SANDY SPRING BANCORP INC
Form 10-Q
May 07, 2007

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

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

For the quarterly period ended March 31, 2007

OR

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

For the transition period from __________ to

Commission File Number: O-19065

Sandy Spring Bancorp, Inc.

(Exact name of registrant as specified in its charter)

Maryland	52-1532952
(State of incorporation)	(I.R.S. Employer Identification Number)

17801 Georgia Avenue, Olney, Maryland	20832	301-774-6400
(Address of principal office)	(Zip Code)	(Telephone Number)

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 filing requirements for the past 90 days.
YES þ NO o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer o Accelerated filer þ Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act)
YES o NO þ

The number of shares of common stock outstanding as of April 23, 2007 is 15,735,864 shares.

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PART I FINANCIAL INFORMATION
Item 1. FINANCIAL STATEMENTS
Sandy Spring Bancorp, Inc. and Subsidiaries
CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except per share data)	March 31, 2007	December 31, 2006
ASSETS		
Cash and due from banks	$ 61,145	$ 54,945
Federal funds sold	48,138	48,978
Cash and cash equivalents	109,283	103,923
Interest-bearing deposits with banks	28,192	2,974
Residential mortgage loans held for sale	9,660	10,595
Investments available-for-sale (at fair value)	282,023	256,845
Investments held-to-maturity fair value of $266,937 (2007) and $273,206 (2006)	261,208	267,344
Other equity securities	17,709	16,719
Total loans and leases	2,036,182	1,805,579
Less: allowance for loan and lease losses	(22,186)	(19,492)
Net loans and leases	2,013,996	1,786,087
Premises and equipment, net	50,834	47,756
Accrued interest receivable	16,485	15,200
Goodwill	53,913	12,494
Other intangible assets, net	15,244	10,653
Other assets	86,930	79,867
Total assets	$ 2,945,477	$ 2,610,457
LIABILITIES		
Noninterest-bearing deposits	$ 449,604	$ 394,662
Interest-bearing deposits	1,824,718	1,599,561
Total deposits	2,274,322	1,994,223
Short-term borrowings	325,657	314,732
Other long-term borrowings	8,274	1,808
Subordinated debentures	35,000	35,000
Accrued interest payable and other liabilities	26,905	26,917
Total liabilities	2,670,158	2,372,680
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS EQUITY		
Common stock par value $1.00; shares authorized 50,000,000; shares issued and outstanding 15,724,895 (2007) and 14,826,805 (2006)	15,725	14,827

Additional paid in capital	60,520	27,869
Retained earnings	203,044	199,102
Accumulated other comprehensive loss	(3,970)	(4,021)
Total stockholders equity	275,319	237,777
Total liabilities and stockholders equity	$ 2,945,477	$ 2,610,457

See Notes to Consolidated Financial Statements.

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Sandy Spring Bancorp, Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share data)	Three Months Ended March 31, 2007	2006
Interest Income:		
Interest and fees on loans and leases	$34,574	$28,858
Interest on loans held for sale	195	150
Interest on deposits with banks	90	10
Interest and dividends on securities:		
Taxable	3,871	3,031
Exempt from federal income taxes	2,727	3,016
Interest on federal funds sold	437	112
TOTAL INTEREST INCOME	41,894	35,177
Interest Expense:		
Interest on deposits	13,788	7,674
Interest on short-term borrowings	3,481	3,749
Interest on long-term borrowings	610	577
TOTAL INTEREST EXPENSE	17,879	12,000
NET INTEREST INCOME	24,015	23,177
Provision for loan and lease losses	839	950
NET INTEREST INCOME AFTER PROVISION FOR LOAN AND LEASE LOSSES	23,176	22,227
Noninterest Income:		
Securities gains	2	0
Service charges on deposit accounts	2,308	1,848
Gains on sales of mortgage loans	638	782
Fees on sales of investment products	800	718
Trust and investment management fees	2,281	2,116
Insurance agency commissions	2,690	2,108
Income from bank owned life insurance	684	553
Visa check fees	590	535
Other income	913	1,186
TOTAL NONINTEREST INCOME	10,906	9,846
Noninterest Expenses:		
Salaries and employee benefits	13,434	12,471
Occupancy expense of premises	2,417	2,126
Equipment expenses	1,602	1,316
Marketing	529	341
Outside data services	926	781
Amortization of intangible assets	802	742
Other expenses	3,904	2,579

TOTAL NONINTEREST EXPENSES	23,614	20,356
Income Before Income Taxes	10,468	11,717
Income Tax Expense	2,923	3,377
NET INCOME	$ 7,545	$ 8,340

See Notes to Consolidated Financial Statements.

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Sandy Spring Bancorp, Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF INCOME (Continued)

	Three Months Ended March 31,	
(In thousands, except per share data)	2007	2006
Basic Net Income Per Share	$0.49	$0.56
Diluted Net Income Per Share	0.49	0.56
Dividends Declared Per Share	0.23	0.22

See Notes to Consolidated Financial Statements.

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Sandy Spring Bancorp, Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in thousands)

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
Cash flows from operating activities:		
Net income	$ 7,545	$ 8,340
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,393	2,066
Provision for loan and lease losses	839	950
Stock compensation expense	226	142
Deferred income taxes (benefits)	(960)	(16)
Origination of loans held for sale	(73,782)	(55,018)
Proceeds from sales of loans held for sale	75,356	58,585
Gains on sales of loans held for sale	(638)	(662)
Securities gains	(2)	0
Net (increase) in accrued interest receivable	(108)	293
Net (increase) decrease in other assets	(4,417)	702
Net decrease in accrued expenses and other liabilities	(2,272)	(4,826)
Other net	(654)	244
Net cash provided by operating activities	3,526	10,800
Cash flows from investing activities:		
Net (increase) decrease in interest-bearing deposits with banks	(25,218)	67
Purchases of other equity securities	(118)	(749)
Purchases of investments available-for-sale	(4,967)	(10,000)
Proceeds from the sales of other real estate owned	192	0
Proceeds from maturities, calls and principal payments of investments held-to-maturity	9,613	4,840
Proceeds from maturities, calls and principal payments of investments available-for-sale	12,382	30,531
Net increase in loans and leases	(34,651)	(57,821)
Purchase of loans and leases	0	(2,148)
Acquisition of business activity, net	(28,039)	0
Expenditures for premises and equipment	(660)	(1,245)
Net cash (used in) investing activities	(71,466)	(36,525)
Cash flows from financing activities:		
Net increase in deposits	83,134	36,145
Net increase (decrease) in short-term borrowings	(6,513)	3,563
Retirement of long-term borrowings	(64)	0
Proceeds from issuance of common stock	346	245
Dividends paid	(3,603)	(3,255)
Net cash provided by financing activities	73,300	36,698

Net increase in cash and cash equivalents	5,360	10,973
Cash and cash equivalents at beginning of period	103,923	53,443
Cash and cash equivalents at end of period	$ 109,283	$ 64,416

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Sandy Spring Bancorp and Subsidiaries
CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

	Three Months Ended March 31,	
(Dollars in thousands)	2007	2006
Supplemental Disclosures:		
Interest payments	$ 17,196	$ 11,511
Income tax payments	5,910	317
Reclassification of borrowings from long-term to short-term	87	87
Details of acquisition:		
Fair value of assets acquired	$ 252,487	0
Fair value of liabilities assumed	(224,956)	0
Stock issued for acquisition	(32,977)	0
Purchase price in excess of net assets acquired	39,914	0
Cash paid for acquisition	34,468	0
Cash acquired with acquisition	(6,429)	0
Acquisition of business activity, net	28,039	0

See Notes to Consolidated Financial Statements.

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Sandy Spring Bancorp, Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY

(Dollars in thousands, except per share data)	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (loss)	Total Stockholders Equity
Balances at January 1, 2007	$ 14,827	$ 27,869	$ 199,102	$ (4,021)	$ 237,777
Comprehensive income:					
Net income			7,545		7,545
Other comprehensive income, net of tax effects and reclassification adjustment				51	51
Total comprehensive income					7,596
Cash dividends $0.23 per share			(3,603)		(3,603)
Stock compensation expense		226			226
Common stock issued pursuant to:					
Acquisition of Potomac Bank- 886,989 shares	887	32,090			32,977
Stock option plan 6,200 shares	6	190			196
Employee stock purchase plan 4,901 shares	5	145			150
Balances at March 31, 2007	$ 15,725	$ 60,520	$ 203,044	$ (3,970)	$ 275,319
Balances at January 1, 2006	$ 14,794	$ 26,599	$ 179,259	$ (594)	$ 220,058
Comprehensive income:					
Net income			8,340		8,340
Other comprehensive loss, net of tax effects				(393)	(393)
Total comprehensive income					7,947
Cash dividends $0.22 per share			(3,255)		(3,255)

Stock Compensation Expense		142			142
Common stock issuance pursuant to:					
Stock option plan 2,950 shares	3	91			94
Employee stock purchase plan 4,997 shares	5	146			151
Balances at March 31, 2006	$ 14,802	$ 26,978	$ 184,344	$ (987)	$ 225,137

See Notes to Consolidated Financial Statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 General

The foregoing financial statements are unaudited. In the opinion of Management, all adjustments (comprising only normal recurring accruals) necessary for a fair presentation of the results of the interim periods have been included. These statements should be read in conjunction with the financial statements and accompanying notes included in Sandy Spring Bancorp s 2006 Annual Report on Form 10-K. There have been no significant changes to the Company s Accounting Policies as disclosed in the 2006 Annual Report on Form 10-K. The results shown in this interim report are not necessarily indicative of results to be expected for the full year 2007.

The accounting and reporting policies of Sandy Spring Bancorp, Inc. (the Company) and its wholly-owned subsidiary, Sandy Spring Bank (the Bank), together with its subsidiaries, Sandy Spring Insurance Corporation, The Equipment Leasing Company, and West Financial Services, Inc., conform to accounting principles generally accepted in the United States of America and to general practices within the financial services industry. Certain reclassifications have been made to amounts previously reported to conform to current classifications.

Consolidation has resulted in the elimination of all significant intercompany accounts and transactions.

Cash Flows

For purposes of reporting cash flows, cash and cash equivalents include cash and due from banks and federal funds sold (which have original maturities of three months or less).

Note 2 Acquisitions

In January 2006, the Company completed the acquisition of Neff & Associates (Neff), an insurance agency located in Ocean City, Maryland. Under the terms of the acquisition agreement, the Company purchased Neff for cash totaling approximately $1.9 million. Additional contingent payments may be made and recorded in 2008 based on the financial results attained by Neff in that year.

In the transaction, $0.3 million of assets were acquired, primarily accounts receivable, and $0.3 million of liabilities were assumed, primarily operating payables. The acquisition resulted in the recognition of $0.5 million of goodwill, which will not be amortized, and $1.4 million of identified intangible assets which will be amortized on a straight-line basis over a period of 5 to 10 years. This acquisition is considered immaterial and, accordingly, no pro forma results of operations are provided for the pre-acquisition periods.

On February 15, 2007, the Company completed the acquisition of Potomac Bank of Virginia (Potomac), a bank headquartered in Fairfax, Virginia. Potomac operated five branch offices in the Northern Virginia metropolitan market at the time of the acquisition. The primary reason for the merger with Potomac was to gain entry into the northern Virginia high growth market. The total consideration paid to Potomac shareholders in connection with the acquisition was $64.4 million. The results of Potomac s operations have been included in the Company s consolidated financial results subsequent to February 15, 2007. The assets and liabilities of Potomac were recorded on the Consolidated Balance Sheet at their respective fair values. The fair values were determined as of February 15, 2007 and are subject to further refinement as further information becomes available. The transaction resulted in total assets acquired as of February 15, 2007 of $252.5 million, including approximately $196.0 million of loans and leases; liabilities assumed were $225.0 million, including $197.0 million of deposits. Additionally, the Company recorded $39.9 million of goodwill, $5.1 million of core deposit intangible (CDI) and $0.3 million of other intangibles. CDI are subject to amortization and are being amortized over seven years on a straight-line basis.

The acquisition of Potomac is considered immaterial for purposes of the disclosures required by FAS No. 141, Business Combinations.

Pending Acquisitions

In December 2006, the Company entered into a merger agreement to acquire CN Bancorp Inc. (CNB) and it s wholly owned subsidiary, County National Bank (County National). CNB is the holding company for County National and had consolidated total assets of $164 million at March 31, 2007. County National, with assets of $158 million as of March 31, 2007, is a commercial bank headquartered in Pasadena, Maryland, with four full-service branches located in Anne Arundel County, Maryland.

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Under the terms of the agreement, each outstanding share of CNB s common stock will be converted into either $25.00 in cash or 0.6657 of a share of the Company s common stock. Each shareholder of CNB will be entitled to elect the number of shares of Potomac common stock to be exchanged for cash or shares of the Company s common stock, subject to a proration which will provide that the Company will pay cash for a minimum of 40% and a maximum of 50% of the outstanding shares of CNB common stock and issue shares of the Company s common stock in exchange for a minimum of 50% and a maximum of 60% of the outstanding shares of CNB common stock. The total purchase price is estimated to be $46.2 million, including $22.6 million in stock issued and stock options assumed and $21.6 million in stock purchased and options settled for cash, and approximately $2.0 million of estimated other direct acquisition costs.

The acquisition is subject to approval by both the CNB shareholders and applicable bank regulatory authorities and is expected to be completed during the second quarter of 2007. As a result of the acquisition, County National will become a newly formed division of Sandy Spring Bank.

Note 3 New Accounting Pronouncements

Adopted Accounting Pronouncements

In February 2006, FASB issued SFAS 155, *Accounting for Certain Hybrid Financial Instruments* , which permits, but does not require, fair value accounting for any hybrid financial instrument that contains an embedded derivative that would otherwise require bifurcation in accordance with SFAS 133, Accounting for Derivative Instruments and Hedging Activities . The statement also subjects beneficial interests in securitized financial assets to the requirements of SFAS 133. This statement is effective for all financial instruments acquired, issued, or subject to remeasurement for fiscal years beginning after September 15, 2006. The Company does not expect that the adoption of this Statement will have a material impact on its financial position, results of operations or cash flows.

In March 2006, the FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets, and an amendment of FASB Statement No. 140.* The statement amends SFAS No. 140 by (1) requiring the separate accounting for servicing assets and servicing liabilities, which arise from the sale of financial assets; (2) requiring all separately recognized serving assets and servicing liabilities to be initially measured at fair value, if practicable; and (3) permitting an entity to choose between an amortization method or a fair value method for subsequent measurement for each class of separately recognized servicing assets and servicing liabilities. This statement is effective for fiscal years beginning after September 15, 2006, with earlier adoption permitted. The Company does not expect that the adoption of this Statement will have a material impact on its financial position, results of operations or cash flows.

In June 2006, the FASB issued FASB Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes.* This interpretation applies to all tax positions accounted for in accordance with SFAS No. 109, *Accounting for Income Taxes.* FIN 48 clarifies the application of SFAS No. 109 by defining the criteria that an individual tax position must meet in order for the position to be recognized within the financial statements and provides guidance on measurement, de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition for tax positions. This interpretation is effective for fiscal years beginning after December 15, 2006, with earlier adoption permitted. The Company has evaluated the impact of the adoption of this interpretation and has determined that it will not have a material impact on its financial position, results of operations or cash flows.

In June 2006, the EITF released Issue 06-05, *Accounting for Purchases of Life Insurance-Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4, Accounting for Purchases of Life Insurance* . On September 7, 2006, the EITF concluded that a policyholder should consider any additional amounts included in the contractual terms of the policy in determining the amount that could be realized under the insurance contract. Amounts that are recoverable by the policyholder at the discretion of the insurance company should be excluded from the amount that could be realized. Amounts that are recoverable by the policyholder in periods beyond one year from the surrender of the policy should be discounted utilizing an appropriate rate of interest. The effective date of EITF 06-05 is for fiscal years beginning after December 15, 2006. The Company does not expect that the adoption of this Statement will have a material impact on its financial position, results of operations or cash flows.

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Pending Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. This Statement defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. It clarifies that fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the market in which the reporting entity operates. This Statement does not require any new fair value measurements, but rather, it provides enhanced guidance to other pronouncements that require or permit assets or liabilities to be measured at fair value. This Statement is effective for fiscal years beginning after November 15, 2007, with earlier adoption permitted. The Company does not expect that the adoption of this Statement will have a material impact on its financial position, results of operations or cash flows.

At its September 2006 meeting, the Emerging Issues Task Force (EITF) reached a final consensus on Issue 06-04, *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements*. The consensus stipulates that an agreement by an employer to share a portion of the proceeds of a life insurance policy with an employee during the postretirement period is a postretirement benefit arrangement required to be accounted for under SFAS No. 106 or Accounting Principles Board Opinion (APB) No. 12, Omnibus Opinion - 1967. The consensus concludes that the purchase of a split-dollar life insurance policy does not constitute a settlement under SFAS No. 106 and, therefore, a liability for the postretirement obligation must be recognized under SFAS No. 106 if the benefit is offered under an arrangement that constitutes a plan or under APB No. 12, if it is not part of a plan. Issue 06-04 is effective for annual or interim reporting periods beginning after December 15, 2007. The Company has endorsement split-dollar life insurance policies totaling $19.0 million as of December 31, 2006 and is currently assessing the financial statement impact of implementing EITF 06-04.

In November 2006, the EITF released Issue 06-10, *Accounting for Deferred compensation and Postretirement Benefit Aspects of Collateral Assignment Split-Dollar Life Insurance Arrangements*. On November 29, 2006 the FASB ratified the tentative conclusions reached by the EITF on this Issue and approved the issuance of a draft abstract for a public comment period. This Issue addresses questions raised about whether the consensus reached in Issue 06-4 should apply to collateral assignment split-dollar life insurance arrangements and the recognition and measurement of the employer s asset in such arrangements. The EITF concluded that an employer should recognize a liability for the postretirement benefit related to a collateral assignment split-dollar life insurance arrangement in accordance with either SFAS No. 106 or APB No. 12 based on the substantive agreement with the employee. In addition the EITF reached a conclusion that an employer should recognize and measure an asset based on the nature and substance of the collateral assignment split-dollar arrangement based on what future cash flows the employer is entitled to, if any, as well as the employee s obligation and ability to repay the employer. The effective date of EITF 06-10 is for fiscal years beginning after December 15, 2007. The Company had no collateral assignment split dollar life insurance policies as of March 31, 2006 and does not expect that the implementation of EITF 06-10 will have a material impact on its financial position, results of operations or cash flows.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities . This statement permits entities to choose, at specified dates, to measure eligible items at fair value. This election is referred to as the fair value option and must generally be applied on an instrument by instrument basis; is irrevocable, unless a new election occurs; and is applied only to an entire instrument, not to only specified risks, specific cash flows, or portions of an instrument. A business entity that elects the fair value option, must report any unrealized gains and losses on the items involved, in earnings at each subsequent reporting date. The statement also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. The effective date of SFAS No. 159 is for fiscal years beginning after November 15, 2007. The Company does not expect that the adoption of this Statement will have a material impact on its financial position, results of operations or cash flows.

Note 4 Stock Based Compensation

At December 31, 2006, the Company had three stock-based compensation plans in existence, the 1992 and 1999 stock option plans (both expired but having outstanding options that may still be exercised) and the 2005 Omnibus Stock Plan, which is described below.

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The Company s 2005 Omnibus Stock Plan (Omnibus Plan) provides for the granting of non-qualifying stock options to the Company s directors, and incentive and non-qualifying stock options, stock appreciation rights and restricted stock grants to selected key employees on a periodic basis at the discretion of the Board. The Omnibus Plan authorizes the issuance of up to 1,800,000 shares of common stock of which 1,464,263 are available for issuance at March 31, 2007, has a term of ten years, and is administered by a committee of at least three directors appointed by the Board of Directors. Options granted under the plan have an exercise price which may not be less than 100% of the fair market value of the common stock on the date of the grant and must be exercised within ten years from the date of grant. The exercise price of stock options must be paid for in full in cash or shares of common stock, or a combination of both. The Stock Option Committee has the discretion when making a grant of stock options to impose restrictions on the shares to be purchased in exercise of such options. Outstanding options granted under the expired 1992 and 1999 Stock Option Plans will continue until exercise or expiration.

Options awarded prior to December 15, 2005 vest ratably over a two-year period, with one third vesting immediately upon grant. Effective October 19, 2005, the Board of Directors approved the acceleration, by one year, of the vesting of the then outstanding options to purchase approximately 66,000 shares of the Company s common stock granted in December 2004. These included options held by certain members of senior management. This effectively reduced the two-year vesting period on these options to one year. The amount that would have been expensed for such unvested options in 2006 had the Company not accelerated the