

Edgar Filing: FALMOUTH BANCORP INC - Form 10QSB

FALMOUTH BANCORP INC
Form 10QSB
May 14, 2003

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-QSB

(Mark One)

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

For the quarterly period ended March 31, 2003

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
(State or other jurisdiction of
incorporation or organization)

04-3337685
(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 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 March 31, 2003 -----
Common Stock, Par Value \$.01	903,173

Transitional small business disclosure format:

Edgar Filing: FALMOUTH BANCORP INC - Form 10QSB

Yes [] No [X]

FALMOUTH BANCORP, INC. AND SUBSIDIARIES INDEX TO FORM 10-QSB

PART I.	FINANCIAL INFORMATION	Page
Item 1	Financial Statements	
	Condensed Consolidated Balance Sheets March 31, 2003 and September 30, 2002	1
	Condensed Consolidated Statements of Income For Three and Six Months Ended March 31, 2003 and 2002	2-3
	Condensed Consolidated Statements of Changes in Stockholders' Equity For Six Months Ended March 31, 2003 and 2002	4
	Condensed Consolidated Statements of Cash Flows For Six Months Ended March 31, 2003 and 2002	5-6
	Notes to Unaudited Condensed Consolidated Financial Statements	7-9
Item 2	Management's Discussion and Analysis of Financial Condition and Operating Results	10-15
Item 3	Controls and Procedures	16
PART II	OTHER INFORMATION	
Item 1.	Legal Proceedings	17
Item 2.	Changes in Securities and Use of Proceeds	17
Item 3.	Defaults Upon Senior Securities	17
Item 4.	Submission of Matters to a Vote of Security Holders	17
Item 5.	Other Information	17
Item 6.	Exhibits and Reports on Form 8-K	18
	Signatures	19
	Certifications	20-21

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

Edgar Filing: FALMOUTH BANCORP INC - Form 10QSB

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

March 31, 2003 and September 30, 2002

	March 31, 2003 ----- (unaudited)	September 30, 2002 -----
ASSETS		
Cash, due from banks, and interest bearing deposits	\$ 2,565,533	\$ 2,916,804
Federal funds sold	16,561,540	4,505,780
	-----	-----
Total cash and cash equivalents	19,127,073	7,422,584
Investments in available-for-sale securities (at fair value)	20,638,764	18,712,954
Investments in held-to-maturity securities (fair values of \$30,438,844 as of March 31, 2003 and \$28,034,474 as of September 30, 2002)	30,395,076	28,060,267
Federal Home Loan Bank stock, at cost	878,000	878,000
Loans, net	81,866,437	95,009,955
Premises and equipment	1,727,307	1,792,016
Accrued interest receivable	1,091,240	1,114,924
Cooperative Central Bank Reserve Fund Deposit	395,395	395,395
Other assets	1,077,522	1,134,907
	-----	-----
Total Assets	\$157,196,814	\$154,521,002
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits:		
Noninterest-bearing	\$ 18,157,202	\$ 17,552,180
Interest-bearing	115,572,701	114,164,879
	-----	-----
Total deposits	133,729,903	131,717,059

Edgar Filing: FALMOUTH BANCORP INC - Form 10QSB

Securities sold under agreements to repurchase	721,688	471,872
Federal Home Loan Bank advances	5,275,144	5,178,175
Other liabilities	738,757	761,663
	-----	-----
Total Liabilities	140,465,492	138,128,769
	-----	-----
Minority preferred stockholders' equity in a subsidiary company of Falmouth Bank	50,500	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	14,547
Paid-in capital	13,972,459	13,981,543
Retained earnings	13,304,221	13,735,221
Unallocated Employee Stock Ownership Plan shares	(257,206)	(301,299)
Treasury stock (551,577 shares as of March 31, 2003; 553,971 shares as of September 30, 2002)	(9,765,505)	(9,807,890)
Unearned compensation	(340,994)	(477,088)
Accumulated other comprehensive loss	(246,700)	(806,301)
	-----	-----
Total stockholders' equity	16,680,822	16,338,733
	-----	-----
Total liabilities and stockholders' equity	\$157,196,814	\$154,521,002
	=====	=====

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

1

FALMOUTH BANCORP, INC. AND SUBSIDIARIES

 CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(unaudited)

	Three Months Ended		Six Months
	March 31,	March 31,	March 31,
	2003	2002	2003
	-----	-----	-----
Interest and dividend income:			
Interest and fees on loans	\$1,321,836	\$1,897,389	\$2,816,705
Interest and dividends on securities:			
Taxable	311,522	215,134	649,634
Dividends on marketable equity securities	20,843	17,989	41,290
Dividends on Cooperative Bank Investment and Liquidity Funds	-	-	-
Other interest	33,501	20,538	63,921
	-----	-----	-----
Total interest and dividend income	1,687,702	2,151,050	3,571,550

Edgar Filing: FALMOUTH BANCORP INC - Form 10QSB

Interest expense:			
Interest on deposits	561,113	764,953	1,214,464
Interest on securities sold under agreement to repurchase	3,226	1,285	5,209
Interest on Federal Home Loan Bank advances	61,644	80,023	124,097
Total interest expense	625,983	846,261	1,343,770
Net interest and dividend income	1,061,719	1,304,789	2,227,780
Provision for loan losses	-	30,000	-
Net interest income after provision for loan losses	1,061,719	1,274,789	2,227,780
Other income:			
Service charges on deposit accounts	43,279	43,815	93,644
Securities gains (losses), net	(378,905)	-	(455,492)
Net gains on sales of loans	286,462	73,109	611,773
Loan servicing fees	34,980	14,856	64,172
Other income	59,645	52,804	147,445
Total other income	45,461	184,584	461,542
Other expense:			
Salaries and employee benefits	506,807	421,653	994,486
Occupancy expense	44,433	40,641	85,414
Equipment expense	44,869	50,548	89,693
Data processing expense	109,053	92,949	197,758
Directors' fees	18,675	22,050	37,285
Legal and professional fees	34,593	47,271	90,913
Other expenses	255,608	165,589	502,663
Total other expenses	1,014,038	840,701	1,998,212
Income before income taxes	93,142	618,672	691,110
Income taxes	92,320	226,425	315,170
Net income before extraordinary item	822	392,247	375,940
Extraordinary item (net of tax benefit of \$300,020)	(572,348)	-	(572,348)
Net income (loss) after extraordinary item	\$ (571,526)	\$ 392,247	\$ (196,408)

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

2

FALMOUTH BANCORP, INC. AND SUBSIDIARIES

 CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Continued)

(unaudited)

Edgar Filing: FALMOUTH BANCORP INC - Form 10QSB

	Three Months Ended		Six Months
	March 31, 2003	March 31, 2002	March 31, 2003
Comprehensive income (loss)	\$ (174,494)	\$ 261,133	\$ 363,193
Earnings per common share before extraordinary item	\$ 0.00	\$ 0.45	\$ 0.43
Loss per common share on extraordinary item	(0.66)	-	(0.66)
Earnings (loss) per common share after extraordinary item	\$ (0.66)	\$ 0.45	\$ (0.23)
Earnings per common share before extraordinary item, assuming dilution	\$ 0.00	\$ 0.43	\$ 0.41
Loss per common share on extraordinary item, assuming dilution	(0.62)	-	(0.62)
Earnings (loss) per common share after extraordinary item, assuming dilution	\$ (0.62)	\$ 0.43	\$ (0.21)

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

3

FALMOUTH BANCORP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

Six Months ended March 31, 2003

(unaudited)

	Common Stock	Paid-In Capital	Retained Earnings	Unallocated Employee Stock Ownership Plan Shares	Treasury Stock	Une Comp
Balance, September 30, 2002	\$14,547	\$13,981,543	\$13,735,221	\$ (301,299)	\$ (9,807,890)	\$ (
Employee Stock Ownership Plan		65,751				
ESOP shares released				44,093		
Recognition and retention plan		68,009				

Edgar Filing: FALMOUTH BANCORP INC - Form 10QSB

Distribution of RRP shares		(136,094)				
Purchase of treasury stock						
Exercise of stock options and related tax benefit		(6,750)			42,385	
Dividends declared (\$.26 per share)				(234,592)		
Comprehensive income:						
Net loss				(196,408)		
Net change in unrealized holding gain on available-for-sale securities						
Comprehensive Income						
Balance, March 31, 2003	\$14,547	\$13,972,459	\$13,304,221	\$ (257,206)	\$ (9,765,505)	\$ (

Six Months ended March 31, 2002

(unaudited)

	Common Stock	Paid-In Capital	Retained Earnings	Unallocated Employee Stock Ownership Plan Shares	Treasury Stock	Une
	-----	-----	-----	-----	-----	-----
Balance, September 30, 2001	\$14,547	\$13,901,279	\$12,676,198	\$ (389,483)	\$ (8,749,737)	\$ (
Employee Stock Ownership Plan ESOP shares released		46,499		44,092		
Recognition and retention plan		36,080				
Distribution of RRP shares		(137,429)				
Purchase of treasury stock					(576,195)	
Exercise of stock options and related tax benefit		(8,182)			69,866	
Dividends declared (\$.26 per share)			(221,310)			
Comprehensive income:						
Net income			858,915			
Net change in unrealized holding gain on available-for-sale securities						
Comprehensive Income						
Balance, March 31, 2002	\$14,547	\$13,838,247	\$13,313,803	\$ (345,391)	\$ (9,256,066)	\$ (

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

Edgar Filing: FALMOUTH BANCORP INC - Form 10QSB

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

 For the Six Months Ended March 31, 2003 and 2002

	2003 ----- (unaudited)	2002 ----- (unaudited)
Cash flows from operating activities		
Net income (loss)	\$ (196,408)	\$ 858
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Realized (gains) losses on available for sale investment securities, net	455,492	(17,000)
Amortization of investment securities, net	641,850	217,000
Provision for loan loss	-	80,000
Change in deferred loan costs net of origination fees	(69,530)	
Net gains on sales of loans	(611,773)	(259,000)
Depreciation and amortization	84,300	101,000
Loss on disposal of equipment	-	1,000
(Increase) decrease in accrued interest receivable	23,684	(43,000)
(Increase) decrease in prepaid expenses	8,494	(17,000)
Increase in other assets	(221,168)	(232,000)
Recognition and retention plan (RRP)	68,009	36,000
Decrease in accrued expenses	(59,544)	(36,000)
Increase in taxes payable	518,447	77,000
Decrease in accrued interest payable	(25)	
Decrease in other liabilities	(205,525)	(90,000)
Net cash provided by operating activities	436,303	674,000
Cash flows from investing activities		
Purchases of available-for-sale securities	(14,804,935)	(4,112,000)
Proceeds from sales of available-for-sale securities	660,788	60,000
Proceeds from maturities of available-for-sale securities	12,159,847	629,000
Purchases of held-to-maturity securities	(19,111,631)	(12,132,000)
Proceeds from maturities of held-to-maturity securities	16,291,371	7,022,000
Loan originations and principal collections, net	(25,800,353)	(11,805,000)
Proceeds from sales of loans	39,625,174	17,054,000
Capital expenditures	(19,591)	(69,000)
Net cash provided by (used in) investing activities	9,000,670	(3,352,000)
Cash flows from financing activities:		
Net increase in demand deposits, NOW and savings accounts	4,381,404	4,941,000
Net decrease in time deposits	(2,368,560)	(2,528,000)
Net increase (decrease) in securities sold under agreements to repurchase	249,816	(342,000)
Repayments of Federal Home Loan Bank long-term advances	(47,031)	(2,043,000)
Net change in Federal Home Loan Bank short-term advances	144,000	
Redemption of preferred shares relative to minority interests	(3,000)	
Proceeds from exercise of stock options	35,635	61,000
Dividends paid	(234,592)	(221,000)
Employee Stock Ownership Plan	65,751	46,000
Unallocated ESOP shares released	44,093	44,000
Purchase of treasury stock	-	(576,000)

Edgar Filing: FALMOUTH BANCORP INC - Form 10QSB

Net cash provided by (used in) financing activities 2,267,516

(618)

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

5

FALMOUTH BANCORP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Six Months Ended March 31, 2003 and 2002

(continued)

	2003 ---- (unaudited)	2002 ---- (unaudited)
Decrease in cash and cash equivalents	11,704,489	(3,296)
Cash and cash equivalents at beginning of period	7,422,584	10,835
Cash and cash equivalents at end of period	\$ 19,127,073 =====	\$ 7,538 =====
Supplemental disclosures		
Interest paid	\$ 1,343,795	\$ 1,832
Income taxes paid	(503,297)	415

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

6

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 six-month period ended March 31, 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

Edgar Filing: FALMOUTH BANCORP INC - Form 10QSB

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

7

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.

Edgar Filing: FALMOUTH BANCORP INC - Form 10QSB

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 March 31,		
	2003 ----- ----	2002 ----- ----	
Net income (loss) as reported, after extraordinary item	\$ (571,526)	\$ 392,247	\$ (19
Stock based compensation expense determined under fair value method, net of tax benefit	(4,694)	(1,141)	(
Pro forma net income (loss)	\$ (576,220) =====	\$ 391,106 =====	\$ (20 =====
 Earnings (loss) per share:			
Basic as reported	\$ (0.66)	\$ 0.45	\$
Basic - pro forma	\$ (0.66)	\$ 0.45	\$
 Diluted as reported			
Diluted - pro forma	\$ (0.62)	\$ 0.43	\$

8

Note 5 - Dividends

On February 24, 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 March 25, 2003 to stockholders of record at the close of business on March 11, 2003.

Note 6 - Recent Developments

During the quarter ended March 31, 2003 the Company issued 600 treasury shares due to exercised employee stock options. At March 31, 2003,

Edgar Filing: FALMOUTH BANCORP INC - Form 10QSB

the Company had 551,577 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 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 this matter.

In a matter that may affect the assessment described above, 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. The Company believes the legislation will be challenged, especially the retroactive provisions, on constitutional and other grounds. The Company would support such a challenge and otherwise intends to defend vigorously its position.

Because of the inability to deduct dividends received from the Bank's REIT and the accrual of interest on taxes, It is expected that net income during the remainder of 2003 will be reduced by approximately \$60,000 per quarter.

9

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 March 31, 2003, there were 903,173 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

Edgar Filing: FALMOUTH BANCORP INC - Form 10QSB

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 902,802 at March 31, 2003, as compared to 915,087 average shares outstanding at March 31, 2002. The Company has continued with its stock buy-back programs. At March 31, 2003, the Company had repurchased a total of 551,577 shares, or 37.92% of its common stock, leaving 903,173 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. These critical policies and their application are periodically reviewed by the Audit Committee and our Board of Directors.

Comparison of Financial Condition at March 31, 2003 and September 30, 2002.

The Company's total assets increased by \$2.7 million or 1.73% for the six months ended March 31, 2003, from \$154.5 million at September 30, 2002 to \$157.2 million at March 31, 2003. Total deposits increased \$2.0 million or 1.53%, from \$131.7 million at September 30, 2002 to \$133.7 million at March 31, 2003. This increase was due, in part, to seasonal deposits in NOW accounts and regular savings accounts during the period. Total net loans were \$81.9 million or 61.2% of total deposits at March 31, 2003, as compared to \$95.0 million or 72.1% of total deposits at September 30, 2002, representing a

10

decrease of \$13.1 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 \$51.9 million or 33.0% of total assets at March 31, 2003, as compared to \$47.7 million or 30.8% of total assets at September 30, 2002. Investment securities increased \$4.3 million or 8.9% 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 increased from \$5.2 million at September 30, 2002 to \$5.3 million at March 31, 2003. The increase of \$97,000 was the result of a one day borrowing at month end.

Securities sold under agreements to repurchase (sweep accounts for commercial depositors) increased from \$472,000 at September 30, 2002 to \$722,000 at March 31, 2003. The increase was attributed to the increased seasonal deposits of our commercial demand deposit customers.

Stockholders' equity was \$16.7 million at March 31, 2003, as compared to \$16.3 million at September 30, 2002, an increase of \$342,000. This

Edgar Filing: FALMOUTH BANCORP INC - Form 10QSB

change was primarily the result of a net loss and dividends paid to stockholders which reduced retained earnings by \$431,000, a decrease in accumulated other comprehensive loss of \$560,000 due to realized losses on available for sale investments and the increased value of available for sale investments, scheduled discharge of liabilities on stock-based employee benefit plans of \$178,000 (ESOP and RRP), and the exercise of stock options, net of tax benefits, of \$35,000. The ratio of stockholders' equity to total assets was 10.61% at March 31, 2003, and the book value per share of common stock was \$18.47, compared to 10.57% and \$18.15, respectively, at September 30, 2002.

The ratio of the allowance for loan losses to total loans was 1.13% at March 31, 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 March 31, 2003 and 2002

Net Income. The Company's net loss, after an extraordinary item, for the three months ended March 31, 2003 was \$572,000, as compared to net income of \$392,000 for the three months ended March 31, 2002. The decrease in net income of \$964,000 was due, in part, to a decrease in interest and dividend income of \$463,000 that was offset, in part, by a decrease in interest expense of \$220,000. Other key factors included a one-time charge to earnings of \$572,000, 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, which is retroactive; a decrease in other income of \$139,000 due to realized losses on investment securities; an increase in other expenses of \$173,000 and a decrease in income taxes of \$134,000. The annualized return on average assets (ROA) for the three months ended March 31, 2003 was -1.46%, a decrease of 253 basis points, as compared to 1.07% for the same period in the prior year. The annualized return on average equity (ROE) for the three months ended March 31, 2003 was -13.52%, as compared to 9.15% 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.

11

Interest and Dividend Income. Total interest and dividend income for the three months ended March 31, 2003 was \$1.7 million, a decrease of \$463,000, as compared to \$2.2 million for the three month period ended March 31, 2002. The decrease was attributed to a decrease in interest and fees on loans of \$576,000, which was the result of generally lower interest rates on loans held for investment, offset by an increase in interest and dividends on debt securities, dividends on equities securities and an increase in other interest of \$112,000.

Interest Expense. Total interest expense for the three months ended March 31, 2003 was \$626,000, as compared to \$846,000 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

Edgar Filing: FALMOUTH BANCORP INC - Form 10QSB

was \$1.06 million for the three-month period ended March 31, 2003 as compared to \$1.3 million for the three months ended March 31, 2002. The \$243,000 decrease was the result of a \$463,000 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 March 31, 2003 was 2.85%, a decrease of 87 basis points, as compared to 3.72% for the three months ended March 31, 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 March 31, 2003, as compared to a provision of \$30,000 for the quarter ended March 31, 2002. This was the result of management's desire 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 decreased \$13.1 million for the three months ended March 31, 2003, primarily due to refinancing activity and the decision to sell most of the refinanced loans. This decrease aided in improving the Bank's allowance for loan loss to 1.13% of total loans at March 31, 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 March 31, 2003. As of March 31, 2003, the Bank had no non-performing loans.

Other Income. Total other income for the three-month period ended March 31, 2003 was \$45,000, as compared to \$185,000 for the three months ended March 31, 2002. The \$140,000 decrease was primarily the result of realized losses on investment securities of \$379,000 due to sales of equity securities which would otherwise have been reported as permanently impaired during the period, an increase in net gains on mortgages sold of \$213,000, an increase in loan servicing fee income of \$20,000 and an increase in other income of \$7,000.

Other Expenses. Total other expenses for the three months ended March 31, 2003 were \$1.0 million, as compared to \$841,000 for the three months ended March 31, 2002. The \$173,000 increase was primarily due to the combination of an increase in salaries of and employee benefits of \$85,000 due to

12

increases in wages and salaries of \$25,000, increases in employer provided insurance of \$10,000, an increase in the ESOP benefit expense of \$8,000 and an increase in the reimbursed payroll account of \$46,000, as well as an increase in occupancy expense of \$4,000, an increase in data processing expense of \$16,000, and an increase in other expenses of \$90,000, combined with a decrease in equipment expense of \$6,000, a decrease in Directors' fees of \$3,000, and a decrease in legal and professional costs of \$13,000.

Edgar Filing: FALMOUTH BANCORP INC - Form 10QSB

The increase in other expenses was primarily the result of the amortization and permanent impairment of mortgage-servicing rights due to the large number of re-financed mortgages sold. The annualized ratio of operating expenses to average total assets for the three months ended March 31, 2003 was 2.60%, as compared to 2.30% for the three-month period ended March 31, 2002, an increase of 30 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. The extraordinary item of \$572,000 is net of an income tax benefit of \$300,000.

Six months Ended March 31, 2003 and 2002

Net Income. The Company's net loss, after an extraordinary item, for the six months ended March 31, 2003 was \$196,000 as compared to net income of \$859,000 at March 31, 2002. The decrease in net income of \$1.1 million was due, in part, to a decrease in interest and dividend income of \$857,000 that was offset, in part, by a decrease in interest expense of \$488,000. Other key factors included a one-time charge to earnings of \$572,000, 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, which is retroactive; a decrease in other income of \$64,000 due to realized losses on investment securities; an increase in other expenses of \$307,000 and a decrease in income taxes of \$177,000. The annualized return on average assets (ROA) for the six months ended March 31, 2003 was -0.25%, as compared to 1.17% for the same period in the prior year. The annualized return on average equity (ROE) for the six months ended March 31, 2003 was -2.29%, as compared to 10.04% for the six months ended March 31, 2002.

Interest and Dividend Income. Total interest and dividend income for the six months ended March 31, 2003 was \$3.6 million, a decrease of \$857,000 as compared to \$4.4 million for the six-month period ended March 31, 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 86.3% of total deposits at March 31, 2002 to 61.2% at March 31, 2003. Although the investment portfolio grew \$23.2 million from \$28.7 million at March 31, 2002 to \$51.9 million at March 31, 2003, interest and dividends on securities and other interest income increased only \$242,000 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 six months ended March 31, 2003 was \$1.3 million, including \$124,000 in interest on FHLB advances, which is a decrease of \$488,000 from \$1.8 million for the six months ended March 31, 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 \$449,000 decrease in interest on

deposits and a \$39,000 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 six-month period ended March 31, 2003 was \$2.2 million as compared to \$2.5 million for the six months ended March 31, 2002. The net interest margin (NIM) for the six months ended March 31, 2003 was 3.00%, a decrease of 67 basis points as compared to 3.70% for the six months ended March 31, 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 six months ended March 31, 2003 compared to \$80,000 for six months period ended March 31, 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 March 31, 2003, the Bank had no loans 90 days or more delinquent. The Bank's allowance for loan losses was 1.13% of total loans at March 31, 2003. Management believes the provision to be adequate and commensurate with the level of credit risk.

Other Income. Total other income for the six-month period ended March 31, 2003 was \$462,000 as compared to \$525,000 for the six months ended March 31, 2002. The \$63,000 decrease is primarily the result of an increase of \$352,000 in gains on loans sold offset by an increase of \$473,000 in securities losses on the sale of investment securities taken during the six months ended March 31, 2003. Other income increased \$56,000 during the same six-month comparative. The \$56,000 increase consisted of increases in service charges of \$1,000, increases in other income of \$15,000, and increases in loan servicing fee income of \$40,000.

Other Expenses. Other expenses for the six months ended March 31, 2003 were \$2.0 million as compared to \$1.69 million for the six months ended March 31, 2002. The \$307,000 increase was primarily due to an increase in salaries and employee benefits expense of \$143,000, an increase in occupancy expense of \$3,000, an increase in data processing expense of \$10,000, an increase in directors fees of \$2,000 and an increase in other expense of \$163,000, off set in part by a decrease in legal and professional fees of \$4,000 and a decrease in equipment expense of \$10,000. The ratio of annualized operating expenses to average total assets for the six months ended March 31, 2003 was 2.57% as compared to 2.30% for the six-month period ended March 31, 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 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. The extraordinary item of \$572,000 is net of an income tax benefit of \$300,000.

Liquidity and Capital Resources

The Bank's primary sources of funds consist of deposits, repayment

Edgar Filing: FALMOUTH BANCORP INC - Form 10QSB

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

14

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 March 31, 2003 was 50.73%.

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 March 31, 2003, regulatory liquidity totaled \$70.0 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 March 31, 2003, the Bank had outstanding advances from the FHLB of Boston in the amount of \$5.3 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 March 31, 2003, the Bank had \$9.5 million in outstanding residential and commercial commitments to originate loans, as well as \$24.0 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 March 31, 2003, certificates of deposit that are scheduled to mature in one year or less totaled \$40.8 million. Based on historical experience, management believes that a significant portion of such deposits will remain with the Bank.

At March 31, 2003 the Bank exceeded all of its regulatory capital requirements.

15

Part 1. Item 3.

Controls and Procedures.

During the 90-day period prior to the filing date of this report,

Edgar Filing: FALMOUTH BANCORP INC - Form 10QSB

management, including the Company's President and Chief Executive Officer and Senior Vice President and Chief Financial Officer, evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based upon and as of the date of 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 significant changes in the Company's internal controls or in other factors which could significantly affect internal controls subsequent to the date the Company carried out its evaluation. There were no significant deficiencies or material weaknesses identified in the evaluation and therefore, no corrective actions were taken.

16

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

The Company held its Annual Meeting of Stockholders ("Meeting") on January 21, 2003. All of the proposals submitted to stockholders and the tabulation of votes for each proposal are as follows:

1. Election of three candidates to the Board of Directors to serve for a three-year term.

The number of votes cast with respect to this matter were as follows:

Nominee	For	%	Withhold	%
Peter A. Frizzell, DDS	800,926	98.9	8,605	1.1
Robert H. Moore	802,939	99.2	6,592	0.8
Henry D. Newman, III	798,025	98.6	11,506	1.4

2. Ratification of the appointment of Shatswell, MacLeod & Company, P.C. as independent public accountants for the fiscal year ending September 30, 2003.

For	%	Against	%	Abstain	%
803,493	89.1	2,537	0.3	3,501	0.4

There were no broker non-votes with respect to the above proposals.

Edgar Filing: FALMOUTH BANCORP INC - Form 10QSB

Item 5. Other Information

The Company's Chief Executive Officer and Chief Financial Officer have furnished statements relating to its Form 10-QSB for the six months period ended March 31, 2003 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 Exhibits 99.1 and 99.2.

17

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

- Exhibit 11, Computation of Earnings (Losses) per Share.
- Exhibit 99.1, Statement Furnished Pursuant to Section 906 of the Sarbanes-Oxley Act.
- Exhibit 99.2, 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 March 5, 2003 reporting in Item 5 a one time charge to earnings resulting from the recently enacted tax legislation in Massachusetts, related to the Company's real estate investment trust subsidiary, which was retroactive.

2. The Company filed a Form 8-K with the Securities and Exchange Commission on April 24, 2003 reporting in Item 12 its earnings for the second quarter of the 2003 fiscal year.

18

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: 5/9/2003

By: /s/ Santo P. Pasqualucci

Santo P. Pasqualucci
President and Chief Executive Officer

Date: 5/9/2003

By: /s/ George E. Young, III

Edgar Filing: FALMOUTH BANCORP INC - Form 10QSB

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

19

Certifications

I, Santo P. Pasqualucci, certify that:

1. I have reviewed this quarterly report on Form 10-QSB of Falmouth Bancorp, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report; and
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report.
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
 - (a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - (b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - (c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
 - (a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 9, 2003

/s/ Santo P. Pasqualucci

Edgar Filing: FALMOUTH BANCORP INC - Form 10QSB

Santo P. Pasqualucci
President and Chief Executive Officer

20

I, George E. Young, III, certify that:

1. I have reviewed this quarterly report on Form 10-QSB of Falmouth Bancorp, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report; and
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report.
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - (a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - (b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - (c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
 - (a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 9, 2003

/s/ George E. Young, III

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

