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# Selected Consolidated Financial Data

The following table represents selected consolidated financial data as of and for the years ended December 31, 2000, 1999, 1998, 1997 and 1996. The selected consolidated financial data is derived from the Company's Consolidated Financial Statements that have been audited by KPMG LLP. The selected consolidated financial data set forth below does not purport to be complete and should be read in conjunction with, and are qualified in their entirety by, the more detailed information, including the Consolidated Financial Statements and related Notes, and "Management's Discussion and Analysis of Financial Condition and Results of Operations," appearing elsewhere herein.

| | As of and for the Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2000 | 1999 | 1998 | 1997 | 1996 (a) |
| | (Dollars in thousands, except Per Share Data) | | | | |
| **Statement of Operations Data:** | | | | | |
| Interest income | $ 50,035 | $ 41,651 | $ 40,034 | $ 37,269 | $ 26,514 |
| Interest expense | 23,678 | 19,600 | 19,845 | 17,478 | 11,778 |
| Net interest income | 26,357 | 22,051 | 20,189 | 19,791 | 14,736 |
| Provision for loan losses | 1,542 | 1,000 | 1,017 | 1,000 | 837 |
| Noninterest income | 3,578 | 3,222 | 2,727 | 1,916 | 1,237 |
| Noninterest expense | 19,662 | 17,354 | 16,043 | 15,273 | 12,718 |
| Income before taxes and change in accounting principle | 8,731 | 6,919 | 5,856 | 5,434 | 2,418 |
| Income taxes | 3,113 | 2,448 | 2,022 | 1,924 | 846 |
| Income before change in accounting principle | 5,618 | 4,471 | 3,834 | 3,510 | 1,572 |
| Cumulative effect of change in accounting principle, net of taxes | — | 109 | — | — | — |
| Net income | 5,618 | 4,362 | 3,834 | 3,510 | 1,572 |
| Dividends on preferred stock | — | 88 | 793 | 1,413 | 720 |
| Net income available to common shareholders | $ 5,618 | $ 4,274 | $ 3,041 | $ 2,097 | $ 852 |
| | | | | | |
| **Per Share Data:** | | | | | |
| Basic earnings per common share: | | | | | |
| Income before change in accounting principle | $ 1.51 | $ 1.18 | $ 0.87 | $ 0.75 | $ 0.30 |
| Cumulative effect of change in accounting principle | — | (0.03) | — | | — — |
| Net income | $ 1.51 | $ 1.15 | $ 0.87 | $ 0.75 | $ 0.30 |
| Basic cash earnings per common share (d) | $ 1.71 | $ 1.35 | $ 1.10 | $ 1.03 | $ 0.52 |
| Diluted earnings per common share: | | | | | |
| Income before change in accounting principle | $ 1.49 | $ 1.17 | $ 0.85 | $ 0.75 | $ 0.30 |
| Cumulative effect of change in accounting principle | — | (0.03) | — | — | — |
| Net income | $ 1.49 | $ 1.14 | $ 0.85 | $ 0.75 | $ 0.30 |
| Diluted cash earnings per common share (d) | $ 1.69 | $ 1.34 | $ 1.07 | $ 1.03 | $ 0.52 |
| Dividends per common share | $ 0.42 | $ 0.10 | — | — | — |
| Dividend pay-out ratio | 28.2% | 8.8% | NA | NA | NA |
| Book value per common share | $ 14.29 | $ 12.79 | $ 12.31 | $ 10.77 | $ 9.92 |
| Tangible book value per common share | $ 11.09 | $ 9.27 | $ 8.44 | $ 5.18 | $ 3.89 |
| Average common shares outstanding - Basic | 3,728,688 | 3,727,010 | 3,506,573 | 2,800,061 | 2,800,000 |
| Average common shares outstanding - Diluted | 3,768,589 | 3,741,778 | 3,584,820 | 2,805,688 | 2,800,000 |

| | As of and for the Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2000 | 1999 | 1998 | 1997 | 1996 (a) |
| | (Dollars in thousands, except Per Share Data) | | | | |
| **Balance Sheet Data:** | | | | | |
| Total assets | $ 739,420 | $ 631,977 | $ 595,964 | $ 533,025 | $ 472,417 |
| Investment securities | 47,296 | 50,503 | 39,703 | 48,319 | 45,120 |
| Mortgage-backed securities | 117,431 | 74,793 | 79,924 | 43,078 | — |
| Total loans receivable | 518,825 | 458,958 | 431,402 | 405,819 | 383,039 |
| Allowance for loan losses | 7,294 | 5,681 | 5,018 | 4,340 | 4,024 |
| Excess of costs over net assets acquired | 11,930 | 13,094 | 14,424 | 15,658 | 16,892 |
| Deposits | 631,632 | 513,416 | 500,713 | 464,907 | 424,817 |
| Borrowings | 51,889 | 67,911 | 45,512 | 19,754 | 1,303 |
| Common shareholders' equity | 53,292 | 47,675 | 45,835 | 30,165 | 27,785 |
| Total shareholders' equity | 53,292 | 47,675 | 47,687 | 44,707 | 43,627 |
| **Average Balance Sheet Data: (b)** | | | | | |
| Total assets | $ 679,085 | $ 616,426 | $ 565,759 | $ 499,382 | $ 465,961 |
| Investment securities | 47,034 | 47,348 | 44,040 | 47,242 | 23,918 |
| Mortgage-backed securities | 86,114 | 79,463 | 57,627 | 15,689 | — |
| Total loans receivable | 491,327 | 439,099 | 421,554 | 395,684 | 384,857 |
| Allowance for loan losses | 6,472 | 5,358 | 4,799 | 4,210 | 3,772 |
| Excess of costs over net assets acquired | 12,540 | 13,720 | 15,077 | 16,318 | 16,788 |
| Deposits | 572,924 | 516,610 | 476,227 | 442,604 | 420,709 |
| Borrowings | 54,471 | 50,496 | 39,944 | 10,823 | 443 |
| Common shareholders' equity | 48,530 | 46,169 | 40,568 | 27,981 | 26,605 |
| Total shareholders' equity | 48,530 | 46,631 | 46,041 | 43,196 | 42,433 |
| **Operating Ratios:** | | | | | |
| Interest rate spread | 3.44% | 3.25% | 3.20% | 3.68% | 3.86% |
| Net interest margin | 4.10% | 3.80% | 3.78% | 4.22% | 4.36% |
| Efficiency ratio (c) | 65.68% | 68.67% | 70.01% | 70.36% | 79.63% |
| Cash basis efficiency ratio (c) (d) | 61.79% | 64.06% | 64.62% | 64.67% | 73.91% |
| Return on average assets (e) | 0.83% | 0.73% | 0.68% | 0.70% | 0.43% |
| Cash basis return on average assets (d) (e) | 0.96% | 0.87% | 0.84% | 0.89% | 0.62% |
| Return on average equity (e) | 11.58% | 9.59% | 8.33% | 8.13% | 4.76% |
| Cash basis return on average equity (d) (e) | 13.12% | 11.20% | 10.08% | 9.97% | 6.55% |
| **Asset Quality Ratios:** | | | | | |
| Nonperforming loans to total loans | 0.10% | 0.24% | 0.36% | 0.41% | 0.35% |
| Nonperforming assets to total assets | 0.07% | 0.18% | 0.33% | 0.38% | 0.28% |
| Allowance for loan losses to nonperforming loans | 1435.83% | 510.88% | 321.05% | 258.49% | 301.88% |
| Allowance for loan losses to total loans | 1.41% | 1.24% | 1.16% | 1.07% | 1.05% |
| Net loans charged-off to average loans outstanding | (0.01%) | 0.08% | 0.08% | 0.17% | 0.06% |
| **Capital Ratios:** | | | | | |
| Average shareholders' equity to average total assets | 7.15% | 7.54% | 8.14% | 8.64% | 9.11% |
| Tier I leverage ratio | 5.91% | 5.88% | 5.72% | 5.62% | 5.92% |
| Tier I risk-based capital ratio | 9.50% | 9.70% | 9.60% | 9.41% | 9.05% |
| Total risk-based capital ratio | 10.76% | 10.96% | 10.85% | 10.66% | 10.30% |

(a) The Bank commenced operations on March 22, 1996.
(b) Average balances for 1996 are computed for the period subsequent to the Bank's opening (March 22, 1996).
(c) Calculated by dividing total noninterest expenses by net interest income plus noninterest income.
(d) Excludes amortization of goodwill and any related income taxes.
(e) Excludes cumulative effect of change in accounting principle, net of taxes.

# Management's Discussion and Analysis of Financial Condition and Results of Operations

## Cautionary Statement

Certain statements contained herein are "Forward Looking Statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Forward Looking Statements may be identified by reference to a future period or periods or by the use of forward looking terminology such as "may," "believes," "intends," "expects," and "anticipates" or similar terms or variations of these terms. Actual results may differ materially from those set forth in Forward Looking Statements as a result of certain risks and uncertainties, including but not limited to, changes in political and economic conditions, interest rate fluctuations, competitive product and pricing pressures, equity and bond market fluctuations, credit risk, inflation, as well as other risks and uncertainties detailed from time to time in filings with the Securities and Exchange Commission ("SEC").

## General

Bancorp Rhode Island, Inc. (the "Company"), a Rhode Island corporation, was organized by Bank Rhode Island (the "Bank") on February 15, 2000, to be a bank holding company and to acquire all of the capital stock of the Bank. The reorganization of the Bank into the holding company form of ownership was completed on September 1, 2000. The Company has no significant assets other than the common stock of the Bank. For this reason, substantially all of the discussion in this document relates to the operations of the Bank and its subsidiaries.

Bank Rhode Island is a commercial bank chartered as a financial institution in the State of Rhode Island. The Bank pursues a community banking mission and is principally engaged in providing banking products and services to individuals and businesses in Providence and Kent counties. The Bank is subject to competition from a variety of traditional and nontraditional financial service providers both within and outside of Rhode Island. The Bank offers its customers a wide range of deposit products, nondeposit investment products, commercial, residential and consumer loans, and other traditional banking products and services, designed to meet the needs of individuals and small- to mid-sized businesses. The Bank also has introduced both commercial and consumer online banking products and maintains a web site at http://www.bankri.com. The Company and Bank are subject to regulation by a number of federal and state agencies and undergo periodic examinations by certain of those regulatory authorities. The Bank's deposits are insured by the Federal Deposit Insurance Corporation ("FDIC"), subject to regulatory limits. The Bank is also a member of the Federal Home Loan Bank of Boston ("FHLB").

## Non-GAAP Measures of Financial Performance

Contained within this document are various measures of financial performance that have been calculated excluding the amortization of goodwill and any related income taxes. These measures are identified as "cash" or "cash basis" and have been provided to assist the reader in evaluating the core performance of the Company. This presentation is not in accordance with Generally Accepted Accounting Principles ("GAAP"), but management believes it to be beneficial to gaining an understanding of the financial performance of the Company.

The Bank's formation in 1996 resulted in the generation of $17.5 million of goodwill that is being amortized over a 15-year period. The amortization of goodwill reduces the Bank's pre-tax income by $1.2 million annually. Because of the impact of this amortization, certain information has been presented on both a GAAP and cash basis. Recently, the Financial Accounting Standards Board ("FASB") has concluded that goodwill would no longer be amortized. Upon the effective date of the final FASB statement, the difference between GAAP and cash basis presentation will no longer exist. Also see discussion under "Recent Accounting Developments".

## Results of Operations

### *Net Interest Income*

The Company's operating results depend primarily on its "net interest income", or the difference between its interest income and its cost of money, and on the quality of its assets. Interest income depends on the amount of interest-earning assets outstanding during the year and the interest rates earned thereon. The Company's cost of money is a function of the average amount of deposits and borrowed money outstanding during the year and the interest rates paid thereon. The quality of assets influences operating results through the amount of additions to the allowance for loan losses, which are a charge against earnings, and the amount of interest income lost on nonaccrual loans.

Net interest income for 2000 was $26.4 million, compared to $22.1 million for 1999 and $20.2 million for 1998. This increase of $4.3 million, or 19.5%, during 2000 was primarily attributable to the continued growth of the commercial loan portfolio, coupled with unparalleled growth in core deposit accounts resulting in part from the unusual market conditions created by the Fleet Financial/BankBoston divestitures. The Company's net interest margin increased in 2000 and was 4.10%, compared to 3.80% in 1999 and 3.78% for 1998. Average earning assets were $63.2 million, or 10.9%, higher and average interest-bearing liabilities were $47.0 million, or 9.4%, higher during 2000 than during the previous year.

### *Average Balances, Yields and Costs*

The following table sets forth certain information relating to the Company's average balance sheet and reflects the average yield on assets and average cost of liabilities for the years indicated. Such yields and costs are derived by dividing income or expense by the average balance of assets or liabilities. Average balances are derived from daily balances and include nonperforming loans.

| | Year Ended December 31, | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2000 | | | 1999 | | | 1998 | | |
| | Average Balance | Interest Earned/ Paid | Average Yield | Average Balance | Interest Earned/ Paid | Average Yield | Average Balance | Interest Earned/ Paid | Average Yield |
| | | | | (Dollars in thousands) | | | | | |
| **Assets:** | | | | | | | | | |
| Earning assets: | | | | | | | | | |
| Federal funds sold | $ 14,571 | $ 930 | 6.38% | $ 10,051 | $ 482 | 4.80% | $ 7,806 | $ 400 | 5.12% |
| Investment securities | 47,034 | 3,056 | 6.50% | 47,348 | 2,814 | 5.94% | 44,040 | 2,744 | 6.23% |
| Mortgage-backed securities | 86,114 | 5,576 | 6.48% | 79,463 | 4,835 | 6.08% | 57,627 | 3,521 | 6.11% |
| Stock in the FHLB | 3,704 | 282 | 7.61% | 3,622 | 237 | 6.54% | 3,248 | 208 | 6.40% |
| Loans receivable: | | | | | | | | | |
| Residential mortgage loans | 243,706 | 17,982 | 7.38% | 244,698 | 16,997 | 6.95% | 266,917 | 19,205 | 7.20% |
| Commercial loans | 197,200 | 17,737 | 8.99% | 151,725 | 12,795 | 8.43% | 118,941 | 10,812 | 9.09% |
| Consumer and other loans | 50,421 | 4,472 | 8.87% | 42,676 | 3,491 | 8.18% | 35,696 | 3,144 | 8.81% |
| Total earning assets | 642,750 | 50,035 | 7.78% | 579,583 | 41,651 | 7.19% | 534,275 | 40,034 | 7.49% |
| Cash and due from banks | 17,998 | | | 18,268 | | | 11,628 | | |
| Allowance for loan losses | (6,472) | | | (5,358) | | | (4,799) | | |
| Premises and equipment | 6,306 | | | 5,283 | | | 4,855 | | |
| Other real estate owned | 80 | | | 226 | | | 502 | | |
| Excess of cost over net assets acquired, net | 12,540 | | | 13,720 | | | 15,077 | | |
| Accrued interest receivable | 4,126 | | | 3,704 | | | 3,967 | | |
| Prepaid expenses and other assets | 1,757 | | | 1,000 | | | 254 | | |
| Total assets | $ 679,085 | | | $ 616,426 | | | $ 565,759 | | |
| **Liabilities and Shareholders' Equity:** | | | | | | | | | |
| Interest-bearing liabilities: | | | | | | | | | |
| Deposits: | | | | | | | | | |
| NOW accounts | $ 31,555 | 205 | 0.65% | $ 27,082 | 175 | 0.65% | $ 22,176 | 175 | 0.79% |
| Money market accounts | 14,113 | 375 | 2.66% | 17,284 | 473 | 2.74% | 13,327 | 401 | 3.01% |
| Savings accounts | 192,217 | 6,137 | 3.19% | 172,073 | 4,742 | 2.76% | 155,420 | 4,670 | 3.00% |
| Certificate of deposit accounts | 252,521 | 13,685 | 5.42% | 230,901 | 11,396 | 4.94% | 231,392 | 12,360 | 5.34% |
| Overnight and short-term borrowings | 11,474 | 636 | 5.54% | 7,329 | 335 | 4.57% | 4,555 | 225 | 4.94% |
| FHLB and other borrowings | 42,997 | 2,640 | 6.14% | 43,167 | 2,479 | 5.74% | 35,389 | 2,014 | 5.69% |
| Total interest-bearing liabilities | 544,876 | 23,678 | 4.34% | 497,836 | 19,600 | 3.94% | 462,259 | 19,845 | 4.29% |
| Noninterest-bearing deposits | 82,518 | | | 69,270 | | | 53,912 | | |
| Other liabilities | 3,161 | | | 2,689 | | | 3,547 | | |
| Total liabilities | 630,555 | | | 569,795 | | | 519,718 | | |
| Shareholders' equity | 48,530 | | | 46,631 | | | 46,041 | | |
| Total liabilities and shareholders' equity | $ 679,085 | | | $ 616,426 | | | $ 565,759 | | |
| Net interest income | | $ 26,357 | | | $ 22,051 | | | $ 20,189 | |
| Net interest rate spread | | | 3.44% | | | 3.25% | | | 3.20% |
| Net interest rate margin | | | 4.10% | | | 3.80% | | | 3.78% |

### *Rate/Volume Analysis*

The following table sets forth certain information regarding changes in the Company's interest income and interest expense for the periods indicated. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to (i) changes in rate (changes in rate multiplied by old average balance) and (ii) changes in volume (changes in average balances multiplied by old rate). The net change attributable to the combined impact of rate and volume was allocated to the individual rate and volume changes.

| | Year Ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2000 vs 1999 Increase/(Decrease) Due To | | | 1999 vs 1998 Increase/(Decrease) Due To | | |
| | Rate | Volume | Total | Rate | Volume | Total |
| | (In thousands) | | | | | |
| **Interest income:** | | | | | | |
| Federal funds sold | $ 190 | $ 258 | $ 448 | $ (24) | $ 106 | $ 82 |
| Investment securities | 261 | (19) | 242 | (110) | 180 | 70 |
| Mortgage-backed securities | 321 | 420 | 741 | (14) | 1,328 | 1,314 |
| Stock in the FHLB | 40 | 5 | 45 | 5 | 25 | 30 |
| Residential mortgage loans | 1,054 | (69) | 985 | (649) | (1,560) | (2,209) |
| Commercial loans | 898 | 4,044 | 4,942 | (706) | 2,689 | 1,983 |
| Consumer and other loans | 311 | 670 | 981 | (199) | 546 | 347 |
| Total interest income | 3,075 | 5,309 | 8,384 | (1,697) | 3,314 | 1,617 |
| **Interest Expense:** | | | | | | |
| NOW accounts | 1 | 29 | 30 | — | — | — |
| Money market accounts | (14) | (84) | (98) | (31) | 103 | 72 |
| Savings accounts | 803 | 592 | 1,395 | (247) | 319 | 72 |
| Certificate of deposit accounts | 1,171 | 1,118 | 2,289 | (938) | (26) | (964) |
| Overnight & short-term borrowings | 82 | 219 | 301 | (16) | 126 | 110 |
| FHLB and other borrowings | 171 | (10) | 161 | 18 | 447 | 465 |
| Total interest expense | 2,214 | 1,864 | 4,078 | (1,214) | 969 | (245) |
| Net interest income | $ 861 | $ 3,445 | $ 4,306 | $ (483) | $ 2,345 | $ 1,862 |

## Comparison of Years Ended December 31, 2000 and December 31, 1999

### *General*

Net income for 2000 increased $1.3 million, or 28.8%, to $5.6 million, or $1.49 per diluted common share, from $4.4 million, or $1.14 per diluted common share, for 1999. Net income for 1999 was reduced by a one-time charge of $109,000 resulting from a change in accounting principle that required remaining unamortized organizational costs to be charged against earnings. Operating income, which excludes this one-time charge, was $5.6 million for 2000, compared to $4.5 million for last year, an increase of $1.1 million, or 25.7%. Diluted cash earnings per common share were $1.69 in 2000, compared to $1.37 in 1999.

This performance represented a return on average assets of 0.83% and a return on average equity of 11.58% for 2000, as compared to a return on average assets of 0.73% and a return on average equity of 9.59% for 1999. Cash basis return on average assets and cash basis return on average equity were 0.96% and 13.12% for 2000, and 0.87% and 11.20% for 1999, respectively.

### *Interest Income - Investments*

Total investment income (consisting of interest or dividends on federal funds sold, investment securities, mortgage-backed securities, and FHLB stock) was $9.8 million for 2000, compared to $8.4 million for 1999. This increase in total investment income of $1.5 million, or 17.6%, was attributable to an increase of $10.9 million, or 7.8%, in the average balance of investments (resulting from growth in deposits), along with an increase in the overall yield of investments of 54 basis points (resulting from increases in market interest rates). The Company's investments at December 31, 2000 were primarily comprised of Treasury and Agency securities with remaining maturities of less than five years, along with mortgage-backed securities ("MBSs") with repricing periods of less than five years. Management believes that this composition, along with a structured maturity ladder, provides more stable earnings and predictable cash flows from the portfolio. As a result of the rising interest rate environment present during the past year, prepayments on MBSs have slowed. These lower prepayment levels have had a positive impact on the yield of MBSs purchased at a premium. Management anticipates a declining interest rate environment in 2001, which is likely to accelerate prepayments, which, in turn, would have a negative impact on the yield of MBSs.

***Interest Income - Loans***

Interest from loans was $40.2 million for 2000, and represented a yield on total loans of 8.18%. This compares to $33.3 million of interest, and a yield of 7.58%, for 1999. Interest from commercial loans increased $4.9 million, or 38.6%, between the two years and represented the fastest growing segment of the total loan portfolio. Income from consumer and other loans increased $981,000, or 28.1%, and residential mortgage loan income increased $985,000, or 5.8%. Since 1996, origination efforts have been concentrated on commercial and, to a lesser extent, consumer loan opportunities, with residential mortgage loans purchased as cash flows dictated. The Bank also originated residential mortgage loans on a limited basis. The average balance of the various components of the loan portfolio changed from 1999 as follows: commercial loans increased $45.5 million, or 30.0%, consumer and other loans increased $7.7 million, or 18.1%, and residential mortgage loans decreased $992,000, or 0.4%. In response to rising market interest rates, the yields on the various loan portfolio components changed as follows: commercial loans increased 56 basis points, to 8.99%; consumer and other loans increased 69 basis points, to 8.87%; and residential mortgage loans increased 43 basis points, to 7.38%. As with MBSs, the rising interest rate and slower prepayment environment present during 2000 has positively impacted the yield on the loan portfolio. The current declining rate environment is expected to increase prepayments and negatively impact the yield on the loan portfolio during 2001.

***Interest Expense - Deposits & Borrowings***

Interest paid on deposits and borrowings increased $4.1 million, or 20.8%, to $23.7 million for 2000, from $19.6 million paid during 1999. The overall average cost of interest-bearing liabilities increased 41 basis points, from 3.94% for 1999 to 4.34% for 2000, and resulted in $2.2 million of additional interest expense. Liability costs are dependent on a number of factors including general economic conditions, national and local interest rates, competition in the local deposit marketplace, interest rate tiers offered and cash flow needs. In general, deposit costs during the second half of 2000 showed signs of reacting (on a delayed basis) to the increases in market rates that occurred during the first half of the year. Average costs for the various components of interest-bearing liabilities changed from 1999 as follows: NOW accounts remained the same at 0.65%, money market accounts decreased 8 basis points, to 2.66%, savings accounts increased 44 basis points, to 3.19%, certificate of deposit accounts increased 48 basis points, to 5.42%, and borrowings increased 44 basis points to 6.01%. Meanwhile, the average balance of interest-bearing liabilities increased $47.0 million, from $497.8 million in 1999 to $544.9 million in 2000, as the Bank actively sought checking and savings deposits ("core deposits") to fund asset growth and benefited from the unusual market conditions created by the Fleet Financial/BankBoston divestitures.

***Provision for Loan Losses***

The provision for loan losses was $1.5 million for 2000, up $542,000, or 54.2%, from the prior year. The commercial loan portfolio grew at a rate of 21.9% during 2000, while the Bank experienced net recoveries of $71,000 for the year. When determining the provision for loan losses, management evaluates several factors including new loan originations, actual and estimated charge-offs and the risk characteristics of the loan portfolio. Also see discussion under "Financial Condition — Allowance for Loan Losses."

***Noninterest Income***

Total noninterest income increased $356,000, or 11.0%, to $3.6 million for 2000, from $3.2 million for 1999. Service Charges on Deposit Accounts, which represent the largest source of noninterest income, rose $507,000, or 22.9%, from $2.2 million for 1999, to $2.7 million for 2000, primarily as a result of growth in core deposit accounts. Loan Related Fees decreased $48,000, or 15.7%, as prepayment penalties were less in 2000 than in the prior year and Other Income decreased $94,000, or 15.2%, as income from investment product sales decreased $110,000. The Bank has recently announced a number of initiatives to revitalize this program.

The following table sets forth the components of noninterest income:

| | Year Ended December 31, 2000 | 1999 |
|---|---|---|
| | (In thousands) | |
| Loan related fees | $ 258 | $ 306 |
| Service charges on deposit accounts | 2,722 | 2,215 |
| Commissions on loans originated for others | 74 | 83 |
| Other income | 524 | 618 |
| Total noninterest income | $ 3,578 | $ 3,222 |

### *Noninterest Expense*

Total noninterest expense for 2000 increased $2.3 million, or 13.3%, to $19.7 million from $17.4 million in 1999. This increase occurred primarily in the following areas: Salaries and Benefits (up $1.5 million, or 18.4%), Occupancy and Equipment (up $383,000, or 18.7%), Marketing (up $186,000, or 21.1%) and Other Expenses (up $329,000, or 16.6%) and primarily represent increased costs associated with the overall growth of the institution. As a result of a relatively strong local economy, the Company anticipates continued upward pressure on compensation and occupancy expense. The increase in Occupancy and Equipment was partially attributable to the Bank opening a de novo branch in the Buttonwoods section of Warwick and the Bank's ongoing replacement and upgrading of fixed assets throughout its branch network. The increase in Marketing expense was attributable to the Bank seeking to take advantage of unusual market conditions created by the Fleet Financial/BankBoston divestitures. Partially offsetting these increases were decreases in: Loan Servicing (down $64,000, or 7.8%) due to decreases in mortgage loans serviced by others and OREO expense (down $77,000, or 71.3%) due to decreased levels of foreclosures. The Company's cash basis efficiency ratio for 2000 was 61.79%, compared to 64.06% for 1999, an improvement of 227 basis points.

The following table sets forth the components of noninterest expense:

| | Year Ended December 31, 2000 | 1999 |
|---|---|---|
| | (In thousands) | |
| Salaries and employee benefits | $ 9,552 | $ 8,065 |
| Occupancy | 1,530 | 1,302 |
| Equipment | 899 | 744 |
| Data processing | 1,340 | 1,348 |
| Marketing | 1,069 | 883 |
| Professional services | 891 | 870 |
| Loan servicing | 761 | 825 |
| Other real estate owned | 31 | 108 |
| Amortization of goodwill | 1,164 | 1,164 |
| Deposit tax and assessments | 109 | 58 |
| Other expenses | 2,316 | 1,987 |
| Total noninterest expense | $ 19,662 | $ 17,354 |

### *Income Tax Expense*

Income tax expense of $3.1 million was recorded for 2000, compared to $2.4 million for 1999. This represented total effective tax rates of 35.7% and 35.4%, respectively. Tax-favored income from U.S. Treasury and Agency securities along with the utilization of a Rhode Island passive investment company has reduced the effective tax rate from the 39.9% combined statutory federal and state tax rates.

## Comparison of Years Ended December 31, 1999 and December 31, 1998

***General***

Net income for 1999 increased $528,000, or 13.8%, to $4.4 million, or $1.14 per diluted common share, from $3.8 million, or $0.85 per diluted common share, for 1998. Net income for 1999 was reduced by a one-time charge of $109,000 resulting from a change in accounting principle which required remaining unamortized organizational costs to be charged against earnings. Operating income, which excludes this one-time charge, was $4.5 million for 1999, compared to $3.8 million for 1998, an increase of $637,000, or 16.6%. Diluted earnings per common share, excluding the one-time charge, were $1.17 in 1999, compared to $0.85 in 1998.

This operating performance represented a return on average assets of 0.73% and a return on average equity of 9.59% for 1999, as compared to a return on average assets of 0.68% and a return on average equity of 8.33% for 1998. Diluted cash earnings per common share were $1.34 for 1999, compared to $1.07 for 1998. Cash basis return on average assets and cash basis return on average equity were 0.87% and 11.20% for 1999, and 0.84% and 10.08% for 1998, respectively.

***Interest Income - Investments***

Total investment income (consisting of interest or dividends on federal funds sold, investment securities, MBSs and FHLB stock) was $8.4 million for 1999, compared to $6.9 million for 1998. This increase in total investment income of $1.5 million, or 21.8%, was primarily attributable to a $21.8 million increase in the average balance of MBSs, partially offset by a decrease of 14 basis points, to 5.96%, in the overall yield on investments. The growth in MBSs was related to the Bank's establishment of a Rhode Island passive investment company and its efforts to leverage its capital. As a result of the declining interest rate environment present for the end of 1998 and the beginning of 1999, purchases of MBSs were at lower yields than those already in the portfolio and caused the overall yield on the MBS portfolio to decline.

***Interest Income - Loans***

Interest from loans was $33.3 million for 1999, and represented a yield on total loans of 7.58%. This compares to $33.2 million of interest, and a yield of 7.87%, for 1998. This increase of $122,000, or 0.4%, in interest on loans was due primarily to an increase in the commercial loan average balance (up $32.8 million, or 27.6%) offset by the decrease in the overall yield of the portfolio resulting from reinvestment of repayments at lower rates. The Bank has continued to change the mix of its loan portfolio away from residential mortgage loans and toward commercial loans by concentrating its origination efforts on commercial and consumer loan opportunities. Nonetheless, the Bank also originated residential mortgage loans on a limited basis. The yields on the various components of the loan portfolio changed as follows: commercial loans decreased 66 basis points, to 8.43%; consumer and other loans decreased 63 basis points, to 8.18%; and residential mortgage loans decreased 25 basis points, to 6.95%. Offsetting these decreases, the average balance of commercial and consumer loans changed as follows: commercial loans increased $32.8 million, or 27.6%, and consumer and other loans increased $7.0 million, or 19.6%.

***Interest Expense - Deposits & Borrowings***

Interest paid on deposits and borrowings decreased $245,000, or 1.2%, to $19.6 million for 1999, from $19.8 million in 1998. The overall average cost for interest-bearing liabilities decreased 35 basis points from 4.29% for 1998, to 3.94% for 1999. The Bank has concentrated its deposit gathering efforts on core deposits and has utilized FHLB borrowings as necessary to fund asset growth in an effort to decrease its overall cost of money. Deposit costs are dependent on a number of factors including general economic conditions, national and local interest rates, competition in the local marketplace, interest rate tiers offered and the Bank's cash flow needs. The average balance of interest-bearing liabilities increased $35.6 million, from $462.3 million in 1998 to $497.8 million in 1999. This growth in average balances of interest-bearing liabilities was centered in core accounts, specifically NOW and money market accounts (up $8.9 million, or 25.0%) and savings accounts (up $16.7 million, or 10.7%). In addition, the Bank increased its utilization of borrowed funds (up $10.6 million, or 26.4%).

***Provision for Loan Losses***

The provision for loan losses was $1.0 million for 1999, similar to the amount provided in the prior year. The Bank experienced net charge-offs during 1999 of $337,000, similar to the $339,000 of net charge-offs experienced in 1998. Management evaluates several factors including new loan originations, actual and estimated charge-offs, and the risk characteristics of the loan portfolio when determining the provision for the period. Also see discussion under "Financial Condition — Allowance for Loan Losses".

### *Noninterest Income*

Total noninterest income increased $495,000, or 18.2%, to $3.2 million for 1999, from $2.7 million for 1998. Excluding non-recurring items ($84,000 of loan prepayment penalties and a $43,000 deposit tax refund received in 1999, and a $272,000 settlement on a bifurcated loan received in 1998), total noninterest income increased $640,000, or 26.1%, year to year. Service Charges on Deposit Accounts, which represents the largest source of noninterest income for the Bank, rose $481,000, or 27.7%, from $1.7 million for 1998, to $2.2 million for 1999. Additionally, Other Income (exclusive of the deposit tax refund and loan settlement) increased $137,000, or 31.3%, from $438,000 to $575,000, for the comparable periods, and resulted primarily from the introduction of ATM access fees for non-customers in September 1998.

The following table sets forth the components of noninterest income:

| | Year Ended December 31, 1999 | 1998 |
|---|---|---|
| | (In thousands) | |
| Loan related fees | $ 306 | $ 137 |
| Service charges on deposit accounts | 2,215 | 1,734 |
| Gain on sales of investment securities | — | 5 |
| Commissions on loans originated for others | 83 | 141 |
| Other income | 618 | 710 |
| Total noninterest income | $ 3,222 | $ 2,727 |

### *Noninterest Expense*

Noninterest expenses for 1999 increased a total of $1.3 million, or 8.2%, to $17.4 million from $16.0 million in 1998. This increase occurred primarily as a result of the overall growth of the Bank, including its de novo Woonsocket office (April 1998), its relocated and expanded Providence East Side office (August 1998) and relocated headquarters (June 1999), and was centered in the following areas: Salaries and Benefits (up $929,000, or 13.0%), Occupancy (up $147,000, or 12.7%), Data Processing (up $211,000, or 18.6%) and Other Expenses (up $102,000, or 5.4%). In addition to the overall growth of the Bank, its Year 2000 efforts contributed to the growth in Data Processing expense. Professional Services increased $284,000, or 48.5%. A significant portion of the increase resulted from the Bank engaging consultants to review the effectiveness of its operations during 1999. Partially offsetting these increases were decreases in: Equipment (down $144,000, or 16.2%) as initial equipment purchases became fully depreciated; Loan Servicing (down $146,000, or 15.0%) as the purchased residential mortgage portfolio decreased in outstandings; OREO (down $58,000, or 34.9%) as the level of foreclosures declined; and amortization of goodwill (down $70,000, or 5.7%) as the Bank expensed any remaining capitalized organizational costs in January 1999. The Bank's cash basis efficiency ratio improved from 64.62% for 1998, to 64.06% for 1999.

The following table sets forth the components of noninterest expense:

| | Year Ended December 31, 1999 | 1998 |
|---|---|---|
| | (In thousands) | |
| Salaries and employee benefits | $ 8,065 | $ 7,136 |
| Occupancy | 1,302 | 1,155 |
| Equipment | 744 | 888 |
| Data processing | 1,348 | 1,137 |
| Marketing | 883 | 829 |
| Professional services | 870 | 586 |
| Loan servicing | 825 | 971 |
| Other real estate owned | 108 | 166 |
| Amortization of goodwill | 1,164 | 1,234 |
| Deposit tax and assessments | 58 | 56 |
| Other expenses | 1,987 | 1,885 |
| Total noninterest expense | $ 17,354 | $ 16,043 |

### *Income Tax Expense*

The Bank recorded income tax expense of $2.4 million for 1999, compared to $2.0 million for 1998. This represented total effective tax rates of 35.4% and 34.5%, respectively. The Bank's tax-favored income from U.S. Treasury and Agency securities and its establishment of a Rhode Island passive investment company reduced its effective tax rate from the 39.9% combined statutory federal and state tax rates.

## Financial Condition

### *Loans Receivable*

Total loans were $518.8 million, or 70.2% of total assets, at December 31, 2000, compared to $459.0 million, or 72.6% of total assets, at December 31, 1999, an increase of $59.9 million, or 13.0%. Total loans as of December 31, 2000 may be segmented in three broad categories: residential mortgages that aggregate $247.9 million, or 47.8% of the portfolio; commercial loans that aggregate $212.8 million, or 41.0% of the portfolio; and consumer and other loans that aggregate $58.1 million, or 11.2% of the portfolio.

During the second quarter of 1998, the Bank completed a comprehensive project begun in late 1997, to refine the classification of its individual commercial loans. This project defined the classification of a loan based on its primary purpose and collateral. As a result of this project, the Bank reclassified a number of loans from the commercial & industrial category to the commercial real estate or multi-family real estate categories. The amounts shown for December 31, 1997 and 1996 have not been restated to reflect this reclassification. Included in the following table as commercial real estate loans at December 31, 2000, 1999 and 1998, are $38.3 million, $34.0 million and $36.9 million of 'owner occupied' loans, many of which were originated in conjunction with a commercial & industrial loan to the same borrower and previously classified as commercial & industrial loans. This classification project did not affect the total outstanding for commercial loans, only the breakdown by individual category within the total portfolio.

The Bank utilizes the term "small business loans" to describe its portfolio comprised of loans to businesses of up to $250,000 in the aggregate.

The following is a summary of loans receivable:

| | December 31, | | | | |
|---|---|---|---|---|---|
| | 2000 | 1999 | 1998 | 1997 | 1996 |
| | | | (In thousands) | | |
| **Residential mortgage loans:** | | | | | |
| One- to four-family adjustable rate | $ 212,197 | $ 196,863 | $ 211,076 | $ 205,020 | $ 201,628 |
| One- to four-family fixed rate | 34,609 | 39,037 | 45,671 | 50,704 | 55,160 |
| Subtotal | 246,806 | 235,900 | 256,747 | 255,724 | 256,788 |
| Premium on loans acquired | 1,166 | 1,446 | 2,110 | 2,045 | 2,589 |
| Net deferred loan origination fees | (49) | (26) | — | — | — |
| Total | $ 247,923 | $ 237,320 | $ 258,857 | $ 257,769 | $ 259,377 |
| **Commercial loans:** | | | | | |
| Commercial real estate | $ 107,587 | $ 90,149 | $ 76,562 | $ 49,412 | $ 34,370 |
| Commercial & industrial | 51,470 | 40,109 | 30,655 | 47,440 | 52,638 |
| Small business | 19,170 | 13,322 | 6,804 | 3,775 | 1,460 |
| Multi-family | 15,933 | 16,270 | 13,221 | 6,874 | 3,969 |
| Leases | 11,731 | 8,499 | 3,370 | 2,600 | — |
| Construction | 7,070 | 6,379 | 3,482 | 4,683 | 244 |
| Subtotal | 212,961 | 174,728 | 134,094 | 114,784 | 92,681 |
| Net deferred loan origination fees | (143) | (180) | (61) | (112) | (34) |
| Total | $ 212,818 | $ 174,548 | $ 134,033 | $ 114,672 | $ 92,647 |
| **Consumer and other loans:** | | | | | |
| Home equity - lines of credit | $ 26,215 | $ 24,166 | $ 18,400 | $ 11,515 | $ 12,328 |
| Home equity - term loans | 23,292 | 19,710 | 16,996 | 18,758 | 15,130 |
| Automobile | 4,643 | — | — | — | — |
| Installment | 1,348 | 1,279 | 1,010 | 888 | 1,387 |
| Savings secured | 987 | 1,005 | 935 | 1,261 | 1,101 |
| Unsecured and other | 1,044 | 590 | 972 | 956 | 1,069 |
| Subtotal | 57,529 | 46,750 | 38,313 | 33,378 | 31,015 |
| Premium on loans acquired | 144 | — | — | — | — |
| Net deferred loan origination costs | 411 | 340 | 199 | — | — |
| Total | $ 58,084 | $ 47,090 | $ 38,512 | $ 33,378 | $ 31,015 |

During 2000, residential mortgage loans increased $10.6 million, or 4.5%, as purchases of $48.5 million and originations of $10.0 million were offset by $47.4 million in repayments. Since 1996, the Bank has concentrated its portfolio lending efforts on commercial and, to a lesser extent, consumer lending opportunities. During late 1997, the Bank began to originate mortgage loans for its own portfolio as well as for sale to others and anticipates continuing to originate mortgage loans on a limited basis for its customers.The Bank does not employ any mortgage originators and typically only holds in its portfolio loans whose rate will adjust in less than 10 years. Until such time as the Bank can originate sufficient commercial and consumer loans to utilize available cash flow, it intends to continue purchasing residential mortgage loans as opportunities develop.

The Bank's commercial loan portfolio (consisting of commercial real estate, commercial & industrial, multi-family real estate, construction and small business loans) increased $38.3 million, or 21.9%, during 2000. The Bank believes it is well positioned for continued commercial loan growth. Particular emphasis is placed on generation of small- to medium-sized commercial relationships (those relationships with $5.0 million or less in loan commitments). The Bank is also active in small business lending in which it utilizes credit scoring, in conjunction with traditional review standards, and employs streamlined documentation. The Bank's small business portfolio increased $5.8 million, or 43.9%, during 2000. The Bank is a participant in the U.S. Small Business Administration ("SBA") Preferred Lender Program ("PLP") in Rhode Island and the 7a Guarantee Loan Program in Massachusetts.

The consumer loan portfolio is comprised primarily of home equity term loans and home equity lines of credit. During 2000, consumer loan outstandings increased $11.0 million, or 23.3%, to $58.1 million at December 31, 2000, from $48.1 million at December 31, 1999. During 2000, the Bank for the first time purchased a package of automobile loans from another New England institution. At December 31, 2000, these automobile loans represented 42.2% of the total growth that occured in the consumer and other loan portfolio. The remainder of the growth was in home equity term loans and lines of credit.

The table below shows loan originations, purchases, sales and repayment activities.

| | Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2000 | 1999 | 1998 | 1997 | 1996 |
| | | | (In thousands) | | |
| **Originations and Principal Additions:** | | | | | |
| Loans purchased: | | | | | |
| Residential mortgage loans | $ 48,491 | $ 53,747 | $ 107,559 | $ 58,271 | $ 29,921 |
| Consumer and other loans | 4,891 | — | — | — | — |
| Total loans purchased | 53,382 | 53,747 | 107,559 | 58,271 | 29,921 |
| Loans originated: | | | | | |
| Residential mortgage loans | 9,985 | 17,659 | 13,093 | 200 | — |
| Commercial loans | 65,465 | 62,430 | 41,872 | 40,065 | 13,492 |
| Consumer and other loans | 17,950 | 18,704 | 16,837 | 12,526 | 8,416 |
| Total loans originated | 93,400 | 98,793 | 71,802 | 52,791 | 21,908 |
| **Principal Reductions:** | | | | | |
| Charge-offs/transfers to OREO | | | | | |
| Residential mortgage loans | (148) | (412) | (950) | (1,116) | — |
| Commercial loans | (93) | (176) | (15) | (145) | (103) |
| Consumer and other loans | (20) | (80) | (163) | (178) | (110) |
| Total charge-offs/transfers to OREO | (261) | (668) | (1,128) | (1,439) | (213) |
| **Principal Payments:** | | | | | |
| Residential mortgage loans | (47,422) | (91,841) | (118,679) | (58,419) | (46,527) |
| Commercial loans | (27,139) | (21,620) | (22,547) | (17,817) | (6,105) |
| Consumer and other loans | (12,042) | (10,187) | (11,739) | (9,985) | (9,351) |
| Total principal payments | (86,603) | (123,648) | (152,965) | (86,221) | (61,983) |
| Change in loans receivable (before net items) | $ 59,918 | $ 28,224 | $ 25,268 | $ 23,402 | $ (10,367) |

The following table sets forth certain information at December 31, 2000, regarding the aggregate dollar amount of certain loans maturing in the loan portfolio based on scheduled payments to maturity. Actual loan principal payments may vary from this schedule due to refinancings, modifications and other changes in loan terms. Demand loans and loans having no stated schedule of repayments and no stated maturity are reported as due in one year or less.

| | Principal Repayments Contractually Due | | |
|---|---|---|---|
| | One Year or Less | After One, But Within Five Years | After Five Years |
| | | (In thousands) | |
| Construction loans | $ 7,070 | $ — | $ — |
| Commercial & industrial loans (including leases) | 38,672 | 19,136 | 5,393 |
| Small business loans | 9,661 | 8,880 | 629 |
| Total | $ 55,403 | $ 28,016 | $ 6,022 |

The following table sets forth as of December 31, 2000, the dollar amount of certain loans due after one year that have fixed interest rates or floating or adjustable interest rates.

| | Loans Due After One Year | |
|---|---|---|
| | Fixed Rates | Floating or Adjustable Rates |
| | (In thousands) | |
| Construction loans | $ — | $ — |
| Commercial & industrial loans (including leases) | 12,788 | 11,741 |
| Small business loans | 5,307 | 4,202 |
| Total | $ 18,095 | $ 15,943 |

***Asset Quality***

The definition of nonperforming assets includes nonperforming loans and OREO. OREO consists of real estate acquired through foreclosure proceedings and real estate acquired through acceptance of a deed in lieu of foreclosure. Nonperforming loans are defined as nonaccrual loans, loans past due 90 days or more, but still accruing and impaired loans. Under certain circumstances the Bank may restructure the terms of a loan as a concession to a borrower. These restructured loans are considered impaired loans. Included in nonaccrual loans at December 31, 1999, were $329,000 of impaired loans. At December 31, 2000 and 1998, the Bank did not have any impaired loans.

***Nonperforming Assets.*** At December 31, 2000, the Bank had nonperforming assets of $538,000, or 0.07% of total assets. This compares to nonperforming assets of $1.2 million, or 0.18% of total assets, at December 31, 1999 and nonperforming assets of $2.0 million, or 0.33% of total assets, at December 31, 1998. The Bank's nonperforming assets at December 31, 2000, consisted of residential mortgage loans aggregating $398,000, commercial loans aggregating $109,000, consumer loans aggregating $1,000 and OREO aggregating $30,000. Nonperforming assets at December 31, 1999 and 1998, were also primarily comprised of nonaccrual residential mortgage loans. The Bank evaluates the underlying collateral of each nonperforming loan and continues to pursue the collection of interest and principal. Management believes that the December 31, 2000 level of nonperforming assets and the charge-off experience for 2000 were unusually low. As the Bank's loan portfolio continues to grow and mature, or if economic conditions worsen, management believes it highly likely that the level of nonperforming assets will increase, as will its level of charged-off loans.

The following table sets forth information regarding nonperforming assets.

| | December 31, 2000 | 1999 | 1998 |
|---|---|---|---|
| | (Dollars in thousands) | | |
| Nonaccrual loans | $ 508 | $ 1,112 | $ 1,563 |
| Loans past due 90 days or more, but still accruing | — | — | — |
| Impaired loans (not included in nonaccrual loans) | — | — | — |
| Total nonperforming loans | 508 | 1,112 | 1,563 |
| Other real estate owned | 30 | 49 | 394 |
| Total nonperforming assets | $ 538 | $ 1,161 | $ 1,957 |
| Nonperforming loans as a percent of total loans | 0.10% | 0.24% | 0.36% |
| Nonperforming assets as a percent of total assets | 0.07% | 0.18% | 0.33% |

***Nonaccrual Loans.*** Accrual of interest income on all loans is discontinued when concern exists as to the collectibility of principal or interest, or when a loan becomes over ninety days delinquent. Additionally, when a loan is placed on nonaccrual status, all interest previously accrued but not collected is reversed against current period income. Loans are removed from nonaccrual when they become less than ninety days past due and in the case of commercial and consumer loans, when concern no longer exists as to the collectibility of principal or interest. Interest collected on nonaccruing loans is either applied against principal or reported as income according to management's judgment as to the collectibility of principal. At December 31, 2000, nonaccrual loans totaled $508,000. Interest on nonaccrual loans that would have been recorded as additional income for the year ended December 31, 2000, had the loans been current in accordance with their original terms, totaled $35,000. This compares with $66,000 and $117,000 of foregone interest income on nonaccrual loans for the years ended December 31, 1999 and 1998, respectively.

The following table sets forth certain information regarding nonaccrual loans.

| | December 31, 2000 | | 1999 | | 1998 | |
|---|---|---|---|---|---|---|
| | Principal Balance | Percent of Total Loans | Principal Balance | Percent of Total Loans | Principal Balance | Percent of Total Loans |
| | (Dollars in thousands) | | | | | |
| **Nonaccrual loans:** | | | | | | |
| Residential mortgage loans | $ 398 | 0.08% | $ 602 | 0.13% | $ 1,475 | 0.34% |
| Commercial loans | 109 | 0.02% | 510 | 0.11% | 57 | 0.01% |
| Consumer and other loans | 1 | 0.00% | — | — | 31 | 0.01% |
| Total nonaccrual loans | $ 508 | 0.10% | $ 1,112 | 0.24% | $ 1,563 | 0.36% |

***Delinquencies.*** At December 31, 2000, $1.1 million of loans were 30 to 89 days past due. This compares to $811,000 and $1.9 million of loans 30 to 89 days past due as of December 31, 1999 and 1998, respectively. The majority of these loans at all three dates were residential mortgage loans and are secured.

Management reviews delinquent loans frequently to assess problem situations and to quickly address these problems. In the case of consumer and commercial loans, the Bank contacts the borrower when a loan becomes delinquent. When a payment is not made, generally within 10-15 days of the due date, a late charge is assessed. After 30 days of delinquency, a notice is sent to the borrower advising that failure to cure the default may result in formal demand for payment in full. In the event of further delinquency, the matter is generally referred to legal counsel to commence civil proceedings to collect all amounts owed. In the case of residential mortgage loans, delinquency and collection proceedings are conducted by either the Bank or its mortgage servicers in accordance with standard servicing guidelines. In any circumstance where the Bank is secured by real property or other collateral, the Bank enforces its rights to the collateral in accordance with applicable law.

The following table sets forth information as to loans delinquent for 30 to 89 days.

| | December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2000 | | 1999 | | 1998 | |
| | Principal Balance | Percent of Total Loans | Principal Balance | Percent of Total Loans | Principal Balance | Percent of Total Loans |
| | (Dollars in thousands) | | | | | |
| Loans delinquent for 30 to 59 days: | | | | | | |
| Residential mortgage loans | $ 584 | 0.11% | $ 378 | 0.08% | $ 483 | 0.11% |
| Commercial loans | 168 | 0.03% | 334 | 0.08% | 1,164 | 0.27% |
| Consumer and other loans | 39 | 0.01% | 6 | 0.00% | 14 | 0.00% |
| Total loans delinquent 30 to 59 days: | 791 | 0.15% | 718 | 0.16% | 1,661 | 0.38% |
| Loans delinquent for 60 to 89 days: | | | | | | |
| Residential mortgage loans | 278 | 0.05% | 92 | 0.02% | 258 | 0.06% |
| Commercial loans | 39 | 0.01% | — | — | — | — |
| Consumer and other loans | 20 | 0.01% | 1 | 0.00% | — | — |
| Total loans delinquent 60 to 89 days | 337 | 0.07% | 93 | 0.02% | 258 | 0.06% |
| Total loans delinquent 30 to 89 days | $ 1,128 | 0.22% | $ 811 | 0.18% | $ 1,919 | 0.44% |

***Adversely Classified Assets.*** The Company's management adversely classifies certain assets as "substandard," "doubtful" or "loss" based on criteria established under banking regulations. An asset is considered substandard if inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard assets include those characterized by the "distinct possibility" that the insured institution will sustain "some loss" if existing deficiencies are not corrected. Assets classified as doubtful have all of the weaknesses inherent in those classified substandard with the added characteristic that the weaknesses present make "collection or liquidation in full," on the basis of currently existing facts, conditions, and values, "highly questionable and improbable." Assets classified as loss are those considered "uncollectible" and of such little value that their continuance as assets without the establishment of a specific loss reserve is not warranted.

At December 31, 2000, the Company had $5.8 million of assets that were classified as substandard. This compares to $1.2 million and $2.5 million of assets that were classified as substandard at December 31, 1999 and 1998, respectively. The Company had no assets that were classified as loss or doubtful at either date. Delinquent loans may or may not be adversely classified depending upon management's judgment with respect to each individual loan. At December 31, 2000, included in the $5.8 million of assets that were classified as substandard, were $3.3 million of performing loans and $2.0 million of performing investment securities. This compares to $127,000 and $916,000 of adversely classified performing assets as of December 31, 1999 and 1998, respectively. These amounts constitute assets that, in the opinion of management, could potentially migrate to nonperforming or doubtful status.

### *Allowance for Loan Losses*

The allowance for loan losses is established for credit losses inherent in the loan portfolio through a charge to earnings. Loans deemed uncollectible are charged against the allowance, while recoveries of amounts previously charged-off are added to the allowance. Amounts are charged-off once the probability of loss has been established, with consideration given to such factors as the customer's financial condition, underlying collateral and guarantees, and general and industry economic conditions.

When an insured institution classifies problem loans as either substandard or doubtful, it is required to establish allowances for loan losses in an amount deemed prudent by management. Additionally, general allowances represent loss allowances that have been established to recognize the inherent risk associated with lending activities, and have not been allocated to particular problem loans.

The following table represents the allocation of the allowance for loan losses as of the dates indicated:

| | December 31, | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2000 | | 1999 | | 1998 | | 1997 | | 1996 | |
| | Amount | Percent of Loans in Each Category to Total Loans | Amount | Percent of Loans in Each Category to Total Loans | Amount | Percent of Loans in Each Category to Total Loans | Amount | Percent of Loans in Each Category to Total Loans | Amount | Percent of Loans in Each Category to Total Loans |
| | (Dollars in thousands) | | | | | | | | | |
| Residential mortgage loans | $ 1,460 | 47.8% | $ 1,395 | 51.7% | $ 1,558 | 60.0% | $ 1,534 | 63.5% | $ 1,532 | 67.7% |
| Commercial loans | 3,210 | 41.0% | 2,007 | 38.0% | 1,277 | 31.1% | 1,040 | 28.3% | 973 | 24.2% |
| Consumer and other loans | 731 | 11.2% | 566 | 10.3% | 456 | 8.9% | 393 | 8.2% | 363 | 8.1% |
| Unallocated | 1,893 | — | 1,713 | — | 1,727 | — | 1,373 | — | 1,156 | — |
| Total | $ 7,294 | 100.0% | $ 5,681 | 100.0% | $ 5,018 | 100.0% | $ 4,340 | 100.0% | $ 4,340 | 100.0% |

Assessing the adequacy of the allowance for loan losses involves substantial uncertainties and is based upon management's evaluation of the amounts required to meet estimated charge-offs in the loan portfolio after weighing various factors. Management's methodology to estimate loss exposure includes an analysis of individual loans deemed to be impaired, reserve allocations for various loan types based on payment status or loss experience and an unallocated allowance that is maintained based on management's assessment of many factors including the growth, composition and quality of the loan portfolio, historical loan experiences, general economic conditions and other pertinent factors. Based on this evaluation, the Bank believes that its year-end allowance for loan losses is adequate.

While management evaluates currently available information in establishing the allowance for loan losses, future adjustments to the allowance may be necessary if conditions differ substantially from the assumptions used in making the evaluations. In addition, various regulatory agencies, as an integral part of their examination process, periodically review a financial institution's allowance for loan losses and carrying amounts of other real estate owned. Such agencies may require the financial institution to recognize additions to the allowance based on their judgments about information available to them at the time of their examination.

During 2000, 1999 and 1998, the Bank made additions to the allowance of $1.5 million, $1.0 million and $1.0 million and experienced net charge-offs (recoveries) of ($71,000), $337,000 and $339,000, respectively. At December 31, 2000, the allowance for loan losses stood at $7.3 million and represented 1435.83% of nonperforming loans and 1.41% of total loans outstanding. This compares to an allowance for loan losses of $5.7 million, representing 510.88% of nonperforming loans and 1.24% of total loans outstanding at December 31, 1999. The increase in the allowance as a percent of total loans is reflective of the increase in commercial and consumer loan outstandings.

An analysis of the activity in the allowance for loan losses is as follows:

| | Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2000 | 1999 | 1998 | 1997 | 1996 |
| | (In thousands) | | | | |
| Balance at beginning of year | $ 5,681 | $ 5,018 | $ 4,340 | $ 4,024 | $ — |
| Acquired reserves | — | — | — | — | 3,400 |
| Loans charged-off: | | | | | |
| Residential mortgage loans | (11) | (128) | (174) | (505) | — |
| Commercial loans | (94) | (176) | (15) | (71) | (103) |
| Consumer and other loans | (20) | (80) | (163) | (135) | (110) |
| Total loans charged-off | (125) | (384) | (352) | (711) | (213) |
| Recoveries of loans previously charged-off: | | | | | |
| Residential mortgage loans | — | 29 | 0 | 8 | — |
| Commercial loans | 191 | 1 | 3 | 3 | — |
| Consumer and other loans | 5 | 17 | 10 | 16 | — |
| Total recoveries of loans previously charged-off | 196 | 47 | 13 | 27 | — |
| Net (charge-offs) recoveries | 71 | (337) | (339) | (684) | (213) |
| Provision for loan losses charged against income | 1,542 | 1,000 | 1,017 | 1,000 | 837 |
| Balance at end of year | $ 7,294 | $ 5,681 | $ 5,018 | $ 4,340 | $ 4,024 |
| Net charge-offs (recoveries) to average loans outstanding | (0.01%) | 0.08% | 0.08% | 0.17% | 0.06% |

### *Investments*

Total investments (consisting of federal funds sold, investment securities, MBSs, and FHLB stock) totaled $174.0 million, or 23.5% of total assets, at December 31, 2000. This compares to total investments of $135.9 million, or 21.5% of total assets, as of December 31, 1999. The increase of $38.2 million, or 28.1%, was primarily in MBSs that were purchased to reinvest the funds generated from the Bank's unusual level of deposit growth. A number of these purchases were of SBA securities that, in addition to a Governmental guarantee, have a floating interest rate indexed to a specific Prime rate.

The investment portfolio provides the Bank with a source of short-term liquidity and acts as a counterbalance to loan and deposit flows. Investment securities and MBSs are primarily comprised of U.S. Government and Agency securities. All investment securities and MBSs at December 31, 2000 and 1999, were classified as securities available for sale. These securities carried a total of $275,000 and $2.6 million in net unrealized losses at December 31, 2000 and 1999, respectively.

A summary of investment and mortgage-backed securities available for sale follows:

| | Amortized Cost | Unrealized Gains | Unrealized Losses | Market Value |
|---|---|---|---|---|
| | (In thousands) | | | |
| **At December 31, 2000:** | | | | |
| U.S. Treasury obligations | $ 1,016 | $ — | $ (11) | $ 1,005 |
| U.S. Agency obligations | 44,256 | 167 | (119) | 44,304 |
| Trust preferred securities | 2,187 | — | (200) | 1,987 |
| U.S. Agency mortgage-backed securities | 104,863 | 457 | (468) | 104,852 |
| Collateralized mortgage obligations | 12,680 | — | (101) | 12,579 |
| Total | $ 165,002 | $ 624 | $ (899) | $ 164,727 |
| **At December 31, 1999:** | | | | |
| U.S. Treasury obligations | $ 10,023 | $ 21 | $ (36) | $ 10,008 |
| U.S. Agency obligations | 39,256 | 5 | (875) | 38,386 |
| Trust preferred securities | 2,198 | — | (89) | 2,109 |
| U.S. Agency mortgage-backed securities | 62,101 | — | (1,125) | 60,976 |
| Collateralized mortgage obligations | 14,357 | — | (540) | 3,817 |
| Total | $ 127,935 | $ 26 | $ (2,665) | $ 125,296 |
| **At December 31, 1998:** | | | | |
| U.S. Treasury obligations | $ 18,050 | $ 245 | $ (14) | $ 18,281 |
| U.S. Agency obligations | 21,245 | 203 | (26) | 21,422 |
| U.S. Agency mortgage-backed securities | 62,814 | 72 | (138) | 62,748 |
| Collateralized mortgage obligations | 17,162 | 14 | — | 17,176 |
| Total | $ 119,271 | $ 534 | $ (178) | $ 119,627 |

The following table sets forth the maturities of investment and mortgage-backed securities available for sale and the weighted average yields of such securities:

| | Within One Year | | After One, But Within Five Years | | After Five, But Within Ten Years | | After Ten Years | |
|---|---|---|---|---|---|---|---|---|
| | Market Value | Weighted Average Yield | Market Value | Weighted Average Yield | Market Value | Weighted Average Yield | Market Value | Weighted Average Yield |
| | (Dollars in thousands) | | | | | | | |
| **At December 31, 2000:** | | | | | | | | |
| U.S. Treasury obligations | $ 1,005 | 4.16% | $ — | — | $ — | — | $ — | — |
| U.S. Agency obligations | 5,243 | 5.70% | 39,061 | 6.40% | — | — | — | — |
| Trust preferred securities | — | — | — | — | — | — | 1,987 | 8.16% |
| U.S. Agency mortgage-backed securities | — | — | — | — | — | — | 104,852 | 6.69% |
| Collateralized mortgage obligations | — | — | — | — | — | — | 12,579 | 6.47% |
| Total | $ 6,248 | 5.46% | $ 39,061 | 6.40% | $ — | — | $119,418 | 6.71% |
| **At December 31, 1999:** | | | | | | | | |
| U.S. Treasury obligations | $ 9,007 | 6.39% | $ 1,002 | 4.15% | $ — | — | $ — | — |
| U.S. Agency obligations | 3,991 | 5.80% | 24,557 | 5.74% | 9,838 | 7.10% | — | — |
| Trust preferred securities | — | — | — | — | — | — | 2,108 | 8.16% |
| U.S. Agency mortgage-backed securities | — | — | — | — | — | — | 60,976 | 5.98% |
| Collateralized mortgage obligations | — | — | — | — | — | — | 13,817 | 6.48% |
| Total | $ 12,998 | 6.21% | $ 25,559 | 5.68% | $ 9,838 | 7.10% | $ 76,901 | 6.13% |
| **At December 31, 1998:** | | | | | | | | |
| U.S. Treasury obligations | $ 8,040 | 6.10% | $ 10,241 | 6.16% | $ — | — | $ — | — |
| U.S. Agency obligations | 2,039 | 6.57% | 19,384 | 6.05% | — | — | — | — |
| U.S. Agency mortgage-backed securities | — | — | — | — | — | — | 62,748 | 6.47% |
| Collateralized mortgage obligations | — | — | — | — | — | — | 17,176 | 6.48% |
| Total | $ 10,079 | 6.19% | $ 29,625 | 6.09% | $ — | — | $ 79,924 | 6.48% |

### *Deposits and Borrowings*

The Bank has devoted considerable time and resources to its deposit gathering network. The Bank experienced a net increase in total deposits during 2000, to $631.6 million, or 85.4% of total assets, at December 31, 2000, from $513.4 million, or 81.2% of total assets, at December 31, 1999. This increase of $118.2 million, or 23.0%, in total deposits was the result of unusual local market conditions and increased marketing expenditures by the Bank. The increase was centered in core accounts and broken down as follows: Demand deposit and NOW accounts up $47.7 million, or 50.1%; savings accounts up $37.0 million, or 21.3%; and certificates of deposit accounts up $37.3 million, or 16.3%. By comparison, the increase in total deposits during 1999 was $12.7 million, or 2.5%.

The following table sets forth certain information regarding deposits:

| | December 31, | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2000 | | | 1999 | | | 1998 | | |
| | Amount | Percent of Total | Weighted Average Rate | Amount | Percent of Total | Weighted Average Rate | Amount | Percent of Total | Weighted Average Rate |
| | (Dollars in thousands) | | | | | | | | |
| NOW accounts | $ 36,910 | 5.8% | 0.64% | $ 27,456 | 5.4% | 0.64% | $ 26,899 | 5.4% | 0.65% |
| Money market accounts | 12,283 | 1.9% | 2.59% | 16,073 | 3.1% | 2.70% | 15,599 | 3.1% | 2.78% |
| Savings accounts | 210,728 | 33.4% | 3.52% | 173,692 | 33.8% | 2.78% | 163,118 | 32.6% | 2.74% |
| Certificate of deposit accounts | 265,623 | 42.1% | 5.76% | 228,351 | 44.5% | 4.95% | 234,541 | 46.8% | 5.14% |
| Total interest bearing deposits | 525,544 | 83.2% | 4.43% | 445,572 | 86.8% | 3.76% | 440,157 | 87.9% | 3.89% |
| Noninterest bearing accounts | 106,088 | 16.8% | — | 67,844 | 13.2% | — | 60,556 | 12.1% | — |
| Total deposits | $631,632 | 100.0% | 3.69% | $ 513,416 | 100.0% | 3.26% | $500,713 | 100.0% | 3.42% |

At December 31, 2000, certificate of deposit accounts with balances greater than $100,000 aggregated $32.1 million, compared to $25.3 million and $23.1 million at December 31, 1999 and 1998, respectively.

Total borrowings (consisting of overnight and short-term borrowings, FHLB and other borrowings) decreased $16.0 million during 2000, to $51.9 million, from $67.9 million at December 31, 1999. The Bank had $45.5 million of overnight and short-term borrowing outstanding at the end of 1998. The decrease during 2000 was primarily attributable to the strong deposit growth the Bank experienced permitting the repayment of maturing FHLB borrowings. During 1999, the increase in total borrowings was the result of the Bank utilizing FHLB borrowings (up $11.7 million, or 32.0%) to partially fund its asset growth, coupled with repurchase agreement growth (up $8.5 million, or 248.1%) resulting from growth of the Bank's overnight cash management product for its commercial customers. The Bank, through its membership in the FHLB, has access to a variety of borrowing alternatives, and management will from time to time take advantage of these opportunities to fund asset growth. However, on a long-term basis, the Bank intends to concentrate on increasing its core deposits.

## Asset and Liability Management

The principal objective of the Bank's asset and liability management process is to maximize profit potential while minimizing the vulnerability of its operations to changes in interest rates by means of managing the ratio of interest rate sensitive assets to interest rate sensitive liabilities within specified maturity or repricing periods. The Bank's actions in this regard are taken under the guidance of the Asset/Liability Committee ("ALCO") that is comprised of members of senior management. The ALCO generally meets monthly and is actively involved in formulating the economic assumptions that the Bank uses in its financial planning and budgeting process and establishes policies which control and monitor the sources, uses and pricing of funds. The Bank has not engaged in any hedging activities.

The ALCO manages the Bank's interest rate risk position using both income simulation and interest rate sensitivity "gap" analysis. The Bank has established internal parameters for monitoring the income simulation and gap analysis. These guidelines serve as benchmarks for evaluating actions to balance the current position against overall strategic goals. The ALCO monitors current exposures and reports these to the Board of Directors.

Simulation is used as the primary tool for measuring the interest rate risk inherent in the Bank's balance sheet at a given point in time by showing the effect on net interest income, over a twenty-four month period, of interest rate ramps of up to 200 basis points. These simulations take into account repricing, maturity and prepayment characteristics of individual products. The ALCO reviews simulation results to determine whether the downside exposure resulting from changes in market interest rates remains within established tolerance levels over both a twelve-month and twenty-four month horizon, and develops appropriate strategies to manage this exposure. The Bank's limits on interest rate risk specify that if interest rates were to shift up or down 200 basis points over a twelve month period, estimated net interest income for those twelve months and the subsequent twelve months, should decline by no more that 5.0% or 10.0% respectively. As of December 31, 2000, net interest income simulation indicated that the Bank's exposure to changing interest rates was within these established tolerance levels. The ALCO reviews the methodology utilized by the Bank for calculating its interest rate risk exposure and may, from time to time, adopt modifications to this methodology. While the ALCO reviews simulation assumptions and methodology to ensure that they reflect historical experience, it should be noted that income simulation may not always prove to be an accurate indicator of interest rate risk because the actual repricing, maturity and prepayment characteristics of individual products may differ from the estimates used in the simulations.

The following table presents the estimated impact of interest rate ramps on estimated net interest income over a twenty-four month period beginning January, 2001:

| | Estimated Exposure to Net Interest Income | |
|---|---|---|
| | Dollar Change | Percent Change |
| | (Dollars in thousands) | |
| **Initial Twelve Month Period:** | | |
| Up 200 basis point ramp | $ 457 | 1.63% |
| Up 100 basis point ramp | 247 | 0.88% |
| Down 100 basis point ramp | (314) | (1.12%) |
| Down 200 basis point ramp | (673) | (2.40%) |
| **Subsequent Twelve Month Period:** | | |
| Up 200 basis point ramp | $ 392 | 1.36% |
| Up 100 basis point ramp | 394 | 1.36% |
| Down 100 basis point ramp | (731) | (2.53%) |
| Down 200 basis point ramp | (1,819) | (6.30%) |

The Company also uses interest rate sensitivity "gap" analysis to provide a more general overview of its interst rate risk profile. The effect of interest rate changes on the assets and liabilities of a financial institution such as the Bank may be analyzed by examining the extent to which such assets and liabilities are "interest rate sensitive" and by monitoring an institution's interest rate sensitivity gap. An asset or liability is said to be interest rate sensitive within a specific time period if it will mature or reprice within that time period. The interest rate sensitivity gap is defined as the difference between interest-earning assets and interest-bearing liabilities maturing or repricing within a given time period. A gap is considered positive when the amount of interest rate sensitive assets exceeds the amount of interest rate sensitive liabilities. A gap is considered negative when the amount of interest rate sensitive liabilities exceeds interest rate sensitive assets. During a period of falling interest rates, positive gap would tend to adversely affect net interest income, while a negative gap would tend to result in an increase in net income. Conversely, during a period of rising interest rates, a positive gap would tend to result in an increase in net interest income while a negative gap would tend to affect net interest income adversely.

The Company has sought to maintain a relatively narrow gap position and has, in some instances, foregone investment in higher yielding assets when such investment, in management's opinion, exposed it to undue interest rate risk. However, the Company does not attempt to perfectly match interest rate sensitive assets and liabilities and will selectively mismatch its assets and liabilities to a controlled degree when it considers it both appropriate and prudent to do so. There are a number of relevant time periods in which to measure the gap position, such as at the 30, 60, 90, or 180 day points in the maturity schedule. Management monitors the gap position at each of these maturity points, while also focusing closely on the gap at the one-year point in making its principal funding decisions, such as with respect to its commercial and residential mortgage loan portfolios. At December 31, 2000, the Company's cumulative one-year gap was a negative $2.4 million, or 0.3% of total assets, compared to positive $14.0 million, or 2.2% of total assets, at the end of 1999.

The following table presents the repricing schedule for interest-earning assets and interest-bearing liabilities at December 31, 2000. To the extent applicable, amounts of assets and liabilities which mature or reprice within a particular period where determined in accordance with their contractual terms. Loans have been allocated based upon expected amortization and prepayment rates based on historical performance. Savings, NOW and money market deposit accounts, which have no contractual term and are subject to immediate repricing, are anticipated to behave more like core accounts and therefore are presented as spread evenly over the first three years. Nonetheless, the presentation does not reflect lags that may occur in the actual repricing of these deposits.

| | Within Three Months | Over Three to Six Months | Over Six to Twelve Months | Over One Year to Five Years | Over Five Years | Total |
|---|---|---|---|---|---|---|
| | | | (Dollars in thousands) | | | |
| **Interest-earning assets:** | | | | | | |
| Federal funds sold | $ 5,600 | $ — | $ — | $ — | $ — | $ 5,600 |
| Investment securities | — | 4,999 | 19,273 | 21,000 | 2,024 | 47,296 |
| Mortgage-backed securities | 27,736 | 10,446 | 16,899 | 59,168 | 3,182 | 117,431 |
| FHLB Stock | 3,704 | — | — | — | — | 3,704 |
| Residential mortgage loans | 32,850 | 26,502 | 47,638 | 115,085 | 25,848 | 247,923 |
| Commercial loans | 80,559 | 10,470 | 20,018 | 93,550 | 8,221 | 212,818 |
| Consumer and other loans | 28,413 | 2,411 | 3,292 | 16,343 | 7,625 | 58,084 |
| Total interest-earning assets | 178,862 | 54,828 | 107,120 | 305,146 | 46,900 | 692,856 |
| **Interest-bearing liabilities:** | | | | | | |
| NOW accounts | 3,075 | 3,075 | 6,152 | 24,608 | — | 36,910 |
| Money market accounts | 1,023 | 1,023 | 2,048 | 8,189 | — | 12,283 |
| Savings accounts | 17,562 | 17,562 | 35,122 | 140,482 | — | 210,728 |
| Certificate of deposit accounts | 66,480 | 45,377 | 113,144 | 40,269 | 353 | 265,623 |
| Overnight & short-term borrowings | 13,847 | — | — | — | — | 13,847 |
| FHLB borrowings | 3,003 | 3 | 10,004 | 20,137 | 145 | 33,292 |
| Other borrowings | — | 4,750 | — | — | — | 4,750 |
| Total interest-bearing liabilities | 104,990 | 71,790 | 166,470 | 233,685 | 498 | 577,433 |
| Net interest sensitivity gap during the period | $ 73,872 | $(16,962) | $(59,350) | $ 71,461 | $ 46,402 | $ 115,423 |
| Cumulative gap | $ 73,872 | $ 56,910 | $ (2,440) | $ 69,021 | $115,423 | |
| Cumulative gap — 12/31/99 | $ 55,263 | $ 34,801 | $ 13,953 | $ 22,572 | $ 81,325 | |
| Interest-sensitive assets as a percent of interest-sensitive liabilities (cumulative) | 170.36% | 132.19% | 99.29% | 111.96% | 119.99% | |
| Cumulative gap as a percent of total assets | 9.99% | 7.70% | (0.33%) | 9.33% | 15.61% | |

The preceding table does not necessarily indicate the impact of general interest rate movements on the Company's net interest income because the repricing of various assets and liabilities is discretionary and is subject to competitive and other factors. As a result, assets and liabilities indicated as repricing within the same period may, in fact, reprice at different times and at different rate levels.

## Liquidity and Capital Resources

### *Liquidity*

Liquidity is defined as the ability to meet current and future financial obligations of a short-term nature. The Company further defines liquidity as the ability to respond to the needs of depositors and borrowers, as well as to earnings enhancement opportunities, in a changing marketplace.

The primary source of funds for the payment of dividends and expenses by the Company is dividends paid to it by the Bank. Bank regulatory authorities generally restrict the amounts available for payment of dividends if the effect thereof would cause the capital of the Bank to be reduced below applicable capital requirements. These restrictions indirectly affect the Company's ability to pay dividends. The primary sources of liquidity for the Bank consist of deposit inflows, loan repayments, borrowed funds, maturity of investment securities and sales of securities from the available for sale portfolio. Management believes that these sources are sufficient to fund the Bank's lending and investment activities.

Management is responsible for establishing and monitoring liquidity targets as well as strategies and tactics to meet these targets. In general, the Company maintains a high degree of flexibility with a liquidity target of 10% to 25% of total assets. At December 31, 2000, federal funds sold, investment securities and mortgage-backed securities available for sale amounted to $170.3 million, or 23.0% of total assets. This compares to $132.1 million, or 20.9% of total assets, at December 31, 1999. The Bank is a member of the FHLB and, as such, has access to both short- and long-term borrowings. In addition, the Bank maintains a line of credit at the FHLB as well as a line of credit with a correspondent bank. There have been no adverse trends in the Company's liquidity or capital reserves. Management believes that the Company has adequate liquidity to meet its commitments.

### Capital Resources

Total shareholders' equity of the Company at December 31, 2000 was $53.3 million, as compared to $47.7 million at December 31, 1999. Major activity in shareholders' equity during 2000 can be summarized as follows: net income for the year was $5.6 million, dividends paid on Common Stock totaled $1.6 million and changes in unrealized gains and losses on securities equaled $1.6 million.

Capital guidelines issued by the Federal Reserve Board require the Company to maintain minimum capital levels for capital adequacy purposes. At December 31, 2000, the Company's Tier I leverage ratio was 5.91%, its Tier I Risk-based capital ratio was 9.50% and its Total Risk-based capital ratio was 10.76%. At December 31, 2000, all of the Company's capital ratios met all of the requirements to which they are subject. The Bank is also subject to FDIC regulations regarding capital requirements. These regulations require banks to maintain minimum capital levels for capital adequacy purposes and higher capital levels to be considered "well capitalized." At December 31, 2000, the Bank's Tier I leverage ratio stood at 5.85%. The Bank is also subject to risk-based capital measures. The risk-based capital guidelines include both a definition of capital and a framework for calculating risk-weighted assets by assigning balance sheet assets and off-balance sheet items to broad risk categories. According to these standards, the Bank had a Tier I risk-weighted capital ratio of 9.41% and a Total risk-weighted capital ratio of 10.66% at December 31, 2000. The minimum Tier I leverage, Tier I risk-weighted, and Total risk-weighted capital ratios necessary to be classified for regulatory purposes as a "well capitalized" institution are 5.00%, 6.00% and 10.00%, respectively. The Bank, therefore, is considered to be "well capitalized."

### Impact of Inflation and Changing Prices

The consolidated financial statements and related notes thereto, included elsewhere herein, have been prepared in accordance with GAAP, which require the measurement of financial position and operating results in terms of historical dollars, without considering changes in the relative purchasing power of money over time due to inflation. Unlike many industrial companies, substantially all of the assets and liabilities of the Bank are monetary in nature. As a result, interest rates have a more significant impact on the Bank's performance than the general level of inflation. Over short periods of time, interest rates may not necessarily move in the same direction or in the same magnitude as inflation.

### Recent Accounting Developments

On December 20, 2000, FASB tentatively concluded that upon the effective date of its final statement on business combinations and intangible assets, goodwill recorded on an entity's balance sheets would no longer be amortized. This conclusion includes existing goodwill (i.e., recorded goodwill at the date the financial statement is issued), as well as goodwill arising subsequent to the effective date of the final statement. Goodwill will not be amortized but will be reviewed for impairment upon the occurance of certain triggering events. The FASB decided to issue a revised Exposure Draft during the first quarter of 2001, limited to its tentative conclusions regarding an impairment-only approach to accounting for goodwill. The FASB plans to issue a final statement in the second quarter of 2001 that incorporates its tentative decisions. At December 31, 2000, the Company had $11.9 million of goodwill on its balance sheet that was being amortized at a rate of $1.2 million annually.

## Management's Report

The management of Bancorp Rhode Island, Inc. is responsible for the preparation, integrity and fair presentation of the financial statements and other financial information in this annual report. Management believes that the financial statements have been prepared in conformity with generally accepted accounting principles applied on a consistent basis in all material respects. In preparing the financial statements and other financial information, management makes certain judgments and estimates where appropriate.

The accounting systems, which record, summarize and report financial data, are supported by a system of internal control. The Company's system of internal control is designed to provide reasonable assurance that assets are safeguarded, that transactions are executed in accordance with management's authorizations and that transactions are properly recorded in the financial statements. This system is augmented by written policies and procedures, along with internal audits. Management recognizes that estimates and judgments are required to assess and balance the relative costs and expected benefits of the controls and that errors or irregularities may nevertheless occur. However, management believes that the Company's internal control system provides reasonable assurance that errors or irregularities that could be material to the financial statements are prevented or would be detected on a timely basis and corrected in the normal course of business.

The Board of Directors oversees the financial statements through an Audit Committee comprised solely of outside directors who are not employees of the Company. The Audit Committee reviews the activities of the internal audit function and meets regularly with representatives of KPMG LLP, the Company's independent auditors. KPMG LLP has been appointed by the Board of Directors to conduct an independent audit and to express an opinion as to the fairness of the presentation of the consolidated financial statements of Bancorp Rhode Island, Inc.

Merrill W. Sherman

**Merrill W. Sherman**
President and
Chief Executive Officer

Albert R. Rietheimer

**Albert R. Rietheimer**
Chief Financial Officer and
Treasurer

## Bancorp Rhode Island, Inc.

### Independent Auditors' Report

The Board of Directors and Shareholders
Bancorp Rhode Island, Inc.:

We have audited the accompanying consolidated balance sheets of Bancorp Rhode Island, Inc. and subsidiaries as of December 31, 2000 and 1999, and the related consolidated statements of operations, changes in shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2000. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Bancorp Rhode Island, Inc. and subsidiaries as of December 31, 2000 and 1999, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2000, in conformity with accounting principles generally accepted in the United States of America.

KPMG LLP

KPMG LLP
Providence, Rhode Island

January 18, 2001

## Consolidated Balance Sheets

| | December 31, 2000 | December 31, 1999 |
|---|---|---|
| | (In thousands) | |
| **Assets:** | | |
| Cash and due from banks (Note 2) | $ 28,853 | $ 17,636 |
| Federal funds sold | 5,600 | 6,850 |
| Investment securities available for sale (amortized cost of $47,459 and $51,476, respectively) (Notes 3, 10, 11 and 12) | 47,296 | 50,503 |
| Mortgage-backed securities available for sale (amortized cost of $117,543 and $76,458, respectively) (Notes 4 and 11) | 117,431 | 74,793 |
| Stock in the Federal Home Loan Bank of Boston (Note 11) | $ 3,704 | $ 3,704 |
| Loans receivable (Notes 5 and 11): | | |
| Residential mortgage loans | $ 247,923 | $ 237,320 |
| Commercial loans | 212,818 | 174,548 |
| Consumer and other loans | 58,084 | 47,090 |
| Total loans receivable | 518,825 | 458,958 |
| Allowance for loan losses (Note 6) | (7,294) | (5,681) |
| Net loans receivable | 511,531 | 453,277 |
| Premises and equipment, net (Note 7) | 6,384 | 5,857 |
| Other real estate owned (Note 8) | 30 | 49 |
| Goodwill, net (Note 2) | 11,930 | 13,094 |
| Accrued interest receivable | 5,630 | 4,670 |
| Prepaid expenses and other assets | 1,031 | 1,544 |
| Total assets | $ 739,420 | $ 631,977 |
| **Liabilities:** | | |
| Deposits (Note 9): | | |
| Demand deposit accounts | $ 106,088 | $ 67,844 |
| NOW accounts | 36,910 | 27,456 |
| Money market accounts | 12,283 | 16,073 |
| Savings accounts | 210,728 | 173,692 |
| Certificate of deposit accounts | 265,623 | 228,351 |
| Total deposits | 631,632 | 513,416 |
| Overnight and short-term borrowings (Note 10) | 13,847 | 14,978 |
| Federal Home Loan Bank of Boston borrowings (Note 11) | 33,292 | 48,183 |
| Other borrowings (Note 12) | 4,750 | 4,750 |
| Other liabilities | 2,607 | 2,975 |
| Total liabilities | $ 686,128 | $ 584,302 |

Commitments and contingencies (Notes 7, 16 and 20)

| | 2000 | 1999 |
|---|---|---|
| **Shareholders' equity (Notes 1 and 18):** | | |
| Common stock, par value $0.01 per share, authorized 11,000,000 shares: | | |
| Voting: Issued and outstanding 3,448,950 shares in 2000 and 3,448,550 shares in 1999 | $ 34 | $ 34 |
| Non-Voting: Issued and outstanding 280,000 shares | 3 | 3 |
| Additional paid-in capital | 39,621 | 39,617 |
| Retained earnings | 13,815 | 9,763 |
| Accumulated other comprehensive loss, net (Notes 3 and 4) | (181) | (1,742) |
| Total shareholders' equity | 53,292 | 47,675 |
| Total liabilities and shareholders' equity | $ 739,420 | $ 631,977 |

See accompanying notes to consolidated financial statements.

## Consolidated Statements of Operations

| | Year Ended December 31, 2000 | 1999 | 1998 |
|---|---|---|---|
| | (In thousands, except per share data) | | |
| **Interest and dividend income:** | | | |
| Residential mortgage loans | $ 17,982 | $ 16,997 | $ 19,205 |
| Commercial loans | 17,737 | 12,795 | 10,812 |
| Consumer and other loans | 4,472 | 3,491 | 3,144 |
| Investment securities | 3,056 | 2,814 | 2,744 |
| Mortgage-backed securities | 5,576 | 4,835 | 3,521 |
| Federal funds sold and other | 930 | 482 | 400 |
| Federal Home Loan Bank of Boston stock dividends | 282 | 237 | 208 |
| Total interest and dividend income | 50,035 | 41,651 | 40,034 |
| **Interest expense:** | | | |
| NOW accounts | 205 | 175 | 175 |
| Money market accounts | 375 | 473 | 401 |
| Savings accounts | 6,137 | 4,742 | 4,670 |
| Certificate of deposit accounts | 13,685 | 11,396 | 12,360 |
| Overnight and short-term borrowings | 636 | 335 | 225 |
| Federal Home Loan Bank of Boston borrowings | 2,359 | 2,198 | 1,871 |
| Other borrowings | 281 | 281 | 143 |
| Total interest expense | 23,678 | 19,600 | 19,845 |
| Net interest income | 26,357 | 22,051 | 20,189 |
| Provision for loan losses (Note 6) | 1,542 | 1,000 | 1,017 |
| Net interest income after provision for loan losses | 24,815 | 21,051 | 19,172 |
| **Noninterest income:** | | | |
| Loan related fees | 258 | 306 | 137 |
| Service charges on deposit accounts | 2,722 | 2,215 | 1,734 |
| Gain on sales of investment securities | — | — | 5 |
| Commissions on loans originated for others | 74 | 83 | 141 |
| Other income | 524 | 618 | 710 |
| Total noninterest income | 3,578 | 3,222 | 2,727 |
| **Noninterest expense:** | | | |
| Salaries and employee benefits (Note 14) | 9,552 | 8,065 | 7,136 |
| Occupancy (Note 7) | 1,530 | 1,302 | 1,155 |
| Equipment | 899 | 744 | 888 |
| Data processing | 1,340 | 1,348 | 1,137 |
| Marketing | 1,069 | 883 | 829 |
| Professional services | 891 | 870 | 586 |
| Loan servicing | 761 | 825 | 971 |
| Other real estate owned (Note 8) | 31 | 108 | 166 |
| Amortization of goodwill | 1,164 | 1,164 | 1,234 |
| Deposit tax and assessments | 109 | 58 | 56 |
| Other expenses (Note 15) | 2,316 | 1,987 | 1,885 |
| Total noninterest expense | 19,662 | 17,354 | 16,043 |
| Income before income taxes and change in accounting principle | 8,731 | 6,919 | 5,856 |
| Income tax expense (Note 13) | 3,113 | 2,448 | 2,022 |
| Net income before change in accounting principle | 5,618 | 4,471 | 3,834 |
| Cumulative effect of change in accounting principle | — | 109 | — |
| Net income | 5,618 | 4,362 | 3,834 |
| Dividends on preferred stock | — | 88 | 793 |
| Net income available to common shareholders | $ 5,618 | $ 4,274 | $ 3,041 |
| Basic earnings per common share (Notes 2 and 19): | | | |
| Income per common share before change in accounting principle | $ 1.51 | $ 1.18 | $ 0.87 |
| Cumulative effect of change in accounting principle, net of tax | — | (0.03) | — |
| Net income per common share | $ 1.51 | $ 1.15 | $ 0.87 |
| Diluted earnings per common share (Notes 2 and 19): | | | |
| Income per common share before change in accounting principle | $ 1.49 | $ 1.17 | $ 0.85 |
| Cumulative effect of change in accounting principle, net of tax | — | (0.03) | — |
| Net income per common share | $ 1.49 | $ 1.14 | $ 0.85 |
| Average common shares outstanding - basic | 3,728,688 | 3,727,010 | 3,506,573 |
| Average common shares outstanding - diluted | 3,768,589 | 3,741,778 | 3,584,820 |

See accompanying notes to consolidated financial statements.

# Bancorp Rhode Island, Inc.

## Consolidated Statements of Changes in Shareholders' Equity

For Years Ended December 31, 2000, 1999 and 1998

| | Preferred Stock | Common Stock | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive Income/(Loss) | Total |
|---|---|---|---|---|---|---|
| | | | (In thousands) | | | |
| Balance at December 31, 1997 | $ 4,770 | $ 28 | $ 36,753 | $ 2,821 | $ 335 | $ 44,707 |
| Net income | — | — | — | 3,834 | — | 3,834 |
| Other comprehensive income, net of tax: | | | | | | |
| Unrealized holding losses arising during the period, net of taxes of $57 | | | | | (122) | (122) |
| Gains included in net income, net of taxes of $2 | | | | | (3) | (3) |
| Comprehensive income | | | | | | 3,709 |
| Issuance of common stock | — | 9 | 12,711 | — | — | 12,720 |
| Exercise of stock options | — | — | 34 | — | — | 34 |
| Redemption of preferred stock | (3,966) | — | (8,724) | — | — | (12,690) |
| Dividends on preferred stock | — | — | — | (793) | — | (793) |
| Balance at December 31, 1998 | 804 | 37 | 40,774 | 5,862 | 210 | 47,687 |
| Net income | — | — | — | 4,362 | — | 4,362 |
| Other comprehensive income, net of tax: | | | | | | |
| Unrealized holding losses arising during the period, net of taxes of $1,002 | | | | | (1,952) | (1,952) |
| Comprehensive income | | | | | | 2,410 |
| Exercise of stock options | — | — | 49 | — | — | 49 |
| Redemption of preferred stock | (804) | — | (1,206) | — | — | (2,010) |
| Dividends on preferred stock | — | — | — | (88) | — | (88) |
| Dividends on common stock | — | — | — | (373) | — | (373) |
| Balance at December 31, 1999 | — | 37 | 39,617 | 9,763 | (1,742) | 47,675 |
| Net income | — | — | — | 5,618 | — | 5,618 |
| Other comprehensive income, net of tax: | | | | | | |
| Unrealized holding gains arising during the period, net of taxes of $(804) | | | | | 1,561 | 1,561 |
| Comprehensive income | | | | | | 7,179 |
| Exercise of stock options | — | — | 4 | — | — | 4 |
| Dividends on common stock | — | — | — | (1,566) | — | (1,566) |
| Balance at December 31, 2000 | $ — | $ 37 | $ 39,621 | $ 13,815 | $ (181) | $ 53,292 |

See accompanying notes to consolidated financial statements.

## Consolidated Statements of Cash Flows

| | Year Ended December 31, 2000 | 1999 | 1998 |
|---|---|---|---|
| | | (In thousands) | |
| **Cash flows from operating activities:** | | | |
| Net income | $ 5,618 | $ 4,362 | $ 3,834 |
| Adjustment to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation and amortization | 2,558 | 3,030 | 3,428 |
| Provision for loan losses | 1,542 | 1,000 | 1,017 |
| Gain on sales of investments | — | — | (5) |
| Loss (gain) on other real estate owned | (7) | 12 | 65 |
| (Increase) decrease in accrued interest receivable | (960) | 59 | 306 |
| (Increase) decrease in prepaid expenses and other assets | (290) | (225) | 61 |
| Increase (decrease) in other liabilities | (368) | 923 | (1,605) |
| Increase (decrease) in other, net | 204 | 213 | 54 |
| Net cash provided by operating activities | 8,297 | 9,374 | 7,155 |
| **Cash flows from investing activities:** | | | |
| Origination of: | | | |
| Residential mortgage loans | (9,960) | (17,630) | (13,093) |
| Commercial loans | (65,421) | (62,281) | (41,899) |
| Consumer loans | (18,111) | (18,909) | (17,051) |
| Purchase of: | | | |
| Investment securities available for sale | (9,000) | (35,168) | (25,950) |
| Mortgage-backed securities available for sale | (58,999) | (17,947) | (55,930) |
| Residential mortgage loans | (48,503) | (53,883) | (108,591) |
| Consumer and other loans | (5,043) | — | — |
| Federal Home Loan Bank of Boston stock | — | (359) | (437) |
| Principal payments on: | | | |
| Investment securities available for sale | 13,000 | 23,000 | 32,670 |
| Mortgage-backed securities available for sale | 17,785 | 21,256 | 18,648 |
| Residential mortgage loans | 47,422 | 91,841 | 118,679 |
| Commercial loans | 27,139 | 21,620 | 22,547 |
| Consumer loans | 12,042 | 10,187 | 11,739 |
| Proceeds from sale of investment securities available for sale | — | — | 2,001 |
| Proceeds from disposition of other real estate owned | 163 | 617 | 673 |
| Proceeds from sale of premises and equipment | — | — | 205 |
| Capital expenditures for premises and equipment | (1,476) | (1,923) | (1,642) |
| Net cash used in investing activities | (98,962) | (39,579) | (57,431) |
| **Cash flows from financing activities:** | | | |
| Net increase in deposits | 118,216 | 12,703 | 35,806 |
| Net increase in overnight and short-term borrowings | (1,131) | 10,716 | 1,933 |
| Proceeds from FHLB and other borrowings | 15,116 | 70,300 | 70,000 |
| Repayment of FHLB and other borrowings | (30,007) | (58,617) | (46,175) |
| Proceeds from issuance of common stock, net | 4 | 49 | 12,754 |
| Redemption of preferred stock | — | (2,010) | (12,690) |
| Dividends on preferred stock | — | (88) | (793) |
| Dividends on common stock | (1,566) | (373) | — |
| Net cash provided by financing activities | 100,632 | 32,680 | 60,835 |
| Net increase (decrease) in cash and cash equivalents | 9,967 | 2,475 | 10,559 |
| Cash and cash equivalents at beginning of year | 24,486 | 22,011 | 11,452 |
| Cash and cash equivalents at end of year | $ 34,453 | $ 24,486 | $ 22,011 |
| **Supplementary disclosures:** | | | |
| Cash paid for interest | $ 23,471 | $ 19,604 | $ 20,473 |
| Cash paid for income taxes | 3,975 | 3,230 | 2,665 |
| Non-cash transactions: | | | |
| Additions to other real estate owned in settlement of loans | 137 | 284 | 776 |
| Change in other comprehensive income, net of taxes | 1,561 | (1,952) | (125) |

See accompanying notes to consolidated financial statements.

### *(1) Organization*

Bancorp Rhode Island, Inc., a Rhode Island corporation (the "Company"), was organized by Bank Rhode Island (the "Bank") on February 15, 2000, to be a bank holding company and to acquire all of the capital stock of the Bank. The reorganization of the Bank into the holding company form of ownership was completed on September 1, 2000. The Company has no significant assets other than the common stock of the Bank. For this reason, substantially all of the discussion in these Consolidated Financial Statements and accompanying Notes relates to the operations of the Bank and its subsidiaries.

Bank Rhode Island is a commercial bank chartered as a financial institution in the State of Rhode Island. The Bank pursues a community banking mission and is principally engaged in providing banking products and services to individuals and businesses in Providence and Kent counties. The Bank is subject to competition from a variety of traditional and nontraditional financial service providers both within and outside of Rhode Island. The Bank offers its customers a broad range of basic deposit services, including checking, savings and certificate of deposit accounts, along with access to their accounts through automated teller machines ("ATMs") and through use of debit cards. The Bank also offers a broad range of commercial, commercial real estate and consumer loans. Additionally, the Bank provides IRA and Keogh accounts, along with nondeposit investment products. The Company and Bank are subject to the regulations of certain state and federal agencies and undergo periodic examinations by those regulatory authorities. The Bank's deposits are insured by the Federal Deposit Insurance Corporation ("FDIC"), subject to regulatory limits.

### *(2) Summary of Significant Accounting Policies*

*Basis of Presentation*

The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America and to prevailing practices within the banking industry. The Company has one reportable operating segment. The following is a summary of the significant accounting and reporting policies used by management in preparing and presenting the consolidated financial statements.

In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenues and expenses for the period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to change relate to the determination of the allowance for loan losses.

*Principles of Consolidation*

The accompanying consolidated financial statements include the accounts of Bancorp Rhode Island, Inc., and its wholly-owned subsidiary, Bank Rhode Island along with the Bank's wholly-owned subsidiaries, BRI Investment Corp. (a Rhode Island passive investment company) and BRI Realty Corp. (a Rhode Island real estate holding company) subsequent to its incorporation on August 10, 1999. All significant intercompany accounts and transactions have been eliminated in consolidation.

*Reclassifications*

Certain amounts in the prior year's financial statements have been reclassified to conform with the current year's presentation.

*Statement of Cash Flows*

For purposes of reporting cash flows, the Company considers cash, due from banks and federal funds sold to be cash equivalents. Cash flows relating to deposits are presented net in the statement of cash flows.

*Comprehensive Income*

Comprehensive income is defined as all changes to equity except investments by and distributions to shareholders. Net income is a component of comprehensive income, with all other components referred to in the aggregate as 'other comprehensive income.'

*Cash and Due From Banks*

The Bank is required to maintain average reserve balances in a noninterest bearing account with the Federal Reserve Bank based upon a percentage of certain deposits. As of December 31, 2000 and 1999, the average daily amount required to be held was $500,000 and $5.4 million, respectively. Additionally, in connection with a line of credit from a correspondent bank, the Bank is required to maintain a compensating balance in a noninterest bearing account. As of both December 31, 2000 and 1999, the required compensating balance was $100,000.

*Investment and Mortgage-Backed Securities*

Debt securities are classified as held to maturity, available for sale, or trading. Securities are classified as held to maturity and carried at amortized cost only if the Company has a positive intent and the ability to hold these securities to maturity. Securities are classified as trading and carried at fair value, with unrealized gains and losses included in earnings, if they are bought and held principally for the purpose of selling in the near term. Securities not classified as either held to maturity or trading are classified as available for sale and reported at fair value, with unrealized gains and losses excluded from earnings and reported as a separate component of shareholders' equity, net of estimated income taxes.

Premiums and discounts on securities are amortized or accreted into income by the level-yield method. If a decline in fair value below the amortized cost basis of a security is judged to be other than temporary, the cost basis of the security is written down to fair value. The amount of the writedown is included as a charge against earnings. Gains and losses on the sale of securities are recognized at the time of sale on a specific identification basis.

*Loans*

Loans held in portfolio are stated at the principal amount outstanding, net of unamortized premiums, discounts, or deferred loan origination fees and costs. Interest income is accrued on a level yield basis based on the principal amount outstanding. Premiums, discounts, and deferred loan origination fees and costs are amortized as an adjustment to yield over the life of the related loans. When a loan is paid-off, the unamortized portion of premiums, discounts or net fees is recognized into income.

Loans on which the accrual of interest has been discontinued are designated nonaccrual loans. Accrual of interest income is discontinued when concern exists as to the collectibility of principal or interest, or when a loan becomes over ninety days delinquent. Additionally, when a loan is placed on nonaccrual status, all interest previously accrued but not collected is reversed against current period income. Loans are removed from nonaccrual when they become less than ninety days past due and when concern no longer exists as to the collectibility of principal or interest. Interest collected on nonaccruing loans is either applied against principal or reported as income according to management's judgment as to the collectibility of principal.

Impaired loans are loans for which it is probable that the Bank will not be able to collect all amounts due according to the contractual terms of the loan agreements. Impairment is measured on a discounted cash flow method, or at the loan's observable market price, or at the fair value of the collateral if the loan is collateral dependent. When foreclosure is probable, impairment is measured based on the fair value of the collateral. In addition, the Bank classifies a loan as an in-substance foreclosure only when the Bank is in possession of the collateral.

*Allowance for Loan Losses*

The allowance for loan losses is established for credit losses inherent in the loan portfolio through a charge to earnings. When management believes that the collectibility of a loan's principal balance, or portions thereof, is unlikely, the principal amount is charged against the allowance. Recoveries on loans which have been previously charged off are credited to the allowance as received.

Management's methodology to estimate loss exposure inherent in the portfolio includes an analysis of individual loans deemed to be impaired, reserve allocations for various loan types based on payment status or loss experience and an unallocated allowance that is maintained based on management's assessment of many factors including the growth, composition and quality of the loan portfolio, historical loss experience, general economic conditions, and other pertinent factors. While management evaluates currently available information in establishing the allowance for loan losses, future adjustments to the allowance may be necessary if economic conditions differ substantially from the assumptions used in making the evaluations. In addition, various regulatory agencies, as an integral part of their examination process, periodically review a financial institution's allowance for loan losses. Such agencies may require the financial institution to recognize additions to the allowance based on their judgments about information available to them at the time of their examination.

*Other Real Estate Owned*

OREO consists of property acquired through foreclosure, real estate acquired through acceptance of a deed in lieu of foreclosure and loans determined to be substantively repossessed. Real estate loans that are substantively repossessed include only those loans for which the Bank has taken possession of the collateral, but has not completed legal foreclosure proceedings.

OREO, including real estate substantively repossessed, is stated at the lower of cost or fair value, minus estimated costs to sell, at the date of acquisition or classification to OREO status. Fair value of such assets is determined based on independent appraisals and other relevant factors. Any write-down to fair value at the time of foreclosure is charged to the allowance for loan losses. A valuation allowance is maintained for known specific and potential market declines and for estimated selling expenses. Increases to the valuation allowance, expenses associated with ownership of these properties, and gains and losses from their sale, are reflected in operations as incurred. Realized gains upon disposal are recognized as income.

Management believes that the net carrying value of OREO reflects the lower of its cost basis or net fair value. Factors similar to those considered in the evaluation of the allowance for loan losses, including regulatory agency requirements, are considered in the evaluation of the net fair value of OREO.

*Transfers and Servicing of Assets and Extinguishments of Liabilities*

The Company accounts and reports for transfers and servicing of financial assets and extinguishments of liabilities based on consistent application of a financial components approach that focuses on control. This approach distinguishes transfers of financial assets that are sales from transfers that are secured borrowings. After a transfer of financial assets, the Company recognizes all financial and servicing assets it controls and liabilities it has incurred and derecognizes financial assets it no longer controls and liabilities that have been extinguished. This financial components approach focuses on the assets and liabilities that exist after the transfer. Many of these assets and liabilities are components of financial assets that existed prior to the transfer. If a transfer does not meet the criteria for a sale, the Company accounts for a transfer as a secured borrowing with a pledge of collateral.

*Premises and Equipment*

Premises and equipment are carried at cost, less accumulated depreciation and amortization. Depreciation and amortization are computed primarily by the straight-line method over the estimated useful lives of the assets, or the terms of the leases if shorter.

*Goodwill*

On March 22, 1996, the Bank acquired certain assets and assumed certain liabilities from Fleet National Bank of Connecticut, formerly known as Shawmut Bank Connecticut, N.A. and other related entities. This acquisition was accounted for utilizing the purchase method of accounting and generated $17.5 million of excess costs over net assets acquired, commonly referred to as "goodwill." This goodwill is being amortized to expense using the straight-line method over 15 years and results in a annual pre-tax charge to earnings of $1.2 million. On an ongoing basis, management reviews the valuation and amortization of its goodwill, taking into consideration any events and circumstances which might have diminished its value.

In April 1998, the FASB issued Statement of Position ("SOP") 98-5, "Accounting for Costs of a Start-Up Entity." SOP 98-5 requires organizational costs, which were being amortized, to be expensed as of the effective date of this statement, January 1, 1999, and accounted for as a cumulative effect of a change in accounting principle. On January 1, 1999, the Bank expensed $166,000 of unamortized organizational costs resulting in a charge to earnings, net of taxes, of $109,000.

*Employee Benefits*

The Bank maintains a Section 401(k) savings plan for employees of the Bank and its subsidiaries. Under the plan, the Bank makes a matching contribution of the amount contributed by each participating employee, up to 4% of the employee's yearly salary. The Bank's contributions are charged against current operations in the year made.

The Company has adopted Statement of Financial Accounting Standards ("SFAS") 123, "Accounting for Stock-Based Compensation." This Statement establishes a fair value based method of accounting for stock-based compensation plans under which compensation cost is measured at the grant date based on the value of the award and is recognized over the service period. However, the Statement allows a company to continue to measure compensation cost for such plans under Accounting Principles Board Opinion ("APB") 25, "Accounting for Stock Issued to Employees." Under APB 25, no compensation cost is recorded if, at the grant date, the exercise price of the options is equal to the fair market value of the Company's common stock. The Company has elected to continue to follow the accounting in APB 25. SFAS 123 requires companies that elect to continue to follow the accounting in APB 25 to disclose in the notes to their financial statements pro forma net income and earnings per share as if the fair value based method of accounting had been applied.

*Income Taxes*

The Company recognizes income taxes under the asset and liability method. Under this method, deferred tax assets and liabilities are established for the future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income during the period that includes the enactment date.

*Earnings Per Share*

Basic earnings per share ("EPS") excludes dilution and is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then share in the earnings of the entity.

### *(3) Investment Securities Available for Sale*

A summary of investment securities available for sale follows:

| | Amortized Cost | Unrealized Gains | Unrealized Losses | Market Value |
|---|---|---|---|---|
| | | (In thousands) | | |
| **At December 31, 2000:** | | | | |
| U.S. Treasury obligations | $ 1,016 | $ — | $ (11) | $ 1,005 |
| U.S. Agency obligations | 44,256 | 167 | (119) | 44,304 |
| Trust Preferred securities | 2,187 | — | (200) | 1,987 |
| Total | $ 47,459 | $ 167 | $ (330) | $ 47,296 |
| **At December 31, 1999:** | | | | |
| U.S. Treasury obligations | $ 10,023 | $ 21 | $ (35) | $ 10,009 |
| U.S. Agency obligations | 39,256 | 5 | (875) | 38,386 |
| Trust Preferred securities | 2,197 | — | (89) | 2,108 |
| Total | $ 51,476 | $ 26 | $ (999) | $ 50,503 |

The following table sets forth the maturities of investment securities available for sale and the weighted average yields of such securities:

| | Within One Year | | | After One, But Within Five Years | | | After Five, But Within Ten Years | | | After Ten Years | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Amortized Cost | Market Value | Weighted Average Yield | Amortized Cost | Market Value | Weighted Average Yield | Amortized Cost | Market Value | Weighted Average Yield | Amortized Cost | Market Value | Weighted Average Yield |
| | (Dollars in thousands) | | | | | | | | | | | |
| **At December 31, 2000:** | | | | | | | | | | | | |
| U.S. Treasury obligations | $ 1,016 | $ 1,005 | 4.16% | $ — | $ — | $—% | $ — | — | —% | $ — | $ — | —% |
| U.S. Agency obligations | 5,256 | 5,243 | 5.70% | 39,000 | 39,061 | 6.40% | — | — | —% | — | — | —% |
| Trust Preferred securities | — | — | —% | — | — | —% | — | — | —% | 2,187 | 1,987 | 8.16% |
| Total | $ 6,272 | $ 6,248 | 5.46% | $ 39,000 | $ 39,061 | 6.40% | $ — | — | —% | $ 2,187 | $ 1,987 | 8.16% |
| **At December 31, 1999:** | | | | | | | | | | | | |
| U.S. Treasury obligations | $ 8,986 | $ 9,007 | 6.39% | $ 1,037 | $ 1,002 | 4.15% | $ — | $ — | —% | $ — | $ — | —% |
| U.S. Agency obligations | 3,991 | 3,991 | 5.80% | 25,265 | 24,557 | 5.74% | 10,000 | 9,838 | 7.10% | — | — | —% |
| Trust Preferred securities | — | — | —% | — | — | —% | — | — | —% | 2,197 | 2,108 | 8.16% |
| Total | $12,977 | $12,998 | 6.21% | $ 26,302 | $ 25,559 | 5.68% | $10,000 | $ 9,838 | 7.10% | $ 2,197 | $ 2,108 | 8.16% |

The weighted average remaining life of investment securities available for sale at December 31, 2000 and 1999 was 3.8 years and 3.9 years, respectively. Included in the weighted average remaining life calculation at December 31, 2000 and 1999, were $31.2 million and $34.0 million, respectively, of securities that are callable at the discretion of the issuer. These call dates were not utilized in computing the weighted average remaining life.

The following table presents the sale of investment securities available for sale and the resulting gains from such sales:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2000 | 1999 | 1998 |
| | (In thousands) | | |
| Amortized cost of Investment Securities sold | $ — | $ — | $ 1,996 |
| Gains realized on sales of Investment Securities | — | — | 5 |
| Net proceeds from sales of Investment Securities | $ — | $ — | $ 2,001 |

### *(4) Mortgage-Backed Securities Available for Sale*

A summary of mortgage-backed securities available for sale by issuer follows:

| | Amortized Cost | Unrealized Gains | Unrealized Losses | Market Value |
|---|---|---|---|---|
| | (In thousands) | | | |
| **At December 31, 2000:** | | | | |
| Small Business Administration | $ 21,785 | $ — | $ (20) | $ 21,765 |
| Federal National Mortgage Association | 66,623 | 381 | (445) | 66,559 |
| Federal Home Loan Mortgage Corporation | 16,455 | 76 | (3) | 16,528 |
| Collateralized Mortgage Obligations | 12,680 | — | (101) | 12,579 |
| Total | $ 117,543 | $ 457 | $ (569) | $ 117,431 |
| **At December 31, 1999:** | | | | |
| Federal National Mortgage Association | $ 57,911 | $ — | $ (1,106) | $ 56,805 |
| Federal Home Loan Mortgage Corporation | 4,190 | — | (19) | 4,171 |
| Collateralized Mortgage Obligations | 14,357 | — | (540) | 13,817 |
| Total | $ 76,458 | $ — | $ (1,665) | $ 74,793 |

The following table sets forth the maturities of mortgage-backed securities available for sale and the weighted average yields of such securities:

| | Within Ten Years | | | After Ten Years | | |
|---|---|---|---|---|---|---|
| | Amortized Cost | Market Value | Weighted Average Yield | Amortized Cost | Market Value | Weighted Average Yield |
| | | | (Dollars in thousands) | | | |
| **At December 31, 2000:** | | | | | | |
| Small Business Administration | $ — | $ — | —% | $ 21,785 | $ 21,765 | 7.27% |
| Federal National Mortgage Association | — | — | —% | 66,623 | 66,559 | 6.50% |
| Federal Home Loan Mortgage Corporation | — | — | —% | 16,455 | 16,528 | 6.74% |
| Collateralized Mortgage Obligations | — | — | —% | 12,680 | 12,579 | 6.47% |
| Total | $ — | $ — | —% | $ 117,543 | $ 117,431 | 6.67% |
| **At December 31, 1999:** | | | | | | |
| Federal National Mortgage Association | $ — | $ — | —% | $ 57,911 | $ 56,805 | 5.93% |
| Federal Home Loan Mortgage Corporation | — | — | —% | 4,190 | 4,171 | 6.67% |
| Collateralized Mortgage Obligations | — | — | —% | 14,357 | 13,817 | 6.48% |
| Total | $ — | $ — | —% | $ 76,458 | $ 74,793 | 6.07% |

Maturities on mortgage-backed securities are based on contractual maturities and do not take into consideration scheduled amortization or prepayments. Actual maturities will differ from contractual maturities due to scheduled amortization and prepayments. The weighted average remaining contractual term of mortgage-backed securities available for sale at December 31, 2000 and 1999 was 25.0 years and 25.9 years, respectively. There were no sales of mortgage-backed securities during 2000, 1999 or 1998.

### *(5) Loans Receivable*

The following is a summary of loans receivable:

| | December 31, 2000 | December 31, 1999 |
|---|---|---|
| | (In thousands) | |
| **Residential mortgage loans:** | | |
| One- to four-family adjustable rate | $ 212,197 | $ 196,863 |
| One- to four-family fixed rate | 34,609 | 39,037 |
| Subtotal | 246,806 | 235,900 |
| Premium on loans acquired | 1,166 | 1,446 |
| Net deferred loan origination fees | (49) | (26) |
| Total | $ 247,923 | $ 237,320 |
| **Commercial loans:** | | |
| Commercial real estate - nonowner occupied | $ 69,315 | $ 56,181 |
| Commercial and industrial | 51,470 | 40,109 |
| Commercial real estate - owner occupied | 38,272 | 33,968 |
| Small business | 19,170 | 13,322 |
| Multi-family | 15,933 | 16,270 |
| Leases | 11,731 | 8,499 |
| Construction | 7,070 | 6,379 |
| Subtotal | 212,961 | 174,728 |
| Net deferred loan origination fees | (143) | (180) |
| Total | $ 212,818 | $ 174,548 |
| **Consumer and other loans:** | | |
| Home equity - lines of credit | $ 26,215 | $ 24,166 |
| Home equity - term loans | 23,292 | 19,710 |
| Automobile | 4,643 | — |
| Installment | 1,348 | 1,279 |
| Savings secured | 987 | 1,005 |
| Unsecured and other | 1,044 | 590 |
| Subtotal | 57,529 | 46,750 |
| Premium on loans acquired | 144 | — |
| Net deferred loan origination costs | 411 | 340 |
| Total | $ 58,084 | $ 47,090 |

## Notes to Consolidated Financial Statements (Continued)

The Bank's commercial and consumer lending activities are conducted principally in the State of Rhode Island and, to a lesser extent, in nearby areas of Massachusetts. The Bank originates commercial real estate loans, commercial and industrial loans, multi-family residential loans and consumer loans (principally home equity loans and lines of credit) for its portfolio. The Bank purchases one- to four-family residential mortgage loans and automobile loans from third party originators. These loans may have been originated from areas outside of New England. Most loans made by the Bank are secured by borrowers' personal or business assets. The Bank considers a concentration of credit to a particular industry to exist when the aggregate credit exposure to a borrower or a group of borrowers in that industry exceeds 25% of the Bank's capital plus reserves. At December 31, 2000, no concentrations of credit to a particular industry existed as defined by these parameters.The ability of the Bank's residential and consumer borrowers to honor their repayment commitments is generally dependent on the level of overall economic activity within the area they reside in. Commercial borrowers' ability to repay is generally dependent upon the general health of the economy and in cases of real estate loans, the real estate sector in particular. Accordingly, the ultimate collectibility of a substantial portion of the Bank's loan portfolio is susceptible to changing conditions in the Rhode Island economy in particular, and the New England and national economies, in general.

The Bank's lending limit to any single borrowing relationship is limited by law to approximately $9.0 million. At December 31, 2000, the Bank had no outstanding commitments to any single borrowing relationship that was in excess of $4.7 million.

At December 31, 2000, the risk elements contained within the loan portfolio were centered in $508,000 of nonaccrual loans and $337,000 of loans past due 60 to 89 days. This compares to $1.1 million of nonaccrual loans and $93,000 of loans past due 60 to 89 days as of December 31, 1999, and $1.6 million of nonaccrual loans and $258,000 of loans past due 60 to 89 days as of December 31, 1998. As of December 31, 2000 and 1998, the Bank did not have any loans that were considered impaired. Included in nonaccrual loans as of December 31, 1999, were $329,000 of impaired loans. No specific reserves were necessary in conjunction with these impaired loans. The average balance of impaired loans during 2000 was $648,000 and during 1999 was $304,000.

The reduction in interest income associated with nonaccrual loans was as follows:

| | Year Ended December 31, 2000 | 1999 | 1998 |
|---|---|---|---|
| | (In thousands) | | |
| Income in accordance with original terms | $ 48 | $ 130 | $ 138 |
| Income recognized | (13) | (64) | (21) |
| Foregone interest income | $ 35 | $ 66 | $ 117 |

Loans outstanding to executive officers and directors of the Company, including their immediate families and affiliated companies ("related parties"), are made in the ordinary course of business under normal credit terms, including interest rates and collateral, prevailing at the time of origination for comparable transactions with other persons, and do not represent more than normal credit risk. An analysis of the activity of these loans is as follows:

| | Year Ended December 31, 2000 | 1999 |
|---|---|---|
| | (In thousands) | |
| Balance at beginning of year | $ 3,767 | $ 2,695 |
| Additions | 4,251 | 4,962 |
| Repayments | (1,633) | (3,890) |
| Balance at end of year | $ 6,385 | $ 3,767 |

### *(6) Allowance for Loan Losses*

An analysis of the activity in the allowance for loan losses is as follows:

| | Year Ended December 31, 2000 | 1999 | 1998 |
|---|---|---|---|
| | (In thousands) | | |
| Balance at beginning of year | $ 5,681 | $ 5,018 | $ 4,340 |
| Provision for loan losses charged against income | 1,542 | 1,000 | 1, 017 |
| Loans charged-off | (125) | (384) | (352) |
| Recoveries of loans previously charged-off | 196 | 47 | 13 |
| Balance at end of year | $ 7,294 | $ 5,681 | $ 5,018 |

The following table represents the allocation of the allowance for loan losses as of the dates indicated:

| | December 31, 2000 | 1999 |
|---|---|---|
| | (In thousands) | |
| **Loan category:** | | |
| Residential mortgage loans | $ 1,460 | $ 1,395 |
| Commercial loans | 3,210 | 2,007 |
| Consumer and other loans | 731 | 566 |
| Unallocated | 1,893 | 1,713 |
| Total | $ 7,294 | $ 5,681 |

### *(7) Premises and Equipment*

Premises and equipment consisted of the following:

| | December 31, 2000 | 1999 |
|---|---|---|
| | (In thousands) | |
| Land | $ 785 | $ 785 |
| Office buildings and improvements | 1,837 | 1,727 |
| Leasehold improvements | 2,233 | 1,886 |
| Data processing equipment and software | 3,297 | 2,896 |
| Furniture, fixtures and other equipment | 2,610 | 2,094 |
| Subtotal | 10,762 | 9,388 |
| Less accumulated depreciation and amortization | (4,378) | (3,531) |
| Total premises and equipment | $ 6,384 | $ 5,857 |

The Company utilizes a useful life of 40 years for buildings and 15 years for building improvements. Leasehold improvements are amortized over their respective lease terms. Data processing equipment and software's useful life is three years and furniture, fixtures and other equipment's useful life varies but is primarily five years. Depreciation expense totaled $941,000, $841,000 and $1.1 million for the years ended December 31, 2000, 1999 and 1998, respectively.

Rent expense for the years ended December 31, 2000, 1999 and 1998 was $686,000, $531,000 and $417,000, respectively. In connection with the acquisition of branches from Fleet National Bank of Connecticut, the Bank assumed the liability for lease payments on seven banking offices previously occupied by Shawmut Bank Connecticut, N.A. The Bank has renegotiated some of these leases and has also entered into agreements to lease additional space. Under the terms of these noncancellable operating leases, the Bank is currently obligated to minimum annual rents as follows:

| | Minimum Less Payments |
|---|---|
| | (In thousands) |
| 2001 | $ 715 |
| 2002 | 726 |
| 2003 | 673 |
| 2004 | 669 |
| 2005 | 659 |
| Thereafter | 2,136 |
| | $ 5,578 |

### *(8) Other Real Estate Owned*

The following table provides a summary of OREO:

| | December 31, 2000 | December 31, 1999 |
|---|---|---|
| | (In thousands) | |
| One- to four-family residential property | $ 61 | $ 84 |
| Subtotal | 61 | 84 |
| Allowance for losses | (31) | (35) |
| Total | $ 30 | $ 49 |

A summary of the activity in the allowance for losses on OREO follows:

| | Year Ended December 31, 2000 | Year Ended December 31, 1999 |
|---|---|---|
| | (In thousands) | |
| Balance at beginning of year | $ 35 | $ 49 |
| Provisions | — | 12 |
| Net charge-offs | (4) | (26) |
| Balance at end of year | $ 31 | $ 35 |

The following summarizes the operating results from OREO excluding net gains attributed to disposition:

| | Year Ended December 31, 2000 | 1999 | 1998 |
|---|---|---|---|
| | (In thousands) | | |
| Collection and repossession expenses | $ 42 | $ 73 | $ 46 |
| Net expenses of holding properties | (4) | 23 | 55 |
| Provision for losses | — | 12 | 75 |
| Total | $ 38 | $ 108 | $ 176 |

### *(9) Deposits*

Certificate of deposit accounts had the following schedule of maturities:

| | Year Ended December 31, 2000 | Year Ended December 31, 1999 |
|---|---|---|
| | (In thousands) | |
| 1 year or less remaining | $ 224,690 | $ 152,025 |
| More than 1 year to 2 years remaining | 36,403 | 69,775 |
| More than 2 years to 4 years remaining | 2,938 | 4,943 |
| More than 4 years remaining | 1,592 | 1,608 |
| Total | $ 265,623 | $ 228,351 |

At December 31, 2000, 1999 and 1998, certificate of deposit accounts with balances $100,000 or more aggregated $32.1 million, $25.3 million and $23.1 million, respectively.

### *(10) Overnight and Short-Term Borrowings*

Overnight and short-term borrowings are comprised of the following:

| | December 31, 2000 | December 31, 1999 |
|---|---|---|
| | (In thousands) | |
| Treasury tax and loan notes | $ 819 | $ 3,104 |
| Retail reverse repurchase agreements | 13,028 | 11,874 |
| Total | $ 13,847 | $ 14,978 |

The Bank utilizes the Note Option for remitting Treasury Tax and Loan payments to the Federal Reserve Bank. Under this option the U.S. Treasury invests in obligations of the Bank, as evidenced by open-ended interest-bearing notes. These notes are collateralized by U.S. Agency securities owned by the Bank. Information concerning these treasury tax and loan notes is as follows:

| | Year Ended December 31, 2000 | 1999 |
|---|---|---|
| | (In thousands) | |
| Outstanding at end of year | $ 819 | $ 3,104 |
| Outstanding collateralized by securities with: | | |
| Amortized cost | 3,999 | 3,996 |
| Market value | 3,987 | 3,999 |
| Average outstanding for the year | 921 | 837 |
| Maximum outstanding at any month end | 3,000 | 3,104 |
| Weighted average rate at end of year | 5.72% | 4.52% |
| Weighted average rate paid for the year | 6.25% | 4.84% |

The Bank utilizes retail reverse repurchase agreements in connection with a cash management product that the Bank offers its commercial customers. Sales of retail reverse repurchase agreements are treated as financings. The obligations to repurchase the identical securities that were sold are reflected as liabilities and the securities remain in the asset accounts. All of these agreements are collateralized by U.S. Agency securities owned by the Bank. The securities underlying the agreements were held by the Bank in a special custody account and remained under the Bank's control. Information concerning these retail repurchase agreements is as follows:

| | Year Ended December 31, 2000 | 1999 |
|---|---|---|
| | (In thousands) | |
| Outstanding at end of year | $ 13,028 | $ 11,874 |
| Maturity date | 1/2/01 | 1/3/00 |
| Outstanding collateralized by securities with: | | |
| Amortized cost | 14,904 | 23,255 |
| Market value | 14,903 | 22,790 |
| Average outstanding for the year | 10,553 | 6,278 |
| Maximum outstanding at any month end | 14,485 | 12,361 |
| Weighted average rate at end of year | 2.74% | 2.88% |
| Weighted average rate paid for the year | 5.48% | 4.50% |

Additionally, at December 31, 2000, the Bank had a $2.0 million line of credit with a correspondent bank to facilitate the issuance of letters of credit by the Bank and the conducting of foreign exchange transactions for the Bank's customers. Since inception, there have been no outstanding balances under this line of credit. The Bank is required to maintain a compensating balance of $100,000 in conjunction with this line of credit.

### *(11) Federal Home Loan Bank of Boston Borrowings*

FHLB borrowings are comprised of the following:

| | December 31, 2000 | 1999 |
|---|---|---|
| | (In thousands) | |
| **Notes payable:** | | |
| 5.76% note due 03/08/00 | $ — | $ 5,000 |
| 5.82% note due 03/30/00 | — | 4,000 |
| 5.84% note due 05/01/00 | — | 4,000 |
| 6.50% note due 01/05/01 | 3,000 | — |
| 5.87% note due 06/02/03 | 10,100 | 10,100 |
| 6.01% note due 11/08/04 (callable 11/08/01) | 10,000 | 10,000 |
| 6.72% note due 12/03/04 | 10,000 | 10,000 |
| 5.25% note due 01/21/09 (amortizing) | 76 | 83 |
| 5.35% note due 10/08/09 (callable 10/10/00) | — | 5,000 |
| 6.97% note due 09/08/20 (amortizing) | 116 | — |
| Total | $ 33,292 | $ 48,183 |

All borrowings from the FHLB are secured by the Bank's stock in the FHLB and a blanket lien on "qualified collateral" defined principally as 90% of the market value of U.S. Government and Agency obligations and 75% of the carrying value of certain residential mortgage loans. Unused term borrowing capacity with the FHLB at December 31, 2000, 1999 and 1998 was $269.7 million, $221.0 million and $241.6 million, respectively. In addition, the Bank has a short-term line of credit with the FHLB. Unused borrowing capacity under this line was $11.2 million for each of the years in the three year period. As one requirement of its borrowings, the Bank is required to invest in the common stock of the FHLB in an amount at least equal to five percent of its outstanding borrowings from the FHLB. As and when such stock is redeemed, the Bank would receive from the FHLB an amount equal to the par value of the stock. As of December 31, 2000, the Bank's FHLB stock holdings, recorded at cost, were $3.7 million.

### *(12) Other Borrowings*

The Bank utilizes term reverse repurchase agreements as an alternative source of long-term funds. These agreements are treated as financings. The obligation to repurchase the identical securities that were sold is reflected as a liability and the securities remain as assets. The securities underlying this agreement are U.S. Agency securities and are held by a third party custodian in a special custody account. Information concerning this term repurchase agreement is as follows:

| | December 31, | |
|---|---|---|
| | 2000 | 1999 |
| | (In thousands) | |
| Outstanding at end of year | $ 4,750 | $ 4,750 |
| Maturity date | 6/29/01 | 6/29/01 |
| Outstanding collateralized by securities with: | | |
| Amortized cost | 5,000 | 5,000 |
| Market value | 4,973 | 4,863 |
| Average outstanding for the year | 4,750 | 4,750 |
| Maximum outstanding at any month end | 4,750 | 4,750 |
| Weighted average rate at end of year | 5.83% | 5.83% |
| Weighted average rate paid for the year | 5.83% | 5.83% |

### *(13) Income Taxes*

The components of income tax expense are as follows:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2000 | 1999 | 1998 |
| | (In thousands) | | |
| **Current expense:** | | | |
| Federal | $ 4,133 | $ 3,011 | $ 2,441 |
| State | 95 | 96 | 173 |
| Total current expense | 4,228 | 3,107 | 2,614 |
| **Deferred benefit** | | | |
| Federal | (1,115) | (659) | (460) |
| State | — | — | (132) |
| Total deferred benefit | (1,115) | (659) | (592) |
| Total income tax expense | $ 3,113 | $ 2,448 | $ 2,022 |

The difference between the statutory federal income tax rate and the effective federal income tax rate is as follows:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2000 | 1999 | 1998 |
| | (In thousands) | | |
| Statutory federal income tax rate | 34.0% | 34.0% | 34.0% |
| Increase resulting from: | | | |
| State income tax, net of federal tax benefit | 1.1 | 0.9 | 0.5 |
| Other, net | 0.6 | 0.5 | — |
| Effective combined federal and state income tax rate | 35.7% | 35.4% | 34.5% |

The components of gross deferred tax assets and gross deferred tax liabilities are as follows:

| | December 31, 2000 | December 31, 1999 |
|---|---|---|
| | (In thousands) | |
| **Gross deferred tax assets:** | | |
| Allowance for loan losses | $ 2,488 | $ 1,537 |
| Organizational costs | 9 | 61 |
| Unrealized loss on securities available for sale | 93 | 897 |
| Other | 294 | 223 |
| Total gross deferred tax assets | 2,884 | 2,718 |
| **Gross deferred tax liabilities:** | | |
| Purchase accounting adjustments | (1,043) | (1,143) |
| Total gross deferred tax liabilities | (1,043) | (1,143) |
| Net deferred tax asset | $ 1,841 | $ 1,575 |

It is management's belief, that it is more likely than not, that the reversal of deferred tax liabilities and results of future operations will generate sufficient taxable income to realize the deferred tax assets. In addition, the Company's net deferred tax asset is supported by recoverable income taxes. Therefore, no valuation allowance was necessary at December 31, 2000, 1999 or 1998 for the deferred tax assets. It should be noted, however, that factors beyond management's control, such as the general state of the economy and real estate values, can affect future levels of taxable income and that no assurance can be given that sufficient taxable income will be generated to fully absorb gross deductible temporary differences.

### *14) Employee Benefits*

*Employee 401(k) Plan*

The Bank maintains a 401(k) Plan (the "Plan") which qualifies as a tax exempt plan and trust under Sections 401 and 501 of the Internal Revenue Code. Generally, Bank employees who are at least twenty-one (21) years of age and have completed one year of service with the Bank, are eligible to participate in the Plan. Expenses associated with the Plan were $191,000, $164,000 and $139,000 for the years ended December 31, 2000, 1999 and 1998, respectively.

*Nonqualified Deferred Compensation Plan*

The Bank also maintains a Nonqualified Deferred Compensation Plan (the "Nonqualified Plan") under which certain participants may contribute the amounts they are precluded from contributing to the Bank's 401(k) Plan because of the qualified plan limitations, and additional compensation deferrals which may be advantageous for personal income tax or other planning reasons. Expenses associated with the Nonqualified Plan were $24,000, $20,000 and $12,000 for the years ended December 31, 2000, 1999 and 1998, respectively.

*Supplemental Executive Retirement Plan*

During 1999, the Bank established a Supplemental Executive Retirement Plan (the "SERP") for certain of its senior executives under which participants designated by the Board of Directors are entitled to an annual retirement benefit. Expenses associated with the SERP were $58,000 and $40,000 for the years ended December 31, 2000 and 1999, respectively.

*Employee Stock Option Plan*

The Company maintains an Incentive and Nonqualified Stock Option Plan (the "Employee Stock Option Plan") under which it may grant options on its common stock to officers and key employees. The total number of shares available for issuance under this plan is 385,000. Options are granted at an exercise price equal to the market value of the stock on the date of the grant and vest over a three to five year period. Unless exercised, options granted under the Employee Stock Option Plan expire ten years from the date granted.

The following table summarizes changes in options outstanding under the Employee Stock Option Plan during 1998, 1999 and 2000 and options exercisable at December 31, 2000:

| | Number of Unexercised Options | Weighed Average Price |
|---|---|---|
| Options outstanding at December 31, 1997 | 155,150 | $ 10.00 |
| Granted | 50,500 | 12.74 |
| Exercised | (3,400) | 10.00 |
| Forfeited/Canceled | (16,300) | 10.69 |
| Options outstanding at December 31, 1998 | 185,950 | 10.68 |
| Granted | 85,000 | 10.63 |
| Exercised | (4,950) | 10.00 |
| Forfeited/Canceled | (26,050) | 10.60 |
| Options outstanding at December 31, 1999 | 239,950 | 10.69 |
| Granted | 62,300 | 10.06 |
| Exercised | (400) | 10.00 |
| Forfeited/Canceled | (1,600) | 10.50 |
| Options outstanding at December 31, 2000 | 300,250 | 10.56 |
| Options exercisable at December 31, 2000 | 186,465 | $ 10.54 |

*Director Stock Plan*

During 1998, the Company established a Non-Employee Director Stock Plan (the "Director Stock Plan") under which it may grant up to 40,000 options on its common stock to non-employee directors. Each non-employee director elected at the 1998 shareholders meeting received an option for 1,500 shares and each new non-employee director elected subsequently will receive an option for 1,000 shares. Non-employee directors will also receive an annual option grant for 500 shares as of the date of each annual meeting of shareholders. Options are granted at an exercise price equal to the market value of the stock on the date of the grant and vest six months after the grant date. Unless exercised, options granted under the Director Stock Plan expire ten years from the date granted.

The following table summarizes changes in options outstanding under the Director Stock Plan during 1998, 1999 and 2000 and options exercisable at December 31, 2000:

| | Number of Unexercised Options | Weighed Average Price |
|---|---|---|
| Options at January 1, 1998 | — | $ — |
| Granted | 16,500 | 17.19 |
| Exercised | — | — |
| Forfeited/Canceled | — | — |
| Options at December 31, 1998 | 16,500 | 17.19 |
| Granted | 5,500 | 10.88 |
| Exercised | — | — |
| Forfeited/Canceled | — | — |
| Options at December 31, 1999 | 22,000 | 15.61 |
| Granted | 5,500 | 10.13 |
| Exercised | — | — |
| Forfeited/Canceled | — | — |
| Options at December 31, 2000 | 27,500 | 14.52 |
| Options exercisable at December 31, 2000 | 27,500 | $ 14.52 |

APB 25 and related interpretations have been applied to account for these plans. Accordingly, no compensation cost has been charged against income. Had compensation cost been determined consistent with SFAS 123, the Company's net income and earnings per share would have been reduced to the pro forma amounts indicated below:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2000 | 1999 | 1998 |
| | | (In thousands) | |
| **Net income (in thousands):** | | | |
| As reported | $ 5,618 | $ 4,362 | $ 3,834 |
| Pro forma | 5,492 | 4,228 | 3,678 |
| **Earnings per common share:** | | | |
| Basic: | | | |
| As reported | $ 1.51 | $ 1.15 | $ 0.87 |
| Pro forma | 1.47 | 1.11 | 0.82 |
| Diluted: | | | |
| As reported | $ 1.49 | $ 1.14 | $ 0.85 |
| Pro forma | 1.46 | 1.11 | 0.80 |

The fair value of each option granted was estimated as of the date of the grant using the Black-Scholes option-pricing model with the following weighted average assumptions: expected life of 7 years; expected volatility of 25%; average risk-free interest rates of 6.65% in 2000, 4.84% in 1999 and 5.52% in 1998; and a dividend rate of 4.26% in 2000 and 3.78% in 1999. No dividends on common stock were assumed during 1998 for purposes of this analysis.

### *(15) Other Operating Expenses*

Major components of other operating expenses are as follows:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2000 | 1999 | 1998 |
| | | (In thousands) | |
| Telephone | $ 470 | $ 424 | $ 422 |
| Forms and supplies | 371 | 287 | 327 |
| Postage | 251 | 207 | 206 |
| Insurance | 128 | 132 | 166 |
| Correspondent bank fees | 128 | 99 | 82 |
| Director fees | 120 | 90 | 68 |
| Recruiting | 117 | 97 | 49 |
| Other | 731 | 651 | 565 |
| Total | $ 2,316 | $ 1,987 | $ 1,885 |

### *(16) Financial Instruments with Off-Balance Sheet Risk*

The Bank is 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 originate loans and letters of credit. The instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet. The contract or notional amounts of those instruments reflect the extent of involvement the Bank has in particular classes of financial instruments.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for loan commitments and letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

Financial instruments with off-balance sheet risk are summarized as follows:

| | December 31, 2000 | December 31, 1999 |
|---|---|---|
| | (In thousands) | |
| Commitments to originate loans | $ 5,440 | $ 12,403 |
| Unused lines of credit | 86,935 | 107,552 |
| Letters of credit | 2,324 | 1,364 |

Commitments to originate loans and unused lines of credit are agreements to lend to a customer provided 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 certain commitments may 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 borrower.

Letters of credit are conditional commitments issued by the Bank to guarantee the performance by a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers.

### *(17) Fair Value of Financial Instruments*

The following disclosure of the estimated fair value of financial instruments is made in accordance with the requirements of SFAS 107, "Disclosures About Fair Value of Financial Instruments." The estimated fair value amounts have been determined by using available quoted market information or other appropriate valuation methodologies. The aggregate fair value amounts presented are in accordance with SFAS 107 guidelines but do not represent the underlying value of the Bank taken as a whole.

The fair value estimates provided are made at a specific point in time, based on relevant market information and the characteristics of the financial instrument. The estimates do not provide for any premiums or discounts that could result from concentrations of ownership of a financial instrument. Because no active market exists for some of the Bank's financial instruments, certain fair value estimates are based on subjective judgments regarding current economic conditions, risk characteristics of the financial instruments, future expected loss experience, prepayment assumptions and other factors. The resulting estimates involve uncertainties and therefore cannot be determined with precision. Changes made to any of the underlying assumptions could significantly affect the estimates.

The book values and estimated fair values for the Company's financial instruments are as follows:

| | December 31, 2000 | | December 31, 1999 | |
|---|---|---|---|---|
| | Book Value | Estimated Fair Value | Book Value | Estimated Fair Value |
| | (In thousands) | | | |
| **Assets:** | | | | |
| Cash and due from banks | $ 28,853 | $ 28,853 | $ 17,636 | $ 17,636 |
| Federal funds sold | 5,600 | 5,600 | 6,850 | 6,850 |
| Investment securities | 47,296 | 47,296 | 50,503 | 50,503 |
| Mortgage-backed securities | 117,431 | 117,431 | 74,793 | 74,793 |
| Stock in the FHLB | 3,704 | 3,704 | 3,704 | 3,704 |
| Loans receivable, net of allowance for loan losses: | | | | |
| Residential mortgage loans | 245,951 | 251,748 | 235,323 | 233,155 |
| Commercial loans | 208,483 | 216,035 | 171,674 | 173,459 |
| Consumer and other loans | 57,097 | 58,382 | 46,280 | 46,380 |
| Accrued interest receivable | 5,630 | 5,630 | 4,670 | 4,670 |
| **Liabilities:** | | | | |
| Deposits: | | | | |
| Demand deposit accounts | 106,088 | 106,088 | 67,844 | 67,844 |
| NOW accounts | 36,910 | 36,910 | 27,456 | 27,456 |
| Money market accounts | 12,283 | 12,283 | 16,073 | 16,073 |
| Savings accounts | 210,728 | 210,728 | 173,692 | 173,692 |
| Certificate of deposit accounts | 265,623 | 267,786 | 228,351 | 227,805 |
| Overnight and short-term borrowings | 13,847 | 13,847 | 14,978 | 14,978 |
| FHLB borrowings | 33,292 | 34,027 | 48,183 | 47,658 |
| Other borrowings | 4,750 | 4,754 | 4,750 | 4,673 |
| Accrued interest payable | 1,424 | 1,424 | 1,217 | 1,217 |

*Cash and due from banks*

The carrying values reported in the balance sheet for cash and due from banks approximates the fair value because of the short maturity of these instruments.

*Federal funds sold*

The carrying values reported in the balance sheet for federal funds sold approximates the fair value because of the short maturity of these instruments.

*Investment and mortgage-backed securities*

The fair values presented for investment and mortgage-backed securities are based on quoted bid prices received from securities dealers.

*Stock in the Federal Home Loan Bank of Boston*

The fair value of stock in the FHLB equals the carrying value reported in the balance sheet. This stock is redeemable at full par value only by the FHLB.

*Loans receivable*

Fair value estimates are based on loans with similar financial characteristics. Loans have been segregated by homogenous groups into residential mortgage, commercial, and consumer and other loans. Fair values are estimated by discounting contractual cash flows, adjusted for prepayment estimates, using discount rates approximately equal to current market rates on loans with similar characteristics and maturities. The incremental credit risk for nonperforming loans has been considered in the determination of the fair value of loans.

*Deposits*

The fair values reported for demand deposit, NOW, money market, and savings accounts are equal to their respective book values reported on the balance sheet. The fair values disclosed are, by definition, equal to the amount payable on demand at the reporting date. The fair values reported for certificate of deposit accounts are based on the discounted value of contractual cash flows. The discount rates used are representative of approximate rates currently offered on certificate of deposit accounts with similar remaining maturities.

*Overnight and short-term borrowings*

The carrying values reported in the balance sheet for overnight and short-term borrowings approximates the fair value because of the short maturity of these instruments.

*Federal Home Loan Bank of Boston borrowings*

The fair values reported for FHLB borrowings are based on the discounted value of contractual cash flows. The discount rates used are representative of approximate rates currently offered on borrowings with similar remaining maturities.

*Other borrowings*

The fair values reported for other borrowings are based on the discounted value of contractual cash flows. The discount rates used are representative of approximate rates currently offered on borrowings with similar remaining maturities.

*Accrued interest receivable and payable*

The carrying values for accrued interest receivable and payable approximates fair value because of the short-term nature of these financial instruments.

*Financial instruments with off-balance sheet risk*

Since the Bank's commitments to originate or purchase loans, and for unused lines and outstanding letters of credit, are primarily at market interest rates, there is no fair value adjustment.

***(18) Shareholders' Equity***

Capital guidelines issued by the Federal Reserve Board require the Company to maintain minimum capital levels for capital adequacy purposes. Tier I capital is defined as common equity and retained earnings, less goodwill. The risk-based capital guidelines include both a definition of capital and a framework for calculating risk-weighted assets by assigning assets and off-balance-sheet items to one of four risk categories, each with an appropriate weight. The risk-based capital rules are designed to make regulatory capital more sensitive to differences in risk profiles among banks and bank holding companies, to account for off-balance sheet exposure and to minimize disincentives for holding liquid assets. At December 31, 2000, the Company's Tier I leverage ratio was 5.91%, its Tier I Risked-based capital ratio was 9.50% and its Total Risk-based capital ratio was 10.76%. At December 31, 2000, all of the Company's capital ratios met all of the requirements to which they are subject.

The Bank is also subject to FDIC regulations regarding capital requirements. These regulations require banks to maintain minimum capital levels for capital adequacy purposes and higher capital levels to be considered "well capitalized." At December 31, 2000 and 1999, the Bank was in compliance with these regulatory capital regulations. There have been no events or conditions since the end of the year that management believes would cause a change in the Bank's categorization.

The Bank's actual and required capital amounts and ratios were as follows:

| | Actual | | For Capital Adequacy | | To Be Considered "Well Capitalized" Purpose by the FDIC | |
|---|---|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| | | | (Dollars in thousands) | | | |
| **At December 31, 2000:** | | | | | | |
| Tier I capital (to average assets) | $ 41,129 | 5.85% | $ 21,086 | 3.00% | $ 35,144 | 5.00% |
| Tier I capital (to risk-weighted assets) | 41,129 | 9.41% | 17,484 | 4.00% | 26,226 | 6.00% |
| Total capital (to risk-weighted assets) | 46,615 | 10.66% | 34,968 | 8.00% | 43,710 | 10.00% |
| **At December 31, 1999:** | | | | | | |
| Tier I capital (to average assets) | $ 36,323 | 5.88% | $ 18,537 | 3.00% | $ 30,896 | 5.00% |
| Tier I capital (to risk-weighted assets) | 36,323 | 9.70% | 14,974 | 4.00% | 22,461 | 6.00% |
| Total capital (to risk-weighted assets) | 41,015 | 10.96% | 29,948 | 8.00% | 37,435 | 10.00% |

*Warrants*. In connection with its acquisition of certain assets and assumption of certain liabilities from Fleet National Bank of Connecticut in 1996, the Bank issued to Fleet Financial Group, Inc. a warrant to acquire 136,315 shares of Common Stock of the Bank. Upon conversion into a holding company structure, the warrant became exercisable for 136,315 shares of the Company's Common Stock. The per share exercise price of the warrant is $10.00. The warrant expires on March 22, 2006, and may be exercised, in whole or in part, at any time prior to its expiration. Upon the occurrence of a change of control event the holders of the warrant may sell the warrant to the Company for an amount that is equal to the product of the number of shares represented by the warrant being sold and the difference between the exercise price of the warrant and the fair market value of the consideration per share received in the change of control transaction.

### *(19) Earnings Per Share*

The following table is a reconciliation of basic EPS and diluted EPS:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2000 | 1999 | 1998 |
| | | (In thousands) | |
| **Basic EPS Computation:** | | | |
| Numerator (in thousands): | | | |
| Net income | $ 5,618 | $ 4,362 | $ 3,834 |
| Preferred dividends | — | (88) | (793) |
| Net income available to common shareholders | $ 5,618 | $ 4,274 | $ 3,041 |
| Denominator: | | | |
| Common shares outstanding | 3,728,688 | 3,727,010 | 3,506,573 |
| Stock options | — | — | — |
| Warrants | — | — | — |
| Total shares | 3,728,688 | 3,727,010 | 3,506,573 |
| Basic EPS | $ 1.51 | $ 1.15 | $ 0.87 |
| **Diluted EPS Computation:** | | | |
| Numerator (in thousands): | | | |
| Net income | $ 5,618 | $ 4,362 | $ 3,834 |
| Preferred dividends | — | (88) | (793) |
| Net income available to common shareholders | $ 5,618 | $ 4,274 | $ 3,041 |
| Denominator: | | | |
| Common shares outstanding | 3,728,688 | 3,727,010 | 3,506,573 |
| Stock options | 24,534 | 7,233 | 36,303 |
| Warrants | 15,367 | 7,535 | 41,944 |
| Total shares | 3,768,589 | 3,741,778 | 3,584,820 |
| Diluted EPS | $ 1.49 | $ 1.14 | $ 0.85 |

### *(20) Regulation and Litigation*

The Company and the Bank are subject to extensive regulation and examination by the Federal Reserve Board, the Rhode Island Division of Banking and the FDIC, which insures the Bank's deposits to the maximum extent permitted by law. The federal and state laws and regulations which are applicable to banks regulate, among other things, the scope of their business, their investments, their reserves against deposits, the timing of the availability of deposited funds and the nature and amount of and collateral for certain loans. The laws and regulations governing the Bank generally have been promulgated to protect depositors and not for the purpose of protecting shareholders. Among other things, bank regulatory authorities have the right to restrict the payment of dividends by banks and bank holding companies to shareholders.

The Company is involved in routine legal proceedings occurring in the ordinary course of business. In the opinion of management, final disposition of these lawsuits will not have a material adverse effect on the consolidated financial condition or results of operations of the Company.

### *(21) Parent Company Statements*

The following are condensed financial statements for Bancorp Rhode Island, Inc. (the "Parent Company"):

*Balance Sheet*

| | December 31, 2000 |
|---|---|
| | (In thousands) |
| **Assets:** | |
| Cash and due from banks | $ 16 |
| Overnight investments | 352 |
| Investment in subsidiaries | 52,878 |
| Total assets | $ 53,246 |
| **Liabilities:** | |
| Income taxes payable | $ (46) |
| Total liabilities | (46) |
| **Shareholders' equity:** | |
| Common stock, par value $0.01 per share, authorized 11,000,000 shares: | |
| Voting: Issued and outstanding 3,448,950 shares | 34 |
| Non-Voting: Issued and outstanding 280,000 shares | 3 |
| Additional paid-in capital | 39,621 |
| Retained earnings | 13,815 |
| Accumulated other comprehensive income (loss), net | (181) |
| Total shareholders' equity | 53,292 |
| Total liabilities and shareholders' equity | $ 53,246 |

*Statements of Operation*

| | Year Ended December 31, 2000 (In thousands, except per share data) |
|---|---|
| **Income:** | |
| Dividends received from subsidiary | $ 950 |
| Interest on overnight investments | 8 |
| Total income | 958 |
| **Expenses:** | |
| Directors' fees | 15 |
| Professional services | 126 |
| Other expenses | 2 |
| Total expenses | 143 |
| Income before income taxes | 815 |
| Income tax expense (benefit) | (46) |
| Income before equity in undistributed earnings of subsidiary | 861 |
| Equity in undistributed earnings of subsidiary | 4,757 |
| Net income | $ 5,618 |
| Basic earnings per common share: | $ 1.51 |
| Diluted earnings per common share: | $ 1.49 |
| Average common shares outstanding - basic | 3,728,688 |
| Average common shares outstanding - diluted | 3,768,589 |

*Statement of Cash Flow*

| | Year Ended December 31, 2000 (In thousands) |
|---|---|
| **Cash flows from operating activities:** | |
| Net income | $ 5,618 |
| Adjustment to reconcile net income to net cash provided by operating activities: | |
| Equity in undistributed earnings of subsidiaries | (4,757) |
| Increase (decrease) in other liabilities | (46) |
| Net cash provided by operating activities | 815 |
| **Cash flows from financing activities:** | |
| Dividends on common stock | (447) |
| Net cash provided by financing activities | (447) |
| Net increase (decrease) in cash and due from banks | 368 |
| Cash and cash equivalents at beginning of year | — |
| Cash and cash equivalents at end of year | $ 368 |
| **Supplementary disclosures:** | |
| Cash paid for income taxes | $ — |
| Non-cash transactions: | |
| Change in other comprehensive income, net of taxes | (181) |

The Parent Company's Statement of Changes in Shareholders' Equity is identical to the Consolidated Statement of Changes in Shareholders' Equity and therefore is not presented here.

### *(22) Quarterly Results of Operations (unaudited)*

| | 2000 Quarter Ended | | | |
|---|---|---|---|---|
| | March 31 | June 30 | September 30 | December 31 |
| | (In thousands, except per share data) | | | |
| Interest income | $ 11,493 | $ 12,195 | $ 12,894 | $ 13,453 |
| Interest expense | 5,372 | 5,684 | 6,128 | 6,494 |
| Net interest income | 6,121 | 6,511 | 6,766 | 6,959 |
| Provision for loan losses | 340 | 382 | 410 | 410 |
| Net interest income after provision for loan losses | 5,781 | 6,129 | 6,356 | 6,549 |
| Noninterest income | 776 | 874 | 984 | 944 |
| Noninterest expense | 4,556 | 4,923 | 5,034 | 5,149 |
| Income before taxes | 2,001 | 2,080 | 2,306 | 2,344 |
| Income taxes | 695 | 724 | 852 | 842 |
| Net income | $ 1,306 | $ 1,356 | $ 1,454 | $ 1,502 |
| Basic EPS | $ 0.35 | $ 0.36 | $ 0.39 | $ 0.40 |
| Diluted EPS | $ 0.35 | $ 0.36 | $ 0.38 | $ 0.39 |

| | 1999 Quarter Ended | | | |
|---|---|---|---|---|
| | March 31 | June 30 | September 30 | December 31 |
| | (In thousands, except per share data) | | | |
| Interest income | $ 9,961 | $ 10,226 | $ 10,500 | $ 10,964 |
| Interest expense | 4,854 | 4,887 | 4,858 | 5,001 |
| Net interest income | 5,107 | 5,339 | 5,642 | 5,963 |
| Provision for loan losses | 225 | 225 | 225 | 325 |
| Net interest income after provision for loan losses | 4,882 | 5,114 | 5,417 | 5,638 |
| Noninterest income | 654 | 744 | 921 | 903 |
| Noninterest expense | 3,995 | 4,242 | 4,615 | 4,502 |
| Income before taxes and accounting principle change | 1,541 | 1,616 | 1,723 | 2,039 |
| Income taxes | 542 | 567 | 592 | 747 |
| Net income before accounting principle change | 999 | 1,049 | 1,131 | 1,292 |
| Cumulative effect of accounting principle change, net | 109 | — | — | — |
| Net income | 890 | 1,049 | 1,131 | 1,292 |
| Preferred dividends | 44 | 44 | — | — |
| Net income available to common shareholders | $ 846 | $ 1,005 | $ 1,131 | $ 1,292 |
| Basic EPS: | | | | |
| Income before accounting principle change | $ 0.26 | $ 0.27 | $ 0.30 | $ 0.35 |
| Cumulative effect of accounting principle change, net | (0.03) | — | — | — |
| Net income | $ 0.23 | $ 0.27 | $ 0.30 | $ 0.35 |
| Diluted EPS: | | | | |
| Income before accounting principle change | $ 0.26 | $ 0.27 | $ 0.30 | $ 0.35 |
| Cumulative effect of accounting principle change, net | (0.03) | — | — | — |
| Net income | $ 0.23 | $ 0.27 | $ 0.30 | $ 0.35 |

## Market For The Company's Common Stock and Related Stockholder Matters

Bancorp Rhode Island, Inc.'s common stock is traded on the Nasdaq Stock Market® under the symbol "BARI". The following table sets forth information regarding the Common Stock for the periods indicated.

| | Stock Price | | Dividend |
| --- | --- | --- | --- |
| | High | Low | Paid |
| **1999** | | | |
| First Quarter | 12.25 | 9.81 | 0.00 |
| Second Quarter | 11.50 | 9.75 | 0.00 |
| Third Quarter | 12.00 | 9.75 | 0.05 |
| Fourth Quarter | 11.25 | 9.75 | 0.05 |
| **2000** | | | |
| First Quarter | 10.19 | 9.13 | 0.10 |
| Second Quarter | 11.50 | 9.00 | 0.10 |
| Third Quarter | 14.50 | 10.50 | 0.10 |
| Fourth Quarter | 14.00 | 12.50 | 0.12 |

As of March 12, 2001 there were approximately 1,000 holders of record of the Common Stock.

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