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BANCORP RHODE ISLAND INC
Form 10-Q
November 13, 2001

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C.

FORM 10-Q

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

For quarter ended: September 30, 2001

Commission File No. 001-16101

BANCORP RHODE ISLAND, INC.

(Exact Name of Registrant as Specified in Its Charter)

RHODE ISLAND

05-0509802

(State or Other Jurisdiction
of Incorporation or Organization)

(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 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 (X) No

Indicate the number of shares outstanding of each of the Registrant's classes of common stock, as of Nov. 5, 2001:

Common Stock - Par Value \$0.01

3,741,050 shares

(class)

(outstanding)

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FORM 10-Q

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BANCORP RHODE ISLAND, INC.
Consolidated Balance Sheets

September 30, De
2001

(Dollars in tho

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ASSETS:

| | |
|---|-----------|
| Cash and due from banks | \$ 19,249 |
| Federal funds sold | 8,725 |
| Investment securities available for sale (amortized cost of \$52,005 and \$47,459 at September 30, 2001 and December 31, 2000, respectively) | 52,806 |
| Mortgage-backed securities available for sale (amortized cost of \$134,711 and \$117,543 at September 30, 2001 and December 31, 2000, respectively) | 136,513 |
| Stock in Federal Home Loan Bank of Boston | 5,664 |
| Loans receivable: | |
| Residential mortgage loans | 319,572 |
| Commercial loans | 226,536 |
| Consumer and other loans | 60,171 |
| | ----- |
| Total loans | 606,279 |
| | |
| Less allowance for loan losses | (8,440) |
| | ----- |
| Net loans | 597,839 |
| Premises and equipment, net | 6,707 |
| Other real estate owned | 22 |
| Goodwill, net | 11,057 |
| Accrued interest receivable | 6,740 |
| Prepaid expenses and other assets | 630 |
| | ----- |
| Total assets | \$845,952 |
| | ===== |

LIABILITIES:

| | |
|---|-----------|
| Deposits: | |
| Demand deposit accounts | \$100,566 |
| NOW accounts | 39,509 |
| Money market accounts | 9,349 |
| Savings accounts | 247,853 |
| Certificate of deposit accounts | 255,107 |
| | ----- |
| Total deposits | 652,384 |
| Overnight and short-term borrowings | 16,436 |
| Federal Home Loan Bank of Boston borrowings | 113,285 |
| Other borrowings | -- |
| Company-obligated mandatorily redeemable capital securities | 3,000 |
| Other liabilities | 2,394 |
| | ----- |
| Total liabilities | 787,499 |
| | ----- |

SHAREHOLDERS' EQUITY:

| | |
|--|-----------|
| Common stock, par value \$0.01 per share, authorized 11,000,000 shares: | |
| Voting: Issued and outstanding 3,509,773 shares in 2001 and 3,448,950 shares in 2000 | 35 |
| Non-Voting: Issued and outstanding 228,477 shares in 2001 and 280,000 shares in 2000 | 2 |
| Additional paid-in capital | 39,655 |
| Retained earnings | 17,178 |
| Accumulated other comprehensive income (loss), net | 1,583 |
| | ----- |
| Total shareholders' equity | 58,453 |
| | ----- |
| Total liabilities and shareholders' equity | \$845,952 |
| | ===== |

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See accompanying notes to consolidated financial statements

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BANCORP RHODE ISLAND, INC. Consolidated Statements of Operations

| | Three Months Ended September 30, | | Nine M Sept |
|---|-------------------------------------|----------|----------------|
| | 2001 | 2000 | 2001 |
| | ---- | ---- | ---- |
| | (Dollars in thousands, except per s | | |
| Interest and dividend income: | | | |
| Residential mortgage loans | \$ 5,613 | \$ 4,522 | \$16,312 |
| Commercial loans | 4,470 | 4,622 | 13,751 |
| Consumer and other loans | 1,121 | 1,141 | 3,590 |
| Investment securities | 856 | 770 | 2,303 |
| Mortgage-backed securities | 1,850 | 1,419 | 5,807 |
| Federal funds sold and other | 65 | 346 | 421 |
| Federal Home Loan Bank of Boston stock dividends | 72 | 74 | 223 |
| | | | |
| Total interest and dividend income | 14,047 | 12,894 | 42,407 |
| | | | |
| Interest expense: | | | |
| NOW accounts | 57 | 55 | 165 |
| Money market accounts | 47 | 92 | 185 |
| Savings accounts | 1,568 | 1,656 | 5,222 |
| Certificate of deposit accounts | 3,321 | 3,551 | 10,595 |
| Overnight and short-term borrowings | 86 | 157 | 394 |
| Federal Home Loan Bank of Boston borrowings | 1,433 | 546 | 3,756 |
| Other borrowings | -- | 71 | 138 |
| Company-obligated mandatorily redeemable capital securities | 73 | -- | 186 |
| | | | |
| Total interest expense | 6,585 | 6,128 | 20,641 |
| | | | |
| Net interest income | 7,462 | 6,766 | 21,766 |
| Provision for loan losses | 566 | 410 | 1,406 |
| | | | |
| Net interest income after provision for loan losses | 6,896 | 6,356 | 20,360 |
| | | | |
| Noninterest income: | | | |
| Service charges on deposit accounts | 869 | 713 | 2,529 |
| Loan related fees | 107 | 100 | 207 |
| Commissions on loans originated for others | 55 | 23 | 185 |
| Gain on sale of mortgage-backed securities | -- | -- | 4 |
| Other income | 325 | 148 | 839 |
| | | | |
| Total noninterest income | 1,356 | 984 | 3,764 |
| | | | |
| Noninterest expense: | | | |

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| | | | |
|---|-----------|-----------|-----------|
| Salaries and employee benefits | 2,826 | 2,540 | 8,141 |
| Occupancy | 458 | 390 | 1,326 |
| Equipment | 213 | 221 | 652 |
| Data processing | 466 | 339 | 1,348 |
| Marketing | 182 | 238 | 739 |
| Professional services | 210 | 178 | 610 |
| Loan servicing | 235 | 177 | 686 |
| Workout and OREO expense | 106 | 30 | 170 |
| Amortization of goodwill | 291 | 291 | 873 |
| Deposit tax and assessments | 29 | 29 | 87 |
| Other | 811 | 601 | 2,232 |
| | ----- | ----- | ----- |
| Total noninterest expense | 5,827 | 5,034 | 16,864 |
| | ----- | ----- | ----- |
| Income before income taxes | 2,425 | 2,306 | 7,260 |
| Income tax expense | 849 | 852 | 2,552 |
| | ----- | ----- | ----- |
| Net income | \$ 1,576 | \$ 1,454 | \$ 4,708 |
| | ===== | ===== | ===== |
| Per share data: | | | |
| Basic earnings per common share | \$ 0.42 | \$ 0.39 | \$ 1.26 |
| Diluted earnings per common share | \$ 0.40 | \$ 0.38 | \$ 1.21 |
| Average common shares outstanding - basic | | | |
| | 3,730,550 | 3,728,701 | 3,729,793 |
| Average common shares outstanding - diluted | | | |
| | 3,922,503 | 3,793,885 | 3,892,485 |

See accompanying notes to consolidated financial statements

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

| Nine months ended September 30, ----- | Common Stock ----- | Additional Paid-in Capital ----- | Retained Earnings ----- | Accumulated Other Compre- hensive Income (Loss), Net ----- | Total ----- |
|--|--------------------------|---|-------------------------------|--|----------------|
| | | | | | |
| 2001 | | | | | |
| ---- | | | | | |
| Balance at December 31, 2000 | \$37 | \$39,621 | \$13,815 | \$ (181) | \$53,2 |
| Net income | -- | -- | 4,708 | -- | 4,7 |
| Other comprehensive income, net of tax: | | | | | |
| Unrealized holding gain (loss) on securities available for sale | | | | 1,761 | 1,7 |
| Gain on securities available for sale included in net income | | | | 3 | |
| | | | | | ----- |

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| | | | | | |
|---|------|----------|----------|------------|--------|
| Comprehensive income | | | | | 6,4 |
| Proceeds from exercise of options | -- | 16 | -- | -- | |
| Common stock issued for incentive stock award, net | -- | 18 | -- | -- | |
| Dividends on common stock | -- | -- | (1,345) | -- | (1,3 |
| Balance at September 30, 2001 | \$37 | \$39,655 | \$17,178 | \$ 1,583 | \$58,4 |
| ----- | | | | | |
| 2000 | | | | | |
| ---- | | | | | |
| Balance at December 31, 1999 | \$37 | \$39,617 | \$ 9,763 | \$ (1,742) | \$47,6 |
| Net income | -- | -- | 4,116 | -- | 4,1 |
| Other comprehensive income, net of tax: | | | | | |
| Unrealized holding gain (loss) on securities available for sale | | | | 257 | 2 |
| Comprehensive income | | | | | 2,2 |
| Proceeds from exercise of options | -- | 4 | -- | -- | |
| Dividends on common stock | -- | -- | (1,118) | -- | (1,1 |
| Balance at September 30, 2000 | \$37 | \$39,621 | \$12,761 | \$ (1,485) | \$50,9 |
| ===== | | | | | |

See accompanying notes to consolidated financial statements

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BANCORP RHODE ISLAND, INC.
Consolidated Statements of Cash Flows

| | Nine Months End | |
|--|-----------------|----------|
| | September 30, | |
| | 2001 | 2000 |
| | ---- | ---- |
| | (In thousands) | |
| Cash flows from operating activities: | | |
| Net income | \$ 4,708 | \$ 4,708 |
| Adjustments to reconcile net income to net cash from operating activities: | | |
| Depreciation and amortization | 2,269 | 1,406 |
| Provision for loan losses | 1,406 | (4) |
| Loss/(gain) on mortgage-backed securities | (4) | (14) |
| Loss/(gain) on other real estate owned, net | (14) | 18 |
| Compensation expense from restricted stock grant | 18 | |
| (Increase) decrease in: | | |
| Accrued interest receivable | (1,110) | (1,110) |
| Prepaid expenses and other assets | (508) | (508) |
| Increase (decrease) in: | | |
| Other liabilities | (213) | (213) |

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| | | |
|--|-----------|-------|
| Other, net | 13 | |
| | 6,565 | 4 |
| Cash flows from investing activities: | | |
| Origination of: | | |
| Residential mortgage loans | (13,270) | (7) |
| Commercial loans | (39,475) | (55) |
| Consumer loans | (14,816) | (13) |
| Purchase of: | | |
| Investment securities available for sale | (38,026) | (7) |
| Mortgage-backed securities available for sale | (50,851) | (32) |
| Residential mortgage loans | (146,154) | (38) |
| Consumer loans | (5,045) | |
| Federal Home Loan Bank of Boston stock | (1,960) | |
| Principal payments on: | | |
| Investment securities available for sale | 33,250 | 10 |
| Mortgage-backed securities available for sale | 29,681 | 12 |
| Residential mortgage loans | 87,329 | 35 |
| Commercial loans | 25,567 | 17 |
| Consumer loans | 17,559 | 9 |
| Proceeds from sale of mortgage-backed securities | 3,885 | |
| Proceeds from disposition of other real estate owned | 84 | |
| Proceeds from sale of premises and equipment | 18 | |
| Capital expenditures for premises and equipment | (1,075) | (1) |
| | (113,299) | (70) |
| Cash flows from financing activities: | | |
| Net increase (decrease) in deposits | 20,752 | 79 |
| Net increase (decrease) in overnight and short-term borrowings | 2,589 | (2) |
| Proceeds from long-term borrowings | 86,000 | 12 |
| Repayment of long-term borrowings | (7,757) | (25) |
| Proceeds from exercise of stock options | 16 | |
| Dividends on common stock | (1,345) | (1) |
| | 100,255 | 62 |
| Net increase (decrease) in cash and cash equivalents | (6,479) | (3) |
| Cash and cash equivalents at beginning of period | 34,453 | 24 |
| Cash and cash equivalents at end of period | \$ 27,974 | \$ 20 |
| Supplementary Disclosures: | | |
| Cash paid for interest | \$ 20,321 | \$ 16 |
| Cash paid for income taxes | 3,445 | 2 |
| Non-cash transactions: | | |
| Additions to other real estate owned in settlement of loans | 62 | |
| Change in other comprehensive income, net of taxes | 1,764 | |

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, was organized by Bank Rhode Island (the "Bank") on February 15, 2000, to be a bank holding company and to acquire all of the capital stock of the Bank. The reorganization of the Bank into the holding company form of ownership was completed on September 1, 2000. The Company has no significant assets other than the common stock of the Bank. For that reason, substantially all of the discussion in this Quarterly Report on Form 10-Q relates to the operations of the Bank and its subsidiaries.

The consolidated financial statements include the accounts of the Company and its wholly-owned direct subsidiaries, the Bank and BRI Statutory Trust I (an issuer of trust preferred securities), and its indirect subsidiaries, BRI Investment Corp. (a Rhode Island passive investment company), BRI Realty Corp. (a real estate holding company) and Acorn Insurance Agency, Inc. (a seller of annuity products). All significant intercompany accounts and transactions have been eliminated in consolidation.

The 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 Annual Report to Shareholders filed with the Securities and Exchange Commission.

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

The unaudited interim consolidated financial statements of the Company have been prepared in accordance with Generally Accepted Accounting Principles ("GAAP") 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.

(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. Diluted EPS reflects the potential dilution that could occur if options, warrants or other contracts to issue common stock were exercised and resulted in the issuance of additional common stock that then shared in the earnings of the entity.

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(3) Recent Accounting Developments

On July 20, 2001, the Financial Accounting Standards Board ("FASB")

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issued Statement of Financial Account Standards ("SFAS") 142, "Goodwill and Other Intangible Assets." SFAS 142 addresses financial accounting and reporting for acquired goodwill and other intangible assets and supersedes APB Opinion No. 17, "Intangible Assets". Under SFAS 142, goodwill and intangible assets that have indefinite useful lives will no longer be amortized, but rather will be tested at least annually for impairment. The Statement applies to existing goodwill (i.e., recorded goodwill at the date the financial statement is issued), as well as goodwill arising subsequent to the effective date of the Statement. Intangible assets that have finite useful lives will continue to be amortized over their useful lives, but without the constraint of the 40-year maximum life required by APB Opinion No. 17. The provisions of SFAS 142 must be applied for fiscal years beginning after December 15, 2001 and may not be adopted earlier. At September 30, 2001, the Company had \$11.1 million of goodwill on its balance sheet that was being amortized at a rate of \$1.2 million annually.

(4) Company-Obligated Mandatorily Redeemable Capital Securities

On January 23, 2001, the Company sponsored the creation of BRI Statutory Trust I (the "Trust"), a Connecticut statutory trust. The Company is the owner of all of the common securities of the Trust. On February 22, 2001, the Trust issued \$3.0 million of its 10.20% Capital Securities through a pooled trust preferred securities offering. The proceeds from this issuance, along with the Company's \$93,000 capital contribution for the Trust's common securities, were used to acquire \$3.1 million of the Company's 10.20% Junior Subordinated notes due February 22, 2031, and constitute the primary asset of the Trust. The Company has, through the Declaration of Trust, the Guarantee Agreement, the notes and the related Indenture, taken together, fully irrevocably and unconditionally guaranteed all of the Trust's obligations under the Capital Securities, to the extent the Trust has funds available therefor.

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

ITEM 2. Management's Discussion and Analysis

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

GENERAL -----

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

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

NON-GAAP MEASURES OF FINANCIAL PERFORMANCE

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

The Bank's formation in 1996 resulted in the generation of \$17.5 million of goodwill that is being amortized over a 15-year period. The amortization of goodwill currently reduces the Company's pre-tax income \$1.2 million annually. Because of the impact of this amortization, certain information has been presented on both a GAAP and cash basis. Recently, the Financial Accounting Standards Board ("FASB") has concluded that goodwill would no longer be amortized, but will be subject to periodic review for impairment. For the Company, beginning in 2002, there will no longer be a difference between GAAP and cash basis presentations. Also see discussion under "Recent Accounting Developments".

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The following table sets forth selected financial measures in accordance with GAAP and on a cash basis:

| | Three Months Ended | | Nine Months Ended | |
|------------------|--------------------|--------|-------------------|--------|
| | September 30, | | September 30, | |
| | 2001 | 2000 | 2001 | 2000 |
| | ---- | ---- | ---- | ---- |
| Basic EPS | \$0.42 | \$0.39 | \$1.26 | \$1.10 |
| Basic Cash EPS | \$0.47 | \$0.44 | \$1.41 | \$1.25 |
| Diluted EPS | \$0.40 | \$0.38 | \$1.21 | \$1.10 |
| Diluted Cash EPS | \$0.45 | \$0.43 | \$1.35 | \$1.25 |
| ROA | 0.75% | 0.83% | 0.78% | 0.82% |
| Cash Basis ROA | 0.85% | 0.95% | 0.89% | 0.95% |

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| | | | | |
|-----------------------------|--------|--------|--------|--------|
| ROE | 11.02% | 11.74% | 11.39% | 11.43% |
| Cash Basis ROE | 12.34% | 13.23% | 12.75% | 12.99% |
| Efficiency Ratio | 66.08% | 64.95% | 66.06% | 65.87% |
| Cash Basis Efficiency Ratio | 62.78% | 61.20% | 62.64% | 61.91% |

OVERVIEW

Total assets increased \$106.5 million, or 14.4%, to \$846.0 million at September 30, 2001 from \$739.4 million at December 31, 2000. The majority of this increase was in residential mortgage loans and was primarily funded by borrowings from the FHLB. In February 2001, the Company through its subsidiary, BRI Statutory Trust I, issued \$3.0 million of trust preferred securities. These securities qualify as Tier I capital for regulatory purposes and supported the growth in assets that has occurred during 2001. Since the end of last year, total loans have risen to \$606.3 million, from \$518.8 million, an increase of \$87.5 million, or 16.9%, while FHLB borrowings have risen to \$113.3 million, from \$33.3 million, an increase of \$80.0 million, or 240.3%. Shareholders' equity was \$58.5 million at September 30, 2001, representing a \$5.2 million, or 9.7%, increase over shareholders' equity at the end of 2000.

FINANCIAL CONDITION

-- Investments. Total investments (consisting of federal funds sold, investment securities, mortgage-backed securities ("MBSs") and stock in the FHLB) totaled \$203.7 million, or 24.1% of total assets, at September 30, 2001, compared to \$174.0 million, or 23.5% of total assets, at December 31, 2000. All \$189.3 million of investment securities and MBSs at September 30, 2001 were classified as available for sale and carried a total of \$2.6 million in net unrealized gains. The increase of \$29.7 million, or 17.1%, in total investments was primarily centered in investment securities and MBSs with rate adjustments or final maturities no longer than 5 years.

-- Loans. Total loans were \$606.3 million, or 71.7% of total assets, at September 30, 2001, compared to \$518.8 million, or 70.2% of total assets, at December 31, 2000. During the first nine months of 2001, the residential mortgage loan portfolio increased \$71.6 million, or 28.9%, as the Bank purchased a number of residential mortgage loans in the secondary market. These purchases were primarily funded with a series of FHLB borrowings and supported by the additional capital created through the issuance of the trust preferred securities.

The commercial loan portfolio (consisting of commercial & industrial, small business, commercial real estate, multi-family real estate and construction loans) increased \$13.7 million, or

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6.4%, during the first three quarters of 2001. Particular emphasis is placed on the generation of small- to medium-sized commercial relationships (those relationships with \$5.0 million or less in loan commitments). The Bank is active in small business lending (loans of \$250,000 or less) in which it utilizes credit scoring, in conjunction with traditional review standards, and employs streamlined documentation. The Bank is also a participant in the U.S. Small Business Administration ("SBA") Preferred Lender Program in Rhode

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Island and the 7a Guarantee Loan Program in Massachusetts.

During the first nine months of 2001, the consumer loan portfolio increased \$2.1 million, or 3.6%, primarily as a result of a \$5.0 million purchase of automobile loans during the first quarter of 2001. While the Bank continues to concentrate its origination efforts on commercial and consumer loan opportunities, management anticipates that the Bank will continue to originate residential mortgage loans on a limited basis for its customers. Until such time as the Bank can originate sufficient commercial and consumer loans to utilize available cash flow, or to otherwise meet investment objectives, it also intends to continue purchasing residential mortgage and automobile loans as opportunities develop.

The following is a breakdown of loans receivable:

| | September 30, 2001 | December 31, 2000 |
|--|-----------------------|----------------------|
| | ----- | ----- |
| | (In thousands) | |
| Residential mortgage loans: | | |
| One- to four-family adjustable rate | \$289,706 | \$212,197 |
| One- to four-family fixed rate | 28,452 | 34,609 |
| | ----- | ----- |
| Subtotal | 318,158 | 246,806 |
| Premium on loans acquired | 1,484 | 1,166 |
| Net deferred loan origination fees | (70) | (49) |
| | ----- | ----- |
| Total residential mortgage loans | \$319,572 | \$247,923 |
| | ===== | ===== |
| Commercial loans: | | |
| Commercial real estate - nonowner occupied | \$ 70,814 | \$ 69,315 |
| Commercial and industrial | 53,628 | 51,470 |
| Commercial real estate - owner occupied | 43,335 | 38,272 |
| Small business | 22,742 | 19,170 |
| Multi-family real estate | 13,699 | 15,933 |
| Leases | 9,899 | 11,731 |
| Construction | 12,611 | 7,070 |
| | ----- | ----- |
| Subtotal | 226,728 | 212,961 |
| Net deferred loan origination fees | (192) | (143) |
| | ----- | ----- |
| Total commercial loans | \$226,536 | \$212,818 |
| | ===== | ===== |
| Consumer loans: | | |
| Home equity - lines of credit | \$ 27,010 | \$ 26,215 |
| Home equity - term loans | 22,380 | 23,292 |
| Automobile | 7,275 | 4,643 |
| Installment | 1,287 | 1,348 |
| Savings secured | 779 | 987 |
| Unsecured and other | 799 | 1,044 |
| | ----- | ----- |
| Subtotal | 59,530 | 57,529 |
| Premium on loans acquired | 219 | 144 |
| Net deferred loan origination costs | 422 | 411 |
| | ----- | ----- |

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| | | |
|----------------------|-----------|-----------|
| Total consumer loans | \$ 60,171 | \$ 58,084 |
| | ===== | |

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-- Deposits and Borrowings. Total deposits increased by \$20.8 million, or 3.3%, during the first nine months of 2001, from \$631.6 million, or 85.4% of total assets, at December 31, 2000, to \$652.4 million, or 77.1% of total assets, at September 30, 2001. The decrease in the relative percentage of total assets that has occurred during 2001 resulted from the increased use of FHLB borrowings. Meanwhile, the composition of total deposits changed as follows: core deposit accounts (checking and savings accounts) increased \$31.3 million, or 8.5%, while certificates of deposit decreased \$10.5 million, or 4.0%. At September 30, 2001, core deposit accounts comprised 60.9% of total deposits, compared to 57.9% of total deposits at December 31, 2000. The Bank continues its strategy of emphasizing core deposit growth over certificate of deposit growth.

The following table sets forth certain information regarding deposits:

| | September 30, 2001 | | | December 31, 2000 | |
|---------------------------------|------------------------|------------------------|-----------------------------|-------------------|------------------------|
| | Amount | Percent of Total | Weighted Average Rate | Amount | Percent of Total |
| | (Dollars in thousands) | | | | |
| NOW accounts | \$ 39,509 | 6.1% | 0.45% | \$ 36,910 | 5.8% |
| Money market accounts | 9,349 | 1.4% | 1.40% | 12,283 | 1.9% |
| Savings accounts | 247,853 | 38.0% | 2.23% | 210,728 | 33.4% |
| Certificate of deposit accounts | 255,107 | 39.1% | 4.79% | 265,623 | 42.1% |
| | ----- | | | | |
| Total interest bearing deposits | 551,818 | 84.6% | 3.27% | 525,544 | 83.2% |
| Noninterest bearing accounts | 100,566 | 15.4% | -- | 106,088 | 16.8% |
| | ----- | | | | |
| Total deposits | \$652,384 | 100.0% | 2.77% | \$631,632 | 100.0% |
| | ===== | | | | |

The Company, through the Bank's membership in the FHLB, has access to a variety of borrowing alternatives, and management will from time to time take advantage of these opportunities to fund asset growth. During the first three quarters of 2001, FHLB borrowings increased \$80.0 million, or 240.3%, as the Company sought to take advantage of lower, long-term borrowing rates to fund its asset growth. However, on a long-term basis, the Company intends to concentrate on increasing its core deposits.

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

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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 also considered impaired loans.

-- Nonperforming Assets. At September 30, 2001, the Company had nonperforming assets of \$3.2 million, which represented .37% of total assets. This compares to an unusually low level of nonperforming assets at December 31, 2000, of \$538,000, or .07% of total assets. Nonperforming assets at September 30, 2001, consisted of nonaccrual commercial loans aggregating \$2.5 million, nonaccrual residential mortgage loans aggregating \$580,000, nonaccrual consumer loans aggregating \$36,000 and OREO aggregating \$22,000. Included in nonaccrual loans were \$2.4 million of impaired loans at September 30, 2001. There were no impaired loans at December 31, 2000. The

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Company maintained reserves of \$1.0 million against impaired loans at September 30, 2001. The Company evaluates the underlying collateral of each nonperforming loan and continues to pursue the collection of interest and principal.

Delinquencies. At September 30, 2001, loans with an aggregate balance of \$625,000 were 60 to 89 days past due, an increase of \$288,000, or 85.5%, from \$337,000 reported at December 31, 2000. The majority of these loans at both dates were residential mortgage loans and are secured.

The following table sets forth information regarding nonperforming assets and loans 60-89 days past due as to interest at the dates indicated.

| | September 30, 2001 | December 31, 2000 |
|--|------------------------|----------------------|
| | ----- | ----- |
| | (Dollars in thousands) | |
| Loans accounted for on a nonaccrual basis | \$3,141 | \$508 |
| Loans past due 90 days or more, but still accruing | -- | -- |
| | ----- | ----- |
| Total nonperforming loans | 3,141 | 508 |
| Other real estate owned | 22 | 30 |
| | ----- | ----- |
| Total nonperforming assets | \$3,163 | \$538 |
| | ===== | ===== |
| | | |
| Delinquent loans 60-89 days past due | \$ 625 | \$337 |
| | | |
| Nonperforming loans as a percent of total loans | .52% | .10% |
| Nonperforming assets as a percent of total assets | .37% | .07% |
| Delinquent loans 60-89 days past due as a percent of total loans | .10% | .07% |

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

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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 September 30, 2001, the Company had \$13.6 million of assets that were classified as substandard. This compares to \$5.8 million of assets that were classified as substandard at December 31, 2000. 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 September 30, 2001, included in the \$13.6 million of assets that were classified as substandard, were \$10.4 million of performing loans. This compares to \$5.3 million of adversely classified performing assets as of December 31, 2000. This increase in adversely classified assets is reflective of a softening in commercial credit quality. This softening may lead to an increase in nonperforming assets and an increase to the provision for loan losses in future periods. While the Bank has not seen any direct impact on credit quality as a result of the September 11th events, it believes that there is still uncertainty as to the ultimate impact those events will have.

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Allowance for Loan Losses

During the first nine months of 2001, the Company made provisions to the allowance for loan losses totaling \$1.4 million and had \$260,000 of net charge-offs, bringing the balance in the allowance to \$8.4 million at September 30, 2001, compared to \$7.3 million at December 31, 2000. The allowance, expressed as a percentage of total loans, was 1.39% as of September 30, 2001, compared to 1.41% at the prior year-end and stood at 268.7% of nonperforming loans at September 30, 2001, compared to 1,435.8% of nonperforming loans at December 31, 2000.

Assessing the adequacy of the allowance for loan losses involves substantial uncertainties and is based upon management's evaluation of the amounts required to meet estimated charge-offs in the loan portfolio after weighing various factors. Among these factors are the risk characteristics of the loan portfolio, the quality of specific loans, the level of nonaccruing loans, current economic conditions, trends in delinquencies and charge-offs, and the value of underlying collateral, all of which can change frequently. Based on this evaluation, management believes that the allowance for loan losses, as of September 30, 2001, is adequate.

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

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RESULTS OF OPERATIONS

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

Three Months Ended September 30, 2001 and 2000

-- Overview. The Company reported net income for the third quarter of 2001 of \$1.6 million, up \$122,000, or 8.4%, from the third quarter of 2000. Diluted earnings per common share were \$0.40 for the third quarter of 2001, compared to \$0.38 for the third quarter of 2000. Diluted cash earnings per common share were \$0.45 for the 2001 period, compared to \$0.43 for the 2000 period.

The Company reported a return on average assets of 0.75% and a return on average equity of 11.02% for the 2001 period, as compared to a return on average assets of 0.83% and a return on average equity of 11.74% for the 2000 period. Cash basis return on average assets and cash basis return on average equity were 0.85% and 12.34% for the 2001 period, and 0.95% and 13.23% for the 2000 period, respectively.

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-- Net Interest Income. For the quarter ended September 30, 2001, net interest income was \$7.5 million, compared to \$6.8 million for the 2000 period. The net interest margin for the third quarter of 2001 was 3.72% compared to a net interest margin of 4.11% for the 2000 period. The increase in net interest income of \$696,000, or 10.3%, was primarily attributable to the continued growth of the Company. Average earnings assets were \$140.1 million, or 21.4%, higher and average interest-bearing liabilities were \$118.5 million, or 21.5%, higher than the comparable period a year earlier. The decrease of 39 basis points in the net interest margin was partially the result of the wholesale transaction (purchase of residential mortgage loans funded with FHLB borrowings) consummated in the first quarter of 2001 and partially the result of the 400 basis point decrease in short-term market interest rates experienced so far in 2001. Assuming further decreases in market interest rates, the Bank believes it likely that it will experience continued pressure on its net interest margin.

-- Interest Income. Investments. Total investment income was \$2.8 million for the quarter ended September 30, 2001, compared to \$2.6 million for the third quarter of 2000. This increase in total investment income of \$234,000, or 9.0%, was primarily attributable to an increase of \$43.4 million, or 50.4%, in the average balance of MBSs. The Company's investments at September 30, 2001 were primarily comprised of Agency securities and MBSs with remaining maturities or repricing periods of less than five years. In addition to assisting in overall tax planning, management believes that this composition, along with a structured maturity ladder, provides more stable earnings and predictable cash flows from the portfolio.

-- Interest Income. Loans. Interest from loans was \$11.2 million for

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the three months ended September 30, 2001, and represented a yield on total loans of 7.49%. This compares to \$10.3 million of interest, and a yield of 8.26%, for the third quarter of 2000. Interest from residential mortgage loans increased \$1.1 million, or 24.1%, between the two quarters and was primarily attributable to the continued purchase of mortgage loans. Income from commercial loans decreased \$152,000, or 3.3%, and consumer and other loan income decreased \$20,000, or 1.8%. Both of these decreases were primarily in response to declining market interest rates. Since its inception, the Bank has concentrated its origination efforts on commercial and consumer loan opportunities, while purchasing residential mortgage loans, and more recently automobile loans, as cash flows dictated. The average balance of the various components of the loan portfolio changed from the third quarter of 2000 as follows: residential mortgage loans increased \$69.4 million, or 28.5%, commercial loans increased \$20.0 million, or 9.9%, and consumer and other loans increased \$10.2 million, or 20.3%. In response to declining market interest rates, the yields on the various loan portfolio components changed as follows: consumer and other loans decreased 167 basis points, to 7.33%; commercial loans decreased 111 basis points, to 7.96%, and residential mortgage loans decreased 25 basis points, to 7.18%.

-- Interest Expense. Interest paid on deposits and borrowings increased \$457,000, or 7.5%, to \$6.6 million for the three months ended September 30, 2001, from \$6.1 million paid during the third quarter of 2000. The increase in total interest expense was the result of an increase in the average balance of interest-bearing liabilities outstanding, partially offset by lower market interest rates. The average balance of interest-bearing liabilities increased \$118.5 million, from \$552.2 million in the third quarter of 2000 to \$670.7 million in the third quarter of 2001, as borrowings were utilized to fund much of the asset growth. Meanwhile, the overall average cost for interest-bearing liabilities

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decreased 52 basis points from 4.41% for the third quarter of 2000 to 3.89% for the third quarter of 2001. Liability costs are dependent on a number of factors including general economic conditions, national and local interest rates, competition in the local deposit marketplace, interest rate tiers offered and the Company's cash flow needs. Average costs for the various components of interest-bearing liabilities changed from the third quarter of 2000 as follows: NOW accounts decreased 10 basis points, to 0.56%, money market accounts decreased 71 basis points, to 1.92%, savings accounts decreased 76 basis points, to 2.56%, certificate of deposit accounts decreased 39 basis points, to 5.12%, and borrowings decreased 88 basis points to 5.27%. All of these decreases in average costs are the result of the unprecedented decline in interest rates since the end of last year.

-- Provision for Loan Losses. The provision for loan losses was \$566,000 for the quarter ended September 30, 2001, up \$156,000, or 38.0%, from the same quarter last year. This increase in the provision was primarily in response to a softening in commercial credit quality. When determining the provision for the quarter, management evaluates several factors including new loan originations, actual and estimated charge-offs, the risk characteristics of the loan portfolio and general economic conditions. Also see discussion under "Asset Quality" and "Allowance for Loan Losses."

-- Noninterest Income. Total noninterest income increased \$372,000, or 37.8%, to \$1.4 million for the third quarter of 2001, from \$984,000 for the 2000 quarter. Service Charges on Deposit Accounts, which represent the largest source of noninterest income for the Company, rose \$156,000, or

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21.9%, from \$713,000 for the quarter ended September 30, 2000, to \$869,000 for the same period in 2001, as core deposit accounts grew. Commissions on Loans Originated for Others increased \$32,000, or 139.1%, from the comparable period, as fixed rate mortgage loan activity increased in response to the falling interest rate environment. Other Income increased \$177,000, or 119.6%, primarily from revitalization of the Company's non-deposit investment sales program, which increased commissions \$149,000 over the third quarter of last year.

-- Noninterest Expense. Total noninterest expense for the third quarter of 2001 increased \$793,000, or 15.8%, to \$5.8 million from \$5.0 million in 2000. This increase occurred in the following areas: Salaries and Benefits (up \$286,000, or 11.3%), Occupancy (up \$68,000, or 17.4%), Data Processing (up \$127,000, or 37.5%), Professional Services (up \$32,000, or 18.0%), Loan Servicing (up \$58,000, or 32.8%), Workout and OREO Expenses (up \$76,000, or 253.3%), and Other Expenses (up \$210,000, or 34.9%). During 2000 and early 2001, the Bank experienced substantial growth in both loans and core deposits that resulted in the increased operating costs evidenced in the third quarter of 2001. In addition, the softening of both the national and local economies in 2001 has led to increases in workout and fraudulent activity charges. The Company's cash basis efficiency ratio for the third quarter of 2001 was 62.78%, compared to 61.20% for the third quarter of 2000, an increase of 158 basis points.

-- Income Tax Expense. Income tax expense of \$849,000 was recorded for the quarter ended September 30, 2001, compared to \$852,000 for the 2000 period. This represented total effective tax rates of 35.0% and 37.0%, respectively. Tax-favored income from U.S. Treasury and Agency securities along with the utilization of a Rhode Island passive investment company has reduced the Company's effective tax rate from last year to this year and from the 39.9% combined statutory federal and state tax rates.

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Nine Months Ended September 30, 2001 and 2000

-- Overview. Net income for the first nine months of 2001, increased \$592,000, or 14.4%, to \$4.7 million, or \$1.21 per diluted common share, from \$4.1 million, or \$1.10 per diluted common share, for the first nine months of 2000. Diluted cash earnings per common share were \$1.35 for the 2001 period, compared to \$1.25 for the 2000 period.

This performance represented a return on average assets of 0.78% and a return on average equity of 11.39% for the 2001 period, as compared to a return on average assets of 0.82% and a return on average equity of 11.43% for the 2000 period. Cash basis return on average assets and cash basis return on average equity were 0.89% and 12.75% for the 2001 period, and 0.95% and 12.99% for the 2000 period, respectively.

-- Net Interest Income. For the nine months ended September 30, 2001, net interest income was \$21.8 million, compared to \$19.4 million for the 2000 period. The net interest margin for the first nine months of 2001 was 3.78% compared to a net interest margin of 4.10% for the 2000 period. The increase in net interest income of \$2.4 million, or 12.2%, was primarily attributable to the overall growth of the Company. Average earning assets increased \$138.5 million, or 21.9%, and average interest-bearing liabilities increased \$113.8 million, or 21.2%, over the comparable period a year earlier. The decrease of 32 basis points in the net interest margin was equally caused by two different factors: 1) the tighter spreads associated

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with the first quarter wholesale transaction, and 2) the dramatic 400 basis point drop in short-term market interest rates since the beginning of 2001.

-- Interest Income. Investments. Total investment income was \$8.8 million for the nine months ended September 30, 2001, compared to \$7.1 million for the 2000 period. This increase in total investment income of \$1.6 million, or 23.2%, was primarily attributable to a \$43.9 million, or 53.0%, increase in the average balance of MBSs. Meanwhile, the overall yield on investments decreased 45 basis points in response to dramatically lower market interest rates.

-- Interest Income. Loans. Interest from loans was \$33.7 million for the nine months ended September 30, 2001, and represented a yield on total loans of 7.79%. This compares to \$29.5 million of interest, and a yield of 8.11%, for the first nine months of 2000. This increase of \$4.2 million, or 14.2%, in interest on loans was due primarily to an increase in the average balance of loans outstanding. The average balance of the various components of the loan portfolio changed as follows: residential mortgage loans increased \$53.1 million, or 21.8%, commercial loans increased \$26.3 million, or 13.6%, and consumer and other loans increased \$12.0 million, or 24.7%. Meanwhile, the yields on the various components of the loan portfolio changed as follows: residential mortgage loans increased 1 basis point, to 7.33%; commercial loans decreased 54 basis points, to 8.39%; and consumer and other loans decreased 89 basis points, to 7.90%. The Company has continued to concentrate its origination efforts on commercial and consumer loan opportunities, but will also originate residential mortgage loans for its portfolio on a limited basis.

-- Interest Expense. Interest paid on deposits and borrowings increased \$3.5 million, or 20.1%, to \$20.6 million for the nine months ended September 30, 2001, compared to \$17.2 million for the same period during 2000. The increase in total interest expense was primarily attributable to growth in savings and certificate of deposit accounts, along with the use of borrowings to fund the overall growth of the Company. The average balance of interest-bearing liabilities increased \$113.8 million, from \$536.7 million in 2000, to \$650.6 million in 2001. The Company continued to experience strong average balance growth in core deposit accounts, specifically noninterest bearing demand

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deposit accounts (up \$17.6 million, or 22.1%) and savings accounts (up \$43.7 million, or 23.4%). In addition, the Company increased its utilization of borrowed funds (up \$55.3 million, or 99.2%). The overall average cost for interest-bearing liabilities decreased 3 basis points from 4.27% for the first nine months of 2000, to 4.24% for the 2001 period. Deposit and borrowing costs are dependent on a number of factors including general economic conditions, national and local interest rates, competition in the local marketplace, interest rate tiers offered, and the Company's cash flow needs.

-- Provision for Loan Losses. The provision for loan losses was \$1.4 million for the nine months ended September 30, 2001, compared to \$1.1 million for the same period last year. Increases to the Provision for Loan Losses were primarily in response to a softening economy and some deterioration in commercial credit quality. Management evaluates several factors including new loan originations, actual and estimated charge-offs, the risk characteristics of the loan portfolio and general economic conditions when determining the provision for each quarter. Also see discussion under "Asset Quality" and "Allowance for Loan Losses."

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-- Noninterest Income. Total noninterest income increased \$1.1 million, or 42.9%, from \$2.6 million for the first nine months of 2000, to \$3.8 million for the first nine months of 2001. Service charges on deposit accounts, which continues to represent the largest source of noninterest income, rose \$549,000, or 27.7%, from \$2.0 million for the 2000 period, to \$2.5 million for the 2001 period, primarily as a result of growth in core deposit accounts. Commissions on Loans Originated for Others increased \$144,000, or 351.2%, in response to significantly higher fixed rate mortgage loan activity resulting from the dramatic drop in market interest rates. Additionally, Other Income increased \$432,000, or 106.1%, primarily from increased commissions on sales of non-deposit investment products (up \$290,000).

-- Noninterest Expense. Noninterest expenses for the first nine months of 2001 increased a total of \$2.4 million, or 16.2%, to \$16.9 million, from \$14.5 million in 2000. This increase occurred primarily as a result of the overall growth of the Company and was centered in the following areas: Salaries and Benefits (up \$1.1 million, or 15.3%), Occupancy (up \$196,000, or 17.3%), Data Processing (up \$400,000, or 42.2%), Loan Servicing (up \$123,000, or 21.8%), Workout and OREO Expense (up \$131,000, or 335.9%) and Other Expenses (up \$520,000, or 30.4%). Partially offsetting these increases was a decrease in Marketing (down \$100,000, or 11.9%). The Company's cash basis efficiency ratio increased 73 basis points, to 62.64% for the 2001 period.

-- Income Tax Expense. The Company recorded income tax expense of \$2.6 million for the first nine months of 2001, compared to \$2.3 million for the same period during 2000. This represented total effective tax rates of 35.2% and 35.6%, respectively. Tax-favored income from U.S. Treasury and Agency securities and its utilization of a Rhode Island passive investment company has reduced the Company's effective tax rate from the 39.9% combined statutory federal and state tax rates.

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LIQUIDITY AND CAPITAL RESOURCES

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

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

Management is responsible for establishing and monitoring liquidity targets as well as strategies and tactics to meet these targets. In general, the Company maintains a high degree of flexibility with a liquidity target of 10% to 25% of total assets. At September 30, 2001, federal funds sold,

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investment securities and MBSs available for sale amounted to \$198.0 million, or 23.4% of total assets. This compares to \$170.3 million, or 23.0% of total assets at December 31, 2000. The Bank is a member of the FHLB and, as such, has access to both short- and long-term borrowings. In addition, the Bank maintains a line of credit at the FHLB as well as a line of credit with a correspondent bank. There have been no adverse trends in the Company's liquidity or capital reserves. Management believes that the Company has adequate liquidity to meet its commitments.

-- Capital Resources. Total shareholders' equity of the Company at September 30, 2001 was \$58.5 million, as compared to \$53.3 million at December 31, 2000. This increase of \$5.2 million was the result of net income for the period of \$4.7 million, less dividends of \$1.3 million and changes in unrealized gains on investment securities of \$1.8 million.

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."

Capital guidelines have also been issued by the Federal Reserve Board ("FRB") 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.

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As of September 30, 2001, the Company and the Bank met all applicable minimum capital requirements and were considered "well capitalized" by both the FRB and the FDIC. 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 Re To Be Cons |
|--|----------|--------|--|-------|--------------------------|
| | Amount | Ratio | Amount | Ratio | "Well Capit |
| At September 30, 2001: | | | | | |
| Bancorp Rhode Island, Inc. | | | | | |
| Tier I capital (to average assets) | \$48,813 | 5.94% | \$24,965 | 3.00% | \$41,609 |
| Tier I capital (to risk weighted assets) | 48,813 | 9.75% | 20,028 | 4.00% | 30,041 |
| Total capital (to risk weighted assets) | 55,097 | 11.00% | 40,055 | 8.00% | 50,069 |
| Bank Rhode Island | | | | | |

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| | | | | | |
|--|----------|--------|----------|-------|----------|
| Tier I capital (to average assets) | \$48,312 | 5.90% | \$24,578 | 3.00% | \$40,963 |
| Tier I capital (to risk weighted assets) | 48,312 | 9.65% | 20,023 | 4.00% | 30,035 |
| Total capital (to risk weighted assets) | 54,596 | 10.91% | 40,046 | 8.00% | 50,058 |

At December 31, 2000:

Bancorp Rhode Island, Inc.

| | | | | | |
|--|----------|--------|----------|-------|----------|
| Tier I capital (to average assets) | \$41,543 | 5.91% | \$21,086 | 3.00% | \$35,144 |
| Tier I capital (to risk weighted assets) | 41,543 | 9.50% | 17,484 | 4.00% | 26,226 |
| Total capital (to risk weighted assets) | 47,029 | 10.76% | 34,968 | 8.00% | 43,710 |

Bank Rhode Island

| | | | | | |
|--|----------|--------|----------|-------|----------|
| Tier I capital (to average assets) | \$41,129 | 5.85% | \$21,086 | 3.00% | \$35,144 |
| Tier I capital (to risk weighted assets) | 41,129 | 9.41% | 17,484 | 4.00% | 26,226 |
| Total capital (to risk weighted assets) | 46,615 | 10.66% | 34,968 | 8.00% | 43,710 |

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BANCORP RHODE ISLAND, INC. Quantitative and Qualitative Disclosures About Market Risk

ITEM 3. Quantitative and Qualitative Disclosures about Market Risk

INTEREST RATE RISK

A 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 that are consistent with its liquidity, capital adequacy, growth and profitability goals, while minimizing the vulnerability of its operations to changes in market interest rates. Simulation modeling is the primary tool used by the Company to measure the interest rate risk inherent in its balance sheet at a given point of time by showing the effect on net interest income, over a twenty-four month period, of interest rate ramps of up to 200 basis points.

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 October 1, 2001:

| | |
|--|---------|
| Estimated Exposure to Net Interest Income | |
| ----- | |
| Dollar | Percent |
| Change | Change |
| ----- | |
| (Dollars in thousands) | |

Initial Twelve Month Period:

| | | |
|---------------------|--------|-------|
| Up 200 basis points | \$ 994 | 3.21% |
| Up 100 basis points | 556 | 1.80% |

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| | | |
|-----------------------|---------|---------|
| Down 100 basis points | (608) | (1.96%) |
| Down 200 basis points | (1,269) | (4.10%) |

Subsequent Twelve Month Period:

| | | |
|-----------------------|----------|---------|
| Up 200 basis points | \$ 1,273 | 4.17% |
| Up 100 basis points | 960 | 3.15% |
| Down 100 basis points | (1,353) | (4.44%) |
| Down 200 basis points | (3,039) | (9.96%) |

While the Company reviews simulation assumptions and methodology to ensure that they reflect historical experience, it should be noted that income simulation may not always prove to be an accurate indicator of interest rate risk because the actual repricing, maturity and prepayment characteristics of individual products may differ from the estimates used in the simulations.

The 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 September 30, 2001, the Company's one year cumulative gap was a positive \$105.3 million, or 12.45% of total assets.

For additional discussion on interest rate risk see the section titled "Asset and Liability Management" contained on pages 34 to 36 of the Company's 2000 Annual Report to Shareholders.

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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 2. CHANGE IN SECURITIES

No information to report.

ITEM 3. DEFAULT UPON SENIOR SECURITIES

No defaults upon senior securities have taken place.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF THE SECURITY HOLDERS

No information to report.

ITEM 5. OTHER INFORMATION

No information to report.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

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No information to report.

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BANCORP RHODE ISLAND, INC.

SIGNATURES

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

Bancorp Rhode Island, Inc.

November 8, 2001

(Date)

By: /s/ Merrill W. Sherman

Merrill W. Sherman
President and
Chief Executive Officer

November 8, 2001

(Date)

By: /s/ Albert R. Rietheimer

Albert R. Rietheimer
Chief Financial Officer
and Treasurer