

BANCORP RHODE ISLAND INC
Form 10-Q
August 08, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

FORM 10-Q

(Quarterly Report Under Section 13 of the Securities Exchange Act of 1934)

For the quarter ended: **June 30, 2007**

Commission File No. 001-16101

BANCORP RHODE ISLAND, INC.
(Exact Name of Registrant as Specified in Its Charter)

Rhode Island
(State or Other Jurisdiction of
Incorporation or Organization)

05-0509802
(IRS Employer
Identification No.)

ONE TURKS HEAD PLACE, PROVIDENCE, RI 02903
(Address of Principal Executive Offices)

(401) 456-5000
(Issuer's Telephone Number, Including Area Code)

Not Applicable
(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer, as defined in Section 12b-2 of the Exchange Act of 1934.

Large accelerated filer Accelerated filer Non-accelerated filer

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

Indicate the number of shares outstanding of each of the Registrant's classes of common stock, as of August 1, 2007:

Common Stock - Par Value \$0.01

4,854,736 shares

(class)

(outstanding)

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Bancorp Rhode Island, Inc.
Quarterly Report on Form 10-Q
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Special Note Regarding Forward Looking Statements

We make certain forward looking statements in this Quarterly Report on Form 10-Q and in other documents that we incorporate by reference into this report that are based upon our current expectations and projections about current events. We intend these forward looking statements to be covered by the safe harbor

provisions for "forward looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and we are including this statement for purposes of these safe harbor provisions. You can identify these statements by reference to a future period or periods by our use of the words "estimate," "project," "may," "believe," "intend," "anticipate," "plan," "seek," "expect" and similar terms or variations of these terms.

Actual results may differ materially from those set forth in forward looking statements as a result of risks and uncertainties, including those detailed from time to time in our filings with the Securities and Exchange Commission. Our forward looking statements do not reflect the potential impact of any future acquisitions, mergers, dispositions, joint ventures or investments we may make. We do not assume any obligation to update any forward looking statements.

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BANCORP RHODE ISLAND, INC.
Consolidated Balance Sheets (unaudited)

	June 30, 2007	December 31, 2006
(In thousands)		
ASSETS:		
Cash and due from banks	\$ 38,020	\$ 24,469
Overnight investments	5,081	37,295
	<hr/>	<hr/>
Total cash and cash equivalents	43,101	61,764
Investment securities available for sale (amortized cost of \$116,049 and \$104,266 at June 30, 2007 and December 31, 2006, respectively)	115,106	103,425
Mortgage-backed securities available for sale (amortized cost of \$220,225 and \$244,258 at June 30, 2007 and December 31, 2006, respectively)	215,198	240,462
	<hr/>	<hr/>
Total securities available for sale	330,304	343,887
Stock in Federal Home Loan Bank of Boston	15,671	16,530
Loans and leases receivable:		
Commercial loans and leases	542,705	519,790
Residential mortgage loans	261,716	263,945
Consumer and other loans	219,814	220,557
	<hr/>	<hr/>
Total loans and leases receivable	1,024,235	1,004,292
Allowance for loan and lease losses	(12,545)	(12,377)
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Net loans and leases receivable	1,011,690	991,915
Premises and equipment, net	14,476	13,736
Goodwill, net	11,317	11,317

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Accrued interest receivable	6,894	6,755
Investment in bank-owned life insurance	23,659	23,148
Prepaid expenses and other assets	9,603	10,047
	<hr/>	<hr/>
Total assets	\$ 1,466,715	\$ 1,479,099
	<hr/>	<hr/>
LIABILITIES:		
Deposits:		
Demand deposit accounts	\$ 198,361	\$ 200,282
NOW accounts	67,040	70,736
Money market accounts	6,735	6,991
Savings accounts	369,028	356,707
Certificate of deposit accounts	384,543	381,707
	<hr/>	<hr/>
Total deposits	1,025,707	1,016,423
Overnight and short-term borrowings	51,272	56,341
Wholesale repurchase agreements	10,000	20,000
Federal Home Loan Bank of Boston borrowings	233,946	242,198
Subordinated deferrable interest debentures	18,558	18,558
Other liabilities	12,152	13,494
	<hr/>	<hr/>
Total liabilities	1,351,635	1,367,014
	<hr/>	<hr/>
SHAREHOLDERS' EQUITY:		
Preferred stock, par value \$0.01 per share, authorized 1,000,000 shares:		
Issued and outstanding: none	--	--
Common stock, par value \$0.01 per share, authorized 11,000,000 shares:		
Issued and outstanding 4,854,736 shares and 4,792,380 shares, respectively	49	48
Additional paid-in capital	69,505	67,960
Treasury stock, at cost (15,000 shares at June 30, 2007)	(605)	--
Retained earnings	50,012	47,091
Accumulated other comprehensive loss, net	(3,881)	(3,014)
	<hr/>	<hr/>
Total shareholders' equity	115,080	112,085
	<hr/>	<hr/>
Total liabilities and shareholders' equity	\$ 1,466,715	\$ 1,479,099
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See accompanying notes to consolidated financial statements

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BANCORP RHODE ISLAND, INC.
Consolidated Statements of Operations (unaudited)

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	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
(In thousands, except per share data)				
Interest and dividend income:				
Loans and leases	\$ 16,597	\$ 15,468	\$ 32,929	\$ 30,297
Available for sale securities	4,268	4,247	8,470	8,572
Federal Home Loan Bank of Boston stock dividends	265	--	546	211
Overnight investments	185	47	472	77
Total interest and dividend income	21,315	19,762	42,417	39,157
Interest expense:				
Deposits	7,242	5,269	14,293	9,755
Overnight and short-term borrowings	636	498	1,303	813
Wholesale repurchase agreements	134	223	330	412
Federal Home Loan Bank of Boston borrowings	2,640	3,081	5,231	6,088
Subordinated deferrable interest debentures	371	362	740	710
Total interest expense	11,023	9,433	21,897	17,778
Net interest income	10,292	10,329	20,520	21,379
Provision for loan and lease losses	100	435	200	702
Net interest income after provision for loan and lease losses	10,192	9,894	20,320	20,677
Noninterest income:				
Service charges on deposit accounts	1,388	1,262	2,704	2,449
Commissions on leases originated for others	286	111	628	173
Income from bank-owned life insurance	260	195	511	374
Loan related fees	194	274	349	418
Commissions on nondeposit investment products	171	251	291	563
Commissions on loans originated for others	50	29	95	52
Other income	315	693	648	1,091
Total noninterest income	2,664	2,815	5,226	5,120
Noninterest expense:				
Salaries and employee benefits	5,285	5,201	10,547	10,708

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Occupancy	896	873	1,802	1,746
Data processing	734	742	1,438	1,479
Professional services	600	513	1,252	929
Marketing	427	619	800	959
Equipment	334	362	667	741
Loan servicing	193	208	386	406
Loss on note receivable	--	--	--	868
Other expenses	1,155	1,207	2,243	2,713
	<hr/>	<hr/>	<hr/>	<hr/>
Total noninterest expense	9,624	9,725	19,135	20,549
	<hr/>	<hr/>	<hr/>	<hr/>
Income before income taxes	3,232	2,984	6,411	5,248
Income tax expense	1,038	978	2,039	1,717
	<hr/>	<hr/>	<hr/>	<hr/>
Net income	\$ 2,194	\$ 2,006	\$ 4,372	\$ 3,531
	<hr/>	<hr/>	<hr/>	<hr/>
Weighted average common shares outstanding - basic	4,839	4,764	4,827	4,755
Weighted average common shares outstanding - diluted	4,958	4,905	4,960	4,896
Per share data:				
Basic earnings per common share	\$ 0.45	\$ 0.42	\$ 0.91	\$ 0.74
Diluted earnings per common share	\$ 0.44	\$ 0.41	\$ 0.88	\$ 0.72
Cash dividends declared per common share	\$ 0.15	\$ 0.15	\$ 0.30	\$ 0.30

See accompanying notes to consolidated financial statements

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BANCORP RHODE ISLAND, INC.
Consolidated Statements of Changes in Shareholders' Equity (unaudited)

Six months ended June 30,	Common Stock	Additional Paid-in Capital	Treasury Stock	Retained Earnings	Accumulated Other Compre- hensive Income (Loss)	Total
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
	(In thousands)					
<u>2006</u>						
Balance at December 31, 2005	\$47	\$65,768	\$ --	\$42,241	\$(3,224)	\$104,832
Net income	--	--	--	3,531	--	3,531
Other comprehensive loss:						
Unrealized holding losses on securities available for					(3,740)	(3,740)

sale,						
net of taxes of \$2,013						
Total comprehensive income						(209)
Exercise of stock options	1	1,111	--	--	--	1,112
Acquisition of Macrolease	--	83	--	--	--	83
Share-based compensation	--	66	--	--	--	66
Tax benefit from exercise of stock options	--	122	--	--	--	122
Dividends on common stock (\$ 0.30 per common share)	--	--	--	(1,427)	--	(1,427)
Balance at June 30, 2006	\$48	\$67,150	\$ --	\$44,345	\$(6,964)	\$104,579
<u>2007</u>						
Balance at December 31, 2006	\$48	\$67,960	\$ --	\$47,091	\$(3,014)	\$112,085
Net income	--	--	--	4,372	--	4,372
Other comprehensive income:						
Unrealized holding losses on securities available for sale, net of taxes of \$466					(867)	(867)
Total comprehensive income						3,505
Exercise of stock options	1	968	--	--	--	969
Stock repurchase	--	--	(605)	--	--	(605)
Share-based compensation	--	124	--	--	--	124
Tax benefit from exercise of stock options	--	453	--	--	--	453
Dividends on common stock (\$ 0.30 per common share)	--	--	--	(1,451)	--	(1,451)
Balance at June 30, 2007	\$49	\$69,505	\$(605)	\$50,012	\$(3,881)	\$115,080

See accompanying notes to consolidated financial statements

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BANCORP RHODE ISLAND, INC.
Consolidated Statements of Cash Flows (unaudited)

	Six Months Ended June 30,	
	2007	2006
	(In thousands)	
Cash flows from operating activities:		
Net income	\$ 4,372	\$ 3,531
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation, amortization and accretion, net	(438)	418
Provision for loan and lease losses	200	702
Income from bank-owned life insurance	(511)	(374)
Share-based compensation expense	124	66
(Increase) decrease in accrued interest receivable	(139)	94
Decrease in prepaid expenses and other assets	910	642
Increase in other liabilities	(1,342)	(1,364)
Other, net	48	9
	3,224	3,724
Cash flows from investing activities:		
Investment securities available for sale:		
Purchases	(30,000)	(8,000)
Maturities and principal repayments	18,161	1,000
Mortgage-backed securities available for sale:		
Maturities and principal repayments	23,993	23,217
Net decrease (increase) in loans and leases	14,828	(35,167)
Purchases of loans and leases, including purchased interest	(33,317)	(10,461)
Sale (purchase) of Federal Home Loan Bank of Boston stock	859	(468)
Capital expenditures for premises and equipment	(1,740)	(1,777)
Purchase of bank-owned life insurance	--	(1,539)
	(7,216)	(33,195)
Cash flows from financing activities:		
Net increase in deposits	9,284	11,542
Net (decrease) increase in overnight and short-term borrowings	(5,069)	16,882
Proceeds from long-term borrowings	80,710	150,000
Repayment of long-term borrowings	(98,962)	(152,461)
Exercise of stock options	969	1,112
Purchase of treasury stock	(605)	--
Tax benefit from exercise of stock options	453	122
Dividends on common stock	(1,451)	(1,427)
	(14,671)	25,770

Net decrease in cash and cash equivalents	(18,663)	(3,701)
Cash and cash equivalents at beginning of period	61,764	40,547
Cash and cash equivalents at end of period	\$ 43,101	\$ 36,846
Supplementary Disclosures:		
Cash paid for interest	\$ 20,510	\$ 17,267
Cash paid for income taxes	2,065	1,265
Non-cash transactions:		
Acquisition of Macrolease	--	83
Change in accumulated other comprehensive loss, net	(867)	(3,740)

See accompanying notes to consolidated financial statements

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BANCORP RHODE ISLAND, INC.
Notes to Consolidated Financial Statements

(1) Basis of Presentation

Bancorp Rhode Island, Inc. (the "Company"), a Rhode Island corporation, is the holding company for Bank Rhode Island (the "Bank"). The Company has no significant assets other than the common stock of the Bank. For this reason, substantially all of the discussion in this Quarterly Report on Form 10-Q relates to the operations of the Bank and its subsidiaries.

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 credit losses, review of goodwill for impairment and accounting for income taxes.

The consolidated financial statements include the accounts of the Company 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), BRI Realty Corp. (a Rhode Island real estate holding company), Acorn Insurance Agency, Inc. (a licensed insurance agency) and Macrolease Corporation (an equipment leasing company). All significant intercompany accounts and transactions have been eliminated in consolidation.

The unaudited interim consolidated financial statements of the Company conform to U.S. generally accepted accounting principles and prevailing practices within the banking industry and include all necessary adjustments (consisting of only normal recurring adjustments) that, in the opinion of management, are required for a fair presentation of the results and financial condition of the Company. Certain prior period amounts have been reclassified to conform to the current year classification. Such reclassifications have no effect on previously reported net income or shareholders' equity.

The unaudited interim results of consolidated operations are not necessarily indicative of the results for any future interim period or for the entire year. These interim consolidated financial statements do not include all disclosures associated with annual financial statements and, accordingly, should be read in conjunction with the annual consolidated financial statements and accompanying notes included in the Company's 2006 Annual

Report on Form 10-K filed with the Securities and Exchange Commission ("SEC").

(2) 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 during the period excluding shares of unvested restricted stock. 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 additional common stock that then share in the earnings of the Company.

(3) Allowance for Credit Losses

The allowance for loan and lease losses and reserve for unfunded lending commitments, collectively referred to as the allowance for credit losses, are established for credit losses inherent in the loan and lease portfolio and inherent in the unfunded lending commitments through a charge to earnings. The allowance for credit losses is maintained at a level management considers appropriate to provide for the current inherent risk of loss based upon an evaluation of known and inherent risks in the loan and lease portfolio, as well as the unfunded lending commitments.

When management believes that the collectibility of a loan or lease principal balance, or portions thereof, is unlikely, the principal amount is charged against the allowance for loan and lease losses. Recoveries on loans and leases that have been previously charged off are credited to the allowance for loan and lease losses

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as received. Increases to the allowance for loan and leases are made by charges to provision for loan and lease losses.

In addition to the allowance for loan and lease losses, management also estimates probable losses related to unfunded lending commitments. In the third quarter of 2006, the Company reclassified the reserve for unfunded lending commitments from the allowance for loan and losses to other liabilities for all periods presented. Additions to the reserve for unfunded lending commitments are made by charges to other expenses.

Management's methodology to estimate loss exposure inherent in the loan and lease portfolio includes an analysis of individual loans or leases deemed to be impaired, reserve allocations for various loan and lease types based on payment status or loss experience and an unallocated allowance that is maintained based on management's assessment of many factors including, but not limited to, the growth, composition and quality of the loan portfolio, historical loss experience, industry loss experience and general economic conditions. Management employs a similar process with respect to unfunded lending commitments. While management evaluates currently available information in establishing the allowance for loan and lease losses and the reserve for unfunded lending commitments, future adjustments to the allowance for credit losses may be necessary if conditions differ substantially from the assumptions used in making the evaluations. The factors supporting the allowance for loan and lease losses do not diminish the fact that the entire allowance for loan and lease losses is available to absorb losses in the loan and lease portfolio. The Company's primary concern is the appropriateness of the total allowance for loan and lease losses, as well as the reserve for unfunded lending commitments. Management performs a comprehensive review of the allowance for loan and lease losses and the reserve for unfunded lending commitments on a quarterly basis.

In addition, various regulatory agencies, as an integral part of their examination process, periodically review a financial institution's allowance for credit 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.

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

	Six Months Ended June 30, 2007	Year Ended December 31, 2006
Allowance for Loan and Lease Losses	(In thousands)	
Balance at beginning of period	\$12,377	\$11,665
Loans charged-off	(78)	(519)
Recoveries of loans previously charged-off	46	29
Provision for loan and lease losses charged against income	200	1,202
Balance at end of period	12,545	12,377
Reserve for Unfunded Lending Commitments		
(1)		
Balance at beginning of period	567	503
Provision for unfunded lending commitments	11	64
Balance at end of period	578	567
Allowance for Credit Losses		
Balance at end of period	\$13,123	\$12,944

(1) In 2006, the Company reclassified the reserve for unfunded lending commitments from the allowance for loan and lease losses to other liabilities for all periods presented.

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(4) Supplemental Executive Retirement Plans

The Bank maintains Supplemental Executive Retirement Plans ("SERPs") 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 SERPs were \$285,000 and \$217,000 for the six months ending June 30, 2007 and 2006, respectively. Accrued liabilities associated with the SERPs were \$2.5 million and \$2.2 million for June 30, 2007 and December 31, 2006, respectively.

(5) Income Taxes

Effective January 1, 2007, the Company adopted Financial Interpretation No. 48 ("FIN 48"), "Accounting for Uncertainty in Income Taxes." FIN 48 clarifies the accounting for uncertainty in income taxes recognized in accordance with SFAS 109, "Accounting for Income Taxes." The adoption of FIN 48 did not have a material impact on the Company's financial statements.

The evaluation of a tax position in accordance with FIN 48 is a two-step process. First, the Company determines whether it is more likely than not that a tax position will be sustained upon examination based on the technical merits of the position. Second, a tax position that meets the more likely than not threshold is measured to determine the amount of benefit to recognize in the financial statements. The tax position is measured at the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement. Tax positions that previously failed to meet the more likely than not recognition threshold are recognized in the first subsequent reporting period in which the threshold is met. Previously recognized tax positions that no longer meet the more likely than not recognition threshold are derecognized in the first subsequent reporting period in which the threshold is no longer met.

The Company had no unrecognized tax benefits at both January 1, 2007 and June 30, 2007. Additionally, there are no unrecognized tax benefits that, if recognized, would affect the Company's effective tax rate.

As of both January 1, 2007 and June 30, 2007, the Company did not have any accrued income tax-related interest and penalties. The Company's policy is to classify income tax related interest and penalties as a component of income tax expense.

The Company's federal income tax returns are open and subject to examination from the 2003 tax return year and forward. The Company's state income tax returns are generally open from the 2003 and later tax return years based on individual state statute of limitations.

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(6) Recent Accounting Pronouncements

In March 2006, the FASB Emerging Issues Task Force ("EITF") issued interpretive guidance in Issue 06-4 ("EITF 06-4"), in which agreements by companies to share a portion of the proceeds of life insurance policies with an employee during the postretirement period is a postretirement benefit arrangement that must be accounted for under SFAS 106, *"Employers' Accounting for Postretirement Benefits Other Than Pensions"*. Under EITF 06-4, the EITF also concluded the purchase of a split-dollar life insurance policy does not constitute a settlement of the postretirement benefit as defined in SFAS 106. Thus, companies will be required to record a liability upon adoption of EITF 06-4, which is effective for periods beginning after December 15, 2007. The Company is currently evaluating the impact EITF 06-4 will have on its consolidated financial statements upon adoption on January 1, 2008.

In September 2006, the FASB issued SFAS No. 157 ("SFAS 157"), *"Fair Value Measurements"*. SFAS 157 provides guidance for measuring assets and liabilities at fair value. This standard is applicable whenever other standards require or permit assets and liabilities to be measured at fair value, but does not expand upon the use of fair value in any new circumstances. SFAS 157 establishes a fair value hierarchy that gives the highest priority to quoted prices in active markets and the lowest priority to unobservable data and requires fair value measurements to be disclosed by level within the hierarchy. SFAS 157 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact SFAS 157 will have on its consolidated financial statements upon adoption on January 1, 2008.

In February 2007, the FASB issued SFAS No. 159 ("SFAS 159"), *"The Fair Value Option for Financial Assets and Financial Liabilities"*. SFAS 159 provides companies with an option to report selected financial assets and liabilities at fair value and to provide additional information that will help investors and other users of financial statements to understand more easily the effect on earnings of the company's choice to use fair value. It also requires companies to display the fair value of those assets and liabilities for which the company has chosen to use fair value on the face of the balance sheet. The Company is currently evaluating the impact SFAS 159 will have on its consolidated financial statements upon adoption on January 1, 2008.

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BANCORP RHODE ISLAND, INC.
Management's Discussion and Analysis

ITEM 2. Management's Discussion and Analysis

General

The Company's principal subsidiary, 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 Rhode Island and nearby areas of Massachusetts. 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 business, commercial real estate, consumer and residential loans and leases, deposit products, nondeposit investment products, cash management, private banking and other banking products and services designed to meet the financial needs of individuals and small- to mid-sized businesses. The Bank also offers both commercial and consumer online banking products and maintains a web site at <http://www.bankri.com>. The Company and Bank are subject to the regulations of certain 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"). The Company's common stock is traded on the Nasdaq Global Select MarketSM under the symbol "BARI". The Company's financial reports can be accessed through its website within 24 hours of filing with the SEC.

Critical Accounting Policies

Accounting policies involving significant judgments and assumptions by management, which have, or could have, a material impact on the carrying value of certain assets or net income, are considered critical accounting policies. The preparation of financial statements in accordance with U.S. generally accepted accounting principles ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and disclosure of contingent assets and liabilities. Actual results could differ from those estimates. As discussed in the Company's 2006 Annual Report on Form 10-K, management has identified the accounting for the allowance for loan and lease losses, which is now reported as a component of the allowance for credit losses, review of goodwill for impairment and accounting for income taxes as the Company's most critical accounting policies. There have been no significant changes in the methods or assumptions used in accounting policies that require material estimates or assumptions.

Overview

The primary drivers of the Company's operating income are net interest income, which is strongly affected by the net yield on interest-earning assets ("net interest margin"), and the quality of the Company's assets.

The Company's net interest income represents the difference between interest income earned on interest-earning assets and interest expense incurred on interest-bearing liabilities. The net interest margin is calculated by dividing net interest income by average interest-earning assets. Net interest spread is the difference between the average rate earned on interest-earning assets and the average rate paid on interest-bearing liabilities. Net interest margin generally exceeds the net interest spread as a portion of interest-earning assets are funded by various noninterest-bearing sources (primarily noninterest-bearing deposits and shareholders' equity). The increases (decreases) in the components of interest income and interest

expense, expressed in terms of fluctuation in average volume and rate, are summarized in the Rate/Volume Analysis tables shown on pages 25 and 30. Information as to the components of interest income and interest expense and average rates is provided under "*Average Balances, Yields and Costs*" on pages 24 and 29.

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Because the Company's assets are not identical in duration and in repricing dates to its liabilities, the spread between the two is vulnerable to changes in market interest rates as well as the overall shape of the yield curve. These vulnerabilities are inherent to the business of banking and are commonly referred to as "interest rate risk". How to measure interest rate risk and, once measured, how much risk to take are based on numerous assumptions and other subjective judgments. See also discussion under "*Interest Rate Risk*" on page 34.

The quality of the Company's assets also influences its earnings. Loans and leases that are not paid on a timely basis and exhibit other weaknesses can result in the loss of principal and/or interest income. Additionally, the Company makes timely provisions to the allowance for loan and lease losses based on estimates of probable losses inherent in the loan and lease portfolio; these additions, which are charged against earnings, are necessarily greater when greater probable losses are expected. Further, the Company incurs expenses as a result of resolving troubled assets. All of these reflect the "credit risk" that the Company takes on in the ordinary course of business and is further discussed under "*Financial Condition - Asset Quality*" on page 17.

The Company's business strategy has been to concentrate its asset generation efforts on commercial and consumer loans and its deposit generation efforts on checking and savings accounts. These deposit accounts are commonly referred to as "core deposit accounts". This strategy is based on the Company's belief that it can distinguish itself from its larger competitors, and indeed attract customers from them, through a higher level of service and through its ability to set policies and procedures, as well as make decisions, locally. The loan and deposit products referenced also tend to be geared more toward customers who are relationship oriented than those who are seeking stand-alone or single transaction products. The Company believes that its service-oriented approach enables it to compete successfully for relationship-oriented customers. Additionally, the Company is predominantly an urban franchise with a high concentration of businesses, which makes deployment of funds in the commercial lending area practicable. Commercial loans are attractive to the Company, among other reasons, because of their higher yields. Similarly, core deposits are attractive to the Company because of their generally lower interest cost and potential for fee income.

The Company also seeks to leverage business opportunities presented by its customer base, franchise footprint and resources. In 2005, the Bank formed a private banking division and completed the Bank's first acquisition, acquiring the operations of an equipment leasing company located in Long Island, New York ("Macrolease"). The Bank is using the Macrolease platform to generate additional income by originating equipment leases for third parties, as well as increasing the Bank's portfolio of equipment leases.

The deposit market in Rhode Island is highly concentrated. The State's three largest banks have an aggregate market share of approximately 85% in Providence and Kent Counties, the Bank's primary marketplace (based upon June 2006 FDIC statistics, excluding one bank that draws its deposits primarily from the internet). Competition for loans and deposits remains intense. This competition has resulted in considerable advertising and promotional product offerings by competitors, including print, radio and television media, as well as direct mailings.

For the six months ended June 30, 2007, approximately 79.7% of the Company's revenues (defined as net interest income plus noninterest income) were derived from its level of net interest income. In a continuing effort to diversify its sources of revenue, the Company has sought to expand its sources of noninterest income (primarily fees and charges for products and services the Bank offers). Service charges on deposit accounts

remain the largest component of noninterest income, while the Bank has recently seen growth in commissions on leases originated for third parties.

The future operating results of the Company will again depend on its ability to maintain and expand its net interest margin, while minimizing its exposure to credit risk, along with increasing sources of noninterest income, while controlling the growth of noninterest or operating expenses.

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Financial Condition - Executive Summary

Selected balance sheet data is presented in the table below as of the dates indicated:

(In thousands)	June 30, 2007	March 31, 2007	December 31, 2006	September 30, 2006	June 30, 2006
Balance sheet data:					
Total assets ^(a)	\$1,466,715	\$1,483,157	\$1,479,099	\$1,496,855	\$1,467,128
Loans and leases receivable	1,024,235	1,007,448	1,004,292	1,008,148	996,838
Securities available for sale	330,304	350,655	343,887	327,198	363,708
Core deposits ^(b) Certificates of deposit	641,164	638,317	634,716	620,743	632,104
Borrowings	384,543	390,295	381,707	366,880	360,407
Total shareholders' equity	313,776	322,336	337,097	362,483	359,190
	115,080	115,357	112,085	109,387	104,579
Core deposit ratio	62.5%	62.1%	62.4%	62.9%	63.7%

(a) The Company has reclassified its reserve for unfunded lending commitments to other liabilities from the allowance for loan and lease losses. Prior period results have been reclassified to conform to the current period presentation.

(b) Core deposits consist of demand deposit, NOW, money market and savings accounts.

Total assets decreased moderately by \$12.4 million since December 31, 2006. Total loans and leases increased by \$19.9 million during the first six months of 2007, highlighted by an increase in commercial loans and leases of \$22.9 million, or 4.4%. Additionally, available for sale securities declined \$13.6 million, or 3.9%, since year-end, as maturities and repayments have been partially redeployed into internally generated assets. The Bank increased its core deposits by \$6.4 million, or 1.0%, since year-end. Within this net growth, demand deposit accounts rebounded in the second quarter of 2007 (up \$16.8 million, or 9.3%) from the normal first quarter seasonal decline. Demand remained strong for higher-yielding term deposit accounts (also referred to as certificates of deposits or CDs) and premium rate savings accounts, which in turn resulted in higher funding costs. Shareholders' equity as a percentage of total assets at June 30, 2007 was 7.8%, an increase from the December 31, 2006 ratio of 7.6%.

The Company's financial position at June 30, 2007 as compared to the prior year quarter-end (June 30, 2006) reflects net growth of \$27.4 million in loans and leases. This increase reflects the continuing conversion

of the balance sheet to a more commercial profile with increases in commercial loans and leases of \$56.6 million (up 11.6%). Consumer loans remained relatively level, with a net decrease of \$2.4 million (down 1.1%). The residential mortgage portfolio (consisting primarily of purchased mortgages) declined \$26.8 million (down 9.3%) since June 30, 2006. Also, available for sale securities at June 30, 2007 were down \$33.4 million from prior year quarter-end balances, with the difference being redeployed into higher-yielding commercial loans. Deposits have increased \$33.2 million, or 3.3%, since the prior year quarter-end. This deposit growth was centered in demand deposit accounts (up \$13.3 million), savings balances (up \$17.3 million) and certificates of deposit (up \$24.1 million). These gains were somewhat offset by decreases in NOW accounts (down \$20.4 million) and money market accounts (down \$1.2 million). Overall core deposits increased \$9.1 million, or 1.4%. Borrowings have decreased since June 30, 2006 by \$45.4 million, due in part to deposit growth.

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Financial Condition - Detailed Analysis

Investments

Total investments consists of available for sale securities (investment securities and mortgage-backed securities ("MBSs")), stock in the FHLB and overnight investments. Total investments comprised \$351.1 million, or 23.9% of total assets, at June 30, 2007, compared to \$397.7 million, or 26.9% of total assets, at December 31, 2006, representing a decrease of \$46.7 million or 11.7%. All \$330.3 million of investment securities and MBSs at June 30, 2007 were classified as available for sale. These available for sale securities carried a total of \$6.0 million in net unrealized losses at the end of the quarter, compared to \$4.6 million of net unrealized losses at December 31, 2006.

The available for sale securities have been deemed to be not other-than-temporarily impaired after considering that substantially all available for sale securities were rated "investment grade" with unrealized losses primarily caused by market interest rate changes. In addition, the Company has the intent and ability to hold all securities with unrealized losses until recovery or maturity. In making these other-than-temporary impairment determinations, management considers, among other things, the length of time and extent to which the fair value has been less than cost and the credit worthiness and near-term prospects of the issuer. Also management considers capital adequacy, interest rate risk, liquidity and business plans in assessing the intent and ability to hold all securities with unrealized losses until recovery or maturity.

The investment portfolio provides the Company a source of short-term liquidity and acts as a counterbalance to loan and deposit flows. During the first six months of 2007, the Company purchased \$30.0 million of available for sale securities, while maturities and principal repayments totaled \$42.2 million. Market interest rate changes during the first six months of this year often made purchases of available for sale securities less attractive than retirement of borrowings or redeployment of funds into higher-yielding internally generated assets.

Loans and Leases

Total loans and leases at both June 30, 2007 and December 31, 2006 was \$1.0 billion. As a percentage of total assets, loans and leases increased to 69.8% at June 30, 2007 compared to 67.9% at December 31, 2006. The Company attempts to concentrate its asset growth in its loan and lease portfolios to maximize the yield on new assets and to take advantage of demand for both commercial and home equity loan products in its market area. Total loans and leases as of June 30, 2007 is segmented into three broad categories: commercial loans and leases that aggregate \$542.7 million, or 53.0% of the portfolio; residential mortgages that aggregate \$261.7 million, or 25.5% of the portfolio; and consumer and other loans that aggregate \$219.8 million, or 21.5% of the

portfolio.

Commercial loans and leases - The commercial loan and lease portfolio (consisting of commercial real estate, business lending, equipment leases, multi-family real estate, construction and small business loans) increased \$22.9 million, or 4.4%, during the first six months of 2007.

Towards the end of 2006, the Bank reorganized its business lending function. The business lending group now concentrates its efforts on business lending relationships primarily in excess of \$1.0 million. Business lending relationships of up to \$1.0 million can now be originated by the Bank's business development group. This group formerly only originated business loans involving relationships under \$250,000. Additionally, business loans under \$100,000 can be originated by our retail branch system. Underwriting, processing and monitoring of the bulk of business credit relationships of under \$1.0 million have been moved to the Bank's new lending services unit ("LSU"). Management believes this reorganization will enhance the Bank's ability to reach more borrowers with the same number of personnel as well as achieve more efficient processing and improved monitoring of these credits.

The Bank's business lending group originates business loans, also referred to as commercial and industrial loans, including owner-occupied commercial real estate loans, term loans and revolving lines of credit. Within the business lending portfolio, commercial and industrial loans increased \$15.2 million, or 14.3%, and owner-occupied commercial real estate loans increased \$5.9 million, or 4.2%, since year-end.

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The Bank historically has purchased equipment leases from originators outside of the Bank. The U.S. Government and its agencies are the principal lessees on the vast majority of these leases. These "government" leases generally have maturities of five years or less and are not dependent on residual collateral values. With the Macrolease platform, the Bank originates equipment leases for its own portfolio, as well as originates leases for third parties as a source of noninterest income. At June 30, 2007, leases comprised 12.1% of the commercial loan and lease portfolio, with \$43.0 million of Macrolease-generated leases and \$20.3 million of government leases.

The Bank's commercial real estate ("CRE") group originates nonowner-occupied commercial real estate, multi-family residential real estate and construction loans. These real estate secured commercial loans are offered as both fixed and adjustable-rate products. Since December 31, 2006, multi-family loans have increased \$10.2 million, or 29.8%.

At June 30, 2007, small business loans were \$43.9 million, compared to \$41.8 million at December 31, 2006, representing 8.1% and 8.0% of the commercial portfolio at each period end, respectively. These loans reflect those historically originated by the Bank's small business lending group and branch system and now originated by the Bank's business development group and branch system. The Bank utilizes credit scoring and streamlined documentation, as well as traditional review standards in originating these credits.

The Bank is a participant in the U.S. Small Business Administration ("SBA") Preferred Lender Program in both Rhode Island and Massachusetts. SBA guaranteed loans are found throughout the portfolios managed by the Bank's various lending groups.

The Company believes it is well positioned for continued commercial growth. The Bank places particular emphasis on generation of small- to medium-sized commercial relationships (those with \$10 million or less in total loan commitments). Unlike most community banks, the Bank is able to offer asset-based commercial loan facilities that monitor advances against receivables and inventories on a formula basis.

Residential mortgage loans - During the first six months of 2007, residential mortgage loans decreased \$2.2 million, or down 0.8%, as repayments (\$27.3 million) exceeded total purchases (\$25.2 million) and originations (\$143,000). Since inception, the Bank has concentrated its portfolio lending efforts on commercial and consumer lending opportunities, but originates mortgage loans for its own portfolio on a limited basis. The Bank does not employ any outside mortgage originators, but periodically purchases residential mortgage loans from third-party originators. Until such time as the Bank can originate sufficient commercial and consumer loans to utilize available cash flow, the Bank may purchase residential mortgage loans as opportunities arise. At June 30, 2007, the Bank did not have commitments to purchase residential mortgage loans within the next 60 days.

Consumer loans - The consumer loan portfolio decreased \$743,000, or 0.3%, during the first six months of 2007 as originations approximated repayments. This net decline has largely corresponded with the softening of local market area housing prices that first started in the latter portion of 2006; the Company believes the softening prices have limited consumer appetite for borrowing against the value of their homes. However, the Company continues to promote consumer lending as it believes that these ten- to twenty-year fixed rate products, along with floating rate lines of credit, possess attractive cash flow characteristics in the current interest rate environment.

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The following is a summary of loans and leases receivable:

	June 30, 2007	December 31, 2006
(In thousands)		
Commercial loans and leases:		
Commercial real estate - owner occupied	\$ 146,685	\$ 140,812
Commercial and industrial	121,195	106,017
Commercial real estate - nonowner occupied	98,831	102,390
Multi-family	44,529	34,294
Small business	43,922	41,785
Construction	31,172	37,237
Leases and other	62,832	62,979
Subtotal	549,166	525,514
Unearned lease income	(7,586)	(6,651)
Net deferred loan origination costs	1,125	927
Total commercial loans and leases	542,705	519,790
Residential mortgage loans:		
One- to four-family adjustable rate	172,381	165,140
One- to four-family fixed rate	87,630	96,880
Subtotal	260,011	262,020
Premium on loans acquired	1,752	1,979
Net deferred loan origination fees	(47)	(54)

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Total residential mortgage loans	261,716	263,945
Consumer loans:		
Home equity - term loans	153,848	152,484
Home equity - lines of credit	62,041	64,208
Savings secured	833	587
Installment	450	506
Automobile	147	178
Unsecured and other	1,005	1,088
Subtotal	218,324	219,051
Net deferred loan origination costs	1,490	1,506
Total consumer loans	219,814	220,557
Total loans and leases receivable	\$1,024,235	\$1,004,292

Deposits

Total deposits increased by \$9.3 million, or 0.9%, during the first six months of 2007, from \$1.02 billion, or 68.7% of total assets, at December 31, 2006, to \$1.03 billion, or 69.9% of total assets, at June 30, 2007.

The following table sets forth certain information regarding deposits:

	June 30, 2007			December 31, 2006		
	Amount	Percent Of Total	Weighted Average Rate	Amount	Percent of Total	Weighted Average Rate
(In thousands)						
NOW accounts	\$ 67,040	6.5%	0.60%	\$ 70,736	7.0%	0.67%
Money market accounts	6,735	0.7%	1.78%	6,991	0.7%	2.69%
Savings accounts	369,028	36.0%	2.95%	356,707	35.1%	2.81%
Certificate of deposit accounts	384,543	37.5%	4.55%	381,707	37.5%	4.45%
Total interest bearing deposits	827,346	80.7%	3.49%	816,141	80.3%	3.40%
Noninterest bearing accounts	198,361	19.3%	--	200,282	19.7%	--
Total deposits	\$1,025,707	100.0%	2.82%	\$1,016,423	100.0%	2.73%

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The overall composition of total deposits remained relatively the same during the first six months of the year. At June 30, 2007, core deposit accounts comprised 62.5% of total deposits, compared to 62.4% of total deposits at December 31, 2006. The Bank continues its strategy of emphasizing the normally lower cost core deposits over CDs. However, during the first six months of 2007, as was the case for most of 2006, the Bank offered higher-yielding savings accounts in an effort to retain and attract deposits. In addition, demand for CDs remained strong.

Throughout 2006 and continuing into 2007, competition for deposits has been intense. In this competitive deposit gathering and rate environment, total deposits increased \$9.3 million as compared to December 31, 2006. Savings and CD accounts grew \$12.3 million and \$2.8 million, respectively, over the past six months. These increases offset the decline of NOW and money market accounts of \$4.0 million in aggregate. By June 30, 2007, demand deposit accounts were near the \$200.3 million mark set at December 31, 2006, down only \$1.9 million. Additionally, in the first quarter, the Bank was able to reduce its brokered CDs by \$10.0 million to \$20.0 million at June 30, 2007, or 1.9% of total deposits. The Bank may utilize brokered CDs if their rates are attractive compared to wholesale funding.

Borrowings

Overnight and short-term borrowings decreased \$5.1 million during the first six months of 2007 from the December 31, 2006 level of \$56.3 million. Through the Bank's membership in the FHLB, the Company has access to a number of different funding structures. FHLB borrowings decreased \$8.3 million from the December 31, 2006 amount of \$242.2 million. Also, in the first quarter of 2007, the Bank decreased the amount of its wholesale repurchase agreements by \$10.0 million. The Bank may utilize wholesale repurchase agreement funding in the future if spreads are favorable compared to FHLB borrowings or for diversification purposes.

On a long-term basis, the Company intends to continue concentrating on increasing its core deposits, and will utilize FHLB borrowings or wholesale repurchase agreements as cash flows dictate, as opportunities present themselves and as part of the Bank's overall strategy to manage interest rate risk.

Asset Quality

The definition of nonperforming assets includes nonperforming loans and other real estate owned ("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 Company may restructure the terms of a loan as a concession to a borrower. These restructured loans are generally considered impaired loans.

Nonperforming assets - At June 30, 2007, the Company had nonperforming assets of \$2.3 million, which represented 0.16% of total assets. This compares to nonperforming assets of \$1.4 million, or 0.10% of total assets, at December 31, 2006. Total nonperforming assets at June 30, 2007 consisted of nonaccrual loans and leases with residential mortgage loans aggregating \$1.4 million, commercial loans and leases aggregating \$802,000 and consumer loans aggregating \$120,000. The Bank believes it is well-secured in its commercial and residential credits as the underlying collateral values exceed the value of the loans and leases. Nonperforming assets at December 31, 2006 were primarily comprised of nonaccrual residential and commercial loans. The increase in nonperforming assets relates primarily to a few commercial loans and leases.

Included in nonaccrual loans and leases at June 30, 2007 were \$611,000 of impaired loans and leases, with specific reserves against these impaired loans and leases of \$143,000. At December 31, 2006, there were no impaired loans and leases and thus, no specific reserve allocated to impaired loans and leases. The increase in nonaccrual loans and leases since year-end relates primarily to a few commercial loans and leases.

The Company evaluates the underlying collateral of each nonperforming loan and continues to pursue the collection of interest and principal. Management believes that the current level of nonperforming assets remains low relative to the size of the Company's loan portfolio. As the loan portfolio continues to grow and

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mature, or if economic conditions worsen, management believes it possible that the level of nonperforming assets may increase, as may its level of charged-off loans.

Delinquencies - At June 30, 2007, loan balances of \$717,000 were 60 to 89 days past due, up from \$476,000 at December 31, 2006.

The following table sets forth information regarding nonperforming assets and loans 60-89 days past due as of the dates indicated:

	June 30, 2007	December 31, 2006
	<u> </u>	<u> </u>
	(In thousands)	
Loans and leases accounted for on a nonaccrual basis	\$2,285	\$1,407
Loans and leases past due 90 days or more, but still accruing	--	6
Impaired loans and leases (not included in nonaccrual loans and leases)	--	--
	<u> </u>	<u> </u>
Total nonperforming loans and leases	2,285	1,413
Other real estate owned	--	--
	<u> </u>	<u> </u>
Total nonperforming assets	<u>\$2,285</u>	<u>\$1,413</u>
Delinquent loans 60-89 days past due	\$ 717	\$ 476
Nonperforming loans and leases as a percent of total loans and leases	0.22%	0.14%
Nonperforming assets as a percent of total assets	0.16%	0.10%
Delinquent loans and leases 60-89 days past due as a percent of total loans	0.07%	0.05%

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 June 30, 2007, the Company had \$11.7 million of assets that were classified as substandard. This compares to \$8.2 million of assets that were classified as substandard at December 31, 2006. The Company had no assets that were classified as doubtful or loss at either date. Performing loans may or may not be adversely classified depending upon management's judgment with respect to each individual loan. At June 30, 2007, included in the assets that were classified as substandard were \$9.4 million of performing loans. This compares to \$6.8 million of adversely classified performing loans as of December 31, 2006. These amounts constitute assets that, in the opinion of management, could potentially migrate to nonperforming or doubtful status. Management believes that the June 30, 2007 level of adversely classified assets is low relative to the size of the Company's loan and lease portfolio. If a significant downturn in the local or regional market occurs or if other economic or market conditions worsen, management believes it possible that the level of adversely classified assets may increase. This in turn may necessitate an increase to the provision for loan losses in future periods.

Allowance for Credit Losses

The allowance for credit losses is comprised of the allowance for loan and lease losses and the reserve for unfunded lending commitments. In the third quarter of 2006, the Company reclassified the reserve for unfunded lending commitments from the allowance for loan and lease losses to other liabilities for all periods presented. The allowance for credit losses was \$13.1 million at June 30, 2007, compared to \$12.9 million at December 31, 2006.

During the first six months of 2007, the Company made additions to the allowance for loan and lease losses of \$200,000 and experienced net charge-offs of \$32,000, compared to additions to the allowance for

loan and lease losses of \$702,000 and net charge-offs of \$446,000 for the first six months of 2006. The net charge-offs in 2007 were primarily from small business loans. At June 30, 2007, the allowance for loan and lease losses stood at \$12.5 million and represented 549.0% of nonperforming loans and 1.22% of total loans and leases outstanding. This compares to an allowance for loan and lease losses of \$12.4 million, representing 875.9% of nonperforming loans and 1.23% of total loans and leases outstanding at December 31, 2006.

During the first six months of 2007, the Company increased the reserve for unfunded lending commitments by \$11,000, bringing the balance to \$578,000 at June 30, 2007. This compares to the December 31, 2006 balance in the reserve for unfunded lending commitments of \$567,000.

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

	Six Months Ended June 30, 2007	Year Ended December 31, 2006
	<hr/>	<hr/>
	(In thousands)	
Allowance for Loan and Lease Losses		
Balance at beginning of period	\$12,377	\$11,665
Loans charged-off:		

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Commercial loans and leases	(31)	(472)
Residential mortgage loans	--	--
Consumer and other loans	(47)	(47)
	<hr/>	<hr/>
Total loans charged-off	(78)	(519)
	<hr/>	<hr/>
Recoveries of loans previously charged-off:		
Commercial loans and leases	22	19
Residential mortgage loans	--	--
Consumer and other loans	24	10
	<hr/>	<hr/>
Total recoveries of loans previously charged-off	46	29
	<hr/>	<hr/>
Net charge-offs	(32)	(490)
Provision for loan and lease losses charged against income	200	1,202
	<hr/>	<hr/>
Balance at end of period	12,545	12,377
	<hr/>	<hr/>
Reserve for Unfunded Lending Commitments		
Balance at beginning of period	567	503
Provision for unfunded lending commitments	11	64
	<hr/>	<hr/>
Balance at end of period	578	567
	<hr/>	<hr/>
Allowance for Credit Losses		
Balance at end of period	\$13,123	\$12,944
	<hr/>	<hr/>

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

	June 30, 2007	December 31, 2006
	<hr/>	<hr/>
	(In thousands)	
Allowance for Loan and Lease Losses		
Loan category		
Commercial loans and leases	\$ 8,284	\$ 7,944
Residential mortgage loans	1,429	1,440
Consumer and other loans	1,726	2,086
Unallocated	1,106	907
	<hr/>	<hr/>

Total	\$12,545	\$12,377
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Assessing the appropriateness of the allowance for credit losses involves substantial uncertainties and is based upon management's evaluation of the amounts required to meet estimated charge-offs in the loan and lease portfolio after weighing various factors. Management's methodology to estimate loss exposure includes an analysis of individual loans and leases 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 experiences, general economic conditions and other pertinent factors. These risk factors are reviewed and revised by management where conditions indicate that the estimates initially applied are different from actual results. Management employs a similar process with respect to unfunded lending commitments. Based on this evaluation, management believes that the allowance for credit losses, as of June 30, 2007, is appropriate.

A portion of the allowance for loan and lease losses is not allocated to any specific segment of the loan portfolio. This non-specific allowance, also referred to as unallocated allowance, is maintained for two primary reasons: (i) there exists an inherent subjectivity and imprecision to the analytical processes employed, and (ii) the prevailing business environment, as it is affected by changing economic conditions and various external factors, may impact the portfolio in ways currently unforeseen. Management, therefore, has established and maintains a non-specific allowance for loan and lease losses. The amount of this measurement imprecision allocation was \$1.1 million at June 30, 2007, compared to \$907,000 at December 31, 2006.

With respect to changes within the allocation of the allowance for loan and lease losses, commercial loans and leases increased on a net basis reflecting increased growth as well as reassessment of risk within leases. The allocation related to consumer loans declined as a result of reassessment of risk within home equity loans. Additionally, the unallocated portion of the allowance for loan and lease losses increased largely from an increase in the number of larger commercial credits.

While management evaluates currently available information in establishing the allowance for loan and lease losses and the reserve for unfunded lending commitments, future adjustments to the allowance for credit losses may be necessary if conditions differ substantially from the assumptions used in making the evaluations. Management performs a comprehensive review of the allowance for loan and lease losses and the reserve for unfunded lending commitments on a quarterly basis. In addition, various regulatory agencies, as an integral part of their examination process, periodically review a financial institution's allowance for loan and lease 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.

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Results of Operations -Executive Overview

Selected income statement and per share data and operating ratios are presented in the table below for the three month periods indicated:

(In thousands, except per share data)	For the three month periods ended				
	June 30, 2007	March 31, 2007	December 31, 2006	September 30, 2006	June 30, 2006

Income statement data:					
Net interest income	\$10,292	\$10,228	\$10,173	\$10,676	\$10,329
				(a)	
Noninterest income	2,664	2,562	2,324	1,544	2,815
			(b)		
Noninterest expense (c)	9,624	9,511	8,674	9,504	9,725
Net income	2,194	2,178	2,537	1,643	2,006
Per share data:					
Diluted earnings per share	\$ 0.44	\$ 0.44	\$ 0.51	\$ 0.33	\$ 0.41
Dividends per common share	0.15	0.15	0.15	0.15	0.15
Operating ratios:					
Net interest margin	2.97%	2.97%	2.91%	3.08%	3.01%
Return on average assets	0.60%	0.61%	0.69%	0.45%	0.56%
Return on average equity	7.63%	7.79%	9.11%	6.10%	7.69%
Efficiency ratio (c)	74.28%	74.36%	69.41%	77.78%	73.99%

- (a) Noninterest income for the three month period ended September 30, 2006 includes losses on sales of available for sale securities of \$858,000 incurred by the Company as it restructured a portion of its investment portfolio during that quarter.
- (b) Noninterest expense for the three month period ended December 31, 2006 reflects the recovery of \$803,000 of insurance proceeds relating to a loss on note receivable incurred in the three month period ended March 31, 2006.
- (c) Effective September 30, 2006, the Company reclassified its reserve for unfunded lending commitments to other liabilities from the allowance for loan and lease losses. Prior period results have been reclassified to conform to the current period presentation.

The Company reported 2007 second quarter net income of \$2.2 million, up \$16,000, or 0.7%, from the prior quarter (three months ended March 31, 2007). Net income was up \$188,000, or 9.4%, on a comparative quarter basis (as compared to the three months ended June 30, 2006). Diluted earnings per common share ("EPS") was flat on a linked-quarter basis (as compared to the three months ended March 31, 2007) and increased 7.3% as compared to the same quarter a year ago.

The Company's second quarter 2006 GAAP earnings and GAAP EPS were negatively affected by the FHLB's deferral of its second quarter 2006 dividend to the third quarter of 2006. As a result, the Bank received approximately six months' worth of income on its investment in the FHLB during the third quarter of 2006. This deferral negatively impacted 2006 second quarter earnings and EPS by approximately \$148,000 and \$0.03 per share, respectively.

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To provide additional analysis regarding the Company's operating results, the following tables set forth certain information relating to the reconciliation of GAAP net income, EPS and related operating ratios to pro forma amounts as described above. Management believes this information is useful to the investor in

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comparing the Company's operating results to those from prior periods.

(In thousands, except per share data)	Quarter Ended June 30, 2007	Quarter Ended March 31, 2007	Quarter Ended June 30, 2006
Net income (GAAP)	\$2,194	\$2,178	\$2,006
Adjust for:			
FHLB dividend, net of tax	--	--	148
Pro forma net income	\$2,194	\$2,178	\$2,154
Diluted earnings per share (GAAP)	\$0.44	\$0.44	\$0.41
Effect of:			
FHLB dividend, net of tax	--	--	0.03
Pro forma diluted earnings per share	\$0.44	\$0.44	\$0.44

Quarter Ended June 30, 2007

	Net Interest Margin	Return on Average Assets	Return on Average Equity	Efficiency Ratio
GAAP ratios	2.97%	0.60%	7.63%	74.28%
Effect of:				
FHLB dividend, net of tax	--	--	--	--
Pro forma ratios	2.97%	0.60%	7.63%	74.28%

Quarter Ended March 31, 2007

	Net Interest Margin	Return on Average Assets	Return on Average Equity	Efficiency Ratio
GAAP ratios	2.97%	0.61%	7.79%	74.36%
Effect of:				
FHLB dividend, net of tax	--	--	--	--
Pro forma ratios	2.97%	0.61%	7.79%	74.36%

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Quarter Ended June 30, 2006

	Net Interest Margin	Return on Average Assets	Return on Average Equity	Efficiency Ratio
GAAP ratios	3.01%	0.56%	7.69%	73.99%
Effect of:				
FHLB dividend, net of tax	0.07%	0.04%	0.57%	-1.26%
Pro forma ratios	3.08%	0.60%	8.26%	72.73%

Net income for the second quarter of 2007 increased \$40,000 (up 1.9%) and EPS remained unchanged as compared to the pro forma amounts for the second quarter of 2006. The Company has mitigated the effects of net interest margin compression of 11 bps through expense control and organic noninterest income growth.

The moderate increase in second quarter 2007 net interest income as compared to the first quarter of 2007 was due in part to increased yields on investment securities of 16 bps. Overall, the yield on earning assets and cost of liabilities were essentially unchanged with increases of 1 bp and 2 bps, respectively. The decrease in borrowing balances offset the slight increases in deposit costs. Compared to the second quarter of
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2006, the net interest margin for the three months ended June 30, 2007 decreased 11 bps to 2.97% on a pro forma basis. In comparison to the same period a year ago, the flat-to-inverted yield curve and increases in short-term rates, in addition to competition for deposits, loans and customers in the Company's market area, have resulted in increases in cost of funds outpacing increases in earning asset yields.

Noninterest income for the second quarter of 2007 increased on a linked-quarter basis by \$102,000. This growth included increases in service charges on deposit accounts, commissions on nondeposit investment products and loan related fees. Commissions on leases originated for third parties, while down from the 2007 first quarter, remained strong at \$286,000 for the current quarter. In comparison to the 2006 second quarter, noninterest income was down \$151,000 for the 2007 second quarter. However, included within other income for the second quarter of 2006 was \$250,000 of commissions on the sale of Rhode Island historic tax credits. Through the second quarter of 2007, these tax credits were not available. The Company partially offset this lack of tax credit availability with organic growth in other noninterest income accounts. Compared to the same quarter a year ago, commissions on leases originated for third parties were up \$175,000, or 157.7%, and deposit service charges were up \$126,000, or 10.0%.

Noninterest expenses for the current quarter were up slightly on a linked-quarter basis by \$113,000, or 1.2%, with increases in marketing and data processing costs. In comparison to the 2006 second quarter, noninterest expenses declined by \$101,000, or 1.0% in the second quarter of 2007. Marketing costs declined \$192,000, or 31.0%, as the Company incurred higher media and customer event sponsorship costs in 2006. The increase in salaries and benefits of \$84,000, or 1.6%, for the 2007 second quarter were largely due to increased employee commissions on leases originated for third parties. Professional services costs were up \$87,000, or 17.0%, reflective of increased costs incurred with the Company's contested election for its Board of Directors partially offset by the absence of third-party costs associated with the sale of Rhode Island historic tax credits.

The Company's key operating ratios (return on average assets, return on average equity, and efficiency ratio) for the second quarter of 2007 were consistent with the first quarter of 2007 and down slightly from the

second quarter of 2006. Throughout 2007, management will continue to focus on expense control as part of its efforts to improve earnings and build shareholder value despite the pressure on the net interest margin.

Results of Operations - Comparison of the Three Months Ended June 30, 2007 and 2006

Net Interest Income

Net interest income for the quarter ended June 30, 2007 was down \$37,000, or 0.4%, from the \$10.3 million earned in the second quarter of 2006. Similarly, the net interest margin for the second quarter of 2007 of 2.97% was down from the net interest margin for the 2006 period of 3.01%. The decrease in net interest income and margin decrease of 4 bps were attributable to movements in the yield curve, increases in short-term rates and competition for deposits, loans and customers in our market area. Average earning assets were \$11.9 million, or 0.9%, higher, and average interest-bearing liabilities were \$1.3 million, or 0.1%, lower, than the comparable period a year earlier.

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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 three month periods 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. Available for sale securities are stated at amortized cost.

(In thousands)

For the three months ended June 30,

Assets	2007			2006		
	Average Balance	Interest Earned/ Paid	Average Yield	Average Balance	Interest Earned/ Paid	Average Yield
Earning assets:						
Overnight investments	\$ 13,651	\$ 185	5.43%	\$ 3,321	\$ 47	5.73%
Investment securities	119,917	1,534	5.12%	160,758	1,724	4.29%
Mortgage-backed securities	227,289	2,734	4.81%	221,426	2,523	4.56%
Stock in the FHLB	15,671	265	6.77%	16,530	--	0.00%
Loans receivable:						
Commercial loans and leases	530,038	9,761	7.38%	457,705	8,279	7.26%
Residential mortgage loans	261,019	3,446	5.28%	295,027	3,898	5.28%
Consumer and other loans	218,195	3,390	6.23%	219,082	3,291	6.02%
Total earning assets	1,385,780	21,315	6.16%	1,373,849	19,762	5.76%

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Total liabilities and shareholders' equity	\$1,461,855	\$1,447,264
Net interest income	\$10,292	\$10,329
Net interest rate spread	2.30%	2.46%
Net interest rate margin	2.97%	3.01%

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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 proportionally to the individual rate and volume changes.

Three Months Ended June 30,
2007 vs. 2006
Increase/(decrease) due to

(In thousands)	Rate	Volume	Total
Interest income:			
Overnight investments	\$ (2)	\$ 140	\$ 138
Investment securities	288	(478)	(190)
Mortgage-backed securities	137	74	211
Stock in the FHLB	265	--	265
Commercial loans and leases	87	1,395	1,482
Residential mortgage loans	(3)	(449)	(452)
Consumer and other loans	130	(31)	99
Total interest income	902	651	1,553
Interest expense:			
NOW accounts	23	(14)	9
Money market accounts	(4)	(9)	(13)
Savings accounts	716	149	865
Certificate of deposit accounts	793	319	1,112
Overnight and short-term borrowings	36	102	138
Wholesale repurchase agreements	39	(128)	(89)
FHLB borrowings	62	(503)	(441)
Subordinated deferrable interest debentures	9	--	9
Total interest expense	1,674	(84)	1,590

Net interest income	\$ (772)	\$ 735	\$ (37)
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Interest Income - Investments - Total investment income (consisting of interest on overnight investments, investment securities and MBSs and dividends on FHLB stock) was \$4.7 million for the quarter ended June 30, 2007, compared to \$4.3 million for the 2006 period. The increase in total investment income was \$424,000, or 9.9%. Investment income for the current quarter benefited from the higher-yielding securities the Company purchased as part of the investment portfolio restructuring conducted in the third quarter of 2006. Additionally, in the second quarter of 2006, the Bank was unable to record approximately \$228,000 of dividends on FHLB stock as the FHLB deferred its second quarter dividend to the third quarter of 2006.

Going forward, the Company intends to primarily redeploy cash flows available from maturing investment securities and MBSs into higher-yielding internally generated assets, such as commercial loans and leases. With respect to duration and repricing of the Company's investment portfolio, the majority of the Company's investments is comprised of U.S. Agency securities and MBSs with repricing periods or expected duration of less than five years.

Interest Income - Loans and Leases - Interest from loans and leases was \$16.6 million for the quarter ended June 30, 2007, and represented a yield on total loans and leases of 6.59%. This compares to \$15.5 million of interest, and a yield of 6.38%, for the second quarter of 2006. Increased interest income resulting from the growth in the average balance of loans and leases of \$37.4 million, or 3.9%, was augmented by an increase in the yield on loans and leases of 21 bps.

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The average balance of the various components of the loan and lease portfolio changed from the second quarter of 2006 as follows: commercial loans and leases increased \$72.3 million, or 15.8%. Consumer and other loans decreased \$887,000, or 0.4%, and residential mortgage loans decreased \$34.0 million, or 11.5%. Changes in the average yields from the first quarter of 2006 were as follows: commercial loans and leases increased 12 bps, to 7.38%, and consumer and other loans increased 21 bps, to 6.23%, while residential mortgage loans remained unchanged at 5.28%. The yields on loans and leases benefited primarily from higher yields on new loan originations and upward repricing of existing variable rate assets.

Interest Expense - Deposits and Borrowings - Interest paid on deposits and borrowings increased \$1.6 million, or 16.9%, to \$11.0 million for the three months ended June 30, 2007, up from \$9.4 million for the same period during 2006. The overall average cost for interest-bearing liabilities increased 56 bps to 3.86% for the second quarter of 2007, compared to 3.30% for the second quarter of 2006. The average balance of total interest-bearing liabilities remained relatively unchanged at \$1.1 billion for the three months ended June 30, 2007 and 2006.

The growth in deposit average balances was centered primarily in CDs (up \$31.7 million, or 9.0%) and savings accounts (up \$26.8 million, or 7.8%). These increases were somewhat offset by decreases in lower-costing NOW accounts (down \$10.1 million, or 13.6%) and money market accounts (down \$2.0 million, or 22.9%). Borrowings decreased as compared to the second quarter of 2006, with increases in customer short-term borrowings (up \$8.2 million, or 19.3%) surpassed by larger decreases in FHLB funding (down \$45.8 million, or 16.0%), as well as wholesale repurchase agreements (down \$10.0 million, or 50.0%).

The rise in deposit and borrowing costs can be attributed to a number of factors. Customer demand remains strong for higher-yielding deposit products, due in part to increases in short-term rates. Competition for deposits continues to be strong. Additionally, bank advertising has been prevalent in the local market area,

which has increased customer awareness of attractive rates. Moreover, online banking has enabled customers to more actively manage their finances and has facilitated the movement of available funds from demand deposit accounts and lower-yielding deposit accounts into higher-yielding deposit products. In an effort to attract and retain customers and deposit relationships, the Bank has offered not only the typically higher-costing CDs, but also higher-yielding savings accounts.

Costs have also increased for short- and long-term borrowings. The Company's borrowing rates have been affected by the flat-to-inverted yield curve as well as the Federal Reserve Board's ("FRB") rate increases over the past few years. Overall, the Company's liability costs continue to be dependent upon a number of factors including general economic conditions, national and local interest rates, competition in the local deposit marketplace, interest rate tiers offered and the Company's cash flow needs.

Provision for Loan and Lease Losses

The provision for loan and lease losses was \$100,000 for the quarter ended June 30, 2007, down \$335,000 from the second quarter of 2006. The primary reasons for the reduction in the provision for loan and lease losses were the lack of net charge-offs this quarter as well as lower relative growth in commercial loans. Additions to the allowance for loan and lease losses during the second quarter of 2007 were primarily in response to growth of the commercial loan and lease portfolio and general concern for economic conditions.

Management evaluates several factors including new loan originations, actual and estimated charge-offs and the risk characteristics of the loan and lease portfolio and general economic conditions when determining the provision for each quarter. As the loan portfolio continues to grow and mature, or if economic conditions worsen, management believes it possible that the level of nonperforming assets may increase, which in turn may lead to increases in the provision for loan and lease losses. Also see discussion under "*Allowance for Credit Losses*".

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Noninterest Income

Total noninterest income decreased \$151,000, or 5.4%, to \$2.7 million for the second quarter of 2007, from \$2.8 million for the second quarter of 2006. Commissions on leases originated for third parties grew \$175,000, or 157.7%, compared to the same quarter a year ago. Also, service charges on deposit accounts increased by \$126,000, or 10.0%, compared to the second quarter of 2006. Income from BOLI benefited from the tax-free exchange the Company entered into in the fourth quarter of 2006 and the additional purchases of BOLI made during 2006, with an overall increase of \$65,000, or 33.3%. These increases were offset by lower commissions on nondeposit investment products in the second quarter of 2007 (down \$80,000, or 31.9%) and loan related fees (down \$80,000, or 29.2%). Additionally, other income decreased by \$378,000, or 54.5%, primarily due to the lack of availability of Rhode Island historic tax credits, which produced \$250,000 in commissions in the second quarter of 2006.

Noninterest Expense

Noninterest expense for the second quarter of 2007 decreased \$101,000, or 1.0%, to \$9.6 million from \$9.7 million in 2006. In the 2007 second quarter, marketing costs declined \$192,000, or 31.0%, compared to the second quarter a year ago. Professional services expenses increased \$87,000, or 17.0%, on a net basis, reflecting an increase in investor relation costs surrounding the Company's contested election for its Board of Directors partially offset by the absence of third-party costs associated with the sale of Rhode Island historic tax credits mentioned above. Salaries and benefits costs increased by \$84,000, or 1.6%, mainly due to increased employee commissions on leases originated for third parties. Other miscellaneous expenses decreased \$31,000, or 2.6%, for the second quarter of 2007 compared to the same period a year ago, led by

lower customer related sweep activity. The Company's efficiency ratio increased from the second quarter 2006 pro forma ratio of 72.73% to 74.28% for the second quarter of 2007. These efficiency ratios continue to be negatively impacted by the compression in the net interest margin, which has partially negated cost savings realized.

Income Tax Expense

Income tax expense of \$1.0 million was recorded for the three months ended June 30, 2007, compared to \$978,000 for the same period during 2006. This represented total effective tax rates of 32.1% and 32.8%, respectively. Tax-favored income from BOLI, along with the Company's utilization of a Rhode Island passive investment company, has reduced the effective tax rate from the 40.9% combined statutory federal and state tax rates.

Results of Operations - Comparison of the Six Months Ended June 30, 2007 and 2006

General

Net income for the first six months of 2007 increased \$841,000, or 23.8%, to \$4.4 million, from \$3.5 million for the first six months of 2006. EPS increases in a similar manner, with an increase of \$0.16 per share, or 22.2%. This increase includes the impact of the lack of an FHLB dividend in the second quarter of 2006, as well as a non-recurring loss that occurred in the first quarter of 2006.

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To provide more meaningful analysis regarding the Company's results, the following tables set forth certain information relating to the reconciliation of GAAP net income, EPS and related operating ratios to pro forma amounts as described above.

(In thousands, except per share data)	Six Months Ended June 30, 2007	Six Months Ended June 30, 2006
Net income (GAAP)	\$4,372	\$3,531
Add back:		
FHLB dividend, net of tax	--	148
Non-recurring loss, net of tax	--	564
Pro forma net income	\$4,372	\$4,243
Diluted earnings per share (GAAP)	\$0.88	\$0.72
Effect of:		
FHLB dividend, net of tax	--	0.03
Non-recurring loss, net of tax	--	0.12
Pro forma diluted earnings per share	\$0.88	\$0.87

Six Months Ended June 30, 2007

Six Months Ended June 30, 2006

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	Net Interest Margin	Return on Average Assets	Return on Average Equity	Efficiency Ratio	Net Interest Margin	Return on Average Assets	Return on Average Equity	Efficiency Ratio
GAAP ratios	2.97%	0.60%	7.72%	74.32%	3.13%	0.50%	6.79%	77.55%
Effect of:								
FHLB dividend, net of tax	--	--	--	--	0.03%	0.02%	0.28%	-0.66%
Non-recurring loss, net of tax	--	--	--	--	--	0.08%	1.08%	-3.25%
Pro forma ratios	2.97%	0.60%	7.72%	74.32%	3.16%	0.60%	8.15%	73.64%

On a pro forma basis, net income increased by \$129,000, or 3.0%, and EPS increased \$0.01 per share, or 1.1%. Noninterest income increased \$106,000, or 2.1%, while noninterest expenses dropped \$546,000, or 2.8%. Provision for loan losses decreased by \$502,000, or 71.5%, primarily as a result of decreased charge-offs. These gains were partially offset by a decline in net interest income of \$1.1 million, or 5.0%. The net interest margin decreased 19 bps, while total average earning assets increased by over \$15 million.

Net Interest Income

For the six months ended June 30, 2007, net interest income was \$20.5 million, compared to \$21.4 million for the 2006 period. The net interest margin for the first six months of 2007 was 2.97%, down from the net interest margin for the 2006 period of 3.13%. The decrease in net interest income of \$859,000, or 4.0%, and margin decrease of 16 bps were attributable to the flat-to-inverted shape of the yield curve, increases in short-term rates, as well as competition for deposits, loans and customers in our market area. Average earning assets were \$15.5 million, or 1.1%, higher, and average interest-bearing liabilities were \$2.8 million, or 0.2%, higher than the comparable period a year earlier.

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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 six month periods 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. Available for sale securities are stated at amortized cost.

(In thousands)

Six Months Ended June 30,

	2007			2006		
Assets	Average balance	Interest earned/paid	Average yield	Average balance	Interest earned/paid	Average yield

Earning assets:

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Overnight investments	\$ 17,490	\$ 472	5.44%	\$ 3,298	\$ 77	4.70%
Investment securities	113,800	2,867	5.04%	159,018	3,395	4.27%
Mortgage-backed securities	233,229	5,603	4.80%	226,942	5,177	4.56%
Stock in the FHLB	15,776	546	6.97%	16,415	211	2.59%
Loans receivable:						
Commercial loans and leases	525,606	19,240	7.37%	448,701	15,965	7.17%
Residential mortgage loans	260,867	6,947	5.33%	300,289	7,979	5.31%
Consumer and other loans	218,108	6,742	6.23%	214,745	6,353	5.97%
	<hr/>			<hr/>		
Total earning assets	1,384,876	42,417	6.15%	1,369,408	39,157	5.74%
	<hr/>			<hr/>		
Cash and due from banks	23,650			22,593		
Allowance for loan and lease losses	(12,443)			(11,777)		
Premises and equipment	14,731			15,309		
Goodwill, net	11,317			11,262		
Accrued interest receivable	5,759			5,930		
Bank-owned life insurance	23,363			20,177		
Prepaid expenses and other assets	9,486			9,766		
	<hr/>			<hr/>		
Total assets	\$1,460,739			\$1,442,668		
	<hr/>			<hr/>		
Liabilities and Shareholders' Equity						
Interest-bearing liabilities:						
Deposits:						
NOW accounts	\$ 64,243	201	0.63%	\$ 77,140	194	0.51%
Money market accounts	6,651	63	1.91%	10,030	76	1.53%
Savings accounts	366,032	5,139	2.83%	338,398	3,179	1.89%
Certificate of deposit accounts	388,547	8,890	4.61%	351,382	6,306	3.62%
Overnight and short-term borrowings	52,069	1,303	5.05%	36,908	813	4.45%
Wholesale repurchase agreements	12,873	330	5.11%	20,000	412	4.16%
FHLB borrowings	238,177	5,231	4.43%	291,950	6,088	4.20%
Subordinated deferrable interest debentures	18,558	740	7.98%	18,558	710	7.65%

Total interest-bearing liabilities	1,147,150	21,897	3.85%	1,144,366	17,778	3.13%
Noninterest-bearing deposits	182,704			175,903		
Other liabilities	16,723			17,499		
Total liabilities	1,346,577			1,337,768		
Shareholders' Equity:	114,162			104,900		
Total liabilities and shareholders' equity	\$1,460,739			\$1,442,668		
Net interest income		\$20,520			\$21,379	
Net interest rate spread			2.30%			2.61%
Net interest rate margin			2.97%			3.13%

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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 proportionally to the individual rate and volume changes.

Six Months Ended June 30,
2007 vs. 2006
Increase/(decrease) due to

(In thousands)	Rate	Volume	Total
Interest income:			
Overnight investments	\$ 14	\$ 381	\$ 395
Investment securities	522	(1,050)	(528)
Mortgage-backed securities	267	159	426
Stock in the FHLB	343	(8)	335
Commercial loans and leases	375	2,900	3,275
Residential mortgage loans	17	(1,049)	(1,032)
Consumer and other loans	331	58	389

Total interest income	1,869	1,391	3,260
	<u> </u>	<u> </u>	<u> </u>
Interest expense:			
NOW accounts	43	(36)	7
Money market accounts	16	(29)	(13)
Savings accounts	1,682	278	1,960
Certificate of deposit accounts	1,866	718	2,584
Overnight and short-term borrowings	121	369	490
Wholesale repurchase agreements	86	(168)	(82)
FHLB borrowings	311	(1,168)	(857)
Subordinated deferrable interest debentures	30	--	30
	<u> </u>	<u> </u>	<u> </u>
Total interest expense	4,155	(36)	4,119
	<u> </u>	<u> </u>	<u> </u>
Net interest income	\$(2,286)	\$1,427	\$ (859)
	<u> </u>	<u> </u>	<u> </u>

Interest Income - Investments - Total investment income (consisting of interest on overnight investments, investment securities and MBSs and dividends on FHLB stock) was \$9.5 million for the six months ended June 30, 2007, compared to \$8.9 million for the 2006 period. The increase in total investment income was \$628,000, or 7.1%, and was primarily attributable to higher yields on newly purchased assets as well as the investment portfolio restructuring the Company conducted in the third quarter of 2006. Additionally, investment income for the first six months of 2006 was negatively impacted by the FHLB's dividend deferral for the second quarter of 2006.

Interest Income - Loans and Leases - Interest from loans and leases was \$32.9 million for the six months ended June 30, 2007, and represented a yield on total loans and leases of 6.59%. This compares to \$30.3 million of interest, and a yield of 6.32%, for the same period a year ago. Increased interest income resulting from the growth in the average balance of loans and leases of \$40.8 million, or 4.2%, was augmented by an increase in the yield on loans of 27 bps.

The average balance of the various components of the loan and lease portfolio changed compared to the same period in 2006 as follows: commercial loans and leases increased \$76.9 million, or 17.1%, and consumer and other loans increased \$3.4 million, or 1.6%, while residential mortgage loans decreased \$39.4 million, or 13.1%. Changes in the average yields from the first six months of 2006 were as follows: commercial loans and leases increased 20 bps, to 7.37%, and consumer and other loans increased 26 bps, to 6.23%, while residential mortgage loans increased 2 bps, to 5.33%. The yields on loans and leases benefited primarily from higher yields on new loan originations and upward repricing of existing variable rate assets.

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Interest Expense - Deposits and Borrowings - Interest paid on deposits and borrowings increased \$4.1 million, or 23.2%, to \$21.9 million for the six months ended June 30, 2007, from \$17.8 million for the same period during 2006. The overall average cost for interest-bearing liabilities increased 72 bps to 3.85% for the first six months of 2007, compared to 3.13% for the first six months of 2006. The average balance of total interest-bearing liabilities increased \$2.8 million, from \$1.14 billion for the first six months of 2006 to \$1.15 billion for the first six months of 2007. The growth in deposit average balances was centered primarily in CDs (up \$37.2 million, or 10.6%) and savings accounts (up \$27.6 million, or 8.2%). Offsetting the increase in CDs and savings accounts were decreases in NOW accounts (down \$12.9 million, or 16.7%) and money market accounts (\$3.4 million, or 33.7%).

Borrowings decreased for the first six months of 2007 compared to the prior year, with increases in short-term borrowings (up \$15.2 million, or 41.1%) surpassed by larger decreases in FHLB borrowings (down \$53.8 million, or 18.4%), as well as wholesale repurchase agreements (down \$7.1 million, or 35.6%).

Provision for Loan and Lease Losses

For the six months ended June 30, 2007, the provision for loan and lease losses was \$200,000, down from the \$702,000 recorded during the same period in 2006. The primary reasons for the reduction in the provision for loan and lease losses were lower net charge-offs thus far in 2007 as well as lower relative growth in commercial loans. Additions to the allowance for loan and lease losses during the first six months of 2007 were primarily in response to growth of the commercial loan and lease portfolio and general concern for economic conditions.

Noninterest Income

Total noninterest income increased \$106,000, or 2.1%, to \$5.2 million for the first six months of 2007 from \$5.1 million for the same period in 2006. The Company experienced increases in commissions on leases originated for third parties (up \$455,000, or 263.0%). Service charges on deposit accounts increased \$255,000, or 10.4%, and remain the largest source of noninterest income for the Company. Additionally, income from bank-owned life insurance was up \$137,000, or 36.6%, benefiting from the tax-free exchange the Company entered into in the fourth quarter of 2006. These increases more than offset the decrease in other income, primarily due to lower customer related sweep activity and no commissions on historic tax credits during the first six months of 2007.

Noninterest Expense

Noninterest expense for the first six months of 2007 decreased \$1.4 million, or 6.9%, to \$19.1 million from \$20.5 million in 2006. In the first quarter of 2006, the Company incurred a non-recurring loss on a note receivable of \$868,000. Excluding this loss, noninterest expenses decreased \$546,000, or 2.8%, which is reflective of the Company's ongoing initiatives to control expense growth.

Salaries and benefits costs declined \$161,000, or 1.5%, during the first months of 2007. Additionally, marketing expenses decreased by \$159,000, or 16.6%, and loan workout costs decreased \$155,000, or 97.5%. Included within the net decrease in noninterest expenses were increases in professional services expenses of \$323,000, or 34.8%, primarily due to costs incurred in connection with the Company's contested election for its Board of Directors. Other miscellaneous expenses decreased \$315,000, or 12.3%, from a year ago, with decreases in customer related sweep activity and operating expenses. On a pro forma basis, adjusting for the aforementioned non-recurring loss and FHLB dividend deferral, the Company's efficiency ratio remained relatively consistent year-over-year at 74.32% for the first six months of 2007 compared to a pro forma ratio of 73.64% for the same period in 2006.

Income Tax Expense

Income tax expense of \$2.0 million was recorded for the six months ended June 30, 2007, compared to \$1.7 million for the same period during 2006. This represented total effective tax rates of 31.8% and 32.7%, respectively. Tax-favored income from BOLI, along with the Company's utilization of a Rhode Island

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passive investment company, has reduced the effective tax rate from the 40.9% combined statutory federal and state tax rates.

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 and 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 seeks to maintain a high degree of flexibility with a liquidity target of 10% to 30% of total assets. At June 30, 2007, overnight investments, investment securities and MBSs available for sale amounted to \$335.4 million, or 22.9% of total assets. This compares to \$381.2 million, or 25.8% of total assets at December 31, 2006. 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. The Bank also has access to funding through wholesale repurchase agreements. 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 June 30, 2007 was \$115.1 million, as compared to \$112.1 million at December 31, 2006. This difference of \$3.0 million was the result of net income of \$4.4 million, proceeds from the exercise of stock options and related tax effects of \$1.4 million, decrease in accumulated other comprehensive income of \$867,000 (attributable to increases in net unrealized losses on investments and MBSs) and share-based compensation of \$124,000. Partially offsetting the aforementioned items were dividend payments of \$1.5 million and stock repurchases of \$605,000.

All FDIC-insured institutions must meet specified minimal capital requirements. These regulations require banks to maintain a minimum leverage capital ratio. In addition, the FDIC has adopted capital guidelines based upon ratios of a bank's capital to total assets adjusted for risk. 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. These regulations require banks to maintain minimum capital levels for capital adequacy purposes and higher capital levels to be considered "well capitalized".

The FRB has also issued capital guidelines for bank holding companies. These guidelines require the Company to maintain minimum capital levels for capital adequacy purposes. In general, the FRB has adopted substantially identical capital adequacy guidelines as the FDIC. Such standards are applicable to bank holding companies and their bank subsidiaries on a consolidated basis.

As of June 30, 2007, the Company and the Bank met all applicable minimum capital requirements and were considered "well capitalized" by both the FRB and the FDIC. Additionally, at June 30, 2007, the Company had approximately \$16 million of additional capital (held at the parent company), which is available

to support the Bank's future growth.

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The Company's and the Bank's actual and required capital amounts and ratios are as follows:

	Actual		Minimum Required For Capital Adequacy Purposes		Minimum Required To Be Considered "Well Capitalized"	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<u>(Dollars in thousands)</u>						
At June 30, 2007:						
<u>Bancorp Rhode Island, Inc.</u>						
Tier I capital (to average assets)	\$125,642	8.62%	\$43,704	3.00%	\$ 72,840	5.00%
Tier I capital (to risk weighted assets)	125,642	12.42%	40,458	4.00%	60,687	6.00%
Total capital (to risk weighted assets)	138,187	13.66%	80,916	8.00%	101,145	10.00%
<u>Bank Rhode Island</u>						
Tier I capital (to average assets)	\$109,256	7.52%	\$43,572	3.00%	\$ 72,620	5.00%
Tier I capital (to risk weighted assets)	109,256	10.81%	40,438	4.00%	60,657	6.00%
Total capital (to risk weighted assets)	121,801	12.05%	80,876	8.00%	101,094	10.00%
At December 31, 2006:						
<u>Bancorp Rhode Island, Inc.</u>						
Tier I capital (to average assets)	\$121,782	8.37%	\$43,658	3.00%	\$ 72,763	5.00%
Tier I capital (to risk weighted assets)	121,782	12.05%	40,428	4.00%	60,642	6.00%
Total capital (to risk weighted assets)	134,159	13.27%	80,856	8.00%	101,070	10.00%
<u>Bank Rhode Island</u>						
Tier I capital (to average assets)	\$104,213	7.18%	\$43,540	3.00%	\$ 72,567	5.00%
Tier I capital (to risk weighted assets)	104,213	10.32%	40,405	4.00%	60,607	6.00%
Total capital (to risk weighted assets)	116,590	11.54%	80,809	8.00%	101,011	10.00%

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Quantitative and Qualitative Disclosures About Market Risk

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Risk

The principal market risk facing the Company is interest rate risk. The Company's objective regarding interest rate risk is to manage its assets and funding sources to produce results which are consistent with its liquidity, capital adequacy, growth and profitability goals, while maintaining interest rate risk exposure within established parameters over a range of possible interest rate scenarios.

Interest rate risk management is governed by the Bank's Asset/Liability Committee ("ALCO"). The ALCO establishes exposure limits that define the Company's tolerance for interest rate risk. The ALCO monitors current exposures versus limits and reports results to the Board of Directors. The policy limits and guidelines serve as benchmarks for measuring interest rate risk and for providing a framework for evaluation and interest rate risk management decision making. The primary tools for managing interest rate risk currently are the securities portfolio, purchased mortgages, wholesale repurchase agreements and borrowings from the FHLB.

The Company's interest rate risk position is measured using both income simulation and interest rate sensitivity "gap" analysis. Income simulation is the primary tool for measuring the interest rate risk inherent in the Company's balance sheet at a given point in time by showing the effect on net interest income, over a 24-month period, of 200 bps interest rate ramps. These simulations take into account repricing, maturity and prepayment characteristics of individual products. The ALCO reviews simulation results to determine whether the exposure resulting from changes in market interest rates remains within established tolerance levels over both a 12-month and 24-month horizon, and develops appropriate strategies to manage this exposure. The Company's guidelines for interest rate risk specify that if interest rates were to shift up or down 200 bps over a 12-month and 24-month period, estimated net interest income should decline by no more than 10.0%. As of June 30, 2007, net interest income simulation indicated that the Company's exposure to changing interest rates was within these tolerances. The ALCO reviews the methodology utilized for calculating interest rate risk exposure and may periodically adopt modifications to this methodology.

The following table presents the estimated impact of interest rate ramps on the Company's estimated net interest income over a twenty-four month period beginning July 1, 2007:

	Estimated Exposure to Net Interest Income	
	Dollar Change	Percent Change
	(Dollars in thousands)	
Initial Twelve Month Period:		
Up 200 bps	\$(1,179)	-2.7%
Down 200 bps	100	0.2%
Subsequent Twelve Month Period:		
Up 200 bps	\$(3,648)	-8.0%
Down 200 bps	(1,203)	-2.6%

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The Company also uses interest rate sensitivity "gap" analysis to provide a more general overview of its interest rate risk profile. 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. At June 30, 2007, the Company's one year cumulative gap was a negative \$201.3 million, or 13.7% of total assets.

For additional discussion on interest rate risk see the section titled "Asset and Liability Management" on pages 55 through 57 of the Company's 2006 Annual Report on Form 10-K.

ITEM 4. Controls and Procedures

As required by Rule 13a-15 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), the Company carried out an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of the end of the period covered by this report. This evaluation was carried out under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and the Company's Chief Financial Officer. Based upon that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms.

There was no significant change in the Company's internal control over financial reporting that occurred during the Company's most recent fiscal quarter that has materially affected, or is reasonably likely to affect, the Company's internal control over financial reporting. The Company continues to enhance its internal controls over financial reporting, primarily by evaluating and enhancing process and control documentation. Management discusses with and discloses these matters to the Audit Committee of the Board of Directors and the Company's auditors.

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BANCORP RHODE ISLAND, INC. Other Information

PART II. Other Information

Item 1. Legal Proceedings

There are no material pending legal proceedings to which the Company or its subsidiaries are a party, or to which any of their property is subject, other than ordinary routine litigation incidental to the business of banking.

Item 1A. Risk Factors

There have been no material changes from the risk factors as previously disclosed in the Company's 2006 Annual Report on Form 10-K.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The table below summarizes the Company's repurchases of common stock during the quarter ended June 30, 2007:

Period	Total number of shares purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Announced Plan (a)	Maximum number of shares that may yet be purchased under the plan
4/1/07 through 4/30/07	--	--	--	240,000
5/1/07 through 5/31/07	10,000	\$38.20	10,000	230,000
6/1/07 through 6/30/07	--	--	--	230,000

- (a) The Company's Board of Directors has authorized the repurchase of up to 245,000 shares of the Company's common stock or approximately five percent of the outstanding shares. The repurchases, which may be conducted through open market purchases or privately negotiated purchases, may be made periodically, subject to market conditions, at the discretion of management. As of June 30, 2007, 15,000 shares have been purchased to date.

Item 3. Defaults Upon Senior Securities

No defaults upon senior securities have taken place.

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

At the Annual Meeting of Shareholders held May 16, 2007, holders of common stock elected the Board's nominees to the Board of Directors and ratified the appointment of independent registered public accountants.

The vote for Class II director nominees with terms expiring in 2010 was:

	<u>FOR</u>	<u>WITHHELD</u>
CLASS II DIRECTORS		
John R. Berger	4,357,397	41,032
Richard L. Bready	4,357,397	41,032
Mark R. Feinstein	2,748,330	5,312
Michael E. McMahon	4,357,272	41,157
Pablo Rodriguez, M.D.	2,747,412	6,230
Richard J. Lashley	1,642,027	2,760
John W. Palmer	1,642,027	2,760

(Date)

Linda H. Simmons
Chief Financial Officer
and Treasurer

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