INGRAM MICRO INC
Form 10-Q
August 08, 2005

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

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

For the quarterly period ended July 2, 2005

OR

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

For the transition period from __________ to __________

Commission file number: 1-12203

Ingram Micro Inc.

(Exact name of Registrant as specified in its charter)

Delaware	**62-1644402**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1600 E. St. Andrew Place, Santa Ana, California 92705-4931

(Address, including zip code, of principal executive offices)

(714) 566-1000

(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 þ No o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes þ No o

The Registrant had 159,792,435 shares of Class A Common Stock, par value $0.01 per share, outstanding at July 2, 2005.

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Part I. Financial Information

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Part I. Financial Information

Item 1. Financial Statements

INGRAM MICRO INC.
CONSOLIDATED BALANCE SHEET
(Dollars in 000 s, except per share data)
(Unaudited)

	July 2, 2005	January 1, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 399,698	$ 398,423
Trade accounts receivable (less allowances of $90,615 and $93,465)	2,660,496	3,037,417
Inventories	1,877,587	2,175,185
Other current assets	344,851	471,137
Total current assets	5,282,632	6,082,162
Property and equipment, net	180,510	199,133
Goodwill	558,090	559,665
Other	84,993	85,777
Total assets	$ 6,106,225	$ 6,926,737
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 2,834,239	$ 3,536,880
Accrued expenses	428,533	607,684
Current maturities of long-term debt	350,243	168,649
Total current liabilities	3,613,015	4,313,213
Long-term debt, less current maturities	191,439	346,183
Other liabilities	32,717	26,531
Total liabilities	3,837,171	4,685,927
Commitments and contingencies (Note 8)		
Stockholders equity:		
Preferred Stock, $0.01 par value, 25,000,000 shares authorized; no shares issued and outstanding		
Class A Common Stock, $0.01 par value, 500,000,000 shares authorized; 159,792,435 and 158,737,898 shares issued and outstanding	1,598	1,587
Class B Common Stock, $0.01 par value, 135,000,000 shares authorized; no shares issued and outstanding		
Additional paid-in capital	830,663	817,378

Retained earnings	1,406,004	1,321,855
Accumulated other comprehensive income	31,348	99,990
Unearned compensation	(559)	
Total stockholders equity	2,269,054	2,240,810
Total liabilities and stockholders equity	$ 6,106,225	$ 6,926,737

See accompanying notes to these consolidated financial statements.

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INGRAM MICRO INC.
CONSOLIDATED STATEMENT OF INCOME
(Dollars in 000 s, except per share data)
(Unaudited)

	Thirteen Weeks Ended		Twenty-six Weeks Ended	
	July 2, 2005	July 3, 2004	July 2, 2005	July 3, 2004
Net sales	$ 6,840,486	$ 5,716,619	$ 13,892,478	$ 11,992,259
Cost of sales	6,472,944	5,405,145	13,145,463	11,339,331
Gross profit	367,542	311,474	747,015	652,928
Operating expenses:				
Selling, general and administrative	289,954	263,519	590,509	538,278
Reorganization costs	6,286	71	8,978	196
	296,240	263,590	599,487	538,474
Income from operations	71,302	47,884	147,528	114,454
Other expense (income):				
Interest income	(483)	(1,956)	(1,486)	(3,708)
Interest expense	12,407	8,304	24,187	18,206
Losses on sales of receivables	64	1,089	699	2,948
Net foreign currency exchange loss	951	1,479	2,889	2,338
Other	1,121	926	2,474	1,400
	14,060	9,842	28,763	21,184
Income before income taxes	57,242	38,042	118,765	93,270
Provision for income taxes	15,544	12,174	34,616	29,847
Net income	$ 41,698	$ 25,868	$ 84,149	$ 63,423
Basic earnings per share	$ 0.26	$ 0.17	$ 0.53	$ 0.41
Diluted earnings per share	$ 0.26	$ 0.16	$ 0.52	$ 0.40

See accompanying notes to these consolidated financial statements.

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INGRAM MICRO INC.
CONSOLIDATED STATEMENT OF CASH FLOWS
(Dollars in 000 s)
(Unaudited)

	Twenty-six Weeks Ended	
	July 2, 2005	**July 3, 2004**
Cash flows from operating activities:		
Net income	$ 84,149	$ 63,423
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	31,580	28,884
Noncash charges for interest and compensation	1,765	2,150
Deferred income taxes	(20,543)	9,840
Changes in operating assets and liabilities, net of effect of acquisitions:		
Changes in amounts sold under accounts receivable programs		10,000
Accounts receivable	307,467	324,304
Inventories	263,240	384,872
Other current assets	158,256	(8,604)
Accounts payable	(601,251)	(365,243)
Accrued expenses	(177,445)	36,387
Cash provided by operating activities	47,218	486,013
Cash flows from investing activities:		
Purchases of property and equipment	(17,586)	(13,193)
Acquisitions, net of cash acquired	(2,737)	(1,078)
Other		505
Cash used by investing activities	(20,323)	(13,766)
Cash flows from financing activities:		
Proceeds from exercise of stock options	10,548	42,677
Change in book overdrafts	(50,080)	(75,015)
Net proceeds from (repayments of) debt	39,129	(24,476)
Cash used by financing activities	(403)	(56,814)
Effect of exchange rate changes on cash and cash equivalents	(25,217)	386
Increase in cash and cash equivalents	1,275	415,819
Cash and cash equivalents, beginning of period	398,423	279,587

Cash and cash equivalents, end of period	$ 399,698	$ 695,406

See accompanying notes to these consolidated financial statements.

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INGRAM MICRO INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in 000 s, except per share data)
(Unaudited)

Note 1 Organization and Basis of Presentation

Ingram Micro Inc. (Ingram Micro) and its subsidiaries are primarily engaged in the distribution of information technology (IT) products and supply chain management services worldwide. Ingram Micro operates in North America, Europe, Asia-Pacific and Latin America.

The consolidated financial statements include the accounts of Ingram Micro and its subsidiaries (collectively referred to herein as the Company). These financial statements have been prepared by the Company, without audit, pursuant to the rules and regulations of the United States Securities and Exchange Commission (the SEC). In the opinion of management, the accompanying unaudited consolidated financial statements contain all material adjustments (consisting of only normal, recurring adjustments) necessary to fairly state the financial position of the Company as of July 2, 2005, and its results of operations for the thirteen and twenty-six weeks ended July 2, 2005 and July 3, 2004, and cash flows for the twenty-six weeks ended July 2, 2005 and July 3, 2004. All significant intercompany accounts and transactions have been eliminated in consolidation. As permitted under the applicable rules and regulations of the SEC, these financial statements do not include all disclosures and footnotes normally included with annual consolidated financial statements and, accordingly, should be read in conjunction with the consolidated financial statements and the notes thereto, included in the Company s Annual Report on Form 10-K filed with the SEC for the year ended January 1, 2005. The results of operations for the thirteen and twenty-six weeks ended July 2, 2005 may not be indicative of the results of operations that can be expected for the full year.

Note 2 Earnings Per Share

The Company reports a dual presentation of Basic Earnings per Share (Basic EPS) and Diluted Earnings per Share (Diluted EPS). Basic EPS excludes dilution and is computed by dividing net income by the weighted average number of common shares outstanding during the reported period. Diluted EPS reflects the potential dilution that could occur if stock options, warrants, and other commitments to issue common stock were exercised using the treasury stock method or the if-converted method, where applicable.

The computation of Basic EPS and Diluted EPS is as follows:

	Thirteen Weeks Ended		Twenty-six Weeks Ended	
	July 2, 2005	July 3, 2004	July 2, 2005	July 3, 2004
Net income	$ 41,698	$ 25,868	$ 84,149	$ 63,423
Weighted average shares	159,628,110	155,410,354	159,406,455	154,348,697
Basic earnings per share	$ 0.26	$ 0.17	$ 0.53	$ 0.41
Weighted average shares, including the dilutive effect of stock options and warrants (2,955,040 and 2,783,450 for the thirteen weeks ended July 2, 2005 and July 3, 2004, respectively, and 3,751,228 and 4,151,719 for the twenty-six weeks ended July 2, 2005 and July 3, 2004, respectively)	162,583,150	158,193,804	163,157,683	158,500,416

Diluted earnings per share	$	0.26	$	0.16	$	0.52	$	0.40

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INGRAM MICRO INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in 000 s, except per share data)
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There were approximately 14,069,000 and 13,934,000 stock options for the thirteen weeks ended July 2, 2005 and July 3, 2004, respectively, and 9,422,000 and 13,719,000 stock options for the twenty-six weeks ended July 2, 2005 and July 3, 2004, respectively, that were not included in the computation of Diluted EPS because the exercise price was greater than the average market price of the Class A Common Stock during the respective periods, thereby resulting in an antidilutive effect.

Accounting for Stock-Based Compensation

The Company has adopted the provisions of Statement of Financial Accounting Standards No. 148, Accounting for Stock-Based Compensation Transition and Disclosure (FAS 148), which amends Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation (FAS 123). As permitted by FAS 148, the Company continues to measure compensation cost in accordance with Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25) and related interpretations, but provides pro forma disclosures of net income and earnings per share as if the fair-value method had been applied. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions to stock-based employee compensation.

	Thirteen Weeks Ended		Twenty-six Weeks Ended	
	July 2, 2005	July 3, 2004	July 2, 2005	July 3, 2004
Net income, as reported	$ 41,698	$ 25,868	$ 84,149	$ 63,423
Compensation expense as determined under FAS 123, net of related tax effects	4,944	6,023	10,218	12,251
Pro forma net income	$ 36,754	$ 19,845	$ 73,931	$ 51,172
Earnings per share:				
Basic as reported	$ 0.26	$ 0.17	$ 0.53	$ 0.41
Basic pro forma	$ 0.23	$ 0.13	$ 0.46	$ 0.33
Diluted as reported	$ 0.26	$ 0.16	$ 0.52	$ 0.40
Diluted pro forma	$ 0.23	$ 0.13	$ 0.45	$ 0.32

The weighted average fair value per option granted was $5.46 and $4.60 for the thirteen weeks ended July 2, 2005 and July 3, 2004, respectively, and $5.99 and $4.78, for the twenty-six weeks ended July 2, 2005 and July 3, 2004, respectively. The fair value of options was estimated using the Black-Scholes option-pricing model assuming no dividends and using the following weighted average assumptions:

	Thirteen Weeks Ended		Twenty-six Weeks Ended	
	July 2, 2005	July 3, 2004	July 2, 2005	July 3, 2004

Risk-free interest rate	3.79%	3.07%	3.67%	2.70%
Expected years until exercise	3.5 years	3.0 years	3.5 years	3.0 years
Expected stock volatility	41.7%	43.8%	41.8%	41.7%

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INGRAM MICRO INC.
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(Dollars in 000 s, except per share data)
(Unaudited)

Note 3 Comprehensive Income

Statement of Financial Accounting Standards No. 130, Reporting Comprehensive Income (FAS 130) establishes standards for reporting and displaying comprehensive income and its components in the Company s consolidated financial statements. Comprehensive income is defined in FAS 130 as the change in equity (net assets) of a business enterprise during a period from transactions and other events and circumstances from nonowner sources and is comprised of net income and other comprehensive income, which consists solely of changes in foreign currency translation adjustments, for the thirteen weeks and for the twenty-six weeks ended July 2, 2005 and July 3, 2004 as summarized below:

	Thirteen Weeks Ended		Twenty-six Weeks Ended	
	July 2, 2005	July 3, 2004	July 2, 2005	July 3, 2004
Net income	$ 41,698	$ 25,868	$ 84,149	$ 63,423
Changes in foreign currency translation adjustments	(40,783)	(9,680)	(68,642)	(21,241)
Comprehensive income	$ 915	$ 16,188	$ 15,507	$ 42,182

Accumulated other comprehensive income included in stockholders equity totaled $31,348 and $99,990 at July 2, 2005 and January 1, 2005, respectively, and consisted solely of foreign currency translation adjustments.

Note 4 Goodwill and Acquisitions

The changes in the carrying amount of goodwill for the twenty-six weeks ended July 2, 2005 and July 3, 2004 are as follows:

	North America	Europe	Asia-Pacific	Latin America	Total
Balance at January 1, 2005	$ 78,495	$ 12,775	$ 468,395	$	$ 559,665
Acquisitions			2,738		2,738
Foreign currency translation	(24)	(1,446)	(2,843)		(4,313)
Balance at July 2, 2005	$ 78,471	$ 11,329	$ 468,290	$	$ 558,090
Balance at January 3, 2004	$ 78,444	$ 9,308	$ 156,422	$	$ 244,174
Acquisitions		1,078			1,078
Foreign currency translation	(20)	(370)	(203)		(593)

Balance at July 3, 2004	$ 78,424	$ 10,016	$ 156,219	$	$ 244,659

Item 1A. Risk Factors:

Our business, financial condition, results of operations and the trading prices of our securities can be materially and adversely affected by many events and conditions including the following:

Risks affecting Our Business:

The nationwide recession may adversely affect our business by reducing real estate values in our trade area and stressing the ability of our customers to repay their loans.

Our New Jersey trade area, like the rest of the United States, is currently experiencing economic contraction. As a result, many companies have experienced reduced revenues and have laid off employees. These factors have stressed the ability of both commercial and consumer customers to repay their loans, and have, and may in the future, result in higher levels of nonaccrual loans. In addition, real estate values have declined in our trade area. Since the majority of our loans are secured by real estate, declines in the market value of real estate impact the value of the collateral securing our loans, and could lead to greater losses in the event of defaults on loans secured by real estate.

Our FDIC deposit insurance premiums have increased and may continue to increase, substantially increasing our noninterest expense.

During 2008 and 2009, the FDIC has significantly increased its assessments for deposit insurance due to the weakness in the economy and the increased number of bank failures. In 2007, we paid $67 thousand in deposit insurance assessments, and in 2008 this increased to $589 thousand. The FDIC has already announced an increased assessment, to go into effect for the second quarter of 2009, which will raise insurance premiums for the healthiest banks by 7 basis points. Banks like the Bank that have opted to remain eligible for the FDIC's increased insurance program for noninterest bearing deposit must also pay an assessment of 10 basis points of the amount of noninterest bearing deposits in excess of $250,000. Finally, the FDIC has proposed a special assessment of 20 basis points of insured deposits as of June 30, 2009, to be paid September 30, 2009, with the possibility of an additional 10 basis point special assessment later in 2009. This proposal has not yet been finalized. Had the special assessment been in effect on our deposits at December 31, 2008, we would have paid $1.4 million. These additional costs will adversely affect our results of operations.

Our non-performing assets have substantially increased over the past year, and this has, and will continue, to affect our results of operations.

Over the course of 2008, our total non-performing assets have increased to $16.8 million, or 2.35% of our total loans, from $5.6 million, or 0.93% of our total loans. In addition, our loans that are 90 days past due and still accruing interest have also increased to $2.5 million from $155 thousand. The increase in non-performing assets and loans past due 90 days and still accruing interest reflects the general economic slowdown in our marketplace and its effect on our borrowers, and our focus on SBA lending, which may entail greater credit risk than other types of lending. This deterioration in credit quality has negatively impacted our results of operations, through additional provisions for loan losses and reduced interest income, and will continue to impact our performance until these assets are resolved. In addition, future increases in our non-performing assets will further negatively affect our results of operations. We can give you no assurance that our non-performing assets will not increase further.

We are subject to interest rate risk and variations in interest rates may negatively affect our financial performance; in addition dislocation and volatility in the credit markets may negatively affect the value of our assets.

Beginning in mid 2007, there has been significant turmoil and volatility in global financial markets. Nationally, we have seen economic factors such as a recession, a rise in unemployment, and a weakened US dollar. Recent market uncertainty regarding the financial sector has increased. In addition to the impact on the economy, changes in interest rates, in the shape of the yield curve, or in valuations in the debt or equity markets or disruptions in the liquidity or other functioning of financial markets, all of which have been seen recently, could directly impact us in one or more of the following ways:

· Net interest income, the difference between interest earned on our interest-earning assets and interest paid on interest-bearing liabilities, represents a significant portion of our earnings. Both increases and decreases in the interest rate environment may reduce our profits. We expect that we will continue to realize income from the spread between the interest we earn on loans, securities and other interest-earning assets, and the interest we pay on deposits, borrowings and other interest-bearing liabilities. The net interest spread is affected by the differences between the maturity and repricing characteristics of our interest-earning assets and interest-bearing liabilities. Our interest-earning assets may not reprice as slowly or rapidly as our interest-bearing liabilities.

· The market value of our securities portfolio may decline and result in other-than-temporary charges or realized losses on the sale of securities. The value of securities in our portfolio are affected by factors that impact the U.S. securities market in general as well specific financial sector factors such as the deterioration of the credit worthiness of issuers. Further declines in these sectors may result in future other-than-temporary impairment charges and/or realized losses on the sale of securities.

· Asset quality may deteriorate as borrowers become unable to repay their loans.

· Lack of liquidity within the capital markets which we use to raise funds to support our business transactions may impact the cost of funds or our ability to raise funds.

Due to the current state of the yield curve, our net interest margin and net interest spread have declined. Continued declines in our net interest margin and net interest spread will negatively impact our results of operations.

During 2008, the yield curve, particularly short-term interest rates, has fallen as the Federal Open Market Committee ("FOMC") has intervened and lowered interest rates to encourage economic growth. This has impacted our results of operations, as our variable rate earning assets have repriced quicker than our funding (our deposits).

Our earnings may not continue to grow if we are unable to successfully attract core deposits and lending opportunities and exploit opportunities to generate fee-based income.

We have experienced significant growth, and our future business strategy is to continue to expand. Historically, the growth of our loans and deposits has been the principal factor in our increase in net interest income. In the event that we are unable to execute our business strategy of continued growth in loans and deposits, our earnings could be adversely impacted. Our ability to continue to grow depends, in part, upon our ability to expand our market share, to successfully attract core deposits and identify loan and investment opportunities, as well as opportunities to generate fee-based income. Our ability to manage growth successfully will also depend on whether we can continue to efficiently fund asset growth and maintain asset quality and cost controls, as well as on factors beyond our control; such as, economic conditions and interest rate trends.

Our growth-oriented business strategy could be adversely affected if we are not able to attract and retain skilled employees and manage our expenses.

We expect to continue to experience growth in the scope of our operations; and, correspondingly, in the number of our employees and customers. We may not be able to successfully manage our business as a result of the strain on our management and operations that may result from this growth. Our ability to manage this growth will depend upon our ability to continue to attract, hire and retain skilled employees. Our ability to attract and retainer senior management may be adversely affected by the restrictions imposed upon us under the CPP, as revised by the American Reinvestment and Recovery Act. Our success will also depend on the ability of our officers and key employees to continue to implement and improve our operational and other systems, to manage multiple, concurrent customer relationships and to hire, train and manage our employees.

Curtailment of the Small Business Administration loan program could negatively affect the Company; the absence of a secondary market for SBA loans could negatively affect our operation.

The Company has historically been a participant in various SBA lending programs, and the Company's activity under these programs has contributed significantly to its net income. Proposals have been made from time to time to curtail the Federal Government's funding of the SBA loan programs. Any reduction in SBA funding for its loan programs could negatively affect our results of operations.

Historically, the Company has sold into the secondary market substantially all of the guaranteed portion of its loans originated under the SBA's loan programs. However, starting in the fall of 2008, the secondary market for SBA loans lost liquidity, and SBA loan program participants like the Company have had difficulty selling SBA loans in the secondary market. To address the situation, the Company must either reduce the number of SBA loans it originates, which could negatively impact its earnings, or keep the loans in its portfolio, increasing its asset base and stressing its capital. Either alternative may adversely affect the Company and its results of operations.

There is a risk that the SBA will not honor their guarantee.

The Company has historically been a participant in various SBA lending programs which guarantee up to 85% of the principal on the underlying loan. There is a risk that the SBA will not honor their guarantee if a loan is not underwritten to SBA guidelines. The Company follows the underwriting guidelines of the SBA, however our ability to manage this will depend on our ability to continue to attract, hire and retain skilled employees who have knowledge of the SBA program.

Risks Related to the Banking Industry:

Changes in local economic conditions could adversely affect our loan portfolio.

Our success depends to a great extent upon the general economic conditions of the local markets that we serve. Unlike larger banks that are more geographically diversified, we provide banking and financial services primarily to customers in the six counties in the New Jersey market and one county in Pennsylvania in which we have branches, so any decline in the economy of New Jersey or eastern Pennsylvania could have an adverse impact on us.

Our loans, the ability of borrowers to repay these loans, and the value of collateral securing these loans are impacted by economic conditions. In addition, a large portion of our income is generated from gains on the sale of SBA loans and the related servicing. Our financial results, the credit quality of our existing loan portfolio, and the ability to generate new loans with acceptable yield and credit characteristics may be adversely affected by changes in prevailing economic conditions, including declines in real estate values, changes in interest rates, adverse employment conditions and the monetary and fiscal policies of the federal government. Although economic conditions in our primary market area are strong and have aided our recent growth, we cannot assure you that these conditions will continue to prevail. We cannot assure you that positive trends or developments discussed in this prospectus will continue or that negative trends or developments will not have a significant adverse effect on us.

There is a risk that we may not be repaid in a timely manner, or at all, for loans we make.

The risk of non-payment (or deferred or delayed payment) of loans is inherent in commercial banking. Such non-payment, or delayed or deferred payment of loans to the Company, if they occur, may have a material adverse effect on our earnings and overall financial condition. Additionally, in compliance with applicable banking laws and regulations, the Company maintains an allowance for loan losses created through charges against earnings. As of December 31, 2008, the Company's allowance for loan losses was $10.3 million. The Company's marketing focus on small to medium size businesses may result in the assumption by the Company of certain lending risks that are different from or greater than those which would apply to loans made to larger companies. We seek to minimize our credit risk exposure through credit controls, which include evaluation of potential borrowers' available collateral, liquidity and cash flow. However, there can be no assurance that such procedures will actually reduce loan losses.

Our allowance for loan losses may not be adequate to cover actual losses.

Like all financial institutions, we maintain an allowance for loan losses to provide for loan defaults and nonperformance. Our allowance for loan losses may not be adequate to cover actual losses, and future provisions for loan losses could materially and adversely affect the results of our operations. Risks within the loan portfolio are analyzed on a continuous basis by management; and, periodically, by an independent loan review function and by the Audit Committee. A risk system, consisting of multiple-grading categories, is utilized as an analytical tool to assess risk and the appropriate level of loss reserves. Along with the risk system, management further evaluates risk characteristics of the loan portfolio under current economic conditions and considers such factors as the financial condition of the borrowers, past and expected loan loss experience and other factors management feels deserve recognition in establishing an adequate reserve. This risk assessment process is performed at least quarterly; and, as adjustments become necessary, they are realized in the periods in which they become known. The amount of future losses is susceptible to changes in economic, operating and other conditions, including changes in interest rates that may be beyond our control, and these losses may exceed current estimates. State and federal regulatory agencies, as an integral part of their examination process, review our loans and allowance for loan losses and have in the past required an increase in our allowance for loan losses. Although we believe that our allowance for loan losses is adequate to cover probable and reasonably estimated losses, we cannot assure you that we will not further increase the allowance for loan losses or that our regulators will not require us to increase this allowance. Either of these occurrences could adversely affect our earnings.

We are in competition with many other banks, including larger commercial banks which have greater resources than us.

The banking industry within the State of New Jersey is highly competitive. The Company's principal market area is also served by branch offices of large commercial banks and thrift institutions. In addition, in 1999 the Gramm-Leach-Bliley Financial Modernization Act of 1999 was passed into law. The Modernization Act permits other financial entities, such as insurance companies and securities firms, to acquire or form financial institutions, thereby further increasing competition. A number of our competitors have substantially greater resources than we do to expend upon advertising and marketing, and their substantially greater capitalization enables them to make much larger loans. Our success depends a great deal upon our judgment that large and mid-size financial institutions do not adequately serve small businesses in our principal market area and upon our ability to compete favorably for such customers. In addition to competition from larger institutions, we also face competition for individuals and small businesses from recently formed banks seeking to compete as "hometown" institutions. Most of these new institutions have focused their marketing efforts on the smaller end of the small business market we serve.

The laws that regulate our operations are designed for the protection of depositors and the public, but not our stockholders.

The federal and state laws and regulations applicable to our operations give regulatory authorities extensive discretion in connection with their supervisory and enforcement responsibilities and generally have been promulgated to protect depositors and the deposit insurance funds and not for the purpose of protecting stockholders. These laws and regulations can materially affect our future business. Laws and regulations now affecting us may be changed at any time, and the interpretation of such laws and regulations by bank regulatory authorities is also subject to change. We can give no assurance that future changes in laws and regulations or changes in their interpretation will not adversely affect our business.

We may be subject to higher operating costs as a result of government regulation.

We are subject to extensive federal and state legislation, regulation and supervision which are intended primarily to protect depositors and the Federal Deposit Insurance Corporation's Bank Insurance Fund, rather than investors. Legislative and regulatory changes may increase our costs of doing business; or, otherwise, adversely affect us and create competitive advantages for non-bank competitors.

We cannot predict how changes in technology will impact our business.

The financial services market, including banking services, is increasingly affected by advances in technology, including developments in:

- telecommunications;
- data processing;
- automation;
- Internet-based banking;
- Tele-banking; and
- debit cards and so-called "smart cards."

Our ability to compete successfully in the future will depend on whether we can anticipate and respond to technological changes. To develop these and other new technologies, we will likely have to make additional capital investments. Although we continually invest in new technology, we cannot assure you that we will have sufficient resources or access to the necessary proprietary technology to remain competitive in the future.

The Company's information systems may experience an interruption or breach in security.

The Company relies heavily on communications and information systems to conduct its business. Any failure, interruption or breach in security of these systems could result in failures or disruptions in the Company's customer-relationship management, general ledger, deposit, loan and other systems. While the Company has policies and procedures designed to prevent or limit the effect of the failure, interruption or security breach of its information systems, there can be no assurance that any such failures, interruptions or security breaches will not occur; or, if they do occur, that they will be adequately addressed. The occurrence of any failures, interruptions or security breaches of the Company's information systems could damage the Company's reputation, result in a loss of customer business, subject the Company to additional regulatory scrutiny or expose the Company to civil litigation and possible financial liability; any of which could have a material adverse affect on the Company's financial condition and results of operations.

Item 1B. Unresolved Staff Comments:

There are no unresolved staff comments.

Item 2. Properties:

The Company presently conducts its business through its main office located at 64 Old Highway 22, Clinton, New Jersey, and its sixteen branch offices.

The following table sets forth certain information regarding the Company's properties from which it conducts business as of December 31, 2008.

Location	Leased or Owned	Date Leased or Acquired	Lease Expiration	2008 Annual Rental Fee
Clinton, NJ	Leased	1996	2009	535,102
Colonia, NJ	Leased	1998	2009	37,394
Flemington, NJ	Owned	2005	-----	-----
Linden, NJ	Owned	1997	-----	-----
Highland Park, NJ	Leased	1999	2009	90,609
North Plainfield, NJ	Owned	1991	-----	-----
Scotch Plains, NJ	Owned	2004	-----	-----
Springfield, NJ	Leased	1995	2011	33,607
South Plainfield, NJ	Leased	1999	2009	109,223
Union, NJ	Owned	2002	-----	-----
Edison, NJ	Leased	1999	2009	126,716
Whitehouse, NJ	Owned	1998	-----	-----
Phillipsburg, NJ	Leased	2005	2010	80,588
Middlesex, NJ	Owned	2007	-----	-----
Forks Township, PA	Leased	2006	2010	55,918
William Penn (Easton), PA	Leased	2007	2010	68,303
Great Neck, NY	Leased	2006	2009	9,073

Item 3. Legal Proceedings:

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

Item 4. Submission of Matters to a Vote of Security Holders:

No matters were submitted for a vote of the Company's shareholders during the fourth quarter of fiscal 2008.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Purchases of Equity Securities:

(a) Market Information

The Company's Common Stock is quoted on the NASDAQ Global National Market under the symbol "UNTY." The following table sets forth the high and low closing prices of the Common Stock as reported on the NASDAQ National Market for the periods indicated. The prices reflect the impact of the 5 percent stock distribution paid on June 27, 2008.

	High	Low
Year Ended December 31, 2008:		
4th Quarter	$ 4.85	$ 2.81
3rd Quarter	6.95	4.00
2nd Quarter	8.00	6.48
1st Quarter	9.25	7.50
Year Ended December 31, 2007:		
4th Quarter	$ 10.78	$ 6.95
3rd Quarter	11.23	9.28
2nd Quarter	11.43	10.74
1st Quarter	13.85	10.98

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(b) Holders

As of March 1, 2009, there were approximately 495 shareholders of record of the Company's Common Stock.

(c) Dividends

The following table sets forth the dividends declared by the Company during 2008 and 2007. The amounts reflect the impact of the 5 percent stock dividend paid on June 27, 2008.

	Dividend Declared	
Year Ended December 31, 2008:		
4th Quarter	$	.00
3rd Quarter	$	.00
2nd Quarter	$	.05
1st Quarter	$	.05
Year Ended December 31, 2007:		
4th Quarter	$	.05
3rd Quarter	$	.05
2nd Quarter	$	.05
1st Quarter	$	.04

Under the terms of the CPP, we are limited in our ability to pay cash dividends. Without the approval of the Treasury, we can
not pay a quarterly cash dividend in excess of $0.05 per share, the amount of our last quarterly cash dividend prior to October 14, 2008. In addition, during the third quarter of 2008, the Company revised its cash dividend payment policy. The decision was made based upon the current economic environment to retain capital so that the holding company can remain a source of strength to the subsidiary bank. Previously, the Company had paid a quarterly cash dividend at a rate set by the Board based upon a number of factors. The Board has now established a targeted dividend payout ratio of 20 percent of the Company's earnings, subject to adjustment based upon factors existing at the time of the dividend and the Company's projected capital needs. The Board now intends to pay a cash dividend once annually, in the next succeeding year. The Company declared two dividends in 2008 totaling $0.10.

Item 6. Selected Financial Data:

The information under the caption, "Selected Consolidated Financial Data," on page 57 of the Company's Annual Report to Shareholders for the year ended December 31, 2008, is incorporated by reference herein.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations:

The information under the caption, "Management's Discussion and Analysis of Financial Condition and Results of Operations," on pages 7 through 26 of the Company's Annual Report to Shareholders for the year ended December 31, 2008, is incorporated by reference herein.

Item 7A. Quantitative and Qualitative Disclosure About Market Risk:

The information under the caption, “Market Risk,” on pages 22 through 23 of the Company’s Annual Report to Shareholders for the year ended December 31, 2008, is incorporated by reference herein.

Item 8. Financial Statements and Supplementary Data:

The Financial Statements and Notes to Consolidated Financial Statements on pages 33 through 57 of the Company’s Annual Report to Shareholders for the year ended December 31, 2008, are incorporated by reference herein.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure:

None.

Item 9A(T). Controls and Procedures:

(a) Evaluation of disclosure controls and proceedings:

Based on their evaluation, as of the end of the period covered by this Annual Report on Form 10-K, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-14(c) and 15d-14(c) under the Securities Exchange Act of 1934 (the “Exchange Act”)) are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms.

(b) Management’s Report on Internal Control Over Financial Reporting

The information under the caption, “Management’s Report on Internal Control Over Financial Reporting,” on page 27 of the Company’s Annual Report to Shareholders for the year ended December 31, 2008, is incorporated by reference herein.

(c) Changes in internal controls:

There were not any significant changes in internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Item 9B. Other Information - None

PART III

Item 10. Directors, Executive Officers and Corporate Governance; Compliance with Section 16(a) of the Exchange Act:

The information concerning the directors and executive officers of the Company under the caption “Election of Directors,” and the information under the captions, “Compliance with Section 16(a) of the Securities Exchange Act of 1934,” and, "Governance of the Company," in the Proxy Statement for the Company’s 2009 Annual Meeting of Shareholders, is incorporated by reference herein. It is expected that such Proxy Statement will be filed with the Securities and Exchange Commission no later than April 30, 2009.

Also, refer to the information under the caption, “Executive Officers of Registrant,” in Part I of this Annual Report on Form 10-K for a description of the Company’s executive officers, who are not also directors.

Item 11. Executive Compensation:

The information concerning executive compensation under the caption, “Executive Compensation,” in the Proxy Statement for the Company’s 2009 Annual Meeting of Shareholders, is incorporated by reference herein. It is expected that such Proxy Statement will be filed with the Securities and Exchange Commission no later than April 30, 2009.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters:

The information concerning the security ownership of certain beneficial owners and management under the caption, "Security Ownership of Certain Beneficial Owners and Management," in the Proxy Statement for the Company's 2009 Annual Meeting of Shareholders is incorporated by reference herein. It is expected that such Proxy Statement will be filed with the Securities and Exchange Commission no later than April 30, 2009.

Securities Authorized for Issuance under Equity Compensation Plans

The following table provides information with respect to the equity securities that are authorized for issuance under the Company's compensation plans as of December 31, 2008.

EQUITY COMPENSATION PLAN INFORMATION

	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)		Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation stock option plans approved by security holders	872,274	$	5.94	75,984
Equity compensation plans approved by security holders	50,424		9.76	44,508
Equity compensation plans not approved by security holders	-		-	-
Total	922,698	$	6.15	120,492

There were no share repurchases during 2008. Pursuant to the requirements of the Treasury's Capital Purchase Program, the Company has suspended its stock repurchase program.

Item 13. Certain Relationships and Related Transactions and Director Independence:

The information concerning certain relationships and related transactions under the caption, "Certain Transactions with Management," in the Proxy Statement for the Company's 2009 Annual Meeting of Shareholders is incorporated by reference herein. It is expected that such Proxy Statement will be filed with the Securities and Exchange Commission no later than April 30, 2009.

Item 14. Principal Accountant Fees and Services:

The information concerning principal accountant fees and services, as well as related pre-approval policies, under the caption, "Appointment of Auditors for Fiscal 2009," in the Proxy Statement for the Company's 2009 Annual Meeting of Shareholders is incorporated by reference herein. It is expected that such Proxy Statement will be filed with the Securities and Exchange Commission no later than April 30, 2009.

PART IV

Item 15. Exhibits, Financial Statement Schedules, and Reports on Form 8-K:

(a) FINANCIAL STATEMENTS:

The following Consolidated Financial Statements of the Company and subsidiaries included in the Company's Annual Report to Shareholders for the year ended December 31, 2008, are incorporated by reference in Part II, Item 8.

Consolidated Statements of Changes in Shareholders' Equity (page 31)

Consolidated Statements of Cash Flows (page 32)

Notes to Consolidated Financial Statements (pages 33 through 57)

(b) EXHIBITS:

Exhibit Number	Description of Exhibits
3(i)	Certificate of Incorporation of the Company, as amended (2)
3(ii)	Bylaws of the Company (7)
4(i)	Form of Stock Certificate (7)
10(i)	1994 Stock Option Plan for Non-Employee Directors (1)
10(ii)	1997 Stock Option Plan (3)
10(iii)	1997 Stock Bonus Plan (3)
10(iv)	1998 Stock Option Plan (4)
10(v)	1999 Stock Option Plan (5)
10(vi)	Employment Agreement dated March 23, 2004 with James A. Hughes (8)
10(vii)	Settlement Agreement and General Release dated December 31, 2003 with Anthony J. Feraro (8)
10(ix)	Retention Agreement dated March 23, 2004 with Michael F. Downes (8)
10(x)	Retention Agreement dated March 23, 2004 with Alan J. Bedner (8)
10(xi)	Retention Agreement dated March 23, 2004 with John Kauchak (8)
10(xiii)	2002 Stock Option Plan (6)
10(xiv)	Second Amendment dated September 19, 2003 to Lease Agreement between Unity Bank and Clinton Unity Group (8)
10(xv)	Real Estate Purchase Agreement dated October 23, 2003 between Unity Bank and Premiere Development II, LLC (8)
10(xvi)	2004 Stock Bonus Plan (9)
10(xvii)	2006 Stock Option Plan (10)
13	Portion of Unity Bancorp. Inc. 2008 Annual Report to Shareholders
21	Subsidiaries of the Registrant
23.1	Consent of McGladrey & Pullen, LLP
31.1	Certification of President and Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of President, Chief Executive Officer, and Chief Financial Officer pursuant to Section 906

(1) Previously filed with the Securities and Exchange Commission as an Exhibit to the Registration Statement on Form S-4 (File No. 33-76392) and incorporated by reference herein.

(2) Previously filed with the Securities and Exchange Commission as an Exhibit to the Current Report on Form 8-K filed on July 22, 2002 and incorporated by reference herein.

(3) Previously filed with the Securities and Exchange Commission as an Exhibit to the Proxy Statement for the Annual Meeting of Shareholders filed on April 4, 1997.

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(4) Previously filed with the Securities and Exchange Commission as an Exhibit to the Proxy Statement for the Annual Meeting of Shareholders filed on March 30, 1998.

(5) Previously filed with the Securities and Exchange Commission as an Exhibit to the Proxy Statement for the Annual Meeting of Shareholders filed on April 2, 1999.

(6) Previously filed with the Securities and Exchange Commission as an Exhibit to the Proxy Statement for the Annual Meeting of Shareholders filed on April 10, 2002.

(7) Previously filed with the Securities and Exchange Commission as an Exhibit to the Annual Report on Form 10-K filed March 26, 2003.

(8) Previously filed with the Securities and Exchange Commission as an Exhibit to the Annual Report on Form 10-K filed March 26, 2004.

(9) Previously filed with the Securities and Exchange Commission as an Exhibit to the Proxy Statement for the Annual Meeting of Shareholders filed on April 15, 2004.

(10) Previously filed with the Securities and Exchange Commission as an Exhibit to the Current Report on Form 8-K filed on April 27, 2006 and incorporated by reference herein.

(c) Not applicable

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

UNITY BANCORP, INC.

/s/ Alan J. Bedner
Alan J. Bedner
Executive Vice President and Chief Financial Officer

Dated: March 19, 2009

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

NAME	TITLE	DATE
/s/ David D. Dallas David D. Dallas	Chairman of the Board and Director	March 19, 2009
/s/ James A. Hughes James A. Hughes	President, Chief Executive Officer And Director	March 19, 2009
/s/ Alan J. Bedner Alan J. Bedner	Chief Financial Officer (Principal Financial and Accounting Officer)	March 19, 2009
/s/ Raj Patel Raj Patel	Director	March 19, 2009
/s/ Dr. Mark S. Brody Dr. Mark S. Brody	Director	March 19, 2009
/s/ Robert H. Dallas, II Robert H. Dallas, II	Director	March 19, 2009
/s/ Peter E. Maricondo	Director	March 19, 2009

Peter E. Maricondo		
/s/ Wayne Courtright Wayne Courtright	Director	March 19, 2009
/s/ Charles S. Loring Charles S. Loring	Director	March 19, 2009
/s/ Allen Tucker Allen Tucker	Director	March 19, 2009

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