

# STATE BANCORP INC

## FORM 10-Q (Quarterly Report)

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Address	2 JERICHO PLZ JERICHO, NY 11753
Telephone	516-465-2200
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Industry	Regional Banks
Sector	Financial
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-Q

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

For the quarterly period ended: **SEPTEMBER 30, 2008**

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. 001-14783

**STATE BANCORP, INC.**

(Exact name of registrant as specified in its charter)

NEW YORK

(State or other jurisdiction of  
incorporation or organization)

11-2846511

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

TWO JERICHO PLAZA, JERICHO, NEW YORK 11753

(Address of principal executive offices) (Zip Code)

(516) 465-2200

(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 requirements for the past 90 days.

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

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 October 23, 2008, there were 14,506,971 shares of registrant's Common Stock outstanding.

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**STATE BANCORP, INC .**  
**Form 10-Q**  
**For the Quarterly Period Ended September 30, 2008**

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**PART I**

**ITEM 1. - FINANCIAL STATEMENTS**

**STATE BANCORP, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)**

September 30, 2008 and December 31, 2007

	September 30, 2008	December 31, 2007
<b>ASSETS:</b>		
Cash and due from banks	\$ 34,477,541	\$ 35,380,214
Securities purchased under agreements to resell	-	61,000,000
Total cash and cash equivalents	34,477,541	96,380,214
Securities available for sale - at estimated fair value	392,423,328	401,229,235
Federal Home Loan Bank and other restricted stock	6,233,143	8,053,643
Loans and leases (net of allowance for loan and lease losses of \$14,572,516 in 2008 and \$14,704,864 in 2007)	1,086,226,998	1,026,304,532
Bank premises and equipment - net	6,452,250	5,777,493
Bank owned life insurance	29,799,137	29,006,619
Net deferred income taxes	20,533,765	17,494,843
Receivable - current income taxes	2,678,208	14,034,377
Receivable - securities sales/calls	-	14,822,820
Other assets	14,343,443	14,910,638
<b>TOTAL ASSETS</b>	<b>\$1,593,167,813</b>	<b>\$1,628,014,414</b>
<b>LIABILITIES:</b>		
<b>Deposits:</b>		
Demand	\$ 327,111,443	\$ 332,464,460
Savings	479,924,478	566,999,841
Time	528,022,736	430,474,815
Total deposits	1,335,058,657	1,329,939,116
Federal funds purchased	4,500,000	-
Other temporary borrowings	101,000,000	139,031,328
Subordinated notes	10,000,000	10,000,000
Junior subordinated debentures	20,620,000	20,620,000
Payable - securities purchases	3,000,000	-
Other accrued expenses and liabilities	7,063,610	14,786,302
Total liabilities	1,481,242,267	1,514,376,746
<b>COMMITMENTS AND CONTINGENT LIABILITIES</b>		
<b>STOCKHOLDERS' EQUITY:</b>		
Preferred stock, \$.01 par value, authorized 250,000 shares; 0 shares issued	-	-
Common stock, \$5.00 par value, authorized 20,000,000 shares; issued 15,489,891 shares in 2008 and 14,996,348 shares in 2007; outstanding 14,502,239 shares in 2008 and 14,008,696 shares in 2007	77,449,455	74,981,740
Surplus	88,989,724	86,654,142
Retained deficit	(31,909,482)	(32,164,263)
Treasury stock (987,652 shares in 2008 and 2007)	(16,646,426)	(16,646,426)
Accumulated other comprehensive (loss) income (net of taxes of (\$3,922,416) in 2008 and \$534,913 in 2007)	(5,957,725)	812,475
Total stockholders' equity	111,925,546	113,637,668
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$1,593,167,813</b>	<b>\$1,628,014,414</b>

*See accompanying notes to unaudited condensed consolidated financial statements.*

**STATE BANCORP, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)**

For the Three and Nine Months Ended September 30, 2008 and 2007

	Three Months		Nine Months	
	2008	2007	2008	2007
<b>INTEREST INCOME:</b>				
Interest and fees on loans and leases	\$ 16,778,178	\$ 20,783,726	\$ 53,370,368	\$ 61,922,130
Federal funds sold and securities purchased under agreements to resell	-	37,670	963,237	2,105,379
Securities held to maturity - taxable	-	-	-	80,541
Securities available for sale - taxable	4,868,898	6,258,452	14,579,365	18,125,460
Securities available for sale - tax-exempt	16,401	130,937	154,646	394,089
Securities available for sale - dividends	-	29,750	39,667	89,250
Dividends on Federal Home Loan Bank and other restricted stock	91,985	231,510	412,834	328,164
<b>Total interest income</b>	<b>21,755,462</b>	<b>27,472,045</b>	<b>69,520,117</b>	<b>83,045,013</b>
<b>INTEREST EXPENSE:</b>				
Deposits	4,979,067	9,719,597	17,875,224	32,494,896
Temporary borrowings	823,943	2,121,502	2,933,161	3,911,312
Subordinated notes	231,186	231,185	693,556	691,264
Junior subordinated debentures	315,734	467,192	994,589	1,381,565
<b>Total interest expense</b>	<b>6,349,930</b>	<b>12,539,476</b>	<b>22,496,530</b>	<b>38,479,037</b>
Net interest income	15,405,532	14,932,569	47,023,587	44,565,976
Provision for loan and lease losses	3,700,000	652,500	10,225,744	2,853,500
<b>Net interest income after provision for loan and lease losses</b>	<b>11,705,532</b>	<b>14,280,069</b>	<b>36,797,843</b>	<b>41,712,476</b>
<b>NON-INTEREST INCOME:</b>				
Service charges on deposit accounts	468,370	447,983	1,623,340	1,586,588
Net security (losses) gains	(9,700)	(15,442)	50,459	(49,891)
Income from bank owned life insurance	275,554	263,606	792,517	823,611
Other operating income	564,323	608,380	1,788,887	1,731,453
<b>Total non-interest income</b>	<b>1,298,547</b>	<b>1,304,527</b>	<b>4,255,203</b>	<b>4,091,761</b>
<b>Income before operating expenses</b>	<b>13,004,079</b>	<b>15,584,596</b>	<b>41,053,046</b>	<b>45,804,237</b>
<b>OPERATING EXPENSES:</b>				
Salaries and other employee benefits	5,631,860	6,294,265	17,370,579	23,881,597
Occupancy	1,425,746	1,404,088	4,200,076	4,045,607
Equipment	301,563	282,876	918,746	935,831
Legal	(196,510)	525,645	2,535,616	1,006,436
Marketing and advertising	150,000	290,809	436,808	1,208,706
Audit and assessment	497,870	279,125	1,150,873	855,967
Other operating expenses	2,355,302	1,754,952	5,902,186	5,278,582
<b>Total operating expenses</b>	<b>10,165,831</b>	<b>10,831,760</b>	<b>32,514,884</b>	<b>37,212,726</b>
<b>INCOME BEFORE INCOME TAXES</b>	<b>2,838,248</b>	<b>4,752,836</b>	<b>8,538,162</b>	<b>8,591,511</b>
<b>PROVISION FOR INCOME TAXES</b>	<b>849,121</b>	<b>1,669,634</b>	<b>2,587,904</b>	<b>2,831,796</b>
<b>NET INCOME</b>	<b>\$ 1,989,127</b>	<b>\$ 3,083,202</b>	<b>\$ 5,950,258</b>	<b>\$ 5,759,715</b>
<b>BASIC EARNINGS PER COMMON SHARE</b>	<b>\$ 0.14</b>	<b>\$ 0.22</b>	<b>\$ 0.42</b>	<b>\$ 0.42</b>
<b>DILUTED EARNINGS PER COMMON SHARE</b>	<b>\$ 0.14</b>	<b>\$ 0.22</b>	<b>\$ 0.42</b>	<b>\$ 0.41</b>
<b>WEIGHTED AVERAGE NUMBER OF SHARES - BASIC</b>	<b>14,207,743</b>	<b>13,820,383</b>	<b>14,097,522</b>	<b>13,688,170</b>
<b>WEIGHTED AVERAGE NUMBER OF SHARES - DILUTED</b>	<b>14,267,510</b>	<b>13,943,622</b>	<b>14,136,695</b>	<b>14,006,757</b>

*See accompanying notes to unaudited condensed consolidated financial statements.*

**STATE BANCORP, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**

For the Nine Months Ended September 30, 2008 and 2007

	2008	2007
<b>OPERATING ACTIVITIES:</b>		
Net income	\$ 5,950,258	\$ 5,759,715
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Provision for loan and lease losses	10,225,744	2,853,500
Depreciation and amortization of bank premises and equipment	996,061	912,711
Amortization of net premium on securities	1,448,679	1,072,776
Deferred income tax expense	1,418,407	2,043,164
Net security (gains) losses	(50,459)	49,891
Income from bank owned life insurance	(792,517)	(823,611)
Restricted stock awards	259,989	-
Stock-based compensation expense	559,208	474,964
Shares issued under the directors' stock plan	701,578	-
Decrease in receivable - current income taxes	11,356,169	-
Decrease (increase) in other assets	567,194	(3,698,043)
Decrease in accrued legal expenses	(619,339)	(64,550,208)
(Decrease) increase in other accrued expenses and other liabilities	(7,103,353)	1,718,735
<b>Net cash provided by (used in) operating activities</b>	<b>24,917,619</b>	<b>(54,186,406)</b>
<b>INVESTING ACTIVITIES:</b>		
Proceeds from maturities of securities held to maturity	-	6,375,996
Proceeds from sales of securities available for sale	84,991,228	120,996,329
Proceeds from maturities of securities available for sale	155,810,357	210,757,808
Purchases of securities available for sale	(226,798,607)	(345,750,864)
Decrease (increase) in Federal Home Loan Bank and other restricted stock	1,820,500	(10,080,300)
Increase in loans and leases - net	(70,148,210)	(29,958,814)
Purchases of bank premises and equipment - net	(1,670,818)	(798,718)
<b>Net cash used in investing activities</b>	<b>(55,995,550)</b>	<b>(48,458,563)</b>
<b>FINANCING ACTIVITIES:</b>		
Decrease in demand and savings deposits	(92,428,380)	(75,347,865)
Increase (decrease) in time deposits	97,547,921	(219,205,063)
Increase in federal funds purchased	4,500,000	9,000,000
(Decrease) increase in other temporary borrowings	(38,031,328)	221,981,669
Increase in overnight sweep accounts payable, net	-	13,896,435
Cash dividends paid	(5,702,488)	(4,138,443)
Private placement expenses	-	(252,735)
Proceeds from shares issued under dividend reinvestment plan	2,737,469	2,296,695
Proceeds from shares issued pursuant to compensation awards	552,064	1,313,144
<b>Net cash used in financing activities</b>	<b>(30,824,742)</b>	<b>(50,456,163)</b>
<b>NET DECREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(61,902,673)</b>	<b>(153,101,132)</b>
<b>CASH AND CASH EQUIVALENTS - JANUARY 1</b>	<b>96,380,214</b>	<b>206,210,873</b>
<b>CASH AND CASH EQUIVALENTS - SEPTEMBER 30</b>	<b>\$ 34,477,541</b>	<b>\$ 53,109,741</b>
<b>SUPPLEMENTAL DATA:</b>		
Interest paid	\$ 23,093,879	\$ 38,124,161
Income taxes paid	\$ 154,551	\$ 70,829

*See accompanying notes to unaudited condensed consolidated financial statements.*

**STATE BANCORP, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**  
**AND COMPREHENSIVE INCOME (UNAUDITED)**

For the Nine Months Ended September 30, 2008 and 2007

	Common Stock	Surplus	Retained Deficit	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity	Comprehensive Income (Loss)
Balance, January 1, 2008	\$ 74,981,740	\$ 86,654,142	\$ (32,164,263)	\$ (16,646,426)	\$ 812,475	\$ 113,637,668	
Comprehensive loss:							
Net income	-	-	5,950,258	-	-	5,950,258	<u>\$ 5,950,258</u>
Other comprehensive loss, net of tax:							
Unrealized holding losses arising during the period (1)	-	-	-	-	-		(6,739,771)
Reclassification adjustment for gains included in net income (2)	-	-	-	-	-		(30,429)
Total other comprehensive loss	-	-	-	-	(6,770,200)	(6,770,200)	<u>(6,770,200)</u>
Total comprehensive loss	-	-	-	-	-		<u>\$ (819,942)</u>
Cash dividend (\$0.40 per share)	-	-	(5,702,488)	-	-	(5,702,488)	
Shares issued under the dividend reinvestment plan (226,040 shares at 95% of market value)	1,130,200	1,607,269	-	-	-	2,737,469	
Shares issued under the directors' stock plan (48,122 shares)	240,610	460,968	-	-	-	701,578	
Shares issued upon exercises of stock options (60,009 shares)	300,045	252,019	-	-	-	552,064	
Restricted stock awards (159,372 shares)	796,860	(536,871)	-	-	-	259,989	
Stock-based compensation expense	-	552,197	7,011	-	-	559,208	
Balance, September 30, 2008	<u>\$ 77,449,455</u>	<u>\$ 88,989,724</u>	<u>\$ (31,909,482)</u>	<u>\$ (16,646,426)</u>	<u>\$ (5,957,725)</u>	<u>\$ 111,925,546</u>	
Balance, January 1, 2007	\$ 73,021,015	\$ 83,767,505	\$ (32,158,439)	\$ (16,646,426)	\$ (3,843,145)	\$ 104,140,510	
Comprehensive income:							
Net income	-	-	5,759,715	-	-	5,759,715	<u>\$ 5,759,715</u>
Other comprehensive income,							

net of tax:							
Unrealized holding gains arising during the period (1)	-	-	-	-	-	-	2,845,211
Reclassification adjustment for losses included in net income (2)	-	-	-	-	-	-	30,078
Cash flow hedges (3)	-	-	-	-	-	-	162,108
Total other comprehensive income	-	-	-	-	3,037,397	3,037,397	3,037,397
Total comprehensive income	-	-	-	-	-	-	<u>\$ 8,797,112</u>
Cash dividend (\$0.30 per share)	-	-	(4,138,443)	-	-	-	(4,138,443)
Shares issued under the dividend reinvestment plan (131,705 shares at 95% of market value)	658,525	1,638,170	-	-	-	-	2,296,695
Shares issued upon exercises of stock options (195,815 shares)	979,075	334,069	-	-	-	-	1,313,144
Stock-based compensation expense	(2,855)	477,819	-	-	-	-	474,964
Private placement expenses	-	(252,735)	-	-	-	-	(252,735)
Balance, September 30, 2007	<u>\$ 74,655,760</u>	<u>\$ 85,964,828</u>	<u>\$ (30,537,167)</u>	<u>\$ (16,646,426)</u>	<u>\$ (805,748)</u>	<u>\$ 112,631,247</u>	

(1) Net of taxes of (\$4,437,299) and \$1,460,118 in 2008 and 2007, respectively.

(2) Net of taxes of \$20,030 and \$19,813 in 2008 and 2007, respectively.

(3) Net of taxes of \$107,892 in 2007.

*See accompanying notes to unaudited condensed consolidated financial statements.*



## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

### 1. FINANCIAL STATEMENT PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

The condensed consolidated financial statements include the accounts of State Bancorp, Inc. and its wholly owned subsidiary, State Bank of Long Island (the "Bank"). The Bank's consolidated financial statements include the accounts of its wholly owned subsidiaries, SB Portfolio Management Corp. ("SB Portfolio"), SB Financial Services Corp. ("SB Financial"), SB ORE Corp., SB Equipment Leasing Corp. ("SB Equipment"), formerly known as Studebaker-Worthington Leasing Corp., and New Hyde Park Leasing Corporation and its subsidiaries, P.W.B. Realty, L.L.C. and State Title Agency, LLC. SB Portfolio is a fixed income portfolio management subsidiary that currently has no assets under management, and SB Financial provides balance sheet management services with a focus on interest rate risk management. On June 2, 2008, the Bank completed the previously announced sale of substantially all of the assets of its leasing subsidiary, SB Equipment. State Bancorp, Inc. and subsidiaries are collectively referred to hereafter as the "Company." All intercompany accounts and transactions have been eliminated.

In addition to the foregoing, the Company has two other subsidiaries, State Bancorp Capital Trust I and II, neither of which are consolidated with the Company for reporting purposes in accordance with Financial Accounting Standards Board revised Interpretation No. 46, "Consolidation of Variable Interest Entities, an interpretation of ARB No. 51." State Bancorp Capital Trust I and II were formed in 2002 and 2003, respectively, for the purpose of issuing trust preferred securities, the proceeds of which were used to acquire junior subordinated debentures issued by the Company. The Company has fully and unconditionally guaranteed the trust preferred securities along with all obligations of State Bancorp Capital Trust I and II under the trust agreements relating to the respective trust preferred securities. See Note 8 of the Notes to Consolidated Financial Statements included in Item 8, "Financial Statements and Supplementary Data" of the Company's 2007 Annual Report on Form 10-K.

In the opinion of the Company's management, the preceding unaudited condensed consolidated financial statements contain all adjustments, consisting of normal accruals, necessary for a fair presentation of its condensed consolidated balance sheets as of September 30, 2008 and December 31, 2007, its condensed consolidated statements of income for the three and nine months ended September 30, 2008 and 2007, its condensed consolidated statements of cash flows for the nine months ended September 30, 2008 and 2007 and its condensed consolidated statements of stockholders' equity and comprehensive income for the nine months ended September 30, 2008 and 2007, in accordance with accounting principles generally accepted in the United States of America. The results of operations for the three and nine months ended September 30, 2008 are not necessarily indicative of the results of operations to be expected for the remainder of the year. For further information, please refer to the consolidated financial statements and footnotes thereto included in the Company's 2007 Annual Report on Form 10-K.

#### *Accounting for Stock-Based Compensation*

The Company accounts for stock-based compensation on a modified prospective basis with the cost of any subsequent grants of stock-based compensation to be reflected in the income statement.

#### *Accounting for Derivative Financial Instruments*

From time to time, the Bank may execute customer interest rate swap transactions together with offsetting interest rate swap transactions with institutional dealers. Each swap is mutually exclusive, and the swaps are marked to market with changes in fair value recognized as other income, with the fair value for each individual swap offsetting the corresponding other. When Lehman Brothers Holdings, Inc. ("Lehman") filed a voluntary petition for bankruptcy on September 15, 2008, an event of default was triggered under the swap agreements the Company had with an affiliate of Lehman. This resulted in several customer transactions no longer offset by those with institutional dealers and a loss to the Company on those swap agreements of approximately \$584 thousand in the third quarter of 2008. Future changes in the fair value of these swap agreements will no longer be offset and will be recognized as income or loss as appropriate. For the three and nine months ended September 30, 2007 and for the first six months of 2008, neither income nor losses associated with interest rate swap transactions were material to the financial statements. At September 30, 2008 and December 31, 2007, the total gross notional amount of swap transactions outstanding was \$28,158,011 and \$43,246,209, respectively. The customer swap program provides a customer financing option that can result in longer maturity terms without incurring the associated interest rate risk. The Company does not hold any derivative financial instruments for trading purposes.

The Bank was party to two swap agreements that hedged a portion of the interest rate variability in its portfolio of prime rate loans. In 2005, the Bank terminated these two interest rate swap agreements in support of enhancing its interest rate sensitivity position. The entire cost to unwind the swap agreements was fully amortized at December 31, 2007, and thus no expenses were recognized during the nine months ended September 30, 2008. For the three and nine months ended September 30, 2007, the Company recognized \$90,000 and \$270,000, respectively, of such expenses.

#### *Accounting for Bank Owned Life Insurance*

The Bank is the beneficiary of a policy that insures the lives of certain current and former senior officers of the Bank and its subsidiaries. The Company has recognized the cash surrender value, or the amount that can be realized under the insurance policy, as an asset in the consolidated balance sheets. Changes in the cash surrender value are recorded in other income.

*Effect of Recently Issued Accounting Standards on the Financial Statements*

In February 2007, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards (“SFAS”) No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities.” The standard provides companies with an option to report selected financial assets and liabilities at fair value and establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. The new standard was effective for the Company on January 1, 2008. The Company did not elect the fair value option for any financial assets or financial liabilities as of January 1, 2008.

In November 2007, the Securities and Exchange Commission (“SEC”) issued Staff Accounting Bulletin (“SAB”) No. 109, “Written Loan Commitments Recorded at Fair Value Through Earnings.” SAB No. 109 provides views on the accounting for written loan commitments recorded at fair value under GAAP. SAB No. 109 supersedes SAB No. 105, “Application of Accounting Principles to Loan Commitments.” Specifically, SAB No. 109 states that the expected net future cash flows related to the associated servicing of a loan should be included in the measurement of all written loan commitments that are accounted for at fair value through earnings. The provisions of SAB No. 109 are applicable on a prospective basis to written loan commitments recorded at fair value under GAAP that are issued or modified in fiscal quarters beginning on or after December 15, 2007. The adoption of this standard did not have a material impact on the Company’s consolidated financial statements.

In December 2007, the FASB issued revised SFAS No. 141, “Business Combination,” or SFAS No. 141(R). SFAS No. 141(R) retains the fundamental requirements of SFAS No. 141 that the acquisition method of accounting (formerly the purchase method) be used for all business combinations; that an acquirer be identified for each business combination; and that intangible assets be identified and recognized separately from goodwill. SFAS No. 141(R) requires the acquiring entity in a business combination 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. Additionally, SFAS No. 141(R) changes the requirements for recognizing assets acquired and liabilities assumed arising from contingencies and recognizing and measuring contingent consideration. SFAS No. 141(R) also enhances the disclosure requirements for business combinations. SFAS No. 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008 and may not be applied before that date. SFAS No. 141(R) is effective for all business combinations closing on or after January 1, 2009 and may or may not have a significant impact on the Company accounting for business combinations on or after such date.

In December 2007, the FASB issued SFAS No. 160, “Noncontrolling Interests in Consolidated Financial Statements - an amendment of ARB No. 51.” SFAS No. 160 amends Accounting Research Bulletin No. 51, “Consolidated Financial Statements,” to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. Among other things, SFAS No. 160 clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements and requires consolidated net income to be reported at amounts that include the amounts attributable to both the parent and the noncontrolling interest. SFAS No. 160 also amends SFAS No. 128, “Earnings per Share,” so that earnings per share calculations in consolidated financial statements will continue to be based on amounts attributable to the parent. SFAS No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008 and is applied prospectively as of the beginning of the fiscal year in which it is initially applied, except for the presentation and disclosure requirements which are to be applied retrospectively for all periods presented. The Company has not yet completed its evaluation of the impact of adopting this standard.

Effective January 1, 2008, the Company adopted Emerging Issues Task Force (“EITF”) Issue No. 06-11, “Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards,” which clarifies the accounting for income tax benefits related to the payment of dividends on equity-classified employee share-based payment awards that are charged to retained earnings under revised SFAS No. 123, “Share-Based Payment.” The EITF concluded that a realized income tax benefit from dividends or dividend equivalents that are charged to retained earnings and are paid to employees for equity classified non-vested equity shares, non-vested equity share units and outstanding equity share options should be recognized as an increase to additional paid-in capital (“APIC”). However, the dividend is not yet realized due to the Bank’s NOL carried-forward. Therefore, the unrealized income tax benefits from the dividend will not be recognized in APIC. Our adoption of EITF Issue No. 06-11 did not have a material impact on our financial condition or results of operations.

In March 2008, the FASB issued SFAS No. 161, “Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133.” SFAS No. 161 amends and expands the disclosure requirements of SFAS No. 133, “Accounting for Derivative Instruments and Hedging Activities,” to provide users of financial statements with an enhanced understanding of: (1) how and why an entity uses derivative instruments; (2) how derivative instruments and related hedged items are accounted for; and (3) how such items affect an entity’s financial position, performance and cash flows. SFAS No. 161 requires qualitative disclosures about objectives and strategies for using derivative instruments, quantitative disclosures about fair value amounts of gains and losses on derivative instruments and disclosures about credit-risk-related contingent features in derivative agreements. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. SFAS No. 161 also encourages, but does not require, disclosures for earlier periods presented for comparative purposes at initial adoption. Since the provisions of SFAS No. 161 are disclosure related, the adoption of SFAS No. 161 will not have an impact on the Company’s financial condition or results of operations.

In May 2008, the FASB issued SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles." SFAS No. 162 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with GAAP. SFAS No. 162 will be effective 60 days following the approval by the SEC of the Public Company Accounting Oversight Board amendments to AU Section 411, "The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles." Any effect of applying the provisions of SFAS No. 162 shall be reported as a change in the accounting principle in accordance with SFAS No. 154, "Accounting Changes and Error Corrections." Additionally, the accounting principles that were used before and after the application of SFAS No. 162 and the reason why applying SFAS No. 162 resulted in a change in accounting principles are to be disclosed. SFAS No. 162 is not expected to result in any change in our accounting principles and, therefore, will not have an impact on our financial condition or results of operations.

In June 2008, the FASB issued Staff Position ("FSP") EITF 03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transactions are Participating Securities," which addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing EPS under the two-class method described in SFAS No. 128, "Earnings per Share." The FSP concluded that unvested share-based payment awards that contain nonforfeitable rights to dividend equivalents are participating securities and shall be included in the computation of EPS pursuant to the two-class method. Our restricted stock awards are considered participating securities. FSP EITF 03-6-1 is effective for fiscal years beginning after December 15, 2008, and interim periods within those years. All prior-period EPS data presented shall be adjusted retrospectively to conform with the provisions of the FSP. Early application is not permitted. FSP EITF 03-6-1 is not expected to have a material impact on our computation of EPS.

In September 2008, the FASB issued FSP No. 133-1 and FIN 45-4, "Disclosures about Credit Derivatives and Certain Guarantees: An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45; and Clarification of the Effective Date of FASB Statement No. 161." The FSP is intended to improve disclosures about credit derivatives by requiring more information about the potential adverse effects of changes in credit risk on the financial position, financial performance, and cash flows of the sellers of credit derivatives. It amends SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," to require disclosures by sellers of credit derivatives, including credit derivatives embedded in hybrid instruments. The FSP also amends FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness to Others," to require an additional disclosure about the current status of the payment/performance risk of a guarantee. Finally, the FSP clarifies the Board's intent about the effective date of SFAS No. 161 that the disclosures required should be provided for any reporting period (annual or quarterly interim) beginning after November 15, 2008. The provisions of the FSP that amend Statement 133 and Interpretation 45 are effective for reporting periods (annual or interim) ending after November 15, 2008. Since the provisions are disclosure related, the adoption of the FSP will not have an impact on the Company's financial condition or results of operations.

## 2. STOCKHOLDERS' EQUITY

The Company has 250,000 shares of preferred stock authorized. No shares have been issued as of September 30, 2008.

Stock held in treasury by the Company is reported as a reduction to total stockholders' equity. During the first nine months of 2008, the Company did not repurchase any of its common shares.

## 3. EARNINGS PER SHARE

Basic earnings per common share is computed based on the weighted-average number of shares outstanding. Diluted earnings per share is computed based on the weighted average number of shares outstanding, increased by the number of common shares that are assumed to have been purchased with the proceeds from the exercise of stock options. These purchases were assumed to have been made at the average market price of the common stock. The average market price is based on the average closing price for the common stock.

	Three Months		Nine Months	
	2008	2007	2008	2007
Net income	\$ 1,989,127	\$ 3,083,202	\$ 5,950,258	\$ 5,759,715
Average market price	\$ 13.95	\$ 16.13	\$ 13.38	\$ 18.32
Weighted average common shares outstanding	14,207,743	13,820,383	14,097,522	13,688,170
Dilutive effect of stock options and restricted stock grants	59,767	123,239	39,173	318,587
Adjusted common shares outstanding - diluted	14,267,510	13,943,622	14,136,695	14,006,757
Net income per share – basic	\$ 0.14	\$ 0.22	\$ 0.42	\$ 0.42
Net income per share – diluted	\$ 0.14	\$ 0.22	\$ 0.42	\$ 0.41
Antidilutive potential shares not included in the calculation	366,514	445,428	430,784	243,973

#### 4. SECURITIES HELD TO MATURITY AND SECURITIES AVAILABLE FOR SALE

At the time of purchase of a security, the Company designates the security as either available for sale or held to maturity, depending upon investment objectives, liquidity needs and intent. Securities held to maturity are stated at cost, adjusted for premium amortized or discount accreted, if any. The Company has the positive intent and ability to hold such securities to maturity. Securities available for sale are stated at estimated fair value. Unrealized gains and losses are excluded from income and reported net of tax as accumulated other comprehensive income (loss) as a separate component of stockholders' equity until realized. Interest earned on investment securities is included in interest income. Realized gains and losses on the sale of securities are reported in the consolidated statements of income and determined using the adjusted cost of the specific security sold.

Declines in the fair value of securities below their cost that are other than temporary are reflected as realized losses. In estimating other-than-temporary losses, management considers: (1) the length of time and extent that fair value has been less than cost, (2) the financial condition and near term prospects of the issuer and (3) the Company's ability and intent to hold the security for a period sufficient to allow for any anticipated recovery in fair value. In analyzing an issuer's financial condition, the Company's management considers whether the securities are issued by the U.S. Government or its agencies, whether downgrades by bond rating agencies have occurred and industry analysts' reports. The Company's management currently conducts impairment evaluations at least on a quarterly basis and has concluded that, at September 30, 2008, there were no other-than-temporary impairments of the Company's investment securities.

At September 30, 2008 and December 31, 2007, the Company had no securities held to maturity. The amortized cost, gross unrealized gains and losses and estimated fair value of securities available for sale at September 30, 2008 and December 31, 2007 are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
<b>September 30, 2008</b>				
Securities available for sale:				
Obligations of states and political subdivisions	\$ 4,780,106	\$ 434	\$ (1,106)	\$ 4,779,434
Government Agency securities	22,604,890	412,593	(28,585)	22,988,898
Corporate debt securities	3,000,000	-	-	3,000,000
Trust preferred securities	12,070,085	-	(9,370,085)	2,700,000
Mortgage-backed securities and collateralized mortgage obligations:				
FHLMC	212,052,369	801,146	(1,068,154)	211,785,361
FNMA	131,332,662	456,870	(977,033)	130,812,499
GNMA	16,463,357	34,692	(140,913)	16,357,136
<b>Total securities available for sale</b>	<b>\$ 402,303,469</b>	<b>\$ 1,705,735</b>	<b>\$ (11,585,876)</b>	<b>\$ 392,423,328</b>
<b>December 31, 2007</b>				
Securities available for sale:				
Obligations of states and political subdivisions	\$ 18,140,263	\$ 4,528	\$ (49,634)	\$ 18,095,157
Government Agency securities	149,638,982	930,453	(35,148)	150,534,287
Corporate debt securities	3,009,980	-	(9,981)	2,999,999
Trust preferred securities	12,076,760	-	(576,760)	11,500,000
Mortgage-backed securities and collateralized mortgage obligations:				
FHLMC	135,674,183	1,502,606	(403,665)	136,773,124
FNMA	72,766,460	581,887	(538,432)	72,809,915
GNMA	7,361,553	14,123	(38,856)	7,336,820
Other	1,213,666	-	(33,733)	1,179,933
<b>Total securities available for sale</b>	<b>\$ 399,881,847</b>	<b>\$ 3,033,597</b>	<b>\$ (1,686,209)</b>	<b>\$ 401,229,235</b>

Information pertaining to securities with gross unrealized losses at September 30, 2008 and December 31, 2007, aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

	Less than 12 Months		12 Months or Longer		Total	
	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value
<b>September 30, 2008</b>						
Securities available for sale:						
Obligations of states and political subdivisions	\$ (1,106)	\$ 250,000	\$ -	\$ -	\$ (1,106)	\$ 250,000
Government Agency securities	(28,585)	7,577,671	-	-	(28,585)	7,577,671
Trust preferred securities	-	-	(9,370,085)	2,700,000	(9,370,085)	2,700,000
Mortgage-backed securities and collateralized mortgage obligations:						
FHLMC	(811,015)	104,723,512	(257,139)	20,073,333	(1,068,154)	124,796,845
FNMA	(439,298)	38,549,015	(537,735)	28,849,822	(977,033)	67,398,837
GNMA	(140,913)	10,675,287	-	-	(140,913)	10,675,287
<b>Total securities available for sale</b>	<b>\$ (1,420,917)</b>	<b>\$ 161,775,485</b>	<b>\$ (10,164,959)</b>	<b>\$ 51,623,155</b>	<b>\$ (11,585,876)</b>	<b>\$ 213,398,640</b>

### December 31, 2007

Securities available for sale:						
Obligations of states and political subdivisions	\$ (48,137)	\$ 4,770,745	\$ (1,497)	\$ 124,943	\$ (49,634)	\$ 4,895,688
Government Agency securities	(11,748)	11,987,830	(23,400)	14,976,600	(35,148)	26,964,430
Corporate debt securities	(9,981)	2,999,999	-	-	(9,981)	2,999,999
Trust preferred securities	-	-	(576,760)	11,500,000	(576,760)	11,500,000
Mortgage-backed securities and collateralized mortgage obligations:						
FHLMC	(752)	721,991	(402,913)	30,873,800	(403,665)	31,595,791
FNMA	(16,645)	1,437,042	(521,787)	38,756,472	(538,432)	40,193,514
GNMA	(1,718)	341,934	(37,138)	5,261,228	(38,856)	5,603,162
Other	-	-	(33,733)	1,179,933	(33,733)	1,179,933
<b>Total securities available for sale</b>	<b>\$ (88,981)</b>	<b>\$ 22,259,541</b>	<b>\$ (1,597,228)</b>	<b>\$ 102,672,976</b>	<b>\$ (1,686,209)</b>	<b>\$ 124,932,517</b>

The securities, at estimated fair value, that have been in a continuous loss position for 12 months or longer at September 30, 2008 are categorized as: (1) adjustable rate mortgage-backed securities totaling \$11,791,929; (2) fixed rate mortgage-backed securities totaling \$37,131,226; (3) adjustable rate trust preferred securities totaling \$1,500,000; and (4) fixed rate trust preferred securities totaling \$1,200,000. The market value and, therefore, the loss position for each type of security respond differently to market conditions. In management's opinion, those market conditions are temporary in nature and provide the basis for the Company's belief that the declines are temporary.

In the case of adjustable rate securities, the coupon rate resets periodically and is typically comprised of a base market index rate plus a credit spread. The market value of these securities is primarily influenced by the length of time remaining before the coupon rate resets to market levels, as well as the current levels for credit spreads. As an adjustable rate security approaches a reset date, it is likely that an unrealized loss position would dissipate provided that the market level for credit spreads are the same or lower than the spread imbedded in the security. As credit spreads widen from the level originally imbedded in the price of a security, a security typically will experience price depreciation. Recovery of the decline in market value of a security due to credit spread widening will occur when credit spreads return to the levels when the security was purchased or when the security matures.

The market value for fixed rate securities changes inversely with changes in interest rates. When interest rates are falling, the market value of fixed rate securities will appreciate, whereas in a rising interest rate environment, the market value of fixed rate securities will depreciate. The market value of fixed rate securities is also affected with the passage of time. The closer a fixed rate security approaches its maturity date, the closer the market value of the security approaches par value.

It is important to note that every category of security mentioned above will mature at a specified date and at par value. Any temporary changes in market value due to market rates will have no impact on the security's ultimate value at maturity. Management believes that the investment securities held by the Company provide an attractive level of interest income and, as the Bank has access to various alternate liquidity sources, management intends to hold these securities for the foreseeable future. However, those classified as "available for sale" could be sold, regardless of their market value, should business conditions or balance sheet management strategies warrant such sale.



There is no subprime exposure in the Company's securities portfolio. All of the mortgage-backed securities and collateralized mortgage obligations held in the Company's portfolio are issued by U.S. Government-sponsored agencies or the underlying mortgage loans are guaranteed by U.S. Government-sponsored agencies. The portfolio contains one single-issuer trust preferred security with an amortized cost of \$2.1 million and an estimated fair value of \$1.2 million. This issue is rated Baa1 by Moody's Investors Service, BBB- by Standard & Poor's and BBB+ by Fitch, Inc. Based upon the financial condition of the issuer, the Company believes the decline in market value to be temporary and therefore the security is not other than temporarily impaired. This fixed rate security has been in a continuous loss position for twelve months or longer at September 30, 2008. In the event that the security's current rating is downgraded or the issuer's financial condition is not deemed adequate to meet its debt obligations, the Company will evaluate it for other than temporary impairment at that time. In addition, the portfolio contains one collateralized debt obligation, which is backed by a portfolio of bank-only pooled trust preferred securities with an amortized cost of \$10 million. The current market for these instruments is very limited with few trades occurring. The pool sponsor has estimated the current value to be approximately \$1.5 million if the security were liquidated. The issue is credit enhanced, with over-collateralization of principal and / or excess spread, and is rated Baa3 by Moody's Investors Service and A- by Fitch, Inc. Based upon management's projected cash flows, review of financial data for banks included in the pool and review of the level of over-collateralization of the pool, the Company believes the value of the security is greater than \$1.5 million and that the decline in market value is temporary. Therefore an impairment charge has not been reflected in earnings. This adjustable rate security has been in a continuous loss position for twelve months or longer at September 30, 2008. In the event that this security's projected cash flows are not adequate to meet contractual obligations, the Company will evaluate it for other than temporary impairment at that time.

##### 5. LOANS AND LEASES

The Company's loan and lease portfolio is concentrated primarily in commercial and industrial loans and commercial mortgage loans. At September 30, 2008, \$4.5 million in loans held for sale were included in net loans. At December 31, 2007, there were no loans held for sale.

The recorded investment in loans that are considered to be impaired, as of September 30, 2008 and December 31, 2007, is summarized below:

	September 30, 2008	December 31, 2007
Impaired loans with related allowances for loss	\$ 10,804,770	\$ 3,734,156
Allowance for loss on impaired loans	(2,039,494)	(1,537,256)
	8,765,276	2,196,900
Impaired loans with no related allowances for loss	1,662,176	287,778
Net impaired loans	<u>\$ 10,427,452</u>	<u>\$ 2,484,678</u>
	Third Quarter 2008	Full Year 2007
Average impaired loans	\$ 12,666,538	\$ 5,746,758

Interest income of \$11,733 and \$57,514, respectively, was recognized on impaired loans for the three and nine months ended September 30, 2008. For the nine months ended September 30, 2007, \$16,198 in interest income was recognized on impaired loans. No such interest income was recognized for the three months ended September 30, 2007.

Activity in the allowance for loan and lease losses for the nine months ended September 30, 2008 and 2007 is as follows:

	2008	2007
Balance, January 1	\$ 14,704,864	\$ 16,411,925
Adjustment due to sale of SB Equipment assets	(2,002,155)	-
Provision charged to income	10,225,744	2,853,500
Charge-offs	(8,627,296)	(4,920,301)
Recoveries	271,359	313,782
Balance, September 30	<u>\$ 14,572,516</u>	<u>\$ 14,658,906</u>



The level of loans classified as special mention, substandard or doubtful by the Company's loan grading process has declined from \$74,314,833 at December 31, 2007 to \$52,950,512 at September 30, 2008.

## 6. LEGAL PROCEEDINGS

### Purported Shareholder Derivative Suit

On July 18, 2007, the Company was served with a Summons and Complaint in a purported shareholder derivative lawsuit, filed in the Supreme Court of the State of New York, County of Nassau (Index No. 07-012411) by Ona Guthartz, First Wall Securities, Inc. and Alan Guthartz as custodian for Jason Guthartz, identifying themselves as shareholders of the Company and purporting to act on behalf of the Company, naming the Company as a nominal defendant and certain of the Company's current and former directors and officers as defendants. The lawsuit alleged, among other things, (1) that the defendant directors and officers breached their fiduciary duty to the Company in connection with the Company's previously disclosed dealings with Island Mortgage Network, Inc. ("IMN") and the resulting litigation in the United States District Court for the Eastern District of New York (the "IMN Matter") and (2) that the directors engaged in corporate waste by awarding bonuses to certain officers who had responsibility for the IMN relationship and by offering a voluntary exit window program to those same officers, each of which have been previously disclosed by the Company. An amount of damages was not specified in the Complaint.

At the Company's Board of Directors meeting held on July 24, 2007, a Special Litigation Committee of the Board of Directors was established to examine the merits of the allegations made in the lawsuit. The members of the Special Litigation Committee were Nicos Katsoulis and the Honorable John J. LaFalce.

On June 12, 2008, all parties to the lawsuit executed a non-binding Stipulation of Settlement that would dispose of the lawsuit. On June 16, 2008 the Honorable Ira B. Warshawsky, J.S.C. signed an Order of Preliminary Approval of Settlement and Form of Notice ("Preliminary Order") with regard to the Stipulation of Settlement among the parties. The Preliminary Order was entered in the County Clerk's Office, Nassau County on June 17, 2008.

As announced by the Company on June 18, 2008, the Company agreed to implement certain corporate governance provisions within 30 days after the effective date of the Stipulation of Settlement. The Stipulation of Settlement includes no admission of liability by the Company, the Bank or any of the defendants named in the lawsuit.

The Preliminary Order was subject to final determination by the Court as to the fairness, reasonableness and adequacy of the Stipulation of Settlement. A fairness hearing was held August 5, 2008 before Judge Ira B. Warshawsky at the Supreme Court of the State of New York, Nassau County, New York, at which time Judge Warshawsky signed a Final Judgment and Order of Dismissal ("Final Judgment") with regard to the Stipulation of Settlement among the parties. The Final Judgment was entered in the County Clerk's Office, Nassau County on August 5, 2008. In addition to issuing final approval of the Stipulation of Settlement, the Final Judgment approved the award to plaintiffs' counsel of attorneys' fees in the sum of \$1,000,000 and expenses in the sum of \$27,839. The Court also determined that each of the individual defendants are fairly and reasonably entitled to be indemnified by the Company for their legal fees and expenses incurred in connection with the defense and settlement of the lawsuit. Gulf Insurance Company agreed to pay an additional \$575 thousand to the Company (above the \$1.2 million agreed to in the Stipulation of Settlement) in final settlement of all insurance claims related to this matter. Upon receipt of these insurance proceeds, the Company recorded a legal expense credit of \$197 thousand during the third quarter of 2008 to offset a portion of the Company's costs incurred in connection with the lawsuit. The statutory appeal period for the Final Judgment expired September 4, 2008. For the nine months ended September 30, 2008, the Company incurred \$1.7 million in expenses related to this lawsuit (net of reimbursement from Gulf Insurance Company). For the nine and twelve month periods ended September 30, 2007 and December 31, 2007, the Company incurred \$500 thousand and \$1.9 million, respectively, of such expenses. All such costs incurred have been recognized in the Company's financial statements.

Effective September 29, 2008 in accordance with the Stipulation of Settlement, the Company's Board amended the Company's bylaws (the "Bylaws") to (a) subject to stockholder approval, require the affirmative vote of a majority of stockholders in an uncontested election of directors, and, in a contested election, require a plurality vote for election of directors. (Previously, a plurality of the votes cast was sufficient to elect directors in both uncontested and contested elections); (b) add a new provision providing that a director who is an employee of the Company and/or its bank subsidiary and then ceases such employment, shall cease to be a director on the day prior to the date of the next stockholders' meeting at which directors are to be elected; (c) add a new provision requiring at least two-thirds of the Board of Directors to consist of directors who are non-management and non-former management of the Company; and (d) add a new provision providing that no director may serve as chairman of the same Board committee, other than the Audit Committee, for more than three (3) consecutive years.

### Other

The Company and the Bank are subject to legal proceedings and claims that arise in the ordinary course of business. In the opinion of management, the amount of ultimate liability, if any, with respect to such matters will not materially affect future operations and will not have a material impact on the Company's financial statements.

## 7. REGULATORY MATTERS

The Company and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated financial statements. Under the capital adequacy guidelines, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The Company's and the Bank's capital amounts and the Bank's classification are also subject to qualitative judgments by the federal banking regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios of total capital and Tier I capital, as defined in the federal banking regulations, to risk-weighted assets and of Tier I capital to average assets as shown in the following table. Each of the Company's and the Bank's capital ratios exceeds applicable regulatory capital requirements and the Bank meets the requisite capital ratios to be well-capitalized as of September 30, 2008 and December 31, 2007. There are no subsequent conditions or events that management believes have changed the Company's or the Bank's capital adequacy. The Company's and the Bank's capital amounts (in thousands) and ratios are as follows:

	Actual		For Capital Adequacy Purposes		To Be Considered Well-Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>As of September 30, 2008:</b>						
Tier I Capital to Total Adjusted Average Assets (Leverage):						
The Company	\$ 127,110	8.05%	\$ 63,178	4.00%	N/A	N/A
The Bank	\$ 132,045	8.37%	\$ 63,141	4.00%	\$ 78,926	5.00%
Tier I Capital to Risk-Weighted Assets:						
The Company	\$ 127,110	10.32%	\$ 49,252	4.00%	N/A	N/A
The Bank	\$ 132,045	10.75%	\$ 49,123	4.00%	\$ 73,684	6.00%
Total Capital to Risk-Weighted Assets:						
The Company	\$ 151,683	12.32%	\$ 98,505	8.00%	N/A	N/A
The Bank	\$ 146,618	11.94%	\$ 98,246	8.00%	\$ 122,807	10.00%
<b>As of December 31, 2007:</b>						
Tier I Capital to Total Adjusted Average Assets (Leverage):						
The Company	\$ 119,900	7.03%	\$ 68,210	4.00%	N/A	N/A
The Bank	\$ 126,575	7.43%	\$ 68,168	4.00%	\$ 85,209	5.00%
Tier I Capital to Risk-Weighted Assets:						
The Company	\$ 119,900	10.04%	\$ 47,775	4.00%	N/A	N/A
The Bank	\$ 126,575	10.62%	\$ 47,673	4.00%	\$ 71,510	6.00%
Total Capital to Risk-Weighted Assets:						
The Company	\$ 144,605	12.11%	\$ 95,551	8.00%	N/A	N/A
The Bank	\$ 141,280	11.85%	\$ 95,347	8.00%	\$ 119,183	10.00%

## 8. STOCK-BASED COMPENSATION

### *Incentive Stock Options*

Under the terms of the Company's incentive stock option plans adopted in April 1994, February 1999 and February 2002, options have been granted to certain key personnel that entitle each holder to purchase shares of the Company's common stock. The option price is the higher of the fair market value or the book value of the shares at the date of grant. Such options were exercisable commencing one year from the date of grant, at the rate of 25% per year, and expire ten years from the date of grant.

At September 30, 2008, incentive stock options for the purchase of 356,203 shares were outstanding and exercisable. The total intrinsic value of options exercised for the nine months ended September 30, 2008 and 2007 was \$292,899 and \$2,401,769, respectively. The total intrinsic value of exercisable shares at September 30, 2008, is \$612,273. A summary of stock option activity follows:

	Number of Shares	Weighted- Average Exercise Price Per Share
Outstanding - January 1, 2008	593,137	\$ 14.89
Granted	-	-
Exercised	(96,390)	\$ 11.01
Cancelled or forfeited	(140,544)	\$ 15.87
Outstanding - September 30, 2008	356,203	\$ 15.55

The following summarizes shares subject to purchase from incentive stock options outstanding and exercisable as of September 30, 2008:

Range of Exercise Prices	Shares Outstanding	Weighted-Average		Shares Exercisable	Weighted- Average Exercise Price
		Remaining Contractual Life	Weighted- Average Exercise Price		
\$ 8.25 - \$ 10.33	98,416	1.8 years	\$ 9.88	98,416	\$ 9.88
\$ 12.45 - \$ 13.61	106,182	4.0 years	\$ 13.08	106,182	\$ 13.08
\$ 19.16 \$ 22.63	73,125 78,480	5.4 years 6.4 years	\$ 19.16 \$ 22.63	73,125 78,480	\$ 19.16 \$ 22.63
	<u>356,203</u>	<u>4.2 years</u>	<u>\$ 15.55</u>	<u>356,203</u>	<u>\$ 15.55</u>

#### Restricted Stock Awards

Under the Company's 2006 Equity Compensation Plan (the "2006 Plan"), the Company can award options, stock appreciation rights ("SARs"), restricted stock, performance units and unrestricted stock. The 2006 Plan also allows the Company to make awards conditional upon attainment of vesting conditions and performance targets.

During the first nine months of 2008, the Company awarded 167,584 shares of restricted stock to certain key employees subject to the participant's continued employment with the Company. Of those shares awarded, 147,461 shares vest one-third on each of the third through fifth anniversaries of the award date and 20,123 shares vested immediately. The restricted stock previously awarded in September 2006 vests in full on the third anniversary of the award date. The fair value of restricted stock awards vested during the nine months ended September 30, 2008 was \$259,989. No restricted stock awards vested during the first nine months of 2007. The Company recognizes compensation expense over the vesting period at the fair market value of the shares on the award date. If a participant's service terminates for any reason other than death or disability, then the participant shall forfeit to the Company any shares acquired by the participant pursuant to the restricted stock award which remain subject to vesting conditions. The total remaining unearned compensation cost related to nonvested shares of restricted stock is \$1,810,595 to be expensed over the remaining period of 4.1 years. For the nine months ended September 30, 2008 and 2007, \$200,108 and \$115,864, respectively, were recognized as compensation expense, net of estimated forfeitures. The Company recognized tax benefits resulting from the compensation expense for the nine months ended September 30, 2008 and 2007 of \$59,831 and \$40,668, respectively.

A summary of restricted stock activity follows:

	Number of Shares	Weighted- Average Grant-Date Fair Value
Nonvested - January 1, 2008	19,670	\$ 19.95
Granted	167,584	\$ 13.05
Vested	(20,123)	\$ 12.92
Cancelled or forfeited	(8,212)	\$ 18.26
Nonvested - September 30, 2008	158,919	\$ 13.65

At September 30, 2008, 434,132 shares were reserved for possible issuance of awards of options, SARs, restricted stock, performance units and unrestricted stock.

### Non-Plan Stock-Based Compensation

In November 2006, non-qualified stock options and restricted stock awards were granted to Thomas M. O'Brien, the Company's and the Bank's President and Chief Executive Officer, pursuant to the terms of his employment agreement. The non-qualified stock options to purchase 164,745 shares have an exercise price of \$17.84 and vest 20% per year over five years. The estimated fair value of the options was \$5.42 per share and was estimated on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions used: (1) dividend yield 3.32%; (2) expected volatility 34.7%; (3) risk-free interest rate 4.57%; and (4) expected life of options 7.3 years. At September 30, 2008, 32,949 of these options were exercisable, but none have been exercised. The options outstanding and those exercisable at September 30, 2008 have no intrinsic value.

The restricted stock awarded to Mr. O'Brien totals 83,612 shares and was awarded at an average price of \$17.94 to vest in 20 equal quarterly installments over five years. The fair value of restricted stock awards vested during the nine months ended September 30, 2008 and 2007 was \$161,136 and \$220,297, respectively. A summary of restricted stock activity follows:

	Number of Shares	Weighted- Average Grant-Date Fair Value
Nonvested - January 1, 2008	62,707	\$ 17.94
Granted	-	-
Vested	(12,543)	\$ 17.94
Nonvested - September 30, 2008	50,164	\$ 17.94

The total remaining unearned compensation cost related to nonvested options and shares of restricted stock awarded to Mr. O'Brien is \$1,476,300 to be expensed over the weighted-average remaining period of 3.1 years. For the nine months ended September 30, 2008 and 2007, \$359,100 was recognized as compensation expense in each period. The non-qualified stock options and the restricted stock awards were not issued as part of any of the Company's registered stock-based compensation plans.

### 9. FEDERAL HOME LOAN BANK ADVANCES

The Bank may use a secured line of credit with the Federal Home Loan Bank of New York ("FHLB") for overnight funding or on a term basis to fund assets. The amount of this line of credit will fluctuate based upon the amount of FHLB stock the Bank owns and the amount of pledged collateral in the form of commercial real estate mortgage loans and investment securities. Based upon a multiple of the FHLB stock that the Bank currently owns combined with approximately \$314,000,000 of collateral, including approximately \$171,000,000 in commercial real estate mortgage loans that the Bank currently has pledged at the FHLB, approximately \$237,000,000 of this line may be drawn on a term or overnight basis. The FHLB line is renewed annually.

At September 30, 2008 and December 31, 2007, approximately \$98,000,000 and \$139,000,000 in advances, respectively, were outstanding under such lines of credit with the FHLB. The average amount of advances outstanding and the weighted-average interest rate on such average amount outstanding for the nine months ended September 30, 2008 and the twelve months ended December 31, 2007 were \$139,916,000 and \$103,093,000, and 2.62% and 5.13%, respectively.

### 10. FAIR VALUE

The FASB issued SFAS No. 157, "Fair Value Measurements" which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. This statement establishes a fair value hierarchy about the assumptions used to measure fair value and clarifies assumptions about risk and the effect of a restriction on the sale or use of an asset. The standard is effective for fiscal years beginning after November 15, 2007. In February 2008, the FASB issued Staff Position (FSP) 157-2, "Effective Date of FASB Statement No. 157." This FSP delays the effective date of FAS 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value on a recurring basis (at least annually) to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.

SFAS No. 157 establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

For the Company's securities available for sale, the estimated fair value equals quoted market price, if available (Level 1 inputs). If a quoted market price is not available, fair value is estimated using a quoted market price for similar securities (Level 2 inputs). Impaired loans are carried at fair value utilizing observable and unobservable information. If applicable, the discounted cash flow analysis method may also be utilized. A loan is impaired when full payment under the loan terms is not expected. Non-accrual commercial business and commercial real estate loans in excess of \$250,000 are individually evaluated for impairment. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported net, at the fair value of collateral if repayment is expected solely from the collateral or, if applicable, at the present value of estimated future cash flows using the loan's existing rate. Large groups of smaller balance homogeneous loans, such as consumer and residential real estate loans, are collectively evaluated, and accordingly, they are not separately identified for impairment disclosures.

Assets and Liabilities Measured on a Recurring Basis

Assets and liabilities measured at fair value on a recurring basis are summarized below:

	September 30, 2008	Fair Value Measurements at September 30, 2008 Using Significant Other Observable Inputs (Level 2)
<u>Assets:</u>		
Available for sale securities	\$392,423,328	\$392,423,328

Assets and Liabilities Measured on a Non-Recurring Basis

Assets and liabilities measured at fair value on a non-recurring basis are summarized below:

	September 30, 2008	Fair Value Measurements at September 30, 2008 Using Significant Unobservable Inputs (Level 3)
<u>Assets:</u>		
Impaired loans	\$10,427,452	\$10,427,452

Impaired loans had a carrying amount of \$12,466,946, with a valuation allowance of \$2,039,494 at September 30, 2008. There was a provision for losses on these loans of \$1,505,153 and \$1,826,908, respectively, for the three and nine months ended September 30, 2008. (See also Note 5. – Loans and Leases.)

**11. NET DEFERRED INCOME TAXES**

At September 30, 2008 the Company has a tax net operating loss carryforward of approximately \$22,029,000, the expected benefit of which is included in net deferred income taxes on the accompanying balance sheet. Based on projected future earnings, management believes it is more likely than not that the tax benefit of the carryforward will be realized within the carryforward period and therefore no valuation allowance has been recorded against the deferred tax asset.

**12. SUBSEQUENT EVENT**

In October 2008, the Company's Board declared a quarterly cash dividend of \$0.10 per share, payable on December 15, 2008 to shareholders of record as of November 21, 2008.

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

**Forward Looking Statements** - Certain statements contained in this discussion are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Words such as "may," "could," "should," "would," "believe," "anticipate," "estimate," "expect," "intend," "plan," "project," "is confident that," and similar expressions are intended to identify these forward looking-statements. These forward-looking statements involve risk and uncertainty and a variety of factors that could cause the Company's actual results and experience to differ materially from the anticipated results or other expectations expressed in these forward-looking statements. The Company's ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Factors that could have a material adverse effect on the operations of the Company and its subsidiaries include, but are not limited to, changes in: market interest rates, general economic conditions, legislative/regulatory changes, monetary and fiscal policies of the U.S. Government, the quality and composition of the loan and lease or investment portfolios, demand for loan and lease products, demand for financial services in the Company's primary trade area, litigation, tax and other regulatory matters, accounting principles and guidelines, other economic, competitive, governmental, regulatory and technological factors affecting the Company's operations, pricing and services and those risks detailed in the Company's periodic reports filed with the SEC.

**Executive Summary** - State Bancorp, Inc. (the "Company") is a one-bank holding company, which was formed in 1985. The Company operates as the parent for its wholly owned subsidiary, State Bank of Long Island and its subsidiaries (the "Bank"), a New York State chartered commercial bank founded in 1966. The Company also has two unconsolidated subsidiaries, State Bancorp Capital Trust I and State Bancorp Capital Trust II (collectively the "Trusts"), entities formed in 2002 and 2003, respectively, to issue trust preferred securities. The income of the Company is principally derived through the operation of the Bank and its subsidiaries.

The Bank maintains its corporate headquarters in Jericho, New York and serves its customer base through seventeen branches in Nassau, Suffolk, Queens and Manhattan. The Bank offers a full range of banking services to our diverse customer base which includes commercial real estate owners and developers, small to middle market businesses, professional service firms, municipalities and consumers. Retail and commercial products include checking accounts, NOW accounts, money market accounts, savings accounts, certificates of deposit, individual retirement accounts, commercial loans, construction loans, commercial mortgage loans, consumer loans, small business lines of credit, cash management services and telephone and online banking. In addition, the Bank also provides access to annuity products and mutual funds. The Company's loan and lease portfolio is concentrated in commercial and industrial loans and commercial mortgage loans. The Bank does not engage in subprime lending and does not offer payment option ARMs or negative amortization loan products.

On June 2, 2008, the Bank completed the previously announced sale of substantially all of the assets of its leasing subsidiary, SB Equipment (formerly known as Studebaker-Worthington Leasing Corp.). The sale proceeds have been used to fund growth in the Company's commercial loan and commercial mortgage portfolios. Both the sale proceeds and losses related to write-downs of non-performing leases prior to sale were immaterial to the Company's financial statements.

As of September 30, 2008, the Company, on a consolidated basis, had total assets of approximately \$1.6 billion, total deposits of approximately \$1.3 billion and stockholders' equity of approximately \$112 million. Unless the context otherwise requires, references herein to the Company include the Company and its subsidiaries on a consolidated basis.

### Financial performance of State Bancorp, Inc.

(dollars in thousands, except per share data)

As of or for the three and nine months ended September 30, 2008 and 2007

	Three months			Nine months		
	2008	2007	Over/ (under) 2007	2008	2007	Over/ (under) 2007
Revenue (1)	\$16,704	\$16,237	2.9%	\$51,279	\$48,658	5.4%
Operating expenses	\$10,166	\$10,832	(6.1)%	\$32,515	\$37,213	(12.6)%
Provision for loan and lease losses	\$3,700	\$653	466.6%	\$10,226	\$2,854	258.3%
Net income	\$1,989	\$3,083	(35.5)%	\$5,950	\$5,760	3.3%
Net income per share - diluted	\$0.14	\$0.22	(36.4)%	\$0.42	\$0.41	2.4%
Return on average total stockholders' equity	6.95%	11.21%	(426)bp	6.91%	7.15%	(24)bp
Tier I leverage ratio	8.05%	7.51%	54bp	8.05%	7.51%	54bp
Tier I risk-based capital ratio	10.32%	10.31%	1bp	10.32%	10.31%	1bp
Total risk-based capital ratio	12.32%	12.38%	(6)bp	12.32%	12.38%	(6)bp

bp - denotes basis points; 100 bp equals 1%.

(1) Represents net interest income plus total non-interest income.

The Company continues to emphasize loan growth and credit oversight, deposit generation, increased market share, improved operational efficiency and ongoing Company-wide expense management, product development, IT infrastructure improvements and enhanced brand building. However, the Company has experienced credit quality pressure as well as deposit and loan pricing pressures that are expected to continue. The Company has numerous competitors for its very attractive core niche of small business, middle market commercial and industrial and municipal customers. Some of these competitors have entered the marketplace through de novo branching, acquisitions and strategic alliances. The Company remains focused on expanding its core commercial business relationships, expense reduction initiatives, capital management and strategies to improve non-interest income generation. The Company expects to continue to expand its staff of professional bankers in selected areas to achieve the foregoing objectives. It is anticipated that future industry consolidation should provide the Company with the opportunity to add experienced, relationship-oriented bankers to its staff to support future growth and market penetration.

The Company recorded net income of \$2.0 million and \$3.1 million for the third quarter of 2008 and 2007, respectively. The decrease in net income during 2008 primarily reflects a significant increase in the provision for loan losses which was offset in part by growth in net interest income and a reduction in operating expenses. Diluted earnings per common share of \$0.14 were recorded in the third quarter of 2008 compared to \$0.22 in the third quarter of 2007. The growth in the Company's net interest income during the third quarter of 2008 as compared to a year ago resulted from an improved net interest margin. The expanded margin resulted from an improved asset mix, moving from investment securities to higher-yielding loans. This was coupled with a decrease in the Company's cost of interest-bearing liabilities, due to the Company's strategic pricing decision to closely manage our funding costs by utilizing more attractively priced funding sources rather than deploying promotional high rates in the current competitive environment. Total operating expenses decreased by 6.1% to \$10.2 million during the third quarter of 2008 when compared to the third quarter of 2007. The decrease in total operating expenses primarily reflects reductions in salaries and other employee benefits and legal expenses, partially offset by a loss on the interest rate swap agreements the Company had with an affiliate of Lehman (see also Note 1. – Financial Statement Presentation and Significant Accounting Policies - *Accounting For Derivative Financial Instruments*).

Total assets of the Company were \$1.6 billion at September 30, 2008 and December 31, 2007. At September 30, 2008 and December 31, 2007, total deposits were \$1.3 billion. Short-term borrowed funds, primarily Federal Home Loan Bank of New York ("FHLB") advances and federal funds purchased, totaled \$106 million at September 30, 2008, compared to \$139 million at December 31, 2007.

As a result of the decrease in net income in the third quarter of 2008 versus the third quarter of 2007, the Company's return on average assets declined to 0.50% in the third quarter of 2008 from 0.74% in the third quarter of 2007, while our return on average stockholders' equity decreased to 6.95% in the third quarter of 2008 from 11.21% in the third quarter of 2007. Primarily due to the improved asset mix and the decrease in the Company's cost of interest-bearing liabilities mentioned above, the Company's net interest margin improved by 23 basis points to 4.12% in the third quarter of 2008 from 3.89% in the third quarter of 2007.



The Company's primary market area of Nassau, Suffolk, Queens and Manhattan provides opportunity for deposit growth and commercial and industrial lending. During 2008, the national economy continued to falter with particular emphasis on the deterioration of the housing and real estate markets. The faltering economy has been marked by contractions in the availability of business and consumer credit, increases in borrowing rates, falling home prices, increasing home foreclosures and unemployment. Management and staff at the Company continue to closely monitor the overall effects of the decline in the local real estate market and its impact on the Company. Based on our assessment of the current market conditions and continuing economic pressures, together with our determination of credit risk within our portfolio from our ongoing review process, we increased our provision for loan losses to \$3.7 million in the third quarter of 2008 from \$653 thousand in the third quarter of 2007. We continue to be very aggressive in the ongoing review of our credit portfolio to identify and address any loans that may begin to show signs of evolving weaknesses. When appropriate, we continue to pursue opportunities to proactively liquidate and dispose of certain problem loans by selling such loans in the market on a discounted basis. Using that same strategy in the third quarter of 2008, we wrote-down \$8 million in problem loans to fair market value and transferred the net balance to loans held for sale after determining that such action represented the most cost-effective solution.

Charge-offs in the third quarter of 2008 were \$6.4 million. Included in this total was a loss of approximately \$3.3 million on the aforementioned disposition and write-down in problem loans. Credit costs will likely continue to remain high in coming quarters, but we expect any increases to be manageable given the Company's ability to generate solid, core operating earnings. Our primary concern is the impact of the present difficult economic conditions on certain residential construction loans when the loan amounts are in excess of expected sales or where the Bank would have to advance significant additional monies to complete the project (see discussion on non-performing assets in the Asset Quality section). It continues to be our belief that the Bank is best served by exiting these projects through the sale of its position to investors who are better suited to realize the value that may come over time. We generally attempt to sell such loans prior to their becoming nonperforming as we did in this past quarter. Although the remainder of our portfolio has not been significantly adversely affected by these difficult economic conditions, we expect that we will see some continued credit weakness and elevated loss provisioning for the next several quarters.

The primary focus of the Company's loan and lease portfolio is commercial real estate and commercial and industrial loans with residential lending constituting less than 10% of our total portfolio at September 30, 2008. The Company's securities portfolio contains no subprime structured debt or exotic structures. At September 30, 2008, the market value of the securities portfolio represented 97.5% of book value.

The disruption and volatility in the financial and capital markets over the past year has recently reached a crisis level as national and global credit markets ceased to function effectively, if at all. Financial entities across the spectrum have been affected by the lack of liquidity and continued credit deterioration. Concern for the stability of the banking and financial systems reached a magnitude which has resulted in unprecedented government intervention on a global scale. At a domestic level, on October 3, 2008, the Emergency Economic Stabilization Act of 2008 (the "EESA") was signed into law providing for, among other things, \$700 billion in funding to the U.S. Treasury to purchase troubled assets from financial institutions. Then, on October 14, 2008, the Treasury, the Board of Governors of the Federal Reserve System (the "FRB"), and the Federal Deposit Insurance Corporation (the "FDIC") issued a joint statement announcing additional steps aimed at stabilizing the financial markets. First, the Treasury announced a \$250 billion voluntary Capital Purchase Program (the "CPP") that allows qualifying financial institutions to sell preferred shares to the Treasury. Second, the FDIC announced the Temporary Liquidity Guarantee Program (the "TLGP"), enabling the FDIC to temporarily guarantee the senior debt of all FDIC-insured institutions and certain holding companies, as well as fully insure all deposits in non-interest bearing transaction accounts. Third, to further increase access to funding for businesses in all sectors of the economy, the FRB announced further details of its Commercial Paper Funding Facility program (the "CPFF"), which provides a broad backstop for the commercial paper market. These actions were intended to restore confidence in the banking system, ease liquidity concerns and stabilize the rapidly deteriorating economy. For a further discussion on the economy and recent government actions, see Part II, "Item 1A — Risk Factors."

We expect to achieve modest loan growth in our core competencies of commercial and industrial credits and commercial mortgage loans for the remainder of 2008. We expect that interest rate spreads may tighten due to competitive pressures, resulting in a narrowing of our interest rate margin on most loans. The Company has chosen to use more attractively priced borrowings to fund some loan volume rather than offer high rates to raise additional deposits in a highly competitive environment. Funding costs are expected to rise during the remainder of 2008 as competitive pressures are expected to push up rates despite the recent rate cuts by the Federal Reserve Open Market Committee. As a result, management expects that, notwithstanding the improved shape of the yield curve, the Company's net interest margin may decline modestly during the remainder of 2008 from current levels.

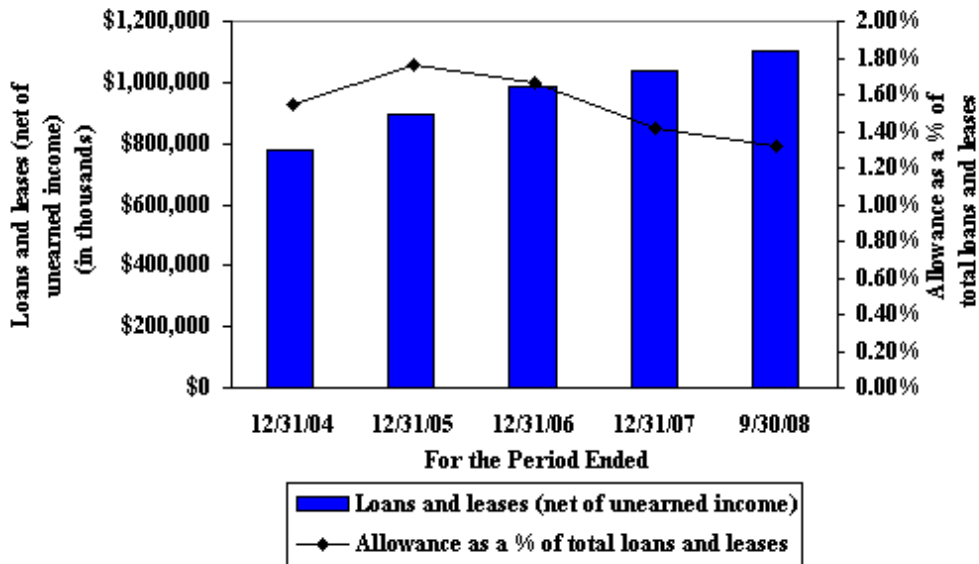
It is management's intent for the Company's branch network to provide funding to support anticipated asset growth, supplemented with short-term borrowings as needed. The Company will continue to pursue product delivery and back office expense reductions and operating efficiencies along with revenue-generating sales initiatives to improve net income. Some of these initiatives may result in the recording of initial costs in order to achieve longer term financial benefits.

The Company will participate in the FDIC's TLGP which, among other things, provides non-interest bearing accounts at the Bank with unlimited FDIC insurance coverage beyond the current limit of \$250,000. The unlimited coverage will be in effect through December 31, 2009. The Company anticipates that the cost of participating in the TLGP will be immaterial to the Company's financial statements. The TLGP also allows the Bank to issue FDIC-guaranteed senior non-secured debt up to certain limits through June 30, 2009. Any such guarantee would be in effect through December 31, 2011.

**Critical Accounting Policies, Judgments and Estimates** - The discussion and analysis of the financial condition and results of operations of the Company are based on the Unaudited Condensed Consolidated Financial Statements contained in this Quarterly Report on Form 10-Q, which are prepared in conformity with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and assumptions affecting the reported amounts of assets, liabilities, revenues and expenses. Management evaluates those estimates and assumptions on an ongoing basis, including those related to the allowance for loan and lease losses, income taxes, other-than-temporary impairment of investment securities and recognition of contingent liabilities. Management bases its estimates on historical experience and various other factors and assumptions that are believed to be reasonable under the circumstances. These form the basis for making judgments on the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from those estimates under different assumptions or conditions.

**Allowance for Loan and Lease Losses** - In management's opinion, one of the most critical accounting policies impacting the Company's financial statements is the evaluation of the allowance for loan and lease losses. Management carefully monitors the credit quality of the portfolio and charges off the amounts of those loans and leases deemed uncollectible. Management evaluates the fair value of collateral supporting any impaired loans and leases using independent appraisals and other measures of fair value. This process involves some subjective judgments and assumptions and is subject to change based on factors that may be outside the control of the Company.

**LOAN AND LEASE PORTFOLIO AND THE ALLOWANCE  
FOR LOAN AND LEASE LOSSES**



Management of the Company recognizes that, despite its best efforts to minimize risk through its credit review process, losses will inevitably occur. In times of economic slowdown, regional or national, the credit risk inherent in the Company's loan and lease portfolio will increase. The timing and amount of loan and lease losses that occur are dependent upon several factors, most notably qualitative and quantitative factors about both the micro and macro economic conditions as reflected in the loan and lease portfolio and the economy as a whole. Factors considered in the evaluation of the allowance for loan and lease losses include, but are not limited to, estimated losses from loan and lease and other credit arrangements, general economic conditions, changes in credit concentrations or pledged collateral, historical loan and lease loss experience and trends in portfolio volume, maturity, composition, delinquencies and non-accruals. The allowance for loan and lease losses is established to absorb probable loan and lease charge-offs. Additions to the allowance are made through the provision for loan and lease losses, which is a charge to current operating earnings. The adequacy of the provision and the resulting allowance for loan and lease losses is determined by management's continuing review of the loan and lease portfolio, including identification and review of individual problem situations that may affect a borrower's ability to repay, delinquency and non-performing loan data, collateral values, regulatory examination results and changes in the size and character of the loan and lease portfolio. Despite such a review, the level of the allowance for loan and lease losses remains an estimate and cannot be precisely determined.



Based on current economic conditions, management has determined that the current level of the allowance for loan and lease losses appears to be adequate in relation to the probable losses present in the portfolio. Management considers many factors in this analysis, among them credit risk grades assigned to commercial loans, delinquency trends, concentrations within segments of the loan and lease portfolio, recent charge-off experience and local economic conditions. Commercial loans are assigned credit risk grades using a scale of one to ten with allocations for probable losses made for pools of similar risk-graded loans. Loans that have indications of some weakness, generally in grade seven, that require close monitoring by senior management, are termed “criticized” loans in accordance with regulatory guidelines. Loans with signs of credit deterioration, generally in grades eight through ten, are termed “classified” loans in accordance with guidelines established by the Company’s regulators. Management assigns allocation factors ranging from 24% to 100% of the outstanding classified loan balance, which are based on the Company’s historic loss experience, and uses these amounts when analyzing the adequacy of the allowance for loan and lease losses. Criticized loans are assigned an allocation factor of 4% based on historic loss experience. Non-accrual loans and leases in excess of \$250 thousand are individually evaluated for impairment and are not included in these risk grade pools. A loan is considered “impaired” when, based on current information and events, it is probable that both the principal and interest due under the original contractual terms will not be collected. The Company measures impairment of collateralized loans based on the estimated fair value of the collateral, less estimated costs to sell. For loans that are not collateral-dependent, impairment is measured by using the present value of expected cash flows, discounted at the loan’s effective interest rate. Allocations for loans which are performing satisfactorily, generally in grades one through six, are based on historic experience for other performing loans and leases and are currently assigned an allocation factor of 0.50% of the loan balance. An allowance allocation factor for portfolio macro factors ranging from 1-30 basis points, increased this past quarter from 1 – 20 basis points in previous quarters, is calculated to cover potential losses from a number of variables, not the least of which is the current economic uncertainty. There have been no adjustments to the underlying methodology used in the analysis of the allowance for loan and lease losses in the past quarter.

Management monitors the level of the allowance for loan and lease losses in order to properly reflect its estimate of the loss, if any, represented by fluctuations in the local real estate market and the underlying value that market provides as collateral to certain segments of the loan and lease portfolio. The provision is continually evaluated relative to portfolio risk and regulatory guidelines and will continue to be closely reviewed. In addition, various bank regulatory agencies, as an integral part of their examination process, closely review the allowance for loan and lease losses. Such agencies may require the Company to recognize additions to the allowance based on their judgment of information available to them at the time of their examinations.

*Accounting for Income Taxes* - The Company accounts for income taxes in accordance with SFAS No. 109 and FIN 48, which require the recording of deferred income taxes that reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Management exercises significant judgment in the evaluation of the amount and timing of the recognition of the resulting tax assets and liabilities. The judgments and estimates required for the evaluation are periodically updated based upon changes in business factors and the tax laws.

*Other-Than-Temporary Impairment of Investment Securities* – If the Company deems any investment security’s decline in market value to be other-than-temporary, the security is written down to a new cost basis and the resulting loss is charged against earnings. The determination of whether a decline in market value is other-than-temporary is necessarily a matter of subjective judgment. The timing and amount of any realized losses reported in the Company’s financial statements could vary if management’s conclusions were to change as to whether an other-than-temporary impairment exists. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. In analyzing an issuer’s financial condition, the Company’s management considers whether the securities are issued by the U.S. Government or its agencies, whether downgrades by bond rating agencies have occurred and industry analysts’ reports. The Company’s management currently conducts impairment evaluations at least on a quarterly basis and has concluded that, at September 30, 2008, there were no other-than-temporary impairments of the Company’s investment securities.

The EESA reaffirmed the authority of the SEC to suspend the application of SFAS No. 157, which governs fair value (mark-to-market) accounting, for any issuer or with respect to any class or category of transaction if the SEC determines that it is necessary or appropriate in the public interest and is consistent with the protection of investors. However, it is unclear at this time whether the SEC will exercise such authority, as it previously expressed resistance to the suspension of fair value accounting.

A suspension of fair value accounting would be beneficial to most financial institutions that are currently required to write down assets that are deemed other-than-temporarily impaired to the current market value of such assets. The market is currently illiquid for many of such assets, so sales are often at very low, distressed prices that may not accurately reflect the value of such assets. On October 10, 2008, the FASB issued FSP No. 157-3, which clarifies the application of SFAS No. 157 in a market that is not active. FSP No. 157-3 states that in determining the fair value for a financial asset, the use of a reporting entity’s own assumptions about future cash flows and appropriately risk-adjusted discount rates is acceptable when relevant observable inputs are not available. SFAS No. 157 discusses a range of information and valuation techniques that a reporting entity might use to estimate fair value when relevant observable inputs are not available.

The SEC is currently conducting a study on mark-to-market accounting as required by recently enacted legislation. The SEC is expected to submit a report of this study to Congress prior to year-end 2008 which will include consideration of the advisability and feasibility of modifications or alternatives to the standards provided for in SFAS No. 157. It is unclear at this time what effects, if any, the results of this report will have on mark-to-market accounting standards in the near future.

*Recognition of Contingent Liabilities* – The Company and the Bank are subject to proceedings and claims that arise in the normal course of business. Management assesses the likelihood of any adverse outcomes to these matters as well as potential ranges of probable losses. There can be no assurance that actual outcomes will not differ from those assessments. A liability is recognized in the Company’s consolidated balance sheets if such liability is both probable and estimable.

Material Changes in Financial Condition - Total assets of the Company were \$1.6 billion at September 30, 2008. When compared to December 31, 2007, total assets decreased by \$35 million or 2%. This was primarily attributable to declines in securities available for sale and securities purchased under agreements to resell of \$9 million and \$61 million, respectively, partially offset by growth in net loans of \$60 million, which is consistent with the Company’s overall goal of shifting its asset mix towards higher yielding loans. The decrease in the investment portfolio reflects declines in U.S. government agencies and municipal securities of \$127 million and \$13 million, respectively, offset by an increase in mortgage-backed securities of \$141 million. The net loan and lease portfolio grew by 6% since year-end 2007, resulting primarily from increases in commercial and industrial loans and commercial mortgage loans of \$58 million and \$63 million, respectively, partially offset by a \$66 million decrease in leases outstanding, as substantially all of the assets of SB Equipment were sold in June 2008.

At September 30, 2008, total deposits were \$1.3 billion, an increase of \$5 million when compared to December 31, 2007. This was largely attributable to increases in jumbo and retail certificates of deposit of \$97 million, partially offset by decreases in demand and savings deposits of \$5 million and \$87 million, respectively. The increase in certificates of deposit primarily reflects the Company’s decision to utilize the Certificate of Deposit Account Registry Service (“CDARS”) for \$137 million in short-term certificates of deposit outstanding at September 30, 2008. CDARS is a network of financial institutions that exchanges deposits with one another to maximize FDIC coverage of their depositors. Certain of our depositors with balances significantly in excess of FDIC insurance limits have found CDARS to be an attractive product at this time. These deposits were generally available at rates lower than the competitive market rates on local certificates of deposit, offered us greater flexibility and were more efficient to obtain. Core deposit balances represented approximately 60% of total deposits at September 30, 2008 compared to 68% at year-end 2007. Short-term borrowed funds, primarily FHLB advances and federal funds purchased, totaled \$106 million at September 30, 2008, compared to \$139 million at December 31, 2007.

Capital Resources - Total stockholders’ equity amounted to \$112 million at September 30, 2008, representing a decrease of \$2 million from December 31, 2007. The decrease from year-end 2007 largely reflects changes in other comprehensive income. Management anticipates that internal capital generation, defined as earnings less cash dividends paid on common stock, will be the primary catalyst supporting the Company’s future growth of assets and stockholder value. Management continually evaluates the Company’s capital position in light of current and future growth objectives and regulatory guidelines.

At September 30, 2008, the Bank’s Tier I leverage ratio was 8.37% while its risk-based capital ratios were 10.75% for Tier I capital and 11.94% for total capital. These ratios exceed the minimum regulatory guidelines for a well-capitalized institution.

Table 2-1 summarizes the Company’s capital ratios as of September 30, 2008 and compares them to current minimum regulatory guidelines and December 31 and September 30, 2007 actual results.

<b>TABLE 2-1</b>	<b>Tier I</b>	<b>Tier I Capital/ Risk-Weighted Assets</b>	<b>Total Capital/ Risk-Weighted Assets</b>
	<b>Leverage</b>		
Regulatory Minimum	3.00% - 4.00%	4.00%	8.00%
Ratios as of:			
September 30, 2008	8.05%	10.32%	12.32%
December 31, 2007	7.03%	10.04%	12.11%
September 30, 2007	7.51%	10.31%	12.38%

The Company's (parent only) primary funding sources are dividends from the Bank and proceeds from the Dividend Reinvestment and Stock Purchase Plan (the "DRP"). In 2008, the Company's Board declared quarterly cash dividends of \$0.15 per share at its January and April meetings and \$0.10 per share at its July and October meetings. The October dividend is payable on December 15, 2008 to shareholders of record as of November 21, 2008.

The Company did not repurchase any shares of its common stock during the first nine months of 2008 under the existing stock repurchase plan. Under the Board of Directors' current stock repurchase authorization, management may repurchase up to 512,348 additional shares if market conditions warrant. This action will only occur if management believes that the purchase will be at prices that are accretive to earnings per share and is the most efficient use of Company capital. The Company does not presently anticipate repurchasing any of its shares in the immediate future.

The Company's two unconsolidated Delaware trust subsidiaries currently have outstanding a total of \$20 million in trust preferred securities which presently qualify as Tier I capital of the Company for regulatory capital purposes. The securities each bear an interest rate tied to three-month LIBOR and are each redeemable by the Company in whole or in part after five years or earlier under certain circumstances. The Company currently has the right to optionally redeem the debentures of Trust I, which bear a coupon rate of three-month LIBOR plus 345 basis points, prior to the maturity date of November 7, 2032, at par. As of September 30, 2008, the Company has chosen not to redeem the debentures of Trust I, but will continue to evaluate the cost effectiveness of this borrowing. The Company has the right to optionally redeem the debentures of Trust II, which bear a coupon rate of three-month LIBOR plus 285 basis points, prior to the maturity date of January 23, 2034, on or after January 23, 2009, at par. Under the occurrence of certain events, the Company may redeem the debentures in whole or in part prior to January 23, 2009. The weighted average rate on all trust preferred securities outstanding was 5.94% and 8.57% for the third quarter of 2008 and 2007, respectively, and 6.29% and 8.53% for the first nine months of 2008 and 2007, respectively.

In 2006, the Company issued \$10 million of 8.25% subordinated notes due June 15, 2013. The notes were sold in a private placement and qualify as Tier II capital for the Company.

On October 14, 2008, the Treasury announced the CPP to strengthen the capital and liquidity positions of healthy institutions and to encourage banks and thrifts to increase lending to creditworthy borrowers. Under the CPP, qualifying financial institutions are able to sell senior preferred shares to the Treasury, which will qualify as Tier 1 capital for regulatory capital purposes. The minimum amount of preferred shares that may be issued is equal to 1% of the institution's risk-weighted assets, and the maximum amount that may be issued is the lesser of \$25 billion and 3% of the institution's risk-weighted assets. If we participate in the program, the Treasury would also receive warrants to purchase our common stock with an aggregate market price equal to 15% of the senior preferred investment. The staffs of both the SEC and FASB have indicated that they would not object if such warrants were to be classified as permanent equity under applicable GAAP, provided that certain conditions are met. In addition, we would be required to adopt the Treasury's standards for executive compensation and corporate governance for the period during which the Treasury holds equity issued under this program. We understand that the Treasury expects to fund the senior preferred shares purchased under the program by year-end 2008. The Company's capital ratios exceed all regulatory requirements at September 30, 2008, and the Bank exceeds the regulatory requirements to be well capitalized at the same date. Management is carefully examining this program, including whether there are appropriate lending opportunities for the deployment of this additional capital. Based on its risk-weighted assets at September 30, 2008, the Company qualifies for a minimum capital infusion of \$12 million and a maximum of \$36 million under the terms of this program.

Liquidity - Liquidity management is defined as both the Company's and the Bank's ability to meet their financial obligations on a continuous basis without material loss or disruption of normal operations. These obligations include the withdrawal of deposits on demand or at their contractual maturity, the repayment of borrowings as they mature, funding new and existing loan commitments and the ability to take advantage of business opportunities as they arise. Asset liquidity is provided by cash, short-term investments and the marketability of securities available for sale. Such liquid assets declined to \$427 million at September 30, 2008 from \$497 million at December 31, 2007, primarily due to the maturities of securities purchased under agreements to resell. Liquidity is affected by the maintenance of a strong base of core deposits, maturing short-term assets including cash and due from banks, the ability to sell or pledge marketable assets and access to lines of credit and the capital markets.

Liquidity is measured and monitored daily, thereby allowing management to better understand and react to emerging balance sheet trends, including temporary mismatches with regard to sources and uses of funds. After assessing actual and projected cash flow needs, management seeks to obtain funding at the most economical cost. These funds can be obtained by converting liquid assets to cash or by attracting new deposits or other sources of funding. Many factors affect the Company's ability to meet liquidity needs, including variations in the markets served, loan demand, its asset/liability mix, its reputation and credit standing in its markets and general economic conditions. Borrowings and the scheduled amortization of investment securities and loans are more predictable funding sources, while deposit flows and securities prepayments are somewhat less predictable in nature, as they are often subject to external factors beyond the control of management. Among these are changes in the local and national economies, competition from other financial institutions and changes in market interest rates.

The Company's primary sources of funds are cash provided by deposits, proceeds from maturities and sales of securities available for sale and cash provided by operating activities. During the first nine months of 2008 and 2007, proceeds from sales and maturities of securities available for sale totaled \$241 million and \$332 million, respectively. During the first nine months of 2008, \$104 million of the Company's available for sale securities, mostly U.S. Government agency issues, either matured or were redeemed at par value by the issuer at preset redemption dates.

The Company's primary uses of funds are for the origination of loans and the purchase of investment securities. During the first nine months of 2008 and 2007, the Company had a net increase in loans (net of unearned income and before allowance for loan and lease losses) totaling \$70 million and \$30 million, respectively, net of the sale of SB Equipment leases in 2008, principal paydowns and other dispositions. The Company did not purchase any loans during the first nine months of 2008 or 2007. The Company purchased securities available for sale totaling \$227 million and \$346 million during the first nine months of 2008 and 2007, respectively. The Company's outstanding FHLB borrowings as of September 30, 2008 were primarily used to support the funding of these assets. At September 30, 2008, total deposits were \$1.3 billion, an increase of \$5 million when compared to December 31, 2007.

The Asset/Liability Management Committee of the Board (the "ALCO") is responsible for oversight of the liquidity position and management of the asset/liability structure. The ALCO establishes specific policies and operating procedures governing liquidity levels and develops plans to address future and current liquidity needs. The ALCO monitors the loan and investment portfolios while also examining the maturity structure and volatility characteristics of liabilities to develop an optimum asset/liability mix. Available funding sources include retail, commercial and municipal deposits, purchased liabilities and stockholders' equity. At September 30, 2008, access to approximately \$237 million in FHLB lines of credit for overnight or term borrowings with maturities of up to thirty years was available. The amount of the FHLB lines of credit will fluctuate based upon the amount of FHLB stock the Bank owns and the amount of pledged collateral in the form of commercial real estate mortgage loans and investment securities. At September 30, 2008, approximately \$75 million in informal lines of credit extended by correspondent banks were also available to be utilized, if needed, for short-term funding purposes. At September 30, 2008, approximately \$98 million and \$5 million were outstanding under such lines of credit with the FHLB and correspondent banks, respectively. To supplement its short-term borrowed funds, the Company also utilized CDARS for \$137 million in short-term certificates of deposit outstanding at September 30, 2008. Notwithstanding the CDARS deposits, and pursuant to authorization limits set by the Board, management may also access the broker-dealer deposit market for funding. As of September 30, 2008, \$40 million in such broker-dealer deposits were outstanding. As the Company's liquidity remains satisfactory due to its deposit base, ample borrowing capacity secured by liquid assets and other funding sources, management believes that existing funding sources will be adequate to meet future liquidity requirements.

The EESA also authorizes the Treasury to establish the Troubled Asset Relief Program (the "TARP") to purchase certain troubled assets from financial institutions, including banks and thrifts. Under TARP, the Treasury may purchase residential and commercial mortgages, and securities, obligations or other instruments based on such mortgages, originated or issued on or before March 14, 2008 that the Secretary of the Treasury determines promotes market stability, as well as any other financial instrument that the Treasury, after consultation with the Chairman of the FRB, determines the purchase of which is necessary to promote market stability. In the case of a publicly-traded financial institution that sells troubled assets into the TARP, the Treasury must receive a warrant giving the Treasury the right to receive nonvoting common stock or preferred stock in such financial institution, or voting stock with respect to which the Treasury agrees not to exercise voting power, subject to certain *de minimis* exceptions. In addition, all financial institutions that sell troubled assets to the TARP and meet certain conditions will also be subject to certain executive compensation restrictions, which differ depending on how the troubled assets are acquired under the TARP.

On October 14, 2008, the FDIC approved the TLGP, the purpose of which is to strengthen confidence and encourage liquidity in the banking system. The TLGP permits the FDIC to (i) guarantee certain newly-issued senior unsecured debt issued by all FDIC-insured depository institutions and certain holding companies and (ii) fully insure non-interest bearing transaction deposit accounts, regardless of the dollar amount. Eligible institutions are covered under the TLGP at no cost for the first 30 days. Institutions that do not want to continue to participate in one or both parts of the TLGP must notify the FDIC of their election to opt out on or before December 5, 2008. Institutions that do not opt out will be subject to a fee, after the first 30 days, of 75 basis points per annum based on the amount of senior unsecured debt issued and a 10 basis point surcharge (annualized) will be added to the institution's current insurance assessment for balances in non-interest bearing transaction accounts that exceed the existing deposit insurance limit of \$250,000.

**Off-Balance Sheet Arrangements** - The Bank is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby and documentary letters of credit. Those instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the consolidated financial statements. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the customer. Collateral required varies, but may include accounts receivable, inventory, equipment, real estate and income-producing commercial properties. At September 30, 2008 and 2007, commitments to originate loans and leases and commitments under unused lines of credit for which the Bank is obligated amounted to approximately \$241 million and \$315 million, respectively.





Letters of credit are conditional commitments guaranteeing payments of drafts in accordance with the terms of the letter of credit agreements. Commercial letters of credit are used primarily to facilitate trade or commerce and are also issued to support public and private borrowing arrangements, bond financing and similar transactions. Collateral may be required to support letters of credit based upon management's evaluation of the creditworthiness of each customer. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan and lease facilities to customers. Most letters of credit expire within one year. At September 30, 2008 and 2007, letters of credit outstanding were approximately \$16 million and \$17 million, respectively. At September 30, 2008 and 2007, the uncollateralized portion was approximately \$3 million.

The use of derivative financial instruments, i.e. interest rate swaps, is an exposure to credit risk. This credit exposure relates to possible losses that would be recognized if the counterparties fail to perform their obligations under the contracts. To mitigate this credit exposure, only counterparties of good credit standing are utilized and the exchange of collateral over a certain credit threshold is required. From time to time, customer interest rate swap transactions together with offsetting interest rate swap transactions with institutional dealers may be executed. At September 30, 2008 and 2007, the total gross notional amount of swap transactions outstanding was \$28 million and \$43 million, respectively. When Lehman filed a voluntary petition for bankruptcy on September 15, 2008, an event of default was triggered under the swap agreements the Company had with an affiliate of Lehman. This resulted in several customer transactions no longer offset by those with institutional dealers and a loss to the Company on those swap agreements of approximately \$584 thousand in the third quarter of 2008. (See also Note 1. – Financial Statement Presentation and Significant Accounting Policies - *Accounting For Derivative Financial Instruments* .)

*Contractual Obligations* – Shown below are the amounts of payments due under specified contractual obligations, aggregated by category of contractual obligation, for specified time periods. All information is as of September 30, 2008.

Contractual Obligations	Payments due by period (in thousands)				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Leases covering various equipment, branches, office space and land	\$ 16,187	\$ 3,266	\$ 7,710	\$ 4,558	\$ 653
Time deposits	528,023	491,772	31,304	4,947	-
Federal funds purchased	4,500	4,500	-	-	-
FHLB borrowings	98,000	98,000	-	-	-
Securities sold under agreements to repurchase	3,000	-	3,000	-	-
Subordinated notes	10,000	-	-	10,000	-
Junior subordinated debentures	20,620	-	-	-	20,620
Payable - securities purchases	3,000	3,000	-	-	-
<b>Total</b>	<b>\$ 683,330</b>	<b>\$ 600,538</b>	<b>\$ 42,014</b>	<b>\$ 19,505</b>	<b>\$ 21,273</b>

Material Changes in Results of Operations for the Three Months Ended September 30, 2008 versus the Three Months Ended September 30, 2007 - Net income for the three months ended September 30, 2008 was \$2.0 million, a decrease of \$1.1 million or 35.5%, when compared to the same 2007 period, principally as a result of a significant increase in the provision for loan losses, offset somewhat by an improved net interest margin and a reduction in operating expenses.

As shown in Table 2-2 (A) following this discussion, net interest income increased by 3.2% to \$15.4 million as the result of a 23 basis point rise in the Company's net interest margin to 4.12% in 2008. Partially offsetting the improved margin was a 3% decrease in average interest-earning assets, primarily securities. The average investment portfolio contracted by 24% to \$391 million during the third quarter of 2008 versus the comparable period in 2007, principally due to government agency securities sold and matured. Growth in commercial and industrial loans, and commercial mortgage loans resulted in an 8% increase in average loans and leases outstanding to \$1.1 billion during the third quarter of 2008 versus the comparable period in 2007. Average borrowings, consisting primarily of FHLB overnight and short-term advances, were \$148 million and helped to fund interest-earning assets. This funding partially offset the \$48 million decrease in average interest-bearing deposits that resulted primarily from the Company's strategic pricing decision to closely manage our funding costs by utilizing more attractively priced funding sources rather than deploying promotional high rates in the current competitive environment. The average cost of interest-bearing deposits declined to 2.06% in the third quarter of 2008 from 3.82% in the third quarter of 2007.

The improvement in the Company's net interest margin to 4.12% during the third quarter of 2008 from 3.89% a year ago primarily resulted from a 193 basis point decrease in the Company's cost of total interest-bearing liabilities, as the Company has chosen to use more attractively priced borrowings to fund some loan volume rather than offer high rates to raise deposits in a highly competitive environment. This lower cost was offset somewhat by a 131 basis point decrease in the Company's earning asset yield to a weighted average rate of 5.82%. The lower asset yield resulted from the impact of a 208 basis point reduction in yield on loans and leases, offset in part by the \$83 million increase in the average balance of our loans and leases, which carry a significantly higher yield than our securities portfolio.

### Revenue of State Bancorp, Inc.

(dollars in thousands)

For the three and nine months ended September 30, 2008 and 2007

	Three months			Nine months		
	2008	2007	Over/ (under)	2008	2007	Over/ (under)
			2007			2007
Net interest income	\$15,406	\$14,933	3.2%	\$47,024	\$44,566	5.5%
Service charges on deposit accounts	468	448	4.5%	1,623	1,587	2.3%
Net security (losses) gains	(10)	(15)	(33.3)%	50	(50)	N/M(1)
Income from bank owned life insurance	276	263	4.9%	793	824	(3.8)%
Other operating income	564	608	(7.2)%	1,789	1,731	3.4%
<b>Total revenue</b>	<b>\$16,704</b>	<b>\$16,237</b>	<b>2.9%</b>	<b>\$51,279</b>	<b>\$48,658</b>	<b>5.4%</b>

(1) N/M - denotes % variance not meaningful for statistical purposes

The provision for loan and lease losses was \$3.7 million in the third quarter of 2008, representing an increase of \$3.0 million versus the comparable 2007 period. The increase in the Company's 2008 provision was due to several factors, including internal risk rating downgrades of two residential construction loan relationships totaling \$10 million resulting from the weakness present in the local economy; an increase in net charge-offs of \$3.9 million recorded in the third quarter of 2008; growth in non-accrual loans of \$7 million and an increase in total loans outstanding (net of unearned income and before allowance for loan and lease losses) in 2008 of \$92 million. The adequacy of the provision and the resulting allowance for loan losses is determined by management's continuing review of the loan portfolio, including identification and review of individual problem situations that may affect a borrower's ability to repay, delinquency and non-performing loan data, collateral values, regulatory examination results and changes in the size and character of the loan portfolio. See also "Critical Accounting Policies, Judgments and Estimates" and "Asset Quality" contained herein.

### Operating expenses of State Bancorp, Inc.

(dollars in thousands)

For the three and nine months ended September 30, 2008 and 2007

	Three months			Nine months		
	2008	2007	Over/ (under)	2008	2007	Over/ (under)
			2007			2007
Salaries and other employee benefits	\$5,632	\$6,294	(10.5)%	\$17,370	\$23,881	(27.3)%
Occupancy	1,426	1,404	1.6%	4,200	4,046	3.8%
Equipment	302	283	6.7%	919	936	(1.8)%
Legal	(197)	526	N/M (1)	2,536	1,006	152.1%
Marketing and advertising	150	291	(48.5)%	437	1,209	(63.9)%
Audit and assessment	498	279	78.5%	1,151	856	34.5%
Other operating expenses	2,355	1,755	34.2%	5,902	5,279	11.8%
<b>Total operating expenses</b>	<b>\$10,166</b>	<b>\$10,832</b>	<b>(6.1)%</b>	<b>\$32,515</b>	<b>\$37,213</b>	<b>(12.6)%</b>

(1) N/M - denotes % variance not meaningful for statistical purposes

Total operating expenses decreased by 6.1% to \$10.2 million during the third quarter of 2008 when compared to the third quarter of 2007. The decrease in total operating expenses primarily reflects reductions in salaries and other employee benefits, legal expenses, and marketing and advertising expenses. These were partially offset by an increase in audit and assessment expenses and a loss on the termination of the interest rate swap agreements the Company had with an affiliate of Lehman (see also Note 1. – Financial Statement Presentation and Significant Accounting Policies - *Accounting For Derivative Financial Instruments* .) The decrease in salaries and other employee benefits is primarily the result of a year-over-year reduction in full-time equivalent headcount of 12% and a reduction in incentive compensation costs. The reduction in legal expenses is due to the final settlement of the purported shareholder derivative suit during the third quarter of 2008. The Company recorded a legal expense credit of \$197 thousand during the third quarter of 2008 resulting from the receipt of \$1.8 million in insurance proceeds to offset a portion of the costs incurred in connection with the lawsuit. (See Part II – Item 1. - Legal Proceedings.) Lower marketing and advertising expenses is attributable to less print and other media advertising in the third quarter of 2008 as compared to 2007. Audit and assessment expenses increased in the third quarter of 2008 when compared to the third quarter of 2007 primarily due to higher deposit insurance assessment fees in 2008 coupled with a higher assessment credit recorded in 2007.

Due in part to the decrease in total operating expenses, the Company's operating efficiency ratio (total operating expenses divided by the sum of fully taxable equivalent net interest income and non-interest income, excluding net securities gains and losses) decreased to 60.2% in the third quarter of 2008 versus 65.7% in the third quarter of 2007. The Company's other measure of expense control, the ratio of total operating expenses to average total assets, was 2.55% for the third quarter of 2008 as compared to 2.62% in 2007, reflecting the decrease in total operating expenses.

As a result of the recent failures of a number of banks and thrifts, there has been a significant increase in the loss provisions of the Deposit Insurance Fund ("DIF") of the FDIC. This has resulted in a decline in the DIF reserve ratio to 1.01% as of June 30, 2008. Because the DIF reserve ratio has declined below 1.15% and is expected to remain below 1.15%, the FDIC is required to establish a restoration plan to restore the reserve ratio to 1.15% within five years. In order to restore the reserve ratio to 1.15%, the FDIC has determined that current assessment rates need to be increased to raise assessment revenue. On October 7, 2008, the FDIC adopted a restoration plan and issued a notice of proposed rulemaking and request for comment to initially raise the assessment rate schedule uniformly 7 basis points (annualized) beginning on January 1, 2009. Under the proposed plan, beginning with the second quarter of 2009, the initial base assessment rates will range from 10 to 14 basis points for Risk Category I institutions and will be 20, 30 and 45 basis points for Risk II, III and IV institutions, respectively (subject to possible adjustment). If this plan is adopted, the increase in our assessment rate will affect our total non-interest expense. For a further discussion of the FDIC restoration plan and proposal, see Part II, Item 1A "Risk Factors."

Income tax expense declined by \$821 thousand in the third quarter of 2008 as compared to 2007. The Company's effective tax rate was 29.9% in 2008 and 35.1% in 2007. The decrease in the effective tax rate is primarily a result of a reduction in taxes from the net deferred tax liability applicable to the sale of substantially all of the leasing assets. The Company has performed an evaluation of its tax positions in accordance with FIN 48, and concluded that there were no significant uncertain tax positions that required recognition in its financial statements.

Material Changes in Results of Operations for the Nine Months Ended September 30, 2008 versus the Nine Months Ended September 30, 2007 - Net income for the nine months ended September 30, 2008 was \$6.0 million, an increase of \$191 thousand or 3.3% when compared to the same 2007 period. The factors contributing to the increase in earnings were a 5.5% increase in net interest income, higher non-interest income and lower total operating expenses, offset by a significant increase in the provision for loan and lease losses.

As shown in Table 2-2 (B) following this narrative, the increase of \$2.5 million in net interest income for the first nine months of 2008 versus the comparable period in 2007 resulted from a 160 basis point reduction in the Company's cost of interest-bearing liabilities, partially offset by a 4% or \$56 million decrease in average interest-earning assets, primarily investment securities, and a 95 basis point decline in the Company's earning asset yield to a weighted average rate of 6.11%. The Company's net interest margin of 4.14% for the first nine months of 2008 represents an increase of 34 basis points from 3.80% one year ago and reflects the impact of the strategic use of more favorably priced borrowings, instead of higher-cost deposits, to fund the growth in loan volume. Average borrowings, consisting primarily of FHLB overnight and short-term advances, increased \$53 million for the nine months ended September 30, 2008 when compared to the same 2007 period.

The provision for loan and lease losses increased by \$7.4 million for the first nine months of 2008 as compared to 2007 due to several factors, including internal risk rating downgrades of two residential construction loan relationships, higher loan charge-offs in 2008, an increase in non-accrual loans and growth in total loans outstanding. The Company recorded net loan and lease charge-offs of \$8.4 million and \$4.6 million for the first nine months of 2008 and 2007, respectively.

Total non-interest income increased to \$4.3 million in 2008, largely due to net securities gains recorded in 2008 versus net securities losses in 2007. Total operating expenses decreased by \$4.7 million in the first nine months of 2008 compared with 2007 mainly due to a \$6.5 million decrease in salaries and other employee benefits expenses, \$3.1 million of which was the result of the 2007 Voluntary Exit Window Program, partially offset by an increase of \$1.5 million in legal expenses in 2008. The Company had been a nominal defendant in a purported shareholder derivative lawsuit (see Part II – Item 1. – Legal Proceedings). The increase in legal expenses was experienced primarily during the first six months of 2008 due to costs related to this recently settled lawsuit.

The Company's operating efficiency ratio was 62.8% for the first nine months of 2008 and 75.3% for the first nine months of 2007. The Company's ratio of total operating expenses to average total assets was 2.67% for the first nine months of 2008 and 2.94% for the first nine months of 2007.

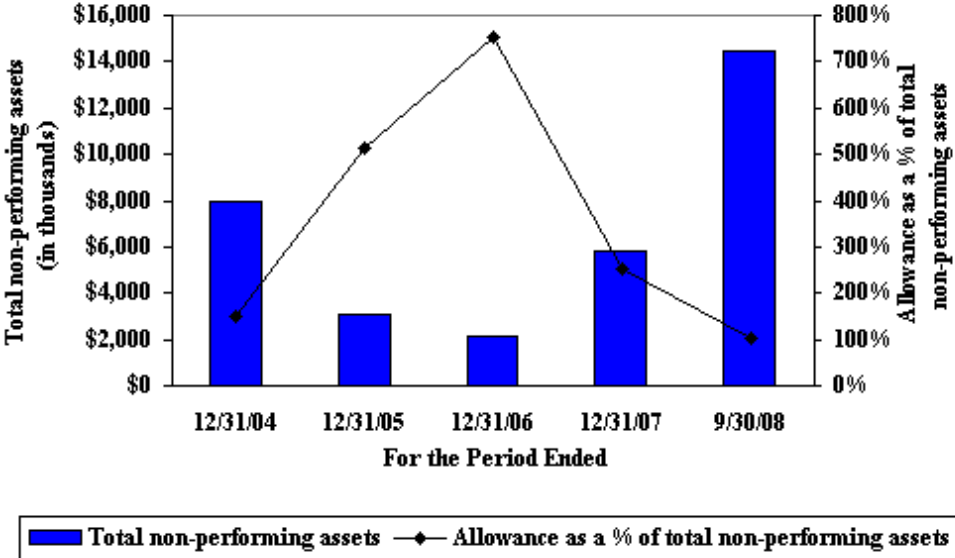
Asset Quality – There is no subprime exposure in the Company's securities portfolio. All of the mortgage-backed securities and collateralized mortgage obligations held in the Company's portfolio are issued by U.S. Government-sponsored agencies or the underlying mortgage loans are guaranteed by U.S. Government-sponsored agencies. The portfolio contains one single-issuer trust preferred security with an amortized cost of \$2.1 million and an estimated fair value of \$1.2 million. This issue is rated Baa1 by Moody's Investors Service, BBB- by Standard & Poor's and BBB+ by Fitch, Inc. Based upon the financial condition of the issuer, the Company believes the decline in market value to be temporary and therefore the security is not other than temporarily impaired. This fixed rate security has been in a continuous loss position for twelve months or longer at September 30, 2008. In the event that the security's current rating is downgraded or the issuer's financial condition is not deemed adequate to meet its debt obligations, the Company will evaluate it for other than temporary impairment at that time. In addition, the portfolio contains one collateralized debt obligation, which is backed by a portfolio of bank-only pooled trust preferred securities with an amortized cost of \$10 million and an estimated fair value of \$1.5 million. This issue is credit enhanced, with over-collateralization of principal and/or excess spread, and is rated Baa3 by Moody's Investors Service and A- by Fitch, Inc. Based upon projected cash flows, reviews of the underlying collateral in the pool and the over-collateralization of the pool, the Company believes the decline in market value to be temporary and therefore the security is not other than temporarily impaired. This adjustable rate security has been in a continuous loss position for twelve months or longer at September 30, 2008. In the event that this security's projected cash flows are not adequate to meet contractual obligations, the Company will evaluate it for other than temporary impairment at that time. The Company's loan and lease portfolio is concentrated in commercial and industrial loans and commercial mortgage loans. The Bank does not engage in subprime lending and the Bank's adjustable-rate mortgage (ARM) exposure is less than 1% of the total loan and lease portfolio. The Bank does not offer payment option ARM or negative amortization loan products.

Non-performing assets, defined by the Company as non-accrual loans and leases and other real estate owned ("OREO"), totaled \$14 million at September 30, 2008, \$6 million at December 31, 2007 and \$8 million at September 30, 2007. The increase in non-accrual loans and leases at September 30, 2008 resulted primarily from the addition of two residential construction loan relationships to non-accrual status during 2008. These relationships, one totaling \$6 million and the other totaling \$4 million, had been on the Bank's internal watch list. For both relationships, the loans appear to be adequately secured by land and are personally guaranteed but exhibit some financial weakness. Payment delinquencies for both relationships resulted from insufficient cash flow due to slowness in developing and selling the properties. Non-accrual loans for the third quarter increased from \$11 million at June 30, 2008 to \$14 million primarily due to additions to non-accrual of \$6 million less non-accrual loans charged off of \$3 million representing two relationships. At September 30, 2008, December 31, 2007 and September 30, 2007, the Company held no OREO and there were no restructured accruing loans and leases. At September 30, 2008, there were no loans 90 days or more past due and still accruing interest. Loans and leases 90 days or more past due and still accruing totaled \$28 thousand at December 31, 2007 and \$371 thousand at September 30, 2007.

The allowance for loan and lease losses amounted to \$15 million or 1.3% of total loans and leases at September 30, 2008, \$15 million or 1.4% of total loans and leases at December 31, 2007, and \$15 million or 1.5% of total loans and leases at September 30, 2007. The decrease in the allowance as a percentage of the total loan and lease portfolio at September 30, 2008 as compared to December 31, 2007 and September 30, 2007 is due to the increase in total loans outstanding in 2008. The allowance for loan and lease losses as a percentage of total non-performing assets decreased to 101% at September 30, 2008 from 254% at December 31, 2007 and 191% one year ago, caused primarily by the increase in non-accrual loans and leases and the impact of write-downs of previously classified watch list loans and loans that were transferred to held for sale. The allowance for loan and lease losses for the third quarter decreased from \$17 million at June 30, 2008 to \$15 million primarily due to charge offs of \$6 million which were in excess of the third quarter provision for loan losses of \$3.7million. The balance of the Company's allowance for loan losses represents management's best estimate of the probable inherent losses in the Company's loan portfolio at September 30, 2008 and December 31, 2007. Management considers many factors in this analysis, among them credit risk grades assigned to commercial, industrial and commercial real estate loans, delinquency trends, concentrations within segments of the loan and lease portfolio, recent charge-off experience, local and national economic conditions, current real estate market conditions in geographic areas where the Company's loans and leases are located, changes in the trend of non-performing loans and leases, changes in interest rates, and loan and lease portfolio growth. Changes in one or a combination of these factors may adversely affect the Company's loan and lease portfolio resulting in increased delinquencies, loan and lease losses and future levels of loan and lease loss provisions. See also "Critical Accounting Policies, Judgments and Estimates" contained herein.

Loans to borrowers which the Bank has identified as requiring special attention (such as a result of changes affecting the borrower’s industry, management, financial condition or other concerns) will be added to the watch list as well as loans which are criticized or classified by bank regulators or loan review auditors. The majority of such watch list loans were originated as commercial and industrial loans. In some cases, additional collateral in the form of commercial real estate was taken based on current valuations. Thus, there exists a broad base of collateral with a mix of various types of corporate assets including inventory, receivables and equipment, and commercial real estate, with no particular concentration in any one type of collateral. At September 30, 2008 there were only two residential relationships on the watch list, representing less than 1% of total watch list loans. As a result of management’s ongoing review and assessment of the Bank’s policies and procedures, the Company has adopted a more aggressive workout and disposition posture for watch list relationships. The Company has workout specialists who are responsible for managing this process and exiting such relationships in an expedited and cost effective manner. Line officers do not maintain control over such relationships. As of September 30, 2008, the Bank had 51 relationships on its watch list, including non-accrual loans and leases, with an aggregate value of \$71.3 million, compared to 45 relationships, including non-accrual loans and leases, with an aggregate value of \$84.5 million at December 31, 2007. The watch list total for the third quarter decreased from \$77.6 million at June 30, 2008 to \$71.3 million primarily due to one \$7.8 million relationship that was transferred to loans held for sale, with the net difference primarily representing two relationships added to the watch list. The loan transferred to held for sale is one of the two relationships that resulted in the charge-offs for the quarter. It is anticipated that management will use a variety of strategies, depending on individual case circumstances, to exit relationships where the fundamental credit quality shows indications of more than temporary or seasonal deterioration. During 2008, \$10.9 million in watch list assets were sold or transferred to held for sale, including \$3.9 million in non-accrual loans. We cannot give any assurance that such strategies will enable us to exit such relationships especially in light of recent credit market conditions.

**TOTAL NON-PERFORMING ASSETS AND THE ALLOWANCE FOR LOAN AND LEASE LOSSES**



The provision for loan and lease losses is continually evaluated relative to portfolio risk and regulatory guidelines considering all economic factors that affect the loan and lease loss allowance, such as fluctuations in the Long Island and New York City real estate markets and interest rates, economic slowdowns in industries and other uncertainties. All of the factors mentioned above will continue to be closely monitored. Due to the uncertainties cited above, management expects to record loan charge-offs in future periods. A further review of the Company’s non-performing assets may be found in Table 2-3 following this analysis.

**TABLE 2 - 2 (A)****NET INTEREST INCOME ANALYSIS**For the Three Months Ended September 30, 2008 and 2007 (unaudited)  
(dollars in thousands)

	2008			2007		
	Average Balance (1)	Interest	Average Yield/Cost	Average Balance (1)	Interest	Average Yield/Cost
<b>ASSETS:</b>						
Interest-earning assets:						
Securities (2)	\$ 391,064	\$ 4,880	4.96%	\$ 516,884	\$ 6,455	4.95%
Federal Home Loan Bank and other restricted stock	8,051	92	4.55	8,494	231	10.79
Federal funds sold	-	-	-	2	-	-
Securities purchased under agreements to resell	-	-	-	2,989	37	4.91
Interest-bearing deposits	3,271	13	1.58	1,370	17	4.92
Loans and leases (3)	1,086,993	16,805	6.15	1,003,747	20,816	8.23
Total interest-earning assets	<u>1,489,379</u>	<u>\$ 21,790</u>	<u>5.82%</u>	<u>1,533,486</u>	<u>\$ 27,556</u>	<u>7.13%</u>
Non-interest-earning assets	<u>95,958</u>			<u>109,660</u>		
Total Assets	<u>\$ 1,585,337</u>			<u>\$ 1,643,146</u>		
<b>LIABILITIES AND STOCKHOLDERS' EQUITY:</b>						
Interest-bearing liabilities:						
Savings deposits	\$ 503,892	\$ 1,491	1.18%	\$ 567,816	\$ 4,270	2.98%
Time deposits	<u>456,092</u>	<u>3,488</u>	<u>3.04</u>	<u>440,431</u>	<u>5,450</u>	<u>4.91</u>
Total savings and time deposits	<u>959,984</u>	<u>4,979</u>	<u>2.06</u>	<u>1,008,247</u>	<u>9,720</u>	<u>3.82</u>
Federal funds purchased	6,485	39	2.39	10,318	140	5.38
Other temporary borrowings	141,402	785	2.21	148,826	1,981	5.28
Subordinated notes	10,000	231	9.19	10,000	231	9.16
Junior subordinated debentures	<u>20,620</u>	<u>316</u>	<u>6.10</u>	<u>20,620</u>	<u>467</u>	<u>8.99</u>
Total interest-bearing liabilities	<u>1,138,491</u>	<u>6,350</u>	<u>2.22</u>	<u>1,198,011</u>	<u>12,539</u>	<u>4.15</u>
Demand deposits	320,464			317,381		
Other liabilities	<u>12,525</u>			<u>18,675</u>		
Total Liabilities	1,471,480			1,534,067		
Stockholders' Equity	<u>113,857</u>			<u>109,079</u>		
Total Liabilities and Stockholders' Equity	<u>\$ 1,585,337</u>			<u>\$ 1,643,146</u>		
Net interest income/margin		15,440	<u>4.12%</u>		15,017	<u>3.89%</u>
Less tax-equivalent basis adjustment		<u>(34)</u>			<u>(84)</u>	
Net interest income		<u>\$ 15,406</u>			<u>\$ 14,933</u>	

(1) Weighted daily average balance for period noted.

(2) Interest on securities includes the effects of tax-equivalent basis adjustments, using a 34% tax rate. Tax-equivalent basis adjustments were \$8 and \$52 in 2008 and 2007, respectively.

(3) Interest on loans and leases includes the effects of tax-equivalent basis adjustments, using a 34% tax rate. Tax-equivalent basis adjustments were \$26 and \$32 in 2008 and 2007, respectively.

**TABLE 2 - 2 (B)****NET INTEREST INCOME ANALYSIS**For the Nine Months Ended September 30, 2008 and 2007 (unaudited)  
(dollars in thousands)

	2008			2007		
	Average Balance (1)	Interest	Average Yield/Cost	Average Balance (1)	Interest	Average Yield/Cost
<b>ASSETS:</b>						
Interest-earning assets:						
Securities (2)	\$ 399,142	\$ 14,789	4.95%	\$ 518,053	\$ 18,797	4.85%
Federal Home Loan Bank and other restricted stock	8,111	413	6.80	5,793	328	7.57
Federal funds sold	-	-	-	8,203	319	5.20
Securities purchased under agreements to resell	39,624	963	3.25	45,110	1,786	5.29
Interest-bearing deposits	3,249	57	2.34	1,446	53	4.90
Loans and leases (3)	1,072,644	53,450	6.66	999,929	62,015	8.29
Total interest-earning assets	1,522,770	\$ 69,672	6.11%	1,578,534	\$ 83,298	7.06%
Non-interest-earning assets	103,434			113,064		
Total Assets	\$ 1,626,204			\$ 1,691,598		
<b>LIABILITIES AND STOCKHOLDERS' EQUITY:</b>						
Interest-bearing liabilities:						
Savings deposits	\$ 544,235	\$ 6,179	1.52%	\$ 610,143	\$ 13,871	3.04%
Time deposits	452,847	11,696	3.45	503,215	18,624	4.95
Total savings and time deposits	997,082	17,875	2.39	1,113,358	32,495	3.90
Federal funds purchased	7,741	161	2.78	7,323	299	5.46
Other temporary borrowings	141,607	2,772	2.61	89,509	3,612	5.40
Subordinated notes	10,000	694	9.27	10,000	691	9.24
Junior subordinated debentures	20,620	995	6.45	20,620	1,382	8.96
Total interest-bearing liabilities	1,177,050	22,497	2.55	1,240,810	38,479	4.15
Demand deposits	319,235			318,232		
Other liabilities	14,975			24,839		
Total Liabilities	1,511,260			1,583,881		
Stockholders' Equity	114,944			107,717		
Total Liabilities and Stockholders' Equity	\$ 1,626,204			\$ 1,691,598		
Net interest income/margin		47,175	4.14%		44,819	3.80%
Less tax-equivalent basis adjustment		(151)			(253)	
Net interest income		\$ 47,024			\$ 44,566	

(1) Weighted daily average balance for period noted.

(2) Interest on securities includes the effects of tax-equivalent basis adjustments, using a 34% tax rate. Tax-equivalent basis adjustments were \$71 and \$160 in 2008 and 2007, respectively.

(3) Interest on loans and leases includes the effects of tax-equivalent basis adjustments, using a 34% tax rate. Tax-equivalent basis adjustments were \$80 and \$93 in 2008 and 2007, respectively.







**TABLE 2 - 3**

**ANALYSIS OF NON-PERFORMING ASSETS  
AND THE ALLOWANCE FOR LOAN AND LEASE LOSSES**  
September 30, 2008 versus December 31, 2007 and September 30, 2007  
(dollars in thousands)

**NON-PERFORMING ASSETS BY TYPE:**

	Period Ended		
	9/30/2008	12/31/2007	9/30/2007
Non-accrual Loans and Leases	\$ 14,485	\$ 5,792	\$ 7,673
Other Real Estate Owned ("OREO")	-	-	-
Total Non-performing Assets	<u>\$ 14,485</u>	<u>\$ 5,792</u>	<u>\$ 7,673</u>
Loans and Leases 90 Days or More Past Due and Still Accruing	\$ -	\$ 28	\$ 371
Gross Loans and Leases Outstanding	\$ 1,100,800	\$ 1,041,009	\$ 1,009,077

**ANALYSIS OF THE ALLOWANCE FOR LOAN AND LEASE LOSSES:**

	Quarter Ended		
	9/30/2008	12/31/2007	9/30/2007
Beginning Balance	\$ 17,248	\$ 14,659	\$ 16,436
Provision	3,700	1,610	653
Net Charge-Offs	(6,375)	(1,564)	(2,430)
Ending Balance	<u>\$ 14,573</u>	<u>\$ 14,705</u>	<u>\$ 14,659</u>

**KEY RATIOS:**

	Period Ended		
	9/30/2008	12/31/2007	9/30/2007
Allowance as a % of Total Loans and Leases	1.3%	1.4%	1.5%
Non-accrual Loans and Leases as a % of Total Loans and Leases	1.3%	0.6%	0.8%
Non-performing Assets as a % of Total Loans and Leases and OREO (1)	1.3%	0.6%	0.8%
Allowance for Loan and Lease Losses as a % of Non-accrual Loans and Leases	101%	254%	191%
Allowance for Loan and Lease Losses as a % of Non-accrual Loans and Leases, and Loans and Leases 90 days or More Past Due and Still Accruing	101%	253%	182%

(1) For purposes of calculating this ratio, non-performing assets excludes loans and leases 90 days or more past due and still accruing interest.

### ITEM 3. - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

**Asset/Liability Management and Market Risk** - The process by which financial institutions manage interest-earning assets and funding sources under different assumed interest rate environments is called asset/liability management. The primary goal of asset/liability management is to increase net interest income within an acceptable range of overall risk tolerance. Management must ensure that liquidity, capital, interest rate and market risk are prudently managed. Asset/liability and interest rate risk management are governed by policies reviewed and approved annually by the Company's Board of Directors. The Board has delegated responsibility for asset/liability and interest rate risk management to the ALCO. The ALCO meets quarterly and sets strategic directives that guide the day to day asset/liability management activities of the Company as well as reviewing and approving all major funding, capital and market risk management programs. The ALCO also focuses on current market conditions, balance sheet management strategies, deposit and loan pricing issues and interest rate risk measurement and mitigation.

**Interest Rate Risk** – Interest rate risk is the potential adverse change to earnings or capital arising from movements in interest rates. This risk can be quantified by measuring the change in net interest margin relative to changes in market rates. Reviewing re-pricing characteristics of interest-earning assets and interest-bearing liabilities identifies risk. The Company's ALCO sets forth policy guidelines that limit the level of interest rate risk within specified tolerance ranges. Management must determine the appropriate level of risk, under policy guidelines, which will enable the Company to achieve its performance objectives within the confines imposed by its business objectives and the external environment within which it operates.

Interest rate risk arises from re-pricing risk, basis risk, yield curve risk and options risk, and is measured using financial modeling techniques including interest rate ramp and shock simulations to measure the impact of changes in interest rates on earnings for periods of up to two years. These simulations are used to determine whether corrective action may be warranted or required in order to adjust the overall interest rate risk profile of the Company. Asset and liability management strategies may also involve the use of instruments such as interest rate swaps to hedge interest rate risk. Management performs simulation analysis to assess the Company's asset/liability position on a dynamic re-pricing basis using software developed by a well known industry vendor. Simulation modeling applies alternative interest rate scenarios to the Company's balance sheet to estimate the related impact on net interest income. The use of simulation modeling assists management in its continuing efforts to achieve earnings stability in a variety of interest rate environments.

The Company's asset/liability and interest rate risk management policy limits interest rate risk exposure to -12% and -15% of the base case net interest income for net earnings at risk at the 12-month and 24-month time horizons, respectively. Net earnings at risk is the potential adverse change in net interest income arising from up to +200/-100 basis point change in interest rates ramped over a 12 month period, and measured over a 24 month time horizon. The Company's balance sheet is held flat over the 24 month time horizon with all principal cash flows assumed to be reinvested in similar products and term points at the simulated market interest rates.

The Company may be considered "asset sensitive" when net interest income increases in a rising interest rate environment or decreases in a falling interest rate environment. Similarly, the Company may be considered "liability sensitive" when net interest income increases in a falling interest rate environment or decreases in a rising interest rate environment. When there is minimal variability in net interest income in either a rising or falling interest rate environment, the Company may be considered "interest rate neutral".

As of September 30, 2008, the Company's balance sheet is considered interest rate neutral as a hypothetical change in interest rates, as described above, result in a slight amount of net interest income variability from 2.6% to -1.6%. This condition is particularly evident in a low interest rate environment and is primarily the result of the shortening of the average life of the investment portfolio, the amount of short-term funding liabilities and the pricing of core deposits.

% Change in Net Interest Income 12 Month Interest Rate Changes Basis Points				
September 30, 2008				
Time Horizon	Down 100	Base Flat	Up 100	Up 200
Year One	-1.6%	0.0%	0.8%	2.6%
Year Two	2.4%	0.8%	-1.1%	-2.4%

Management also monitors equity value at risk as a percentage of market value of portfolio equity ("MVPE"). The Company's MVPE is the difference between the market value of its interest-sensitive assets and the market value of its interest-sensitive liabilities. MVPE at risk is the potential adverse change in the present value (market value) of total equity arising from an immediate hypothetical shock in interest rates. Management uses scenario analysis on a static basis to assess its equity value at risk by modeling MVPE under various interest rate shock scenarios. When modeling MVPE at risk, management recognizes the high degree of subjectivity when projecting long-term cash flows and reinvestment rates, and therefore uses MVPE at risk as a relative indicator of interest rate risk. Accordingly, the Company does not set policy limits over MVPE at risk.



As of September 30, 2008, the variability in the Company's MVPE after an immediate hypothetical shock in interest rates of +200/-100 basis points is low. The small changes in the percentage change in MVPE and the MVPE Ratio continue to be a result of the closely matched duration of assets and liabilities on the bank's balance sheet. The low volatility of MVPE is also attributable to the low interest rate environment at September 30, 2008 and its hypothetical impact on the market value of the Company's investment assets and lower cost core deposits.

MVPE Variability				
Immediate Interest Rate Shocks				
Basis Points				
September 30, 2008				
	Down 100	Base Flat	Up 100	Up 200
% Change in MVPE (1)	2.8%	0.0%	-0.5%	-1.2%
MVPE Ratio	17.3%	16.8%	17.0%	17.0%

(1) Assumes 40% marginal tax rate.

Simulation and scenario techniques in asset/liability modeling are influenced by a number of estimates and assumptions with regard to embedded options, prepayment behaviors, pricing strategies and cash flows. Such assumptions and estimates are inherently uncertain and, as a consequence, simulation and scenario output will neither precisely estimate the level of, or the changes in, net interest income and MVPE, respectively.

#### ITEM 4. – CONTROLS AND PROCEDURES

The Company carried out an evaluation, under the supervision and with the participation of its principal executive officer and principal financial officer, of the effectiveness of the design and operation of its disclosure controls and procedures as defined in Rule 13a-15(e) and Rule 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Based on this evaluation, the Company's principal executive officer and principal financial officer concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures are effective in timely alerting them to material information required to be included in the Company's periodic reports filed with the SEC. There have been no significant changes in the Company's internal controls or in other factors that could significantly affect internal controls subsequent to the date the Company carried out its evaluation.

There were no changes to the Company's internal control over financial reporting as defined in Rule 13a-15(f) and Rule 15d-15(f) under the Exchange Act that occurred in the third quarter of 2008 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## PART II

#### ITEM 1. - LEGAL PROCEEDINGS

##### *Purported Shareholder Derivative Suit*

On July 18, 2007, the Company was served with a Summons and Complaint in a purported shareholder derivative lawsuit, filed in the Supreme Court of the State of New York, County of Nassau (Index No. 07-012411) by Ona Guthartz, First Wall Securities, Inc. and Alan Guthartz as custodian for Jason Guthartz, identifying themselves as shareholders of the Company and purporting to act on behalf of the Company, naming the Company as a nominal defendant and certain of the Company's current and former directors and officers as defendants. The lawsuit alleged, among other things, (1) that the defendant directors and officers breached their fiduciary duty to the Company in connection with the Company's previously disclosed dealings with Island Mortgage Network, Inc. ("IMN") and the resulting litigation in the United States District Court for the Eastern District of New York (the "IMN Matter") and (2) that the directors engaged in corporate waste by awarding bonuses to certain officers who had responsibility for the IMN relationship and by offering a voluntary exit window program to those same officers, each of which have been previously disclosed by the Company. An amount of damages was not specified in the Complaint.

At the Company's Board of Directors meeting held on July 24, 2007, a Special Litigation Committee of the Board of Directors was established to examine the merits of the allegations made in the lawsuit. The members of the Special Litigation Committee were Nicos Katsoulis and the Honorable John J. LaFalce.

On June 12, 2008, all parties to the lawsuit executed a non-binding Stipulation of Settlement that would dispose of the lawsuit. On June 16, 2008 the Honorable Ira B. Warshawsky, J.S.C. signed an Order of Preliminary Approval of Settlement and Form of Notice (“Preliminary Order”) with regard to the Stipulation of Settlement among the parties. The Preliminary Order was entered in the County Clerk’s Office, Nassau County on June 17, 2008.

As announced by the Company on June 18, 2008, the Company agreed to implement certain corporate governance provisions within 30 days after the effective date of the Stipulation of Settlement. The Stipulation of Settlement includes no admission of liability by the Company, the Bank or any of the defendants named in the lawsuit.

The Preliminary Order was subject to final determination by the Court as to the fairness, reasonableness and adequacy of the Stipulation of Settlement. A fairness hearing was held August 5, 2008 before Judge Ira B. Warshawsky at the Supreme Court of the State of New York, Nassau County, New York, at which time Judge Warshawsky signed a Final Judgment and Order of Dismissal (“Final Judgment”) with regard to the Stipulation of Settlement among the parties. The Final Judgment was entered in the County Clerk’s Office, Nassau County on August 5, 2008. In addition to issuing final approval of the Stipulation of Settlement, the Final Judgment approved the award to plaintiffs’ counsel of attorneys’ fees in the sum of \$1,000,000 and expenses in the sum of \$27,839. The Court also determined that each of the individual defendants are fairly and reasonably entitled to be indemnified by the Company for their legal fees and expenses incurred in connection with the defense and settlement of the lawsuit. Gulf Insurance Company agreed to pay an additional \$575 thousand to the Company (above the \$1.2 million agreed to in the Stipulation of Settlement) in final settlement of all insurance claims related to this matter. Upon receipt of these insurance proceeds, the Company recorded a legal expense credit of \$197 thousand during the third quarter of 2008 to offset a portion of the Company’s costs incurred in connection with the lawsuit. The statutory appeal period for the Final Judgment expired September 4, 2008. For the nine months ended September 30, 2008, the Company incurred \$1.7 million in expenses related to this lawsuit (net of reimbursement from Gulf Insurance Company). For the nine and twelve month periods ended September 30, 2007 and December 31, 2007, the Company incurred \$500 thousand and \$1.9 million, respectively, of such expenses. All such costs incurred have been recognized in the Company’s financial statements.

Effective September 29, 2008 in accordance with the Stipulation of Settlement, the Company’s Board amended the Company’s bylaws (the “Bylaws”) to (a) subject to stockholder approval, require the affirmative vote of a majority of stockholders in an uncontested election of directors, and, in a contested election, require a plurality vote for election of directors. (Previously, a plurality of the votes cast was sufficient to elect directors in both uncontested and contested elections); (b) add a new provision providing that a director who is an employee of the Company and/or its bank subsidiary and then ceases such employment, shall cease to be a director on the day prior to the date of the next stockholders’ meeting at which directors are to be elected; (c) add a new provision requiring at least two-thirds of the Board of Directors to consist of directors who are non-management and non-former management of the Company; and (d) add a new provision providing that no director may serve as chairman of the same Board committee, other than the Audit Committee, for more than three (3) consecutive years.

#### Other

The Company and the Bank are subject to legal proceedings and claims that arise in the ordinary course of business. In the opinion of management, the amount of ultimate liability, if any, with respect to such matters will not materially affect future operations and will not have a material impact on the Company’s financial statements.

### **ITEM 1A. – RISK FACTORS**

There are no other material changes from the risks disclosed in the “Risk Factors” section of our annual report on Form 10-K for the year ended December 31, 2007, except as described below.

***Banking laws and regulations could limit our access to funds from the Bank, one of our primary sources of liquidity.*** As a bank holding company, one of our principal sources of funds is dividends from our subsidiaries. These funds are used to service our debt as well as to pay expenses and dividends on our common stock. Our non-consolidated interest expense on our debt obligations was \$1.7 million and \$2.1 million and our non-consolidated operating expenses were \$19,000 and \$11,000 for the nine months ended September 30, 2008 and 2007, respectively. State banking regulations limit, absent regulatory approval, the Bank’s dividends to us to the lesser of the Bank’s undivided profits and the Bank’s retained net income for the current year plus its retained net income for the preceding two years (less any required transfers to capital surplus) up to the date of any dividend declaration in the current calendar year. As a result of the net operating loss we incurred in 2005, from 2005 through 2007 the Bank was required to obtain advance regulatory approval from the New York State Banking Department (“Banking Department”) to pay dividends to the Company. As of January 1, 2008 the Bank is no longer required to seek regulatory approval from the Banking Department to declare dividends. As of September 30, 2008, a maximum of approximately \$17 million was available to the Company from the Bank according to these limitations.

Federal bank regulatory agencies have the authority to prohibit the Bank from engaging in unsafe or unsound practices in conducting its business. The payment of dividends or other transfers of funds to us, depending on the financial condition of the Bank, could be deemed an unsafe or unsound practice.

Dividend payments from the Bank would also be prohibited under the “prompt corrective action” regulations of the federal bank regulators if the Bank is, or after payment of such dividends would be, undercapitalized under such regulations. In addition, the Bank is subject to restrictions under federal law that limit its ability to transfer funds or other items of value to us and our nonbanking subsidiaries, including affiliates, whether in the form of loans and other extensions of credit, investments and asset purchases, or other transactions involving the transfer of value. Unless an exemption applies, these transactions by the Bank with us are limited to 10% of the Bank’s capital and surplus and, with respect to all such transactions with affiliates in the aggregate, to 20% of the Bank’s capital and surplus. As of September 30, 2008, a maximum of approximately \$27 million was available to us from the Bank according to these limitations. Moreover, loans and extensions of credit to affiliates generally are required to be secured in specified amounts. A bank’s transactions with its non-bank affiliates also are required generally to be on arm’s-length terms. We do not have any borrowings from the Bank and do not anticipate borrowing from the Bank in the future.

Accordingly, we can provide no assurance that we will receive dividends or other distributions from the Bank and our other subsidiaries.

Our other primary source of funding is our DRP, which allows existing stockholders to reinvest cash dividends in our common stock and/or to purchase additional shares through optional cash investments on a quarterly basis. Shares are purchased at up to a 5% discount from the current market price under the dividend reinvestment option. Shares purchased with additional cash payments are not discounted under the DRP. No assurance can be given that we will continue the DRP or that stockholders will make purchases in the future.

***Our results of operations are affected by economic conditions in the New York metropolitan area and nationally.*** Our operations are located almost entirely in New York, with approximately 95% of our loan portfolio as of September 30, 2008, derived from operations in Nassau, Suffolk, Queens and Manhattan. As a result of this geographic concentration, our results of operations largely depend upon economic conditions in this area.

We are operating in a challenging and uncertain economic environment, both nationally and locally. Financial institutions continue to be affected by sharp declines in the real estate market and constrained financial markets. Continued declines in real estate values, home sales volumes and financial stress on borrowers as a result of the uncertain economic environment, including job losses, could have an adverse effect on our borrowers or their customers, which could adversely affect our financial condition and results of operations. In addition, decreases in real estate values could adversely affect the value of property used as collateral for our loans. Adverse changes in the economy may also have a negative effect on the ability of our borrowers to make timely repayments of their loans, which would have an adverse impact on our earnings. If poor economic conditions result in decreased demand for real estate loans, our profits may decrease because our investment alternatives may earn less income for us than real estate loans.

We have begun to see some increases in loan delinquencies and charge-offs in 2008. A possible national economic recession or further deterioration in local economic conditions in our markets could drive losses beyond that which is provided for in our allowance for loan losses and result in the following other consequences: loan delinquencies, problem assets and foreclosures may increase; demand for our products and services may decline; deposits may decrease, which would adversely impact our liquidity position; and collateral for our loans, especially real estate, may decline in value, in turn reducing customers’ borrowing power, and reducing the value of assets and collateral associated with our existing loans.

***There can be no assurance that recently enacted legislation and related regulatory actions will stabilize the U.S. financial system.*** There can be no assurance as to the actual impact that the EESA, CPP, TLGP, or CPFF or any other governmental program will have on the financial markets. The failure of any such program or the U.S. government to stabilize the financial markets and a continuation or worsening of current financial market conditions and the national and regional economy is expected to materially and adversely affect our business, financial condition, results of operations, access to credit or the trading price of our common stock.

***We operate in a highly regulated industry, which limits the manner and scope of our business activities.*** We are subject to extensive supervision, regulation and examination by the FRB, the FDIC and the Banking Department. As a result, we are limited in the manner in which we conduct our business, undertake new investments and activities and obtain financing. This regulatory structure is designed primarily for the protection of the deposit insurance funds and our depositors, and not to benefit our stockholders. This regulatory structure also gives the regulatory authorities extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to capital levels, the timing and amount of dividend payments, the classification of assets and the establishment of adequate loan loss reserves for regulatory purposes. In addition, we must comply with significant anti-money laundering and anti-terrorism laws. Government agencies have substantial discretion to impose significant monetary penalties on institutions which fail to comply with these laws.

We expect to face increased regulation and supervision of our industry as a result of the existing financial crisis, and there will be additional requirements and conditions imposed on us to the extent that we participate in any of the programs established or to be established by the Treasury under the EESA or by the federal bank regulatory agencies. Such additional regulation and supervision may increase our costs and limit our ability to pursue business opportunities.

***The FDIC's proposed increase in deposit insurance premiums is expected to cause a significant increase in our non-interest expense.*** The FDIC recently adopted a restoration plan and issued a notice of proposed rulemaking and request for comment that would initially raise the assessment rate schedule, uniformly across all four risk categories into which the FDIC assigns insured institutions, by seven basis points (annualized) of insured deposits beginning on January 1, 2009. Under the proposed plan, beginning with the second quarter of 2009, the initial base assessment rates will range from 10 to 45 basis points depending on an institution's risk category, with adjustments resulting in increased assessment rates for institutions with a significant reliance on secured liabilities and brokered deposits. Under the proposal the FDIC may continue to adopt actual rates that are higher without further notice-and-comment rulemaking subject to certain limitations. If the FDIC determines that assessment rates should be increased, institutions in all risk categories could be affected. The FDIC has exercised this authority several times in the past and could continue to raise insurance assessment rates in the future. The increased deposit insurance premiums proposed by the FDIC are expected to result in a significant increase in our non-interest expense.

***If we choose to participate in the Treasury's Capital Purchase Program, we will be subject to several restrictions including restrictions on our ability to declare or pay dividends and repurchase our shares as well as restrictions on our executive compensation.*** If we participate in the CPP, our ability to declare or pay dividends on any of our shares will be limited. Specifically, we will not be able to declare dividends payments on common, junior preferred or *pari passu* preferred shares if we are in arrears on the dividends on the senior preferred shares issued to the Treasury. Further, we will not be permitted to increase dividends on our common stock without the Treasury's approval until the third anniversary of the investment unless the senior preferred stock issued to the Treasury has been redeemed or transferred. In addition, our ability to repurchase our shares will be restricted. Treasury consent generally will be required for us to make any stock repurchase until the third anniversary of the investment by the Treasury unless the senior preferred issued to the Treasury has been redeemed or transferred. Further, common, junior preferred or *pari passu* preferred shares may not be repurchased if we are in arrears on the senior preferred dividends to the Treasury.

If we choose to participate in the program, we must also adopt the Treasury's standards for executive compensation and corporate governance for the period during which the Treasury holds equity issued under this program. These standards would generally apply to our Chief Executive Officer, Chief Financial Officer and the three next most highly compensated officers. The standards include (1) ensuring that incentive compensation for senior executives does not encourage unnecessary and excessive risks that threaten the value of the financial institution; (2) required clawback of any bonus or incentive compensation paid to a senior executive based on statements of earnings, gains or other criteria that are later proven to be materially inaccurate; (3) prohibition on making golden parachute payments to senior executives; and (4) agreement not to deduct for tax purposes executive compensation in excess of \$500,000 for each senior executive. In particular, the change to the deductibility limit on executive compensation would likely increase the overall cost of our compensation programs in future periods. In conjunction with any purchase of senior preferred shares, the Treasury would receive warrants to purchase our common stock with an aggregate market price equal to 15% of the senior preferred investment. The warrants would be immediately exercisable and have a term of 10 years. Therefore, we could potentially be subject to the executive compensation and corporate governance restrictions for a ten - year time period if we participate in the CPP.

***Alternatives to deposits as a funding source may become more expensive.*** The Company's primary sources of funds are cash provided by deposits, proceeds from maturities and sales of securities available for sale and cash provided by operating activities. If deposits become less attractive to customers due to customer preference, competition, or rates, we may have to rely on alternative sources of funding such as FHLB advances, which we have used from time to time. However, there is no assurance that such alternative funding sources will be available or, if available, at rates that allow us to maintain a reasonable net interest margin.

***Insufficient cash flows of a pool of trust preferred securities serving as collateral for a collateralized debt obligation held in our portfolio may result in other than temporary impairment.*** Our investment securities portfolio currently contains one collateralized debt obligation, which is backed by a portfolio of bank-only pooled trust preferred securities with an amortized cost of \$10 million and an estimated fair value of \$1.5 million. Based upon the projected cash flows, reviews of the underlying collateral in the pool and the over-collateralization of the pool, we believe the decline in the market value to be temporary. This adjustable rate security has been in a continuous loss position for twelve months or longer at September 30, 2008. In the event that this security's projected cash flows are not adequate to meet contractual obligations, it may be necessary to realize an other than temporary impairment charge with respect to this security which would be reflected as a charge to earnings in the period in which the impairment charge is recognized.



*The downgrade of the investment rating of a trust preferred security held in our portfolio or the inability of its issuer to meet its debt obligations may result in other than temporary impairment.* Our investment securities portfolio currently contains one single-issuer trust preferred security with an amortized cost of \$2.1 million and an estimated fair value of \$1.2 million. Based upon the financial condition of the issuer, we believe the decline in market value to be temporary. This fixed rate security has been in a continuous loss position for twelve months or longer at September 30, 2008. In the event that this security's current rating is downgraded or the issuer's financial condition is not deemed adequate to meet its debt obligations, it may be necessary to realize an other than temporary impairment charge with respect to this security which would be reflected as a charge to earnings in the period in which the impairment charge is recognized.

**ITEM 2. – UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

Not applicable.

**ITEM 3. – DEFAULTS UPON SENIOR SECURITIES**

Not applicable.

**ITEM 4. – SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

Not applicable.

**ITEM 5. – OTHER INFORMATION**

Not applicable.

**ITEM 6. - EXHIBITS**

- 31.1 Certification of principal executive officer pursuant to Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of principal financial officer pursuant to Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (this exhibit will not be deemed filed for purposes of Section 18 of the Exchange Act or otherwise subject to the liability of that section)

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

STATE BANCORP, INC.

11/10/08  
Date

/s/ Thomas M. O'Brien  
Thomas M. O'Brien,  
President and Chief Executive Officer

11/10/08  
Date

/s/ Brian K. Finneran  
Brian K. Finneran,  
Chief Financial Officer

## EXHIBIT INDEX

<b>Exhibit Number</b>	<b>Description</b>
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**EXHIBIT 31.1**

CERTIFICATION PURSUANT TO RULE 13a-14(a) OR 15d-14(a) OF THE SECURITIES EXCHANGE ACT OF 1934, AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Thomas M. O'Brien, President and Chief Executive Officer of State Bancorp, Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of State Bancorp, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

11/10/08  
Date

/s/ Thomas M. O'Brien  
Thomas M. O'Brien,  
President and Chief Executive Officer

**EXHIBIT 31.2**

CERTIFICATION PURSUANT TO RULE 13a-14(a) OR 15d-14(a) OF THE SECURITIES EXCHANGE ACT OF 1934, AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Brian K. Finneran, Chief Financial Officer of State Bancorp, Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of State Bancorp, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

11/10/08

Date

/s/ Brian K. Finneran

Brian K. Finneran,  
Chief Financial Officer

CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

This statement is being furnished in connection with the Quarterly Report of State Bancorp, Inc. (the "Company") on Form 10-Q for the period ending September 30, 2008 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Thomas M. O'Brien, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- 1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- 2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

11/10/08

Date

/s/ Thomas M. O'Brien

Thomas M. O'Brien,  
President and Chief Executive Officer

CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

This statement is being furnished in connection with the Quarterly Report of State Bancorp, Inc. (the "Company") on Form 10-Q for the period ending September 30, 2008 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Brian K. Finneran, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- 1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- 2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

11/10/08

Date

/s/ Brian K. Finneran

Brian K. Finneran,  
Chief Financial Officer