FALMOUTH BANCORP INC
Form 10QSB
August 13, 2002

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

# FORM 10-QSB

(Mark One)

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

For the quarterly period ended June 30, 2002

OR

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

For the transition period from __________ to _________

Commission file number 01-13465

Falmouth Bancorp, Inc.
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Delaware | 04-3337685 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

20 Davis Straits, Falmouth, MA 02540
(Address of principal executive offices) (Zip Code)

(508) 548-3500
(Registrant's telephone number including area code)

NA
(Former name, former address and former fiscal year, if changed from 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 twelve months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirement for the past 90 days.
Yes [X] No [ ]

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date

| Class | Outstanding at June 30, 2002 |
|---|---|
| Common Stock, Par Value $.01 | 898,679 |

Transitional small business disclosure format:

Yes [ ] No [X]

FALMOUTH BANCORP, INC.
AND SUBSIDIARIES
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FORWARD LOOKING STATEMENTS

This report contains certain forward-looking statements consisting of estimates with respect to the financial condition, results of operations and business of the Company and the Bank that are subject to various factors which could cause actual results to differ materially from these estimates. These factors include, but are not limited to: general and local economic conditions; changes in interest rates, deposit flows, demand for mortgages and other loans, real estate values, and competition; changes in accounting principles, policies, or guidelines; changes in legislation or regulation; and other economic, competitive, governmental, regulatory, and technological factors affecting our operations, pricing, products and services.

Any or all of our forward-looking statements in the report and in any other public statements we make may turn out to be wrong. They can be affected by inaccurate assumptions we might make or by known or unknown risks and uncertainties. Consequently, no forward-looking statement can be guaranteed.

We undertake no obligation to publicly update forward-looking statements, whether as a result of new information, future events or otherwise.

Part I. Item I. FALMOUTH BANCORP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

June 30, 2002 and September 30, 2001

| | June 30, 2002 (unaudited) |
|---|---|
| ASSETS | |
| Cash, due from banks, and interest bearing deposits | $ 2,528,914 |
| Federal funds sold | 6,903,174 |
| Total cash and cash equivalents | 9,432,088 |
| Investments in available-for-sale securities (at fair value) | 17,430,588 |
| Investments in held-to-maturity securities (fair values of $16,994,755 as of June 30, 2002 and $10,036,408 as of September 30, 2001) | 16,990,872 |
| Federal Home Loan Bank stock, at cost | 878,000 |
| Loans, net | 106,350,214 |
| Premises and equipment | 1,823,538 |
| Accrued interest receivable | 917,467 |
| Cooperative Central Bank Reserve Fund Deposit | 395,395 |
| Other assets | 1,153,904 |
| Total Assets | $155,372,066 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | |
| Deposits: | |
| Noninterest-bearing | $ 18,274,219 |
| Interest-bearing | 114,821,441 |
| Total deposits | 133,095,660 |
| Securities sold under agreements to repurchase | 396,945 |
| Advances from Federal Home Loan Bank of Boston | 5,201,008 |
| Other liabilities | 314,715 |
| Total Liabilities | 139,008,328 |
| Minority preferred stockholders' equity in a subsidiary company of | |

| | |
|---|---|
| Falmouth Co-operative Bank | 53,500 |
| Stockholders' equity: | |
| Preferred stock, par value $.01 per share, authorized 500,000 shares; none issued | |
| Common stock, par value $.01 per share, authorized 2,500,000 shares; issued 1,454,750 shares | 14,547 |
| Paid-in capital | 13,895,526 |
| Retained earnings | 13,622,608 |
| Unallocated Employee Stock Ownership Plan shares | (323,345) |
| Treasury stock (556,071 shares as of June 30, 2002; 516,743 shares as of September 30, 2001) | (9,844,997) |
| Unearned compensation | (477,088) |
| Accumulated other comprehensive loss | (577,013) |
| Total stockholders' equity | 16,310,238 |
| Total liabilities and stockholders' equity | $155,372,066 |

The accompanying notes are an integral part of these condensed consolidated financial statements.

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FALMOUTH BANCORP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(unaudited)

| | Three Months Ended | | Nine months |
|---|---|---|---|
| | June 30, 2002 | June 30, 2001 | June 30, 2002 |
| Interest and dividend income: | | | |
| Interest and fees on loans | $1,860,975 | $2,147,048 | $5,779,848 |
| Interest and dividends on securities: | | | |
| Taxable | 318,263 | 210,129 | 723,753 |
| Dividends on marketable equity securities | 19,209 | 24,200 | 61,931 |
| Dividends on Cooperative Bank Investment and Liquidity Funds | - | 7,378 | 551 |
| Other interest | 29,302 | 51,228 | 90,541 |
| Total interest and dividend income | 2,227,749 | 2,439,983 | 6,656,624 |
| Interest expense: | | | |
| Interest on deposits | 714,616 | 1,019,785 | 2,378,554 |
| Interest on securities sold under agreement to repurchase | 857 | 7,193 | 4,256 |
| Interest on Federal Home Loan Bank advances | 62,799 | 116,095 | 227,337 |

| | | | |
|---|---|---|---|
| Total interest expense | 778,272 | 1,143,073 | 2,610,147 |
| Net interest and dividend income | 1,449,477 | 1,296,910 | 4,046,477 |
| Provision for loan losses | 30,000 | 30,000 | 110,000 |
| Net interest income after provision for loan losses | 1,419,477 | 1,266,910 | 3,936,477 |
| Other income: | | | |
| Service charges on deposit accounts | 43,450 | 39,084 | 136,221 |
| Securities gains (losses), net | (70,020) | 39,340 | (52,958) |
| Gains (losses) on mortgages sold, net | 78,560 | 1,116 | 338,086 |
| Other income | 82,846 | 75,205 | 238,984 |
| Total other income | 134,836 | 154,745 | 660,333 |
| Other expense: | | | |
| Salaries and employee benefits | 434,746 | 423,892 | 1,286,498 |
| Occupancy expense | 38,182 | 51,124 | 120,363 |
| Equipment expense | 44,706 | 47,305 | 144,294 |
| Data processing expense | 103,849 | 87,832 | 291,562 |
| Directors' fees | 17,900 | 12,900 | 52,950 |
| Legal and professional fees | 55,559 | 49,849 | 150,277 |
| Other expenses | 178,147 | 171,445 | 518,102 |
| Total other expenses | 873,089 | 844,347 | 2,564,046 |
| Income before income taxes | 681,224 | 577,308 | 2,032,764 |
| Income taxes | 253,667 | 202,645 | 746,292 |
| Net income | $ 427,557 | $ 374,663 | $1,286,472 |
| Comprehensive income | $ 218,728 | $ 352,035 | $1,114,146 |
| Earnings per common share | $0.49 | $0.39 | $1.46 |
| Earnings per common share, assuming dilution | $0.46 | $0.38 | $1.39 |

The accompanying notes are an integral part of these condensed consolidated financial statements.

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FALMOUTH BANCORP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

Nine months ended June 30, 2002

(unaudited)

| | Common Stock | Paid-In Capital | Retained Earnings | Unallocated Employee Stock Ownership Plan Shares | Treasury Stock | Unea Compen |
|---|---|---|---|---|---|---|
| Balance, September 30, 2001 | $14,547 | $13,901,279 | $12,676,198 | $(389,483) | $(8,749,737) | $(137 |
| Employee Stock Ownership Plan | | 77,746 | | | | |
| ESOP shares released | | | | 66,138 | | |
| Recognition and retention plan | | 53,825 | | | | (477 |
| Distribution of RRP shares | | (137,429) | | | | 137 |
| Purchase of treasury stock | | | | | (1,328,901) | |
| Exercise of stock options and related tax benefit | | 105 | | | 233,641 | |
| Dividends declared | | | (340,062) | | | |
| Comprehensive income: | | | | | | |
| Net income | | | 1,286,472 | | | |
| Net change in unrealized holding gain on available-for-sale securities | | | | | | |
| Comprehensive Income | | | | | | |
| Balance, June 30, 2002 | $14,547 | $13,895,526 | $13,622,608 | $(323,345) | $(9,844,997) | $(477 |

Nine months ended June 30, 2001

(unaudited)

| | Common Stock | Paid-In Capital | Retained Earnings | Unallocated Employee Stock Ownership Plan Shares | Treasury Stock | Unea Compen |
|---|---|---|---|---|---|---|
| Balance, September 30, 2000 | $14,547 | $13,901,452 | $11,669,877 | $(477,668) | $(6,850,722) | $(291 |
| Employee Stock Ownership Plan | | 34,300 | | | | |
| ESOP shares released | | | | 66,138 | | |
| Recognition and retention plan | | 82,759 | | | | |
| Distribution of RRP shares | | (153,668) | | | | 153 |
| Purchase of treasury stock | | | | | (427,432) | |
| Exercise of stock options and related tax benefit | | (8,521) | | | 74,453 | |
| Dividends declared | | | (306,163) | | | |
| Comprehensive income: | | | | | | |
| Net income | | | 1,035,522 | | | |
| Net change in unrealized holding gain on available-for-sale securities | | | | | | |
| Comprehensive Income | | | | | | |
| Balance, June 30, 2001 | $14,547 | $13,856,322 | $12,399,236 | $(411,530) | $(7,203,701) | $(137 |

The accompanying notes are an integral part of these condensed consolidated financial statements.



FALMOUTH BANCORP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Nine months Ended June 30, 2002 and 2001

| | 2002 (unaudited) | 2001 (unaudited |
|---|---|---|
| Cash flows from operating activities | | |
| Net income | $ 1,286,472 | $ 1,035,5 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| (Gains) losses on sales of investment securities, net | 52,958 | (193,0 |
| Amortization of investment securities, net | 313,254 | 8,5 |
| Provision for loan loss | 110,000 | 145,0 |
| Change in unearned income | (2,242) | 80,2 |
| Net gains on sales of loans | (338,086) | (17,4 |
| Depreciation and amortization | 145,375 | 139,2 |
| Loss on disposal of equipment | 1,071 | |
| Amortization of mortgage servicing rights | 20,547 | |
| Increase in mortgage servicing rights | (308,934) | |
| Increase in accrued interest receivable | (87,046) | (23,3 |
| (Increase) decrease in prepaid expenses | (6,311) | 3,4 |
| Increase in other assets | (410) | (1,1 |
| Recognition and retention plan (RRP) | 53,825 | 82,7 |
| Decrease in minority interests in a consolidated subsidiary of Falmouth Co-operative Bank | (500) | |
| Increase (decrease) in accrued expenses | 1,663 | (77,0 |
| Increase (decrease) in taxes payable | (114,191) | 121,3 |
| Increase in accrued interest payable | 5 | |
| Decrease in other liabilities | (41,487) | (43,2 |
| Net cash provided by operating activities | 1,085,963 | 1,260,8 |
| Cash flows from investing activities | | |
| Purchases of available-for-sale securities | (9,875,415) | (4,165,1 |
| Proceeds from sales of available-for-sale securities | 60,881 | 841,0 |
| Proceeds from maturities of available-for-sale securities | 1,350,285 | 2,200,5 |
| Purchases of held-to-maturity securities | (19,471,386) | (9,160,0 |
| Proceeds from maturities of held-to-maturity securities | 12,278,909 | 11,547,7 |
| Purchase of Federal Home Loan Bank Stock | - | (157,3 |
| Loan originations and principal collections, net | (17,036,358) | (13,159,4 |
| Proceeds from sales of loans | 23,470,564 | 2,733,5 |
| Capital expenditures | (72,287) | (91,6 |
| Net cash used in by investing activities | (9,294,807) | (9,410,7 |

| | | |
|---|---|---|
| Cash flows from financing activities: | | |
| Net increase in demand deposits, NOW and savings accounts | 11,857,728 | 1,719,4 |
| Net increase (decrease) in time deposits | (937,903) | 5,897,0 |
| Net decrease in securities sold under agreements to repurchase | (278,811) | (178,1 |
| Proceeds from Federal Home Loan Bank long-term advances | - | 6,500,0 |
| Repayments of Federal Home Loan Bank long-term advances | (2,066,940) | (4,562,9 |
| Net change in Federal Home Loan Bank short-term advances | - | 2,000,0 |
| Proceeds from exercise of stock options | 233,746 | 65,9 |
| Dividends paid | (340,062) | (306,1 |
| Employee Stock Ownership Plan | 77,746 | 34,3 |
| Unallocated ESOP shares released | 66,138 | 66,1 |
| Purchase of company shares for RRP Trust | (477,088) | |
| Purchase of treasury stock | (1,328,901) | (427,4 |
| Net cash provided by financing activities | 6,805,653 | 10,808,2 |

The accompanying notes are an integral part of these condensed consolidated financial statements.

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FALMOUTH BANCORP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Nine months Ended June 30, 2002 and 2001

(continued)

| | 2002 (unaudited) | 2001 (unaudited |
|---|---|---|
| Increase (decrease) in cash and cash equivalents | (1,403,191) | 2,658,3 |
| Cash and cash equivalents at beginning of period | 10,835,279 | 6,830,4 |
| Cash and cash equivalents at end of period | $ 9,432,088 | $ 9,488,8 |
| Supplemental disclosures | | |
| Interest paid | $ 2,610,142 | $ 3,421,9 |
| Income taxes paid | 860,483 | 628,2 |

The accompanying notes are an integral part of these condensed consolidated financial statements.

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FALMOUTH BANCORP, INC.

AND SUBSIDIARIES

Notes to Unaudited Condensed Consolidated Financial Statements

Note 1 - Basis of Presentation

The condensed consolidated financial statements of Falmouth Bancorp, Inc. (the "Company") and its subsidiaries presented herein are unaudited and should be read in conjunction with the consolidated financial statements of the Company for the year ended September 30, 2001. The results of operations for the nine-month period ended June 30, 2002 are not necessarily indicative of the results to be expected for the full year. All material intercompany balances and transactions have been eliminated in consolidation. In the opinion of management, the condensed consolidated financial statements reflect all adjustments (consisting solely of normal recurring adjustments) necessary for a fair presentation of results for the interim periods. The year-end condensed balance sheet was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the USA (GAAP).

Note 2 - Accounting Policies

The accounting and reporting policies of the Company conform to GAAP and prevailing practices within the banking industry. The interim financial information should be read in conjunction with the Company's 2001 Annual Report contained on Form 10-KSB.

Management is required to make estimates and assumptions that affect amounts reported in the consolidated financial statements. Actual results could differ significantly from those estimates.

Note 3 - Impact of New Accounting Standards

In June 1998, the FASB issued SFAS No. 133 "Accounting for Derivative Instruments and Hedging Activities". Statement No. 133, as amended by SFAS No. 138, establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities. The Statement is effective for all fiscal quarters of fiscal years beginning after June 15, 2000. The adoption of SFAS No. 133, did not have a material effect on the Company's consolidated financial statements.

FASB has issued SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. This replaces SFAS No, 125, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, and rescinds SFAS Statement No. 127, "Deferral of the Effective Date of Certain Provisions of FASB Statement No. 125." SFAS No. 140 provides accounting and reporting standards for transfers and servicing of financial assets and extinguishments of liabilities. This Statement provides consistent standards for distinguishing transfers of financial assets that are sales from transfers that are secured borrowings. This Statement is effective for transfers and servicing of financial assets and extinguishments of liabilities occurring after March 31, 2001; however, the disclosure provisions are effective for fiscal years ending after December 15, 2000. The effect of this Statement did not have a material impact on the Company's financial position or result of operations.

Statement of Financial Accounting Standards No. 141, Business Combinations, improves the consistency of the accounting and reporting for business combinations by requiring that all business combinations be accounted for under a single method - the purchase method. Use of the pooling-of-



interests method is no longer permitted. Statement No. 141, Goodwill and Other Intangible Assets, requires that the purchase method be used for business combinations initiated after June 30, 2001. Adoption of this Statement had no impact on the consolidated financial statements.

Statement of Financial Accounting Standards No. 142 requires that goodwill no longer be amortized to earnings, but instead be reviewed for impairment. The amortization of goodwill ceases upon adoption of the Statement, which for most companies, will be January 1, 2002. Adoption of this Statement had no impact on the consolidated financial statements.

Note 4 - Earnings per Share

Earnings per share (EPS) for the three months and nine months ended June 30, 2002 and 2001 have been calculated according to the guidelines of FASB Statement 128. ESOP shares are only considered outstanding for earnings per share calculations when they are committed to be released.

Reconciliation of the numerators and the denominators in the calculation of basic and diluted earnings per share are as follows:

| | Income (Numerator) | Shares (Denominator) | Per Sh Amoun |
|---|---|---|---|
| **Three Months Ended June 30, 2002** | | | |
| Basic EPS | | | |
| Net income and income available to common stockholders | $ 427,557 | 873,431 | $0.4 |
| Effect of dilutive securities options and warrants | | 53,659 | |
| Diluted EPS | | | |
| Income available to common stockholders | $ 427,557 | 927,090 | $0.4 |
| **Three Months Ended June 30, 2001** | | | |
| Basic EPS | | | |
| Net income and income available to common stockholders | $ 374,663 | 964,798 | $0.3 |
| Effect of dilutive securities options and warrants | | 21,633 | |
| Diluted EPS | | | |
| Income available to common stockholders | $ 374,663 | 986,431 | $0.3 |

| | | | |
|---|---|---|---|
| Nine months ended June 30, 2002 | | | |
| Basic EPS | | | |
| Net income and income available to common stockholders | $1,286,472 | 880,471 | $1.4 |
| Effect of dilutive securities options and warrants | | 45,678 | |
| Diluted EPS | | | |
| Income available to common stockholders | $1,286,472 | 926,149 | $1.3 |

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| | Income (Numerator) | Shares (Denominator) | Per Sh Amoun |
|---|---|---|---|
| Nine months Ended June 30, 2001 | | | |
| Basic EPS | | | |
| Net income and income available to common stockholders | $1,035,522 | 974,468 | $1.0 |
| Effect of dilutive securities options and warrants | | 15,547 | |
| Diluted EPS | | | |
| Income available to common stockholders | 1,035,522 | 990,015 | $1.0 |

Note 5 - Dividends

On May 21, 2002, the Board of Directors of the Company declared a quarterly cash dividend of $0.13 per share of common stock, which was paid on June 20, 2002 to stockholders of record on June 6, 2002.

Note 6 - Recent Developments

During the quarter ended June 30, 2002 the Company repurchased 25,600 shares of its common stock. The Company issued 9,532 treasury shares due to exercised employee stock options. At June 30, 2002, the Company had 556,071 treasury shares.

Note 7 - Contingency

Falmouth Capital Corporation ("FCC"), a subsidiary of the Bank, was established in December 1999 as a Massachusetts-chartered real estate investment trust (the "REIT"). The Bank received dividends from FCC.

The Bank, and several other financial institutions operating in the Commonwealth of Massachusetts with similar real estate investment trust subsidiaries, have recently received Notices of Intent to Assess additional state excise taxes from the Massachusetts Department of Revenue (the "DOR"), challenging the dividends received deduction claimed by the Bank and other institutions. The Bank received a Notice of Intent to assess a tax in the amount of $470,972 and intends to vigorously appeal this Notice. The Company has not recorded a loss provision in regard to the matter.

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Part I. Item 2. Management's Discussion and Analysis of Financial Condition and Operating Results

General

Falmouth Bancorp, Inc. (the "Company" or "Bancorp"), a Delaware corporation, is the holding company for Falmouth Co-operative Bank (the "Bank" or "Falmouth"), a Massachusetts chartered stock co-operative bank. At June 30, 2002, there were 898,679 shares of the common stock of the company outstanding. The Company's stock trades on the American Stock Exchange under the symbol "FCB".

The Company's sole business activity is ownership of the Bank. The Company also makes investments in long and short-term marketable securities and other liquid investments. The business of the Bank consists of attracting deposits from the general public and local businesses and using these funds to originate primarily residential and commercial real estate loans located in Falmouth, Massachusetts and surrounding areas and to invest in United States Government and Agency securities. To a lesser extent, the Bank engages in various forms of consumer and home equity lending. The Bank's business strategy is to operate as a profitable community bank dedicated to financing home ownership, small business, and consumer needs in its market area and to provide personal, high quality service to its customers. The Bank has one subsidiary, Falmouth Capital Corporation, a real estate investment trust.

The Company had average shares outstanding of 873,431 in the three months ended June 30, 2002, as compared to 964,798 average shares outstanding in the three months ended June 30, 2001. The Company has continued with its stock buy-back programs. At June 30, 2002, the Company had a total of 556,071 shares of treasury stock, or 38.23% of its common stock, leaving 898,679 shares issued and outstanding.

Comparison of Financial Condition at June 30, 2002 and September 30, 2001.

The Company's total assets increased by $7.9 million or 5.4% from $147.4 million at September 30, 2001, to $155.4 million at June 30, 2002. Total deposits increased $10.9 million or 8.9%, from $122.2 million at September 30, 2001 to $133.1 million at June 30, 2002. This increase was due, in part to seasonal deposits in NOW accounts, regular savings accounts and Money Market Deposit accounts during the period. Total net loans were $106.4 million or 80.0% of total deposits at June 30, 2002, as compared to $112.6 million or 92.1% of total deposits at September 30, 2001, representing a decrease of $6.2 million for the period. This decrease was due, in part, to the large number of 1-4 family mortgages that were re-written, due to lower market rates, and then sold by the Bank on the secondary market. Investment securities were $35.3 million or 22.7% of total assets at June 30, 2002, as compared to $20.2 million or 13.7% of total assets at September 30, 2001. Investment securities increased $15.1 million or 74.7% due, in part, to the reinvestment of cash flows generated from loan payoffs and sold loans into short-term securities.

Borrowed funds from the Federal Home Loan Bank of Boston decreased from $7.3 million at September 30, 2001 to $5.2 million at June 30, 2002. The decrease of $2.1 million was the result of the repayment of maturing debt along with normal amortization of long term borrowings.

Securities sold under agreements to repurchase (sweep accounts for commercial depositors) decreased from $676,000 at September 30, 2001 to $397,000 at June 30, 2002. The decrease was attributed to the increased seasonal needs of our commercial demand deposit customers.

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Stockholders' equity was $16.3 million at June 30, 2002, as compared to $16.9 million at September 30, 2001, a decrease of $600,000. This change was primarily the result of net income, net of dividends paid to stockholders, added to retained earnings of $946,000 and the scheduled discharge of liabilities on stock based employee benefit plans of $431,000 (ESOP, RRP, and stock options), off-set in part by a decrease in accumulated other comprehensive income of $172,000, the purchase of treasury shares under the Company's stock repurchase programs at a cost of $1,328,000, and the purchase of company stock for the RRP Trust at a cost of $477,000. The ratio of stockholders' equity to total assets was 10.50% at June 30, 2002, and the book value per share of common stock was $18.15, compared to 11.47% and $18.01, respectively, at September 30, 2001.

The ratio of the allowance for loan losses to total loans was .98% at June 30, 2002. Management believes the allowance will be adequate based upon, among other things, past loss experience, prevailing economic conditions, and the level of credit risk in the loan portfolio. However, the Bank may periodically provide additional provisions as deemed necessary to maintain a sufficient allowance for the loan loss to total loan ratio. The Bank plans to continue to set aside additional general reserves as well as specific reserves for commercial loans and large residential mortgages.

Three Months Ended June 30, 2002 and 2001

Net Income. The Company's net income for the three months ended June 30, 2002 was $428,000, as compared to $375,000 for the three months ended June 30, 2001. The increase in net income of $53,000 was due, in part, to a decrease in interest and dividend income of $212,000 that was more than offset by a decrease in interest expense of $365,000. Other key factors included a decrease in other income of $20,000, an increase in other expenses of $29,000 and an increase in income taxes of $51,000. The annualized return on average assets (ROA) for the three months ended June 30, 2002 was 1.13%, an increase of 8 basis points, as compared to 1.05% for the same period of the prior year. The annualized return on average equity (ROE) for the three months ended June 30, 2002 was 10.20%, an increase of 203 basis points, as compared to 8.17% for the same period of the previous year. Interest and dividend income decreased, primarily as the result of low interest rates, loan payoffs, and loan sales during the period. The decrease in interest expense was primarily due to a reduction in the general level of interest rates while total deposits rose only slightly.

Net Interest and Dividend Income. Net interest and dividend income was $1.5 million for the three-month period ended June 30, 2002 as compared to $1.3 million for the three months ended June 30, 2001. The $153,000 increase was the result of a $212,000 decrease in interest and dividend income, offset by a $365,000 decrease in interest expense. The net interest margin for the three months ended June 30, 2002 was 4.08%, an increase of 21 basis points, as compared to 3.87% for the three months ended June 30, 2001. The increase in net interest margin was primarily the result of a decrease in interest expense.

Interest Expense. Total interest expense for the three months ended June 30, 2002 was $778,000, as compared to $1.14 million for the same period of the prior year, a decrease of $365,000. This was the result of decreased FHLB borrowings as well as a reduction in interest rates paid on deposits during the period.

Provision for Loan Losses. The Bank added $30,000 to its allowance for loan losses during the quarter ended June 30, 2002, as compared to $30,000 for the quarter ended June 30, 2001. Management believes that, although the provision is deemed adequate based on its delinquency and loan loss record, additional provisions may be added from time to time as the loan portfolio expands by loan type and volume, including expansion in the commercial loan portfolio. The Bank reviews the general and specific reserves allocated to each loan type, both on and off the balance sheet. This review procedure allows management to



look at the growth and risk of each loan type. If necessary, additional reserves can be allocated where loss exposure appears to have risen. Where commercial loans traditionally have a greater degree of loss exposure, the amount of the allowance may be greater than that of traditional 1-4 family mortgage loan of the same amount. If losses appear imminent within a loan type or in general, allowances could be increased. General allowances are generally increased as the total loan portfolio increases. Net loans decreased $6.2 million for the three months ended June 30, 2002, primarily due to 1-4 family loan sales. This decrease aided in improving the Bank's allowance for loan loss to .98 % of total loans at June 30, 2002. The Bank's Asset/Liability Committee routinely reviews the risk weighting applied to each type of loan. There have been no changes during the period ended June 30, 2002. As of June 30, 2002, the Bank had no non-performing loans.

Other Income. Other income for the three-month period ended June 30, 2002 was $135,000, as compared to $155,000 for the three months ended June 30, 2001. The $20,000 decrease was primarily the result of a decrease in net gains realized from the sale of investment securities of $109,000, an increase in service charge income of $4,000, an increase in net gains on mortgages sold of $77,000, and an increase in other income of $8,000.

Operating Expenses. Operating expenses for the three months ended June 30, 2002 were $873,000, as compared to $844,000 for the three months ended June 30, 2001. The $29,000 increase was primarily due to increase in salaries and employee benefits of $11,000, an increase in legal and professional costs of $6,000, combined with an increase in data processing expense of $16,000, an increase in directors' fees of $5,000 and an increase in other expenses of $7,000, offset, in part, by the combination of a decrease in occupancy expense of $13,000, and decrease in equipment expense of $3,000. The annualized ratio of operating expenses to average total assets for the three months ended June 30, 2002 was 2.31%, as compared to 2.36% for the three-month period ended June 30, 2001, a decrease of 5 basis points. The increase in salaries and employee benefits was due, substantially, to increased employees' medical insurance premiums and in the cost of the employees stock ownership plan, whose cost fluctuates with the current market price of Falmouth Bancorp, Inc. common stock. The decrease in occupancy expense was due, primarily to the decrease in equipment depreciation expense. Data processing expense increased, in part, due to the increased operating costs of Internet Banking and bill paying as well as Internet Cash Management and bill paying for our business customers.

Nine months Ended June 30, 2002 and 2001

Net Income. The Company's net income for the nine months ended June 30, 2002 was $1.3 million as compared to $1.0 million at June 30, 2001, an increase of $251,000, or 24.2%. This was primarily due to a decrease in interest and dividend income of $565,000, offset by a decrease in interest expense of $812,000, a decrease in the provision for loan losses of $35,000, an increase in other income of $127,000, a decrease on other expenses of $19,000 and an increase in taxes of $177,000. The loan loss provision was decreased due to the reduction in the Bank's loan portfolio due to the sale of loans. It had been increased in the previous year to better align the reserve with the size of the portfolio at that time. At June 30, 2002, the Bank had three loans, with a combined balance of $87,000, which are 30 days or more delinquent. The Bank's allowance for loan losses was 0.98% of total loans at June 30, 2002. The annualized return on average equity (ROE) for the nine months ended June 30, 2002 was 9.06%, an increase of 182 basis points, as compared to 7.24% for the nine months ended June 30, 2001.

Interest and Dividend Income. Total interest and dividend income for the nine months ended June 30, 2002 was $6.7 million, a decrease of $565,000 as compared to $7.2 million for the nine-month period ended June 30, 2001. The decrease in interest and dividend income is attributable to lower interest rates on loans

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and other investments as well as a reduction of loans held for investment from 92.1% of total deposits at June 30, 2001 to 79.9% at June 30, 2002. Although the investment portfolio grew $15.1 million from $20.2 million at June 30, 2001 to $35.3 million at June 30, 2002, investment and other interest income decreased $48,000 due to the decrease in interest rates generally and the Bank's strategy of investing in short term, lower yielding securities in anticipation of rising interest rates. Management believes it is well positioned for a rising rate scenario. In the short term, profitability will remain relatively unchanged as the effects of higher earning assets being replaced with lower earning assets are offset by the effects of higher cost term deposits and borrowings being replaced with lower cost term deposits and borrowings.

Interest Expense. Interest expense for the nine months ended June 30, 2002 was $2.6 million, including $227,000 in interest on FHLB advances, which is a decrease of $812,000 from $3.4 million for the nine months ended June 30, 2001. This was the result of decreased FHLB borrowings as well as a reduction in interest rates paid on deposits during the period. There was a $753,000 decrease in interest on deposits and a $59,000 decrease in interest on borrowed funds and securities sold under agreement to repurchase.

Net Interest and Dividend Income. Net interest and dividend income for the nine-month period ended June 30, 2002 was $4.1 million as compared to $3.8 million for the nine months ended June 30, 2001. The net interest margin for the nine months ended June 30, 2002 was 3.83%, a decrease of 7 basis points as compared to 3.90% for the nine months ended June 30, 2001. The annualized return on average assets (ROA) for the nine-month period ended June 30, 2002 was 1.15%, an increase of 15 basis points, as compared to 1.00% for the same period of the prior year. The reason for the increase in the ROA was primarily due to the increase in net interest income after the provision for loan loss, the gain on sales of current production loans, and decreases in other expenses, offset somewhat by the net losses on sales of investment securities.

Provision for Loan Losses. The Bank added $110,000 to its allowance for loan loss account for the nine months ended June 30, 2002 which is $35,000 less than the $145,000 added for the nine month period ended June 30, 2001. The loan loss provision was decreased because of the reduction in the Bank's loan portfolio due to the sale of loans. It had been increased in the previous year to better align the reserve with the size and risk associated with the portfolio at that time. At June 30, 2002, the Bank had three loans, with a combined balance of $87,000, which are 30 days or more delinquent. The Bank's allowance for loan losses was 0.98% of total loans at June 30, 2002. Management believes the provision to be adequate and commensurate with the level of credit risk.

Other Income. Total other income for the nine-month period ended June 30, 2002 was $660,000 as compared to $534,000 for the nine months ended June 30, 2001. The $126,000 increase is primarily the result of an increase of $320,000 in gains on loans sold offset, in part by a decrease of $246,000 in securities gains net, on the sale of investment securities taken during the nine months ended June 30, 2002. Other income increased $28,000 and services charges on deposit accounts increased $24,000 during the same nine-month period. The $28,000 increase in other income consisted of increases in ATM fees collected of $21,000, increases in loan servicing fee income of $28,000 and increases in loan processing fees, wire transfer fees, and prepayment penalty fees of $14,000. These were offset by a decrease in rental income of $26,000 and a decrease in miscellaneous income of $9,000.

Operating Expenses. Operating expenses for the nine months ended June 30, 2002 and 2001 were $2.6 million. A $19,000 decrease was primarily due to a decrease in salaries and employee benefits expense of $40,000, a decrease in occupancy expense of $28,000, and a decrease in legal and professional fees of $35,000 partially offset by an increase in equipment expense of $10,000, an increase in data processing

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expense of $55,000, an increase in directors fees of $12,000, and an increase of other expense of $7,000. The ratio of annualized operating expenses to average total assets for the nine months ended June 30, 2002 was 2.31% as compared to 2.42% for the nine-month period ended June 30, 2001. The decrease in salary and employee benefits was due, substantially, to the recent elimination of the Bank's defined benefit retirement plan. The decrease in legal and professional cost was due to the absence of third party consultants utilized during the same period of the previous year. Data Processing expense increased, in part, due to the increased operating costs of Internet Banking and bill paying as well as Internet Cash Management and bill paying for our business customers.

Liquidity and Capital Resources

The Bank's primary sources of funds consist of deposits, repayment and prepayment of loans and mortgage-backed securities, maturities of investments and interest-bearing deposits, and funds provided from operations. While scheduled repayments of loans and mortgage-backed securities and maturities of investment securities are predictable sources of funds, deposit flows and loan prepayments are greatly influenced by the general level of interest rates, economic conditions and competition. The Bank uses its liquidity resources principally to fund existing and future loan commitments, to fund net deposit outflows, to invest in other interest-earning assets, to maintain liquidity, and to meet operating expenses.

The Bank is required to maintain adequate levels of liquid assets. This guideline, which may be varied depending upon economic conditions and deposit flows, is based upon a percentage of deposits and short-term borrowings. The Bank has historically maintained a level of liquid assets in excess of regulatory requirements. The Bank's liquidity ratio at June 30, 2002 was 31.96%.

A major portion of the Bank's liquidity consists of short-term securities obligations. The level of these assets is dependent on the Bank's operating, investing, lending and financing activities during any given period. At June 30, 2002, regulatory liquidity totaled $44.2 million. The primary investing activities of the Bank include origination of loans and the purchase of investment securities.

Liquidity management is both a daily and long-term function of management. If the Bank requires funds beyond its ability to generate them internally, the Bank believes that it could borrow additional funds from the Federal Home Loan Bank of Boston (FHLB). At June 30, 2002, the Bank had outstanding advances from the FHLB of Boston in the amount of $5.2 million in short and long-term borrowings. As these advances mature, they will be repaid or re-written as longer term matched borrowings which will assist the match of rate sensitive assets to rate sensitive liabilities as well as reduce interest expense.

At June 30, 2002, the Bank had $5.2 million in outstanding residential and commercial commitments to originate loans, as well as $21.0 million in unadvanced loan commitments. If the Bank anticipates that it may not have sufficient funds available to meet its current loan commitments it may commence further matched borrowing from the FHLB. At June 30, 2002, certificates of deposit that are scheduled to mature in one year or less totaled $47.4 million. Based on historical experience, management believes that a significant portion of such deposits will remain with the Bank.

At June 30, 2002 the Bank exceeded all of its regulatory capital requirements.



## OTHER INFORMATION

Part II.

Item 1. Legal Proceedings

None

Item 2. Changes in Securities and Use of Proceeds

None

Item 3. Defaults upon Senior Securities

None

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

None

Item 5. Other Information

The Company's Chief Executive Officer and Chief Financial Officer have furnished statements relating to its Form 10-Q for the quarter ended June 30, 2002 pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002. The statements are attached hereto as Exhibit 99.1.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

Exhibit 99.1 Certification of Chief Executive Officer and Treasurer.

(b) Reports on Form 8-K.

None

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Falmouth Bancorp, Inc. is a publicly owned bank holding company and the parent corporation of Falmouth Co-operative Bank, a Massachusetts chartered stock co-operative bank offering traditional products and services. The Bank conducts business through its main office located at 20 Davis Straits, Falmouth, Massachusetts 02540, and its two branch locations in North and East Falmouth. The telephone number is (508) 548-3500.

SIGNATURES

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

FALMOUTH BANCORP, INC.
(Registrant)

Date: August 12, 2002 By: /s/ Santo P. Pasqualucci

Santo P. Pasqualucci
President and Chief Executive Officer

Date: August 12, 2002 By: /s/ George E. Young, III

George E. Young, III
Senior Vice President and Chief Financial Officer

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