FALMOUTH BANCORP INC
Form 10QSB
August 14, 2003

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 ACTS OF 1934

For the quarterly period ended June 30, 2003

OR

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

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date:

Class	Outstanding at June 30, 2003
Common Stock, Par Value $.01	905,642

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, 2003 and September 30, 2002

	June 30, 2003 (unaudited	Se
ASSETS		
Cash, due from banks, and interest bearing deposits	$ 6,128,166	$
Federal funds sold	3,931,558	
Total cash and cash equivalents	10,059,724	
Investments in available-for-sale securities (at fair value)	34,052,054	
Investments in held-to-maturity securities (fair values of $30,397,848 as of June 30, 2003 and $28,034,474 as of September 30, 2002)	30,375,569	
Federal Home Loan Bank stock, at cost	878,000	
Loans, net	83,832,032	
Premises and equipment	1,784,722	
Accrued interest receivable	1,340,733	
Cooperative Central Bank Reserve Fund Deposit	395,395	
Other assets	1,237,521	
Total Assets	$163,955,750	$1
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits:		
Non-Interest-bearing	$ 19,403,451	$
Interest-bearing	121,996,357	1
Total deposits	141,399,808	1
Securities sold under agreements to repurchase	1,246,812	
Federal Home Loan Bank advances	3,607,146	
Other liabilities	272,689	
Total Liabilities	146,526,455	1
Minority preferred stockholders' equity in a subsidiary company of Falmouth Bank	50,500	
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	14,030,959	
Retained earnings	13,755,005	
Unallocated Employee Stock Ownership Plan shares	(235,160)	
Treasury stock (549,108 shares as of June 30, 2003; 553,971 shares as of September 30, 2002)	(9,721,792)	
Unearned compensation	(340,994)	
Accumulated other comprehensive loss	(123,770)	
Total stockholders' equity	17,378,795	
Total liabilities and stockholders' equity	$163,955,750	$1

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		Nin
	June 30, 2003	June 30, 2002	June 3 2003
Interest and dividend income:			
Interest and fees on loans	$1,269,363	$1,860,975	$4,086,
Interest and dividends on securities:			
Taxable	300,894	318,263	950,
Dividends on marketable equity securities	16,819	19,209	58,
Dividends on Cooperative Bank Investment and Liquidity Funds	-	-	
Other interest	37,531	29,302	101,
Total interest and dividend income	1,624,607	2,227,749	5,196,
Interest expense:			
Interest on deposits	500,461	714,616	1,714,
Interest on securities sold under agreement to repurchase	4,125	857	9,
Interest on Federal Home Loan Bank advances	53,819	62,799	177,
Total interest expense	558,405	778,272	1,902,
Net interest and dividend income	1,066,202	1,449,477	3,293,
Provision for loan losses	-	30,000	

Net interest income after provision for loan losses	1,066,202	1,419,477	3,293,
Other income:			
Service charges on deposit accounts	53,664	43,450	147,
Security losses, net	(1,211)	(70,020)	(456,
Net gains on sales of loans	243,531	78,560	855,
Loan servicing fees	40,969	18,320	105,
Other income	75,102	64,526	222,
Total other income	412,055	134,836	873,
Other expense:			
Salaries and employee benefits	453,147	434,746	1,447,
Occupancy expense	42,033	38,182	127,
Equipment expense	48,844	44,706	138,
Data processing expense	111,270	103,849	309,
Directors' fees	24,815	17,900	62,
Legal and professional fees	34,835	55,559	125,
Other expenses	384,889	178,147	887,
Total other expenses	1,099,833	873,089	3,098,
Income before income taxes	378,424	681,224	1,069,
Income taxes	105,295	253,667	420,
Net income before extraordinary item	273,129	427,557	649,
Extraordinary item (net of tax expense of $146,221 for the 3 month period ended June 30, 2003 and net of tax benefit of $153,799 for the 9 month period ended June 30, 2003)	295,389	-	(276,
Net income after extraordinary item	$ 568,518	$ 427,557	$ 372,

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

FALMOUTH BANCORP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Continued)

(unaudited)

	Three Months Ended		Nin
	June 30, 2003	June 30, 2002	June 3 2003

Comprehensive income	$ 691,448	$ 218,728	$1,054,
Earnings per common share before extraordinary item	$ 0.31	$ 0.49	$ 0
Earnings(loss) per common share on extraordinary item	.34	-	(
Earnings per common share after extraordinary item	$ 0.65	$ 0.49	$ 0
Earnings per common share before extraordinary item, assuming dilution	$ 0.30	$ 0.46	$ 0
Earnings (loss) per common share on extraordinary item, assuming dilution	.32	-	(
Earnings per common share after extraordinary item, assuming dilution	$ 0.62	$ 0.46	$ 0

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

FALMOUTH BANCORP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

Nine Months ended June 30, 2003

(unaudited)

	Common Stock	Paid-In Capital	Retained Earnings	Unallocated Employee Stock Ownership Plan Shares	Treasury Stock	Unear Compens
Balance, September 30, 2002	$14,547	$13,981,543	$13,735,221	$(301,299)	$(9,807,890)	$(477,
Employee Stock Ownership Plan		99,011				
ESOP shares released				66,139		
Recognition and retention plan		93,396				
Distribution of RRP shares		(136,094)				136,
Purchase of treasury stock						
Exercise of stock options and related tax benefit		(6,897)			86,098	

Dividends declared ($.39 per share)			(352,326)			
Comprehensive income:						
Net Income			372,110			
Net change in unrealized holding gain on available-for-sale securities						
Comprehensive Income						
Balance, June 30, 2003	$14,547	$14,030,959	$13,755,005	$(235,160)	$(9,721,792)	$(340,

Nine Months ended June 30, 2002

(unaudited)

	Common Stock	Paid-In Capital	Retained Earnings	Unallocated Employee Stock Ownership Plan Shares	Treasury Stock	Unear Compens
Balance, September 30, 2001	$14,547	$13,901,279	$12,676,198	$(389,483)	$(8,749,737)	$(137,
Employee Stock Ownership Plan		77,746				
ESOP shares released				66,138		
Recognition and retention plan		53,825				(477,
Distribution of RRP shares		(137,429)				137,
Purchase of treasury stock					(1,328,901)	
Exercise of stock options and related tax benefit		105			233,641	
Dividends declared ($.37 per share)			(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,

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, 2003 and 2002

	2003 (Unaudited)
Cash flows from operating activities	
Net income	$ 372,110
Adjustments to reconcile net income to net cash provided by operating activities:	
Realized losses on available for sale investment securities, net	456,703
Amortization of investment securities, net	1,049,456
Provision for loan loss	-
Change in deferred loan costs net of origination fees	(36,049)
Net gains on sales of loans	(855,304)
Depreciation and amortization	124,838
Loss on disposal of equipment	-
Increase in accrued interest receivable	(225,809)
(Increase) decrease in prepaid expenses	7,726
Increase in other assets	(124,726)
Recognition and retention plan (RRP)	93,396
(Increase) decrease accrued expenses	(31,315)
Decrease (increase) in taxes payable	36,840
Increase in accrued interest payable	319
Decrease in other liabilities	(457,978)
Net cash provided by operating activities	410,207
Cash flows from investing activities	
Purchases of available-for-sale securities	(40,299,762)
Proceeds from sales of available-for-sale securities	664,940
Proceeds from maturities of available-for-sale securities	24,185,809
Purchases of held-to-maturity securities	(32,666,947)
Proceeds from maturities of held-to-maturity securities	29,615,476
Loan originations and principal collections, net	(41,873,128)
Proceeds from sales of loans	53,942,404
Capital expenditures	(117,544)
Net cash used in investing activities	(6,548,752)
Cash flows from financing activities:	
Net increase in demand deposits, NOW and savings accounts	12,808,372
Net decrease in time deposits	(3,125,623)
Net increase (decrease) in securities sold under agreements to repurchase	774,940
Repayments of Federal Home Loan Bank long-term advances	(1,571,029)
Redemption of preferred shares relative to minority interests	(3,000)
Proceeds from exercise of stock options	79,201
Dividends paid	(352,326)
Employee Stock Ownership Plan	99,011
Unallocated ESOP shares released	66,139
Purchase of company shares for RRP Trust	-

Purchase of treasury stock	-
Net cash provided by financing activities	8,775,685

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, 2003 and 2002

(continued)

	2003 (Unaudited)
Increase (decrease) in cash and cash equivalents	2,637,140
Cash and cash equivalents at beginning of period	7,422,584
Cash and cash equivalents at end of period	$ 10,059,724
Supplemental disclosures	
Interest paid	$ 1,901,856
Income taxes paid	(229,826)

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, 2002. The results of operations for the nine-month period ended June 30, 2003 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 2002 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

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 requires that the purchase method be used for business combinations initiated after June 30, 2001. The adoption of SFAS No. 141 had no immediate effect on the Company's consolidated financial statements since it had no pending business combinations as of June 30, 2001 or as of the date of the issuance of these consolidated financial statements. If the Company consummates business combinations in the future, any such combinations that would have been accounted for by the pooling-of-interests method under Opinion 16 will be accounted for under the purchase method and the difference in accounting could have a substantial impact on the Company's consolidated financial statements.

SFAS 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. All of the provisions of SFAS No. 142 were effective for the Company beginning with its fiscal year ending September 30, 2002. The adoption of SFAS No. 142 did not have an impact on the Company's consolidated financial statements.

In August 2001, the FASB issued SFAS No. 144 "Accounting for Impairment or Disposal of Long Lived Assets." The provisions of SFAS No. 144 are required to be adopted starting with fiscal years

beginning after December 15, 2001. The adoption of this Statement did not have a material impact on the Company's consolidated financial statements.

In June 2002, the FASB issued SFAS No. 146 "Accounting for Costs Associated with Exit or Disposal Activities." This statement requires that a liability for a cost associated with an exit or disposal activity be recognized and measured initially at fair value only when the liability is incurred. SFAS No. 146 is effective for exit or disposal activities that are initiated after December 31, 2002. This Statement did not have a material impact on the Company's consolidated financial statements.

In October 2002, the FASB issued SFAS No. 147 "Acquisitions of Certain Financial Institutions" an Amendment of SFAS No. 72 and SFAS No. 144 and FASB Interpretation No. 9 SFAS No. 72 "Accounting for Certain Acquisitions of Banking or Thrift Institutions" and FASB interpretation No. 9 "Applying APB Opinions No. 16 and 17 When a Savings and Loan Association Is Acquired in a Business Combination Accounted for by the Purchase Method," that provided interpretive guidance on the application of the purchase method to acquisitions of financial institutions. SFAS No. 147 was effective October 1, 2002. There was no impact on the Company's consolidated financial statements on adoption of this Statement.

Note 4 - Accounting for Stock-Based Compensation.

Statement of Financial Accounting Standards No. 148 "Accounting for Stock-Based Compensation - Transition and Disclosure, an amendment to FASB Statement No. 123 (SFAS No. 148)" was issued by FASB in December 2002. This new Statement requires, in interim financial statements, certain new disclosures about stock-based compensation. Management measures stock-based compensation in accordance with APB Opinion No. 25. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provision of SFAS No. 123 "Accounting for Stock-Based Compensation" to stock-based compensation.

	Three months ended June 30, 2003	Three months ended June 30, 2002	Nine m 2003
Net income (loss) as reported, after extraordinary item	$568,518	$427,557	$372,110
Stock based compensation expense determined under fair value method, net of tax benefit	(4,746)	(4,780)	(14,187
Pro forma net income (loss)	$563,772	$422,777	$357,923
Earnings (loss) per share:			
Basic as reported	$ 0.65	$ 0.49	$ 0.43
Basic - pro forma	$ 0.65	$ 0.48	$ 0.41
Diluted as reported	$ 0.62	$ 0.46	$ 0.40
Diluted - pro forma	$ 0.61	$ 0.46	$ 0.39

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Note 5 - Dividends

On May 20, 2003, 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 24, 2003 to stockholders of record at the close of business on June 10, 2003.

Note 6 - Recent Developments

During the quarter ended June 30, 2003 the Company issued 2,469 treasury shares due to exercised employee stock options. At June 30, 2003, the Company had 549,108 treasury shares.

Note 7 - Contingency and Extraordinary Item

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 previously 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 its intentions were to vigorously appeal this Notice. The Company did not record a loss provision in regard to this matter.

On March 5, 2003, the Commonwealth of Massachusetts enacted tax legislation that imposed taxes on the Bank for the above described dividends paid by the Bank's REIT to the Bank. The new tax, including interest, for the Bank was $572,348 covering the years ending 1999, 2000, 2001, 2002, and the five months ended February 28, 2003. The Company expensed this amount in its financial statements for the quarter ended March 31, 2003, net of the tax benefit of approximately $300,020 and classified it as an extraordinary item on the statements of income for the three months ended March 31, 2003 and the six months ended March 31, 2003.

On June 20, 2003, the Bank and its subsidiary real estate investment trust entered into an agreement with the DOR settling the dispute concerning the dividends received deduction claimed by the Bank. Under the agreement, the Bank paid $250,970 to the DOR, which will abate the balance of assessments and all tax and interest otherwise remaining due under the assessments. The Bank recorded a credit to extraordinary expense of $295,389. Net of tax effects, the item of extraordinary expense was reduced from $572,348 as reported for the three month and six month periods ended March 31, 2003 to $276,959 on the statements of income for the nine month period ended June 30, 2003.

Because of the inability to deduct dividends received from the Bank's REIT, it is expected that net income during the remainder of 2003 will be reduced by approximately $40,000 per quarter.

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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 Bank (the "Bank" or "Falmouth"), a Massachusetts chartered stock co-operative bank. At June 30, 2003, there were 905,642 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 investments trust.

The Company had average shares outstanding of 904,524 at June 30, 2003, as compared to 873,431 average shares outstanding at June 30, 2002. At June 30, 2003, the Company had repurchased a total of 549,108 shares, or 37.74% of its common stock, leaving 905,642 shares issued and outstanding.

Critical Accounting Policies

The Notes to our Audited Consolidated Financial Statements for the year ended September 30, 2002, included in our Annual Report, contain a summary of our significant accounting policies. We believe our policies with respect to the methodology for our determination of the allowance for loan losses, the valuation of mortgage servicing rights and asset impairment judgments, and other than temporary declines in the value of our securities, involve a higher degree of complexity and require management to make difficult and subjective judgments which often require assumptions or estimates about highly uncertain matters. Changes in these judgments, assumptions or estimates could cause reported results to differ materially. The Audit Committee and our Board of Directors periodically review these critical policies and their application.

Comparison of Financial Condition at June 30, 2003 and September 30, 2002.

The Company's total assets increased by $9.4 million or 6.11% for the nine months ended June 30, 2003, from $154.5 million at September 30, 2002 to $163.9 million at June 30, 2003. Total deposits increased $9.7 million or 7.35%, from $131.7 million at September 30, 2002 to $141.4 million at June 30, 2003. This increase was due, in part, to seasonal deposits in NOW accounts and regular savings accounts during the period. Total net loans were $83.8 million or 59.3% of total deposits at June 30, 2003, as compared to $95.0 million or 72.1% of total deposits at September 30, 2002, representing a decrease of

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$11.2 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 with the loan servicing retained. Investment securities were $65.3 million or 39.8% of total assets at June 30, 2003, as compared to $47.7 million or 30.8% of total assets at September 30, 2002. Investment securities increased $17.6 million or 37.0% 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 $5.2 million at September 30, 2002 to $3.6 million at June 30, 2003. The decrease of $1.6 million was due to routine amortization and maturity of advances during the period.

Securities sold under agreements to repurchase (sweep accounts for commercial depositors) increased from $472,000 at September 30, 2002 to $1.3 at June 30, 2003. The increase was attributed to the increased seasonal deposits of our commercial demand deposit customers.

Stockholders' equity was $17.38 million at June 30, 2003, as compared to $16.34 million at September 30, 2002, an increase of $1.04 million. This change was primarily due to an increase of $20,000 in retained earnings, a decrease in other comprehensive loss of $683,000 due to realized gains on available for sale investments and the increased value of available for sale investments, the scheduled discharge of liabilities on stock-based employee benefit plans of $258,000 (ESOP and RRP), and the exercise of stock options, net of tax benefits, of $79,000. The ratio of stockholders' equity to total assets was 10.60% at June 30, 2003, and the book value per share of common stock was $19.19, compared to 10.57% and $18.15, respectively, at September 30, 2002.

The ratio of the allowance for loan losses to total loans was 1.11% at June 30, 2003. 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.

Three Months Ended June 30, 2003 and 2002

Net Income. The Company's net gain, after an extraordinary item, for the three months ended June 30, 2003 was $569,000, as compared to net income of $428,000 for the three months ended June 30, 2002. The increase in net income of $141,000 was due, in part, to a decrease in interest and dividend income of $603,000 that was offset, in part, by a decrease in interest expense of $220,000. Other key factors include a reduction of $295,000 of a one-time charge to earnings of $572,000 (classified as an extraordinary item on the March 31, 2003 consolidated statements of income) that is related to a dispute and subsequent settlement between the Bank and the Commonwealth of Massachusetts concerning the tax treatment of dividends received of the Bank's real estate investment trust subsidiary; an increase in total other expenses of $227,000 and a decrease in income taxes of $148,000. The annualized return on average assets (ROA) for the three months ended June 30, 2003 was 1.43%, an increase of 253 basis points, as compared to 1.13% for the same period in the prior year. The annualized return on average equity (ROE) for the three months ended June 30, 2003 was 13.27%, as compared to 10.20% 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 slightly.

Interest and Dividend Income. Total interest and dividend income for the three months ended June

30, 2003 was $1.6 million, a decrease of $603,000, as compared to $2.2 million for the three-month period ended June 30, 2002. The decrease was attributed to a decrease in interest and fees on loans of $592,000, which was the result of generally lower interest rates on loans held for investment, offset by a decrease in interest and dividends on debt securities of $17,000, dividends on equities securities of 2,000, and an increase in other interest of $8,000.

Interest Expense. Total interest expense for the three months ended June 30, 2003 was $558,000, as compared to $778,000 for the same period of the prior year, a decrease of $220,000. This was the result of decreased FHLB borrowings as well as a reduction in interest rates paid on deposits during the period.

Net Interest and Dividend Income. Net interest and dividend income was $1.07 million for the three-month period ended June 30, 2003 as compared to $1.45 million for the three months ended June 30, 2002. The $383,000 decrease was the result of a $603,000 decrease in interest and dividend income, offset in part by a $220,000 decrease in interest expense. The net interest margin for the three months ended June 30, 2003 was 2.82%, a decrease of 121 basis points, as compared to 4.03% for the three months ended June 30, 2002. The decrease in net interest margin was primarily the result of a decrease in the yield on earning assets.

Provision for Loan Losses. The Bank made no additional provision to its allowance for loan losses during the quarter ended June 30, 2003, as compared to a provision of $30,000 for the quarter ended June 30, 2002. This was the result of management's decision to sell a substantial amount of its newly originated loans on the secondary market, thus reducing the amount of growth in loans as compared to the same period of the previous year. 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 have declined since September 30, 2002. The Bank's allowance for loan loss was 1.11% of total loans at June 30, 2003. 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, 2003. As of June 30, 2003, the Bank had no non-performing loans.

Other Income. Total other income for the three-month period ended June 30, 2003 was $412,000, as compared to $135,000 for the three months ended June 30, 2002. The $277,000 increase was primarily the result of an increase in net gains on mortgages sold of $165,000, an increase in services charges on deposit accounts of $10,000, an increase in loan servicing fee income of $23,000 an increase in other income of $10,000, and a reduction in realized losses on investments securities of $69,000.

Other Expenses. Total other expenses for the three months ended June

30, 2003 were $1.1 million, as compared to $873,000 for the three months ended June 30, 2002. The $227,000 increase was primarily due to the combination of an increase in salaries and employee benefits of $18,000, an increase in occupancy expense of $4,000, an increase in data processing expense of $7,000, and an increase in other expenses of $207,000, combined with an increase in equipment expense of $4,000, an increase in Directors' fees of $7,000, and a decrease in legal and professional costs of $20,000. The increase in other

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expenses was primarily the result of the amortization and impairment of mortgage-servicing rights due to the large number of loans serviced for others that have been re-financed and the general market for mortgage servicing rights. The annualized ratio of operating expenses to average total assets for the three months ended June 30, 2003 was 2.75%, as compared to 2.31% for the three-month period ended June 30, 2002, an increase of 44 basis points.

Extraordinary Item. The extraordinary item expense was the result of the recent Massachusetts tax legislation effecting the 95% tax dividend exclusion of dividends received by the Bank from its real estate investment trust subsidiary. The new tax legislation expressly disallows the deduction for dividends received from a real estate investment trust subsidiary. As a result of the enactment of the legislation, the Company ceased recording the tax benefits associated with the dividend-received deduction and an extraordinary item of $572,000 (net of income tax benefits of $300,000) was recorded in March 2003.

On June 20, 2003, the Bank and its subsidiary real estate investment trust entered into an agreement with Massachusetts concerning the dividends received deduction claimed by the Bank. Under the agreement, the Bank paid $250,970 to the DOR, which will abate the balance of assessments and all tax and interest otherwise remaining due under the assessments. During the three months period ended June 30, 2003, the Bank recorded a credit to extraordinary expense of $295,000, net of tax effects.

Nine months Ended June 30, 2003 and 2002

Net Income. The Company's net gain, after an extraordinary item, for the nine months ended June 30, 2003 was $372,000 as compared to net income of $1,286,000 at June 30, 2002. The decrease in net income of $914,000 was due, in part, to a decrease in interest and dividend income of $1,460,000 that was offset, in part, by a decrease in interest expense of $708,000. Other key factors included a one-time charge to earnings of $277,000, classified as an extraordinary item on the consolidated statements of income, that is the result of tax legislation recently enacted by the Commonwealth of Massachusetts related to the Company's real estate investment trust subsidiary; an increase in total other income of $213,000, an increase in total other expenses of $534,000 and a decrease in income taxes of $326,000. The annualized return on average assets (ROA) for the nine months ended June 30, 2003 was 0.31%, as compared to 1.15% for the same period in the prior year. The annualized return on average equity (ROE) for the nine months ended June 30, 2003 was 2.90%, as compared to 10.09% for the nine months ended June 30, 2002.

Interest and Dividend Income. Total interest and dividend income for the nine months ended June 30, 2003 was $5.2 million, a decrease of $1.5 million as compared to $6.7 million for the nine-month period ended June 30, 2002. The decrease in interest and dividend income is attributable to lower interest rates on loans and other investments as well as a reduction of loans held for investment from 79.9% of total deposits at June 30, 2002 to 59.3% at June 30, 2003. Although the investment portfolio grew $30.0 million from $35.3 million at June 30, 2002 to $65.3 million at June 30, 2003, interest and dividends on securities increased $223,000 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 costing term deposits and borrowings being replaced with lower costing term deposits and borrowings.

Interest Expense. Interest expense for the nine months ended June 30, 2003 was $1.9 million, including $178,000 in interest on FHLB advances, which is a decrease of $708,000 from $2.6 million for the nine months ended June 30, 2002. 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 $664,000 decrease in interest on

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deposits and a $44,000 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, 2003 was $3.3 million as compared to $4.0 million for the nine months ended June 30, 2002. The net interest margin (NIM) for the nine months ended June 30, 2003 was 2.82%, a decrease of 121 basis points as compared to 4.03% for the nine months ended June 30, 2002. The reason for the decrease in the NIM was primarily due to the decrease in interest and fees on loans and the low interest rate environment.

Provision for Loan Losses. The Bank made no allocation to its allowance for loan loss account for the nine months ended June 30, 2003 compared to $110,000 for nine months period ended June 30, 2002. 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 and risk associated with the portfolio at that time. At June 30, 2003, the Bank had no loans 90 days or more delinquent. The Bank's allowance for loan losses was 1.11% of total loans at June 30, 2003. 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, 2003 was $873,000 as compared to $660,000 for the nine months ended June 30, 2002. The $213,000 increase is primarily the result of an increase of $517,000 in gains on sales of loans, an increase of $11,000 in service charges on deposit accounts, and increase in loan servicing fee income of $63,000, an increase of $26,000 in other income, and an increase of $404,000 on realized losses on the sale of investment securities taken during the nine months ended June 30, 2003.

Other Expenses. Total other expenses for the nine months ended June 30, 2003 were $3.1 million as compared to $2.6 million for the nine months ended June 30, 2002. The $534,000 increase was primarily due to an increase in salaries and employee benefits expense of $161,000, an increase in occupancy expense of $7,000, an increase in data processing expense of $17,000, an increase in directors fees of $9,000 and an increase in other expense of $369,000, offset in part by a decrease in legal and professional fees of

$24,000 and a decrease in equipment expense of $5,000. The ratio of annualized operating expenses to average total assets for the nine months ended June 30, 2003 was 2.63% as compared to 2.30% for the nine-month period ended June 30, 2003. The increase in salary and employee benefits was due, substantially, to the annual increase in employee compensation. The increase in other expense was primarily the result of the amortization and impairment of mortgage servicing rights.

Extraordinary Item. The extraordinary item expense was the result of the recent Massachusetts tax legislation effecting the 95% tax dividend exclusion of dividends received by the Bank from its real estate investment trust subsidiary. The new tax legislation expressly disallows the deduction for dividends received from a real estate investment trust subsidiary. As a result of the enactment of the legislation, the Company ceased recording the tax benefits associated with the dividend-received deduction and an extraordinary item of $572,000 (net of income tax benefits of $300,000) was recorded in March 2003.

On June 20, 2003, the Bank and its subsidiary real estate investment trust entered into an agreement with Massachusetts concerning the dividends received deduction claimed by the Bank. Under the agreement, the Bank paid $250,970 to the DOR, which will abate the balance of assessments and all tax and interest otherwise remaining due under the assessments. The Bank recorded a credit to extraordinary expense of $295,000. Net of tax effects, the item of extraordinary expense was reduced from $572,000 as reported for the three month and six month periods ended March 31, 2003 to $277,000 on the statements of income for the nine month period ended June 30, 2003.

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, 2003 was 51.13%.

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, 2003, regulatory liquidity totaled $111.5 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, 2003, the Bank had outstanding advances from the FHLB of Boston in the amount of $3.6 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, 2003, the Bank had $10.3 million in outstanding residential and commercial commitments to originate loans, as well as $23.9 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, 2003, certificates of deposit that are scheduled to mature in one year or less totaled $40.2 million. Based on historical experience, management believes that a significant portion of such deposits will remain with the Bank.

At June 30, 2003 the Bank exceeded all of its regulatory capital requirements.

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Part 1. Item 3.

Controls and Procedures.

Management, including the Company's President and Chief Executive Officer and Senior Vice President and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(f) and 15d-15(e)) as of the end of the period covered by this report. Based upon that evaluation, the President and Chief Executive Officer and Senior Vice President and Chief Financial Officer concluded that the disclosure controls and procedures were effective, in all material respects, to ensure that information required to be disclosed in the reports the Company files and submits under the Exchange Act is recorded, processed, summarized and reported as and when required.

There have been no changes in the Company's internal control over financial reporting identified in connection with the evaluation that occurred during the Company's last fiscal quarter that has materially affected, or that is reasonably likely to materially affect, the Company's internal control over financial reporting.

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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

None

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

Exhibit 11, Computation of Earnings (Losses) per Share.
Exhibit 31.1, Certifications Furnished Pursuant to Section 302 of the Sarbanes-Oxley Act.
Exhibit 32.1, Statement Furnished Pursuant to Section 906 of the Sarbanes-Oxley Act.
Exhibit 32.2, Statement Furnished Pursuant to Section 906 of the Sarbanes-Oxley Act.

(b) Reports on Form 8-K

1. The Company filed a Form 8-K with the Securities and Exchange Commission on June 23, 2003 reporting in Item 5 a reduction of a previously reported one-time charge to earnings. The recovery is the result of a settlement between a number of Massachusetts's banks and the Massachusetts Department of Revenue, related to the banks' real estate investment trust subsidiaries.

Falmouth Bancorp, Inc. is a publicly owned bank holding company and the parent corporation of Falmouth 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

In accordance with 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 8, 2003	By: /s/ Santo P. Pasqualucci
	Santo P. Pasqualucci President and Chief Executive Officer
Date: August 11, 2003	By: /s/ George E. Young, III
	George E. Young, III Senior Vice President and Chief Financial Officer