates. Unrealized gains and losses on items for which the fair value measurement option has been elected are reported in earnings at each subsequent reporting date. The fair value option (i) may be applied instrument by instrument, with certain exceptions, thus the Company may record identical financial assets and liabilities at fair value or by another measurement basis permitted under generally accepted accounting principals, (ii) is irrevocable (unless a new election date occurs) and (iii) is applied only to entire instruments and not to portions of instruments. Adoption of SFAS No. 159 on January 1, 2008 did not have a significant impact on the Company’s financial statements.

### (3) Acquisition of Unaffiliated Branch

On February 27, 2007, the Company, through the Bank, completed its acquisition of the Hightstown, New Jersey branch of another financial institution for a purchase price of \$747,330.

As a result of the acquisition, the Hightstown branch became a branch of the Bank. Included in the acquisition of the branch were deposit liabilities of \$19.5 million, mostly in certificates of deposit, and cash of approximately \$18.8 million, net of assets acquired consisting of cash on hand of approximately \$137,000, fixed and other assets of approximately \$91,000 and the assumption of the lease of the branch premises. The cash received in the transaction was utilized to repay short term borrowings used to purchase investment securities prior to, and in contemplation of, the completion of the acquisition.

In addition, the Bank recorded goodwill of \$472,726 and a core deposit intangible asset of \$274,604.



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

The purpose of this discussion and analysis of the operating results and financial condition at March 31, 2008 is intended to help readers analyze the accompanying financial statements, notes and other supplemental information contained in this document. Results of operations for the three month period ended March 31, 2008 are not necessarily indicative of results to be attained for any other period.

This discussion and analysis should be read in conjunction with the Consolidated Financial statements, notes and tables included elsewhere in this report and Part II, Item 7 of the Company's Form 10-K (Management's Discussion and Analysis of Financial Condition and Results of Operations) for the year ended December 31, 2007, as filed with the SEC on April 15, 2008.

General

Throughout the following sections, the "Company" refers to 1ST Constitution Bancorp and, as the context requires, its wholly-owned subsidiaries, 1ST Constitution Bank and 1ST Constitution Capital Trust II, the "Bank" refers to 1ST Constitution Bank, "Trust II" refers to 1ST Constitution Capital Trust II, and "Trust I" refers to 1ST Constitution Capital Trust I, which was a subsidiary of the Company until its termination in April 2007.

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

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

Trust II, a subsidiary of the Company, was created in May 2006 to issue trust preferred securities to assist the Company to raise additional regulatory capital.

Trust I, which was a statutory business trust and a wholly-owned subsidiary of the Company, had issued \$5.0 million of variable rate trust preferred securities in April 2002 and had held, as its sole asset, subordinated debentures issued by the Company until such debentures were redeemed by the Company, and Trust I was terminated, in April 2007.

The Company's Annual Report on Form 10-K filed with the SEC on April 15, 2008 contains restated unaudited consolidated financial information of the Company for each of the first three quarters of 2007. To the extent that the discussion and analysis contained herein relates or refers to the Company's results for the first quarter of 2007, such discussion and analysis reflects the Company's restated results for the three months ended March 31, 2007.

Forward-Looking Statements

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

statements, each of which speak only as of the date made. Such statements are subject to certain risks and uncertainties that could cause actual results to differ materially from historical earnings and those presently anticipated or projected.

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Factors that may cause actual results to differ from those results expressed or implied, include, but are not limited to, those listed under “Business”, “Risk Factors” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in the Company’s Annual Report on Form 10-K filed with the SEC on April 15, 2008, such as the overall economy and the interest rate environment; the ability of customers to repay their obligations; the adequacy of the allowance for loan losses; competition; significant changes in accounting, tax or regulatory practices and requirements; certain interest rate risks; risks associated with investments in mortgage-backed securities; and risks associated with speculative construction lending. Although management has taken certain steps to mitigate any negative effect of the aforementioned items, significant unfavorable changes could severely impact the assumptions used and have an adverse effect on profitability. The Company has no obligation to publicly release the result of any revisions which may be made to any forward-looking statements to reflect anticipated or unanticipated events or circumstances occurring after the date of such statements.

## RESULTS OF OPERATIONS

### Summary

The Company reported net income of \$802,197 for the three months ended March 31, 2008, a decrease of 39.5% from the \$1,325,894 reported for the three months ended March 31, 2007. Diluted net income per share was \$0.20 for the three months ended March 31, 2008 compared to \$0.33 reported for the three months ended March 31, 2007. All prior year share information has been restated for the effect of a 6% stock dividend declared on December 20, 2007 and paid on February 6, 2008 to shareholders of record on January 23, 2008.

Key performance ratios declined for the three months ended March 31, 2008 as compared to the three months ended March 31, 2007. Return on average assets and return on average equity were 0.72% and 7.75%, respectively, for the three months ended March 31, 2008, compared to 1.31% and 14.79%, respectively, for the corresponding prior year period.

A significant factor impacting the Company’s net interest income has been the declining level of market interest rates and the resulting compression of the Company’s net interest margin. The net interest margin for the three months ended March 31, 2008 was 3.88% as compared to the 4.81% net interest margin recorded for the quarter ended March 31, 2007, a reduction of 93 basis points. The Federal Reserve has decreased the level of market interest rates by 250 basis points since September 18, 2007. Since the majority of the Company’s interest earning assets earn at floating rates, these interest rate reductions have resulted in a decreased level of interest income. The Company will continue to closely monitor the mix of earning assets and funding sources to maximize net interest income during this challenging interest rate environment.

The Company has a significant investment in collateralized mortgages and mortgage-backed securities. Several financial institutions have reported significant write-downs of the value of mortgage related securities. Certain of these types of securities may also not be marketable except at significant discounts. While management of the Company is as of the date of this report unaware of any material exposures in its portfolio of these securities, market conditions could further deteriorate and result in the recognition of losses in the value of these securities.

### Earnings Analysis

#### Net Interest Income

Net interest income, the Company’s largest and most significant component of operating income, is the difference between interest and fees earned on loans and other earning assets, and interest paid on deposits and borrowed funds. This component represented 83.6% of the Company’s net revenues for the three-month period ended March 31, 2008 and 87.4% of net revenues for the three-month period ended March 31, 2007. Net interest income also depends upon

the relative amount of interest-earning assets, interest-bearing liabilities, and the interest rate earned or paid on them.

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The following table sets forth the Company's consolidated average balances of assets, liabilities and shareholders' equity as well as interest income and expense on related items, and the Company's average rates for the three month periods ended March 31, 2008 and 2007, respectively. The average rates are derived by dividing interest income and expense by the average balance of assets and liabilities, respectively.

Average Balance Sheets with Resultant Interest and Rates

(yields on a tax-equivalent basis)

	Three months ended March 31, 2008			Three months ended March 31, 2007		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
<b>Assets:</b>						
<b>Federal Funds</b>						
Sold/Short-Term Investments	\$ 4,140,640	\$ 36,956	3.58%	\$ 2,003,236	\$ 22,544	5.20%
<b>Securities:</b>						
<b>Collateralized Mortgage Obligations/ Mortgage Backed Securities</b>						
States and Political Subdivisions	75,746,746	975,401	5.17%	77,250,121	992,327	5.14%
Total	15,373,203	215,486	5.62%	21,202,098	305,721	5.77%
Total	91,119,949	1,190,888	5.24%	98,452,219	1,298,048	5.27%
<b>Loan Portfolio:</b>						
Construction	130,639,223	2,381,892	7.31%	126,866,201	2,857,337	9.13%
Residential real estate	10,110,283	159,309	6.32%	7,156,527	212,274	12.03%
Home Equity	14,627,203	245,339	6.73%	14,392,895	270,455	7.62%
Commercial and commercial real estate	123,704,192	2,320,400	7.52%	110,973,830	2,147,906	7.85%
Installment	1,399,625	28,330	8.12%	1,573,806	33,436	8.62%
All Other Loans	44,822,153	873,830	7.82%	22,709,509	646,317	11.54%
Total	325,302,679	6,009,100	7.49%	283,672,768	6,167,725	8.82%
Total Interest-Earning Assets	420,563,268	7,236,943	6.90%	384,128,223	7,448,317	7.91%
Allowance for Loan Losses	(3,405,168)			(3,051,032)		
Cash and Due From Bank	10,094,025			9,414,281		
Other Assets	20,330,862			16,296,108		
Total Assets	\$ 447,582,987			\$ 406,787,580		
<b>Interest-Bearing Liabilities:</b>						
<b>Money Market and NOW Accounts</b>						
Savings Accounts	\$ 86,359,683	\$ 504,836	2.34%	\$ 83,302,779	\$ 415,115	2.02%
Certificates of Deposit	68,446,977	499,764	2.93%	62,486,829	449,086	2.91%
Other Borrowed Funds	132,123,368	1,533,493	4.66%	113,702,589	1,351,884	4.82%
Trust Preferred Securities	32,736,813	376,027	4.61%	22,116,111	286,339	5.25%
Total Interest-Bearing Liabilities	18,000,000	249,806	5.55%	23,000,000	429,067	7.46%
Total Interest-Bearing Liabilities	337,666,841	3,163,926	3.76%	304,608,308	2,931,491	3.90%
Net Interest Spread			3.14%			4.01%

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Demand Deposits	63,097,231		60,679,465	
Other Liabilities	5,176,947		5,436,127	
Total Liabilities	405,941,019		370,723,900	
Shareholders' Equity	41,641,968		36,063,680	
Total Liabilities and Shareholders' Equity	\$ 447,582,987		\$ 406,787,580	
Net Interest Margin	\$ 4,073,017	3.88%	\$ 4,556,826	4.81%

The Company's net interest income on a tax-equivalent basis decreased by \$483,809, or 10.6%, to \$4,073,017 for the three months ended March 31, 2008 from the \$4,556,826 reported for the three months ended March 31, 2007. The decrease in net interest income was attributable to the decreases in net interest margin and spread, partially offset by increased average balances.

Average interest earning assets increased by \$36,435,045, or 9.5%, to \$420,563,268 for the quarter ended March 31, 2008 from \$384,128,223 for the quarter ended March 31, 2007, with an increase of \$41,629,911 in average total loans and a decrease of \$7,332,270 in average total securities in the three months ended March 31, 2008 when compared to the three months ended March 31, 2007.

The Bank's average loan portfolio grew by 14.7% when compared to the average loan portfolio for the first quarter of 2007. The yields on loans averaged 7.49% for the first quarter of 2008, decreasing 133 basis points compared to the 8.82% yield on loans for the first quarter of 2007. The Bank's average securities portfolio decreased by 7.45% and the yield on that portfolio decreased by 3 basis points for the quarter ended March 31, 2008 when compared to the quarter ended March 31, 2007. Overall, the yield on interest earning assets decreased 101 basis points to 6.90% for the quarter ended March 31, 2008 when compared to 7.91% for the quarter ended March 31, 2007.

Average interest bearing liabilities increased by \$33,058,533, or 10.9%, to \$337,666,841 for the quarter ended March 31, 2008 from \$304,608,308 for the quarter ended March 31, 2007. Certificates of deposit increased on average by \$18,420,779, or 16.2%, for the three months ended March 31, 2008 when compared to the three months ended March 31, 2007. The cost of certificates of deposit decreased 16 basis points to 4.66% for the first quarter of 2008 compared to 4.82% for the first quarter of 2007. Overall, the cost of total interest bearing liabilities decreased 14 basis points to 3.76% for the three months ended March 31, 2008 compared to 3.90% for the three months ended March 31, 2007.

The net interest margin (on a tax-equivalent basis), which is net interest income divided by average interest earning assets, was 3.88% for the first three months of 2008 compared to 4.81% for the first three months of 2007.

#### Non-Interest Income

Total non-interest income for the three months ended March 31, 2008 was \$786,377, an increase of \$142,636, or 22.2%, over non-interest income of \$643,741 for the three months ended March 31, 2007.

Service charges on deposit accounts represents a significant source of non-interest income. Service charge revenues increased by \$36,033, or 24.0%, to \$185,888 for the three months ended March 31, 2008 from the \$149,855 for the three months ended March 31, 2007. This increase was the result of a higher volume of uncollected funds and overdraft fees collected on deposit accounts during the first quarter of 2008 compared to the first quarter of 2007.

Gain on sales of loans increased by \$78,267, or 33.8%, to \$310,044 for the three months ended March 31, 2008 when compared to \$231,777 for the three months ended March 31, 2007. The Bank sells both residential mortgage loans and SBA loans in the secondary market. The lower interest rate environment that continued into the first quarter of 2008 has significantly increased the volume of sales transactions in the SBA loan markets and resultant gains resulting from these transactions.

Non-interest income also includes income from bank-owned life insurance ("BOLI"), which amounted to \$91,827 for the three months ended March 31, 2008 compared to \$90,348 for the three months ended March 31, 2007. The Bank purchased tax-free BOLI assets to partially offset the cost of employee benefit plans and reduced the Company's overall effective tax rate.

The Bank also generates non-interest income from a variety of fee-based services. These include safe deposit box rental, wire transfer service fees and Automated Teller Machine fees for non-Bank customers. Increased customer demand for these services contributed to the other income component of non-interest income amounting to \$198,618 for the three months ended March 31, 2008, compared to \$171,761 for the three months ended March 31, 2007.

## Non-Interest Expense

Non-interest expenses increased by \$340,126, or 11.1%, to \$3,414,350 for the three months ended March 31, 2008 from \$3,074,224 for the three months ended March 31, 2007. The following table presents the major components of non-interest expenses for the three months ended March 31, 2008 and 2007.

Non-interest Expenses	Three months ended March 31,	
	2008	2007 (restated)
Salaries and employee benefits	\$ 1,978,061	\$ 1,863,252
Occupancy expenses	432,015	393,491
Equipment expense	137,791	125,413
Marketing	66,329	24,881
Computer services	211,781	197,076
Regulatory, professional and other fees	171,718	108,786
Office expense	141,171	142,374
All other expenses	275,484	218,951
	\$ 3,414,350	\$ 3,074,224

Salaries and employee benefits, which represent the largest portion of non-interest expenses, increased by \$114,809, or 6.2%, to \$1,978,061 for the three months ended March 31, 2008 compared to \$1,863,252 for the three months ended March 31, 2007. The increase in salaries and employee benefits for the three months ended March 31, 2008 was a result of an increase in the number of employees, regular merit increases and increased health care costs. Staffing levels overall increased to 105 full-time equivalent employees at March 31, 2008 as compared to 102 full-time equivalent employees at March 31, 2007.

Regulatory, professional and other fees increased by \$62,932, or 57.8%, to \$171,718 for the three months ended March 31, 2008 compared to \$108,786 for the three months ended March 31, 2007. During the first quarter of 2008, the Company incurred additional accounting and legal fees primarily as a result of the restatement of the Company's financial statements for the first three quarters and the year ended December 31, 2006 and the first three quarters of the year ended December 31, 2007, as described in Item 8 of the Company's Annual Report on Form 10-K filed with the SEC on April 15, 2008.

Marketing expenses increased by \$41,448, or 167%, to \$66,329 for the three months ended March 31, 2008 compared to \$24,881 for the three months ended March 31, 2007. The increase in expense was attributable to marketing campaigns designed to increase low-cost core deposits, further develop our brand image and continue the Bank's support of community activities.

All other expenses increased by \$56,533, or 25.8%, to \$275,484 for the three months ended March 31, 2008 compared to \$218,951 for the three months ended March 31, 2007. All other expenses are comprised of a variety of operating expenses and fees as well as expenses associated with lending activities.

An important financial services industry productivity measure is the efficiency ratio. The efficiency ratio is calculated by dividing total operating expenses by net interest income plus non-interest income. An increase in the efficiency ratio indicates that more resources are being utilized to generate the same or greater volume of income, while a decrease would indicate a more efficient allocation of resources. The Bank's efficiency ratio increased to 71.3% for the three months ended March 31, 2008, compared to 60.3% for the three months ended March 31, 2007. The decline in efficiency ratio is due to the above-noted increases in non-interest expenses and reduced net interest income.



Provision for Loan Losses

The provision for loan losses was \$165,000 for the three months ended March 31, 2008 and \$40,000 for the three months ended March 31, 2007. Management considers a complete review of the following specific factors in determining the provision for loan losses: historical losses by loan category, non-accrual loans, problem loans as identified through internal classifications, collateral values, and the growth and size of the portfolio. In addition to these factors, management takes into consideration current economic conditions and local real estate market conditions. Net charge offs/recoveries amounted to zero for the three months ended March 31, 2008 compared to a net recovery of \$79,703 for the three months ended March 31, 2007. See "Allowance for Loan Losses" on page 14.

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