

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

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

FORM 10-Q

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

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

Commission File No. 001-16101

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

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

05-0509802
(IRS Employer
Identification No.)

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

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

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

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

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

Large accelerated filer Accelerated filer Non-accelerated filer

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

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

Common Stock - Par Value \$0.01

4,765,421 shares

(class)

(outstanding)

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

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

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

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

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

	September 30, 2007	December 31, 2006
(In thousands)		
ASSETS:		
Cash and due from banks	\$ 25,490	\$ 24,469
Overnight investments	42,968	37,295
	<hr/>	<hr/>
Total cash and cash equivalents	68,458	61,764
Investment securities available for sale (amortized cost of \$123,528 and \$104,266 at September 30, 2007 and December 31, 2006, respectively)	123,260	103,425
Mortgage-backed securities available for sale (amortized cost of \$210,075 and \$244,258 at September 30, 2007 and December 31, 2006, respectively)	207,489	240,462
	<hr/>	<hr/>
Total securities available for sale	330,749	343,887
Stock in Federal Home Loan Bank of Boston	15,671	16,530
Loans and leases receivable:		
Commercial loans and leases	554,887	519,790
Residential mortgage loans	248,259	263,945
Consumer and other loans	222,729	220,557
	<hr/>	<hr/>
Total loans and leases receivable	1,025,875	1,004,292
Allowance for loan and lease losses	(12,562)	(12,377)
	<hr/>	<hr/>
Net loans and leases receivable	1,013,313	991,915
Premises and equipment, net	14,204	13,736
Goodwill, net	11,317	11,317

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Accrued interest receivable	7,142	6,755
Investment in bank-owned life insurance	23,923	23,148
Prepaid expenses and other assets	7,918	10,047
	<hr/>	<hr/>
Total assets	\$ 1,492,695	\$ 1,479,099
	<hr/>	<hr/>
LIABILITIES:		
Deposits:		
Demand deposit accounts	\$ 185,472	\$ 200,282
NOW accounts	61,262	70,736
Money market accounts	5,808	6,991
Savings accounts	384,748	356,707
Certificate of deposit accounts	381,821	381,707
	<hr/>	<hr/>
Total deposits	1,019,111	1,016,423
Overnight and short-term borrowings	73,047	56,341
Wholesale repurchase agreements	10,000	20,000
Federal Home Loan Bank of Boston borrowings	243,242	242,198
Subordinated deferrable interest debentures	13,403	18,558
Other liabilities	16,024	13,494
	<hr/>	<hr/>
Total liabilities	1,374,827	1,367,014
	<hr/>	<hr/>
SHAREHOLDERS' EQUITY:		
Preferred stock, par value \$0.01 per share, authorized 1,000,000 shares:		
Issued and outstanding: none	--	--
Common stock, par value \$0.01 per share, authorized 11,000,000 shares:		
Issued and outstanding 4,864,321 shares and 4,792,380 shares, respectively	49	48
Additional paid-in capital	69,979	67,960
Treasury stock, at cost (52,200 shares at September 30, 2007)	(1,874)	--
Retained earnings	51,569	47,091
Accumulated other comprehensive loss, net	(1,855)	(3,014)
	<hr/>	<hr/>
Total shareholders' equity	117,868	112,085
	<hr/>	<hr/>
Total liabilities and shareholders' equity	\$ 1,492,695	\$ 1,479,099
	<hr/>	<hr/>

See accompanying notes to consolidated financial statements

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
(In thousands, except per share data)				
Interest and dividend income:				
Loans and leases	\$ 17,134	\$ 16,408	\$ 50,063	\$ 46,705
Available for sale securities	4,197	4,073	12,667	12,645
Overnight investments	365	80	837	157
Federal Home Loan Bank of Boston stock dividends	254	456	800	667
Total interest and dividend income	21,950	21,017	64,367	60,174
Interest expense:				
Deposits	7,573	5,925	21,866	15,680
Overnight and short-term borrowings	703	639	2,006	1,452
Wholesale repurchase agreements	136	231	466	643
Federal Home Loan Bank of Boston borrowings	2,767	3,171	7,998	9,259
Subordinated deferrable interest debentures	506	375	1,246	1,085
Total interest expense	11,685	10,341	33,582	28,119
Net interest income	10,265	10,676	30,785	32,055
Provision for loan and lease losses	290	400	490	1,102
Net interest income after provision for loan and lease losses	9,975	10,276	30,295	30,953
Noninterest income:				
Service charges on deposit accounts	1,386	1,328	4,090	3,777
Net gains on lease sales and commissions on loans originated for others	295	94	1,018	319
Income from bank-owned life insurance	264	199	775	573
Loan related fees	119	162	468	580
Commissions on nondeposit investment products	146	180	437	743
Gain (loss) on sale of available for sale securities	254	(858)	254	(858)
Other income	392	439	1,040	1,530

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Total noninterest income	2,856	1,544	8,082	6,664
Noninterest expense:				
Salaries and employee benefits	5,316	4,942	15,863	15,650
Occupancy	882	894	2,684	2,640
Data processing	691	741	2,129	2,220
Professional services	446	711	1,698	1,640
Marketing	347	383	1,147	1,342
Equipment	337	332	1,004	1,073
Loan servicing	220	245	606	651
Loss on note receivable	--	--	--	868
Other expenses	1,253	1,256	3,496	3,969
Total noninterest expense	9,492	9,504	28,627	30,053
Income before income taxes	3,339	2,316	9,750	7,564
Income tax expense	1,061	673	3,100	2,390
Net income	\$ 2,278	\$ 1,643	\$ 6,650	\$ 5,174
Weighted average common shares outstanding				
- basic	4,818	4,772	4,824	4,761
Weighted average common shares outstanding				
- diluted	4,925	4,935	4,954	4,909
Per share data:				
Basic earnings per common share	\$ 0.47	\$ 0.34	\$ 1.38	\$ 1.09
Diluted earnings per common share	\$ 0.46	\$ 0.33	\$ 1.34	\$ 1.05
Cash dividends declared per common share	\$ 0.16	\$ 0.15	\$ 0.46	\$ 0.45

See accompanying notes to consolidated financial statements

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

Nine months ended September 30,	Common Stock	Additional Paid-in Capital	Treasury Stock	Retained Earnings	Accumulated Other Compre- hensive Income (Loss)	Total
(In thousands)						
<u>2006</u>						
Balance at December 31, 2005	\$47	\$65,768	\$ --	\$42,241	\$(3,224)	\$104,832

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Net income	--	--	--	5,174	--	5,174
Other comprehensive loss:						
Unrealized holding losses on securities available for sale, net of taxes of \$228					(630)	(630)
Reclassification adjustment, net of taxes \$(300)					558	558
						<hr/>
Total comprehensive income						5,102
Exercise of stock options	1	1,201	--	--	--	1,202
Acquisition of Macrolease	--	83	--	--	--	83
Share-based compensation	--	140	--	--	--	140
Tax benefit from exercise of stock options	--	171	--	--	--	171
Dividends on common stock (\$ 0.45 per common share)	--	--	--	(2,143)	--	(2,143)
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Balance at September 30, 2006	\$48	\$67,363	\$ --	\$45,272	\$(3,296)	\$109,387
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
<u>2007</u>						
Balance at December 31, 2006	\$48	\$67,960	\$ --	\$47,091	\$(3,014)	\$112,085
Net income	--	--	--	6,650	--	6,650
Other comprehensive income:						
Unrealized holding gains on securities available for sale, net of taxes of \$(624)					1,159	1,159
						<hr/>
Total comprehensive income						7,809
Exercise of stock options	1	1,311	--	--	--	1,312
Stock repurchase	--	--	(1,874)	--	--	(1,874)
Share-based compensation	--	225	--	--	--	225
Tax benefit from exercise of stock options	--	483	--	--	--	483
Dividends on common stock (\$ 0.46)	--	--	--	(2,172)	--	(2,172)

per common share)

Balance at September 30, 2007	\$49	\$69,979	\$(1,874)	\$51,569	\$(1,855)	\$117,868
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See accompanying notes to consolidated financial statements

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

	Nine Months Ended September 30,	
	2007	2006
	(In thousands)	
Cash flows from operating activities:		
Net income	\$ 6,650	\$ 5,174
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation, amortization and accretion, net	(812)	477
Provision for loan and lease losses	490	1,102
Income from bank-owned life insurance	(775)	(573)
Share-based compensation	225	140
Net gains on lease sales	(860)	(222)
(Gain) loss on sale of available for sale securities, net	(254)	858
Proceeds from sales of leases	17,597	8,368
Leases originated for sale	(16,737)	(8,146)
(Increase) decrease in accrued interest receivable	(387)	344
Decrease in prepaid expenses and other assets	1,505	774
Increase in other liabilities	2,530	640
Other, net	55	16
Net cash provided by operating activities	9,227	8,952
Cash flows from investing activities:		
Investment securities available for sale:		
Purchases	(40,000)	(8,000)
Maturities and principal repayments	20,661	5,095
Proceeds from sales	254	60,982
Mortgage-backed securities available for sale:		
Purchases	--	(9,812)
Maturities and principal repayments	34,129	33,266
Proceeds from sales	--	445
Net decrease (increase) in loans and leases	13,219	(39,343)
Purchases of loans and leases, including purchased interest	(33,317)	(17,098)
Proceeds from disposition of other real estate owned	590	--
Sale (purchase) of Federal Home Loan Bank of Boston stock	859	(468)

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Capital expenditures for premises and equipment	(1,960)	(2,000)
Proceeds from sale of premises and equipment	--	1,209
Purchase of bank-owned life insurance	--	(1,539)
	<u> </u>	<u> </u>
Net cash (used in) provided by investing activities	(5,565)	22,737
	<u> </u>	<u> </u>
Cash flows from financing activities:		
Net increase in deposits	2,688	6,654
Net increase in overnight and short-term borrowings	16,706	32,817
Proceeds from long-term borrowings	100,710	160,000
Repayment of long-term borrowings	(109,666)	(175,103)
Redemption of capital trust securities	(5,155)	--
Exercise of stock options	1,312	1,202
Repurchase of common stock	(1,874)	--
Tax benefit from exercise of stock options	483	171
Dividends on common stock	(2,172)	(2,143)
	<u> </u>	<u> </u>
Net cash used in financing activities	3,032	23,598
	<u> </u>	<u> </u>
Net increase (decrease) in cash and cash equivalents	6,694	55,287
Cash and cash equivalents at beginning of period	61,764	40,547
	<u> </u>	<u> </u>
Cash and cash equivalents at end of period	\$ 68,458	\$ 95,834
	<u> </u>	<u> </u>
Supplementary Disclosures:		
Cash paid for interest	\$ 33,056	\$ 26,517
Cash paid for income taxes	3,305	3,236
Non-cash transactions:		
Change in accumulated other comprehensive loss, net	1,159	(72)
Transfer of loans to OREO	587	--
Acquisition of Macrolease	--	83
Purchase of mortgage-backed securities not yet settled	--	24,510

See accompanying notes to consolidated financial statements

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BANCORP RHODE ISLAND, INC.
Notes to Consolidated Financial Statements

(1) Basis of Presentation

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

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

goodwill for impairment and accounting for income taxes.

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, Bank Rhode Island, along with the Bank's wholly-owned subsidiaries, BRI Investment Corp. (a Rhode Island passive investment company), BRI Realty Corp. (a Rhode Island real estate holding company), Acorn Insurance Agency, Inc. (a licensed insurance agency) and Macrolease Corporation (an equipment leasing company). All significant intercompany accounts and transactions have been eliminated in consolidation.

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

The unaudited interim results of consolidated operations are not necessarily indicative of the results for any future interim period or for the entire year. These interim consolidated financial statements do not include all disclosures associated with annual financial statements and, accordingly, should be read in conjunction with the annual consolidated financial statements and accompanying notes included in the Company's 2006 Annual Report on Form 10-K filed with the Securities and Exchange Commission ("SEC").

(2) Earnings Per Share

Basic earnings per share ("EPS") excludes dilution and is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding during the period excluding shares of unvested restricted stock. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of additional common stock that then share in the earnings of the Company.

(3) Supplemental Executive Retirement Plans

The Bank maintains Supplemental Executive Retirement Plans ("SERPs") for certain of its senior executives under which participants designated by the Board of Directors are entitled to an annual retirement benefit. Expenses associated with the SERPs were \$416,000 and \$326,000 for the nine months ending September 30, 2007 and 2006, respectively. Accrued liabilities associated with the SERPs were \$2.6 million and \$2.2 million for September 30, 2007 and December 31, 2006, respectively.

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(4) Income Taxes

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

The evaluation of a tax position in accordance with FIN 48 is a two-step process. First, the Company determines whether it is more likely than not that a tax position will be sustained upon examination based on the technical merits of the position. Second, a tax position that meets the more likely than not threshold is measured to determine the amount of benefit to recognize in the financial statements. The tax position is measured at the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate

settlement. Tax positions that previously failed to meet the more likely than not recognition threshold are recognized in the first subsequent reporting period in which the threshold is met. Previously recognized tax positions that no longer meet the more likely than not recognition threshold are derecognized in the first subsequent reporting period in which the threshold is no longer met.

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

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

The Company's federal income tax returns are open and subject to examination from the 2004 tax return year and forward. The Company's state income tax returns are generally open from the 2004 and later tax return years based on individual state statute of limitations.

(5) Recent Accounting Pronouncements

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

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

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

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

ITEM 2. Management's Discussion and Analysis

General

The Company's principal subsidiary, Bank Rhode Island, is a commercial bank chartered as a financial institution in the State of Rhode Island. The Bank pursues a community banking mission and is principally engaged in providing banking products and services to individuals and businesses in Rhode Island and nearby areas of Massachusetts. The Bank is subject to competition from a variety of traditional and nontraditional financial service providers both within and outside of Rhode Island. The Bank offers its customers a wide range of business, commercial real estate, consumer and residential loans and leases, deposit products, nondeposit investment products, cash management, private banking and other banking products and services designed to meet the financial needs of individuals and small- to mid-sized businesses. The Bank also offers both commercial and consumer online banking products and maintains a web site at <http://www.bankri.com>. The Company and Bank are subject to the regulations of certain federal and state agencies and undergo periodic examinations by certain of those regulatory authorities. The Bank's deposits are insured by the Federal Deposit Insurance Corporation ("FDIC"), subject to regulatory limits. The Bank is also a member of the Federal Home Loan Bank of Boston ("FHLB"). The Company's common stock is traded on the Nasdaq Global Select MarketSM under the symbol "BARI". The Company's financial reports can be accessed through its website within 24 hours of filing with the SEC.

Critical Accounting Policies

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

Overview

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

The Company's net interest income represents the difference between interest income earned on interest-earning assets and interest expense incurred on interest-bearing liabilities. The net interest margin is calculated by dividing net interest income by average interest-earning assets. Net interest spread is the difference between the average rate earned on interest-earning assets and the average rate paid on interest-bearing liabilities. Net interest margin generally exceeds the net interest spread as a portion of interest-earning assets are funded by various noninterest-bearing sources (primarily noninterest-bearing deposits and shareholders' equity). The increases (decreases) in the components of interest income and interest expense, expressed in terms of fluctuation in average volume and rate, are summarized in the Rate/Volume Analysis tables shown on pages 23 and 28. Information as to the components of interest income and interest expense and average rates is provided under "*Average Balances, Yields and Costs*" on pages 22 and 27.

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Because the Company's assets are not identical in duration and in repricing dates to its liabilities, the spread between the two is vulnerable to changes in market interest rates as well as the overall shape of the yield curve. These vulnerabilities are inherent to the business of banking and are commonly referred to as "interest rate risk". How to measure interest rate risk and, once measured, how much risk to take are based on numerous assumptions and other subjective judgments. See also discussion under "*Interest Rate Risk*" on page 32.

The quality of the Company's assets also influences its earnings. Loans and leases that are not paid on a timely basis and exhibit other weaknesses can result in the loss of principal and/or interest income. Additionally, the Company makes timely provisions to the allowance for loan and lease losses based on estimates of probable losses inherent in the loan and lease portfolio; these additions, which are charged against earnings, are necessarily greater when greater probable losses are expected. Further, the Company incurs expenses as a result of resolving troubled assets. All of these reflect the "credit risk" that the Company takes on in the ordinary course of business and is further discussed under "*Financial Condition - Asset Quality*" on page 15.

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

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

The deposit market in Rhode Island is highly concentrated. The State's three largest banks have an aggregate market share of approximately 85% in Providence and Kent Counties, the Bank's primary marketplace (based upon June 2007 FDIC statistics, excluding one bank that draws its deposits primarily from the internet). Competition for loans and deposits remains intense. This competition has resulted in considerable advertising and promotional product offerings by competitors, including print, radio and television media.

For the nine months ended September 30, 2007, approximately 79.2% of the Company's revenues (defined as net interest income plus noninterest income) were derived from its level of net interest income. In a continuing effort to diversify its sources of revenue, the Company has sought to expand its sources of noninterest income (primarily fees and charges for products and services the Bank offers). Service charges on deposit accounts remain the largest component of noninterest income, while the Bank has recently seen growth in gains on lease sales and commissions on loans originated for others.

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

Financial Condition - Executive Summary

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

(In thousands)	September 30, 2007	June 30, 2007	March 31, 2007	December 31, 2006	September 30, 2006
Balance sheet data:					
Total assets	\$1,492,695	\$1,466,715	\$1,483,157	\$1,479,099	\$1,496,855
Loans and leases receivable	1,025,875	1,024,235	1,007,448	1,004,292	1,008,148
Securities available for sale	330,749	330,304	350,655	343,887	327,198
Core deposits ^(a)	637,290	641,164	638,317	634,716	620,743
Certificates of deposit	381,821	384,543	390,295	381,707	366,880
Borrowings	339,692	313,776	322,336	337,097	362,483
Total shareholders' equity	117,868	115,080	115,357	112,085	109,387
Core deposit ratio	62.5%	62.5%	62.1%	62.4%	62.9%

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

Total assets increased by \$13.6 million since December 31, 2006. Total loans and leases increased by \$21.6 million during the first nine months of 2007, with an increase in commercial loans and leases of \$35.1 million, or 6.8%. Available for sale securities declined \$13.1 million, or 3.8%, since year-end, as maturities and repayments have been partially redeployed into internally generated assets. The Bank increased its core deposits by \$2.6 million, or 0.4%, since year-end. Within this net growth, savings accounts grew by \$28.0 million, or 7.9%, while demand deposit accounts experienced third quarter seasonality with a decrease of \$14.8 million, or 7.4%, since year-end. Demand remained high for higher-yielding term deposit accounts (also referred to as certificates of deposit or CDs) and premium rate savings accounts, which in turn resulted in higher funding costs. Shareholders' equity as a percentage of total assets at September 30, 2007 was 7.9%, an increase from the December 31, 2006 ratio of 7.6%.

The Company's financial position at September 30, 2007 as compared to the prior year quarter-end (September 30, 2006) reflects net growth of \$17.7 million in total loans and leases. This increase reflects the continuing conversion of the balance sheet to a more commercial profile with increases in commercial loans and leases of \$46.4 million (up 9.1%). Consumer loans remained consistent with the prior year quarter-end, while the residential mortgage portfolio (consisting primarily of purchased mortgages) declined \$28.6 million (down 10.3%) from September 30, 2006. Also, available for sale securities at September 30, 2007 remained consistent with prior year quarter-end balances, with a net increase of \$3.6 million. Deposits have increased \$31.5 million, or 3.2%, since the prior year quarter-end. This deposit growth was centered in demand deposit accounts (up \$7.9 million), savings balances (up \$21.6 million) and certificates of deposit (up \$14.9 million). These gains were somewhat offset by decreases in NOW accounts (down \$11.4 million) and money market accounts (down \$1.5 million). Borrowings have decreased since September 30, 2006 by \$22.8 million, due in part to deposit growth. Additionally, the Company redeemed \$5.2 million of subordinated deferrable interest debentures, which were held by BRI Statutory Trust II, in September 2007.

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Financial Condition - Detailed Analysis

Investments

Total investments consists of available for sale securities (investment securities and mortgage-backed securities ("MBSs")), stock in the FHLB and overnight investments. Total investments comprised \$389.4 million, or 26.1% of total assets, at September 30, 2007, compared to \$397.7 million, or 26.9% of total assets, at December 31, 2006, representing a decrease of \$8.3 million, or 2.1%. All \$330.7 million of investment securities and MBSs at September 30, 2007 were classified as available for sale. These available for sale securities carried a total of \$2.9 million in net unrealized losses at the end of the quarter, compared to \$4.6 million of net unrealized losses at December 31, 2006.

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

The investment portfolio provides the Company a source of short-term liquidity and acts as a counterbalance to loan and deposit flows. During the first nine months of 2007, the Company purchased \$40.0 million of available for sale securities, while maturities and principal repayments totaled \$54.8 million. Also, during the three-month period ended September 30, 2007, the Company sold \$254,000 of available for sale equity securities via a corporate action. During the past nine months, fluctuations in market interest rates have often made purchases of available for sale securities less attractive than retirement of borrowings or redeployment of funds into higher-yielding internally generated assets.

Loans and Leases

Total loans and leases increased by \$21.6 million since December 31, 2006 to stand at \$1.03 billion at September 30, 2007. As a percentage of total assets, loans and leases increased to 68.7% at September 30, 2007 compared to 67.9% at December 31, 2006. The Company attempts to concentrate its asset growth in its loan and lease portfolios to maximize the yield on new assets and to take advantage of demand for both commercial and home equity loan products in its market area. Total loans and leases as of September 30, 2007 is segmented into three broad categories: commercial loans and leases that aggregate \$554.9 million, or 54.1% of the portfolio; residential mortgages that aggregate \$248.3 million, or 24.2% of the portfolio; and consumer and other loans that aggregate \$222.7 million, or 21.7% of the portfolio.

Commercial loans and leases - The commercial loan and lease portfolio (consisting of commercial real estate, business lending, equipment leases, multi-family real estate, construction and small business loans) increased \$35.1 million, or 6.8%, during the first nine months of 2007.

Towards the end of 2006, the Bank reorganized its business lending function. The business lending group now concentrates its efforts on business lending relationships primarily in excess of \$1.0 million. Business lending relationships of up to \$1.0 million can now be originated by the Bank's business development group. This group formerly only originated business loans involving relationships under \$250,000. Additionally, business loans under \$100,000 can be originated by our retail branch system. Underwriting, processing and

monitoring of the bulk of business credit relationships of under \$1.0 million have been moved to the Bank's new lending services unit ("LSU"). This reorganization has enhanced the Bank's ability to reach more borrowers with the same number of personnel as well as achieve more efficient processing and improved monitoring of these credits. As of September 30, 2007, the Bank's LSU managed approximately 1,400 loans with balances aggregating over \$85 million.

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The Bank's business lending group originates business loans, also referred to as commercial and industrial loans, including owner-occupied commercial real estate loans, term loans and revolving lines of credit. Within the business lending portfolio, commercial and industrial loans increased \$15.7 million, or 14.8%, and owner-occupied commercial real estate loans increased \$13.2 million, or 9.4%, since year-end.

The Bank historically has purchased equipment leases from originators outside of the Bank. The U.S. Government and its agencies are the principal lessees on the vast majority of these leases. These "government" leases generally have maturities of five years or less and are not dependent on residual collateral values. With the Macrolease platform, the Bank originates equipment leases for its own portfolio, as well as originates leases for third parties as a source of noninterest income. At September 30, 2007, leases comprised 11.6% of the commercial loan and lease portfolio, with \$45.0 million of Macrolease-generated leases and \$17.7 million of purchased government leases. There were no leases held for sale at September 30, 2007.

The Bank's commercial real estate ("CRE") group originates nonowner-occupied commercial real estate, multi-family residential real estate and construction loans. These real estate secured commercial loans are offered as both fixed and adjustable-rate products. Since December 31, 2006, CRE loans have increased \$3.2 million, or 1.9%, on a net basis. During the past nine months, the Bank originated \$34 million of new CRE loans, however repayments nearly equalled originations during this period.

At September 30, 2007, small business loans were \$44.3 million, compared to \$41.8 million at December 31, 2006, representing 8.0% of the commercial portfolio at each period end. These loans reflect those historically originated by the Bank's small business lending group and branch system and now originated by the Bank's business development group and branch system. The Bank utilizes credit scoring and streamlined documentation, as well as traditional review standards in originating these credits.

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

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

Residential mortgage loans - During the first nine months of 2007, residential mortgage loans decreased \$15.7 million, or down 5.9%. Since year-end, repayments of \$40.1 million exceeded total purchases of \$25.2 million and originations of \$377,000. Since inception, the Bank has concentrated its portfolio lending efforts on commercial and consumer lending opportunities, but originates mortgage loans for its own portfolio on a limited basis. The Bank does not employ any outside mortgage originators, but periodically purchases residential mortgage loans from third-party originators. Until such time as the Bank can originate sufficient commercial and consumer loans to utilize available cash flow, the Bank will purchase residential mortgage loans as opportunities arise. At September 30, 2007, the Bank did not have any commitments to purchase residential mortgage loans within the next 60 days.

Consumer loans - The consumer loan portfolio increased \$2.2 million, or 1.0%, during the first nine months of 2007 as originations approximated repayments. The modest net growth through September 30, 2007 was reflective of the softening of housing prices in the local market area over the past year. The Company believes the softening prices have reduced consumer appetite for borrowing against the value of their homes. However, the Company continues to promote consumer lending as it believes that these ten- to twenty-year fixed rate products, along with floating rate lines of credit, possess attractive cash flow characteristics in the current interest rate environment.

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The following is a summary of loans and leases receivable:

	September 30, 2007	December 31, 2006
(In thousands)		
Commercial loans and leases:		
Commercial real estate - owner occupied	\$ 154,007	\$ 140,812
Commercial and industrial	121,741	106,017
Commercial real estate - nonowner occupied	102,079	102,390
Small business	44,281	41,785
Multi-family	43,043	34,294
Construction	32,045	37,237
Leases and other	62,775	62,979
Subtotal	559,971	525,514
Unearned lease income	(6,234)	(6,651)
Net deferred loan origination costs	1,150	927
Total commercial loans and leases	554,887	519,790
Residential mortgage loans:		
One- to four-family adjustable rate	160,346	165,140
One- to four-family fixed rate	86,306	96,880
Subtotal	246,652	262,020
Premium on loans acquired	1,652	1,979
Net deferred loan origination fees	(45)	(54)
Total residential mortgage loans	248,259	263,945
Consumer loans:		
Home equity - term loans	153,687	152,484
Home equity - lines of credit	65,077	64,208
Savings secured	846	587
Installment	494	506

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Automobile	133	178
Unsecured and other	1,024	1,088
	<hr/>	<hr/>
Subtotal	221,261	219,051
Net deferred loan origination costs	1,468	1,506
	<hr/>	<hr/>
Total consumer loans	222,729	220,557
	<hr/>	<hr/>
Total loans and leases receivable	\$1,025,875	\$1,004,292
	<hr/>	<hr/>

Deposits

Total deposits increased by \$2.7 million, or 0.3%, during the first nine months of 2007, from \$1.02 billion, or 68.7% of total assets, at December 31, 2006, to \$1.02 billion, or 68.3% of total assets, at September 30, 2007.

The following table sets forth certain information regarding deposits:

	September 30, 2007			December 31, 2006		
	Amount	Percent Of Total	Weighted Average Rate	Amount	Percent of Total	Weighted Average Rate
	(In thousands)					
NOW accounts	\$ 61,262	6.0%	0.61%	\$ 70,736	7.0%	0.67%
Money market accounts	5,808	0.6%	2.05%	6,991	0.7%	2.69%
Savings accounts	384,748	37.8%	3.15%	356,707	35.1%	2.81%
Certificate of deposit accounts	381,821	37.4%	4.62%	381,707	37.5%	4.45%
	<hr/>	<hr/>		<hr/>	<hr/>	
Total interest bearing deposits	833,639	81.8%	3.63%	816,141	80.3%	3.40%
Noninterest bearing accounts	185,472	18.2%	--	200,282	19.7%	--
	<hr/>	<hr/>		<hr/>	<hr/>	
Total deposits	\$1,019,111	100.0%	2.96%	\$1,016,423	100.0%	2.73%
	<hr/>	<hr/>		<hr/>	<hr/>	

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

During the first nine months of 2007, competition for deposits has been intense. In this competitive deposit gathering and rate environment, total deposits increased \$2.7 million as compared to December 31, 2006. Savings and CD accounts grew \$28.0 million and \$114,000, respectively, over the past nine months. These increases offset the decline of NOW and money market accounts of \$10.7 million in the aggregate. By September 30, 2007, demand deposit accounts stood at \$185.5 million, partially reflecting seasonality with a decrease of \$14.8 million from \$200.3 million at December 31, 2006. At September 30, 2007, brokered CDs were \$20.0 million, or 2.0% of total deposits. The Bank may utilize brokered CDs if their rates are attractive compared to wholesale funding.

Borrowings

Overnight and short-term borrowings increased \$16.7 million during the first nine months of 2007 from the December 31, 2006 level of \$56.3 million. Through the Bank's membership in the FHLB, the Company has access to a number of different funding structures. FHLB borrowings marginally increased by \$1.0 million from the December 31, 2006 amount of \$242.2 million. Also, in the first quarter of 2007, the Bank decreased the amount of its wholesale repurchase agreements by \$10.0 million. The Bank may utilize wholesale repurchase agreement funding in the future if spreads are favorable compared to FHLB borrowings or for diversification purposes.

In September 2007, the Company redeemed \$5.2 million of subordinated deferrable interest debentures, which were held by BRI Statutory Trust II. On a long-term basis, the Company intends to continue concentrating on increasing its core deposits, and will utilize FHLB borrowings or wholesale repurchase agreements as cash flows dictate, as opportunities present themselves and as part of the Bank's overall strategy to manage interest rate risk.

Asset Quality

The definition of nonperforming assets includes nonperforming loans and other real estate owned ("OREO"). OREO consists of real estate acquired through foreclosure proceedings and real estate acquired through acceptance of a deed in lieu of foreclosure. Nonperforming loans are defined as nonaccrual loans, loans past due 90 days or more but still accruing and impaired loans. Under certain circumstances the Company may restructure the terms of a loan as a concession to a borrower. These restructured loans are generally considered impaired loans.

Nonperforming assets - At September 30, 2007, the Company had nonperforming assets of \$4.0 million, which represented 0.27% of total assets. This compares to nonperforming assets of \$1.4 million, or 0.10% of total assets, at December 31, 2006. Total nonperforming assets at September 30, 2007 consisted of nonaccrual loans and leases with commercial loans and leases aggregating \$3.2 million, residential mortgage loans aggregating \$360,000 and commercial loans and leases 90 days past due, but still accruing of \$418,000. Nonperforming assets at December 31, 2006 were primarily comprised of nonaccrual residential and commercial loans.

Included in nonaccrual loans and leases at September 30, 2007 were \$3.0 million of impaired loans and leases, with specific reserves against these impaired loans and leases of \$539,000. At December 31, 2006, there were no impaired loans and leases and thus, no specific reserve allocated to impaired loans and leases. The increase in nonaccrual loans and leases since year-end relates primarily to a few commercial loans and leases.

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The Company evaluates the underlying collateral of each nonperforming loan and continues to pursue the collection of interest and principal. Management believes that the current level of nonperforming assets remains low relative to the size of the Company's loan portfolio. As the loan portfolio continues to grow and mature, or if economic conditions worsen, management believes it possible that the level of nonperforming assets may increase, as may its level of charged-off loans.

Delinquencies - At September 30, 2007, loan balances of \$675,000 were 60 to 89 days past due, up from \$476,000 at December 31, 2006.

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

	September 30, 2007	December 31, 2006
(In thousands)		
Loans and leases accounted for on a nonaccrual basis	\$3,601	\$1,407
Loans and leases past due 90 days or more, but still accruing	418	6
Impaired loans and leases (not included in nonaccrual loans and leases)	--	--
	<hr/>	<hr/>
Total nonperforming loans and leases	4,019	1,413
Other real estate owned	--	--
	<hr/>	<hr/>
Total nonperforming assets	<u>\$4,019</u>	<u>\$1,413</u>
Delinquent loans 60-89 days past due	\$ 675	\$ 476
Nonperforming loans and leases as a percent of total loans and leases	0.39%	0.14%
Nonperforming assets as a percent of total assets	0.27%	0.10%
Delinquent loans and leases 60-89 days past due as a percent of total loans	0.07%	0.05%

Adversely classified assets - The Company's management classifies certain assets as "substandard," "doubtful" or "loss" based on criteria established under banking regulations. An asset is considered substandard if inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard assets include those characterized by the "distinct possibility" that the insured institution will sustain "some loss" if existing deficiencies are not corrected. Assets classified as doubtful have all of the weaknesses inherent in those classified substandard with the added characteristic that the weaknesses present make "collection or liquidation in full," on the basis of currently existing facts, conditions and values, "highly questionable and improbable." Assets classified as loss are those considered "uncollectible" and of such little value that their continuance as assets without the establishment of a specific loss reserve is not warranted.

At September 30, 2007, the Company had \$9.6 million of assets that were classified as substandard. This compares to \$8.2 million of assets that were classified as substandard at December 31, 2006. The Company had no assets that were classified as doubtful or loss at either date. Performing loans may or may not be

adversely classified depending upon management's judgment with respect to each individual loan. At September 30, 2007, included in the assets that were classified as substandard were \$5.6 million of performing loans. This compares to \$6.8 million of adversely classified performing loans as of December 31, 2006. These amounts constitute assets that, in the opinion of management, could potentially migrate to nonperforming or doubtful status. Management believes that the September 30, 2007 level of adversely classified assets is low relative to the size of the Company's loan and lease portfolio. If a significant downturn in the local or regional market occurs or if other economic or market conditions worsen, management believes it possible that the level of adversely classified assets may increase. This in turn may necessitate an increase to the provision for loan losses in future periods.

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Allowance for Credit Losses

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

During the first nine months of 2007, the Company made additions to the allowance for loan and lease losses of \$490,000 and experienced net charge-offs of \$305,000 compared to additions to the allowance for loan and lease losses of \$1.1 million and net charge-offs of \$466,000 for the first nine months of 2006. The net charge-offs in 2007 were primarily from residential mortgages and small business loans. At September 30, 2007, the allowance for loan and lease losses stood at \$12.6 million and represented 312.6% of nonperforming loans and 1.22% of total loans and leases outstanding. This compares to an allowance for loan and lease losses of \$12.4 million, representing 875.9% of nonperforming loans and 1.23% of total loans and leases outstanding at December 31, 2006.

During the first nine months of 2007, the Company increased the reserve for unfunded lending commitments by \$17,000, bringing the balance to \$584,000 at September 30, 2007. This compares to the December 31, 2006 balance in the reserve for unfunded lending commitments of \$567,000.

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

	Nine Months Ended September 30, 2007	Year Ended December 31, 2006
	(In thousands)	
Allowance for Loan and Lease Losses		
Balance at beginning of period	\$12,377	\$11,665
Loans charged-off:		
Commercial loans and leases	(82)	(472)
Residential mortgage loans	(205)	--
Consumer and other loans	(76)	(47)
	<hr/>	<hr/>
Total loans charged-off	(363)	(519)
	<hr/>	<hr/>

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Recoveries of loans previously charged-off:		
Commercial loans and leases	27	19
Residential mortgage loans	--	--
Consumer and other loans	31	10
	<hr/>	<hr/>
Total recoveries of loans previously charged-off	58	29
	<hr/>	<hr/>
Net charge-offs	(305)	(490)
Provision for loan and lease losses charged against income	490	1,202
	<hr/>	<hr/>
Balance at end of period	12,562	12,377
	<hr/>	<hr/>
Reserve for Unfunded Lending Commitments		
Balance at beginning of period	567	503
Provision for unfunded lending commitments	17	64
	<hr/>	<hr/>
Balance at end of period	584	567
	<hr/>	<hr/>
Allowance for Credit Losses		
Balance at end of period	\$13,146	\$12,944
	<hr/>	<hr/>

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

	September 30, 2007	December 31, 2006
	<hr/>	<hr/>
	(In thousands)	
Allowance for Loan and Lease Losses		
Loan category		
Commercial loans and leases	\$ 8,553	\$ 7,944
Residential mortgage loans	1,326	1,440
Consumer and other loans	1,765	2,086
Unallocated	918	907
	<hr/>	<hr/>
Total	\$12,562	\$12,377
	<hr/>	<hr/>

Assessing the appropriateness of the allowance for credit losses involves substantial uncertainties and is based upon management's evaluation of the amounts required to meet estimated charge-offs in the loan and lease portfolio after weighing various factors. Management's methodology to estimate loss exposure includes an analysis of individual loans and leases deemed to be impaired, reserve allocations for various loan types based on payment status or loss experience and an unallocated allowance that is maintained based on management's assessment of many factors including the growth, composition and quality of the loan portfolio, historical loss experiences, general economic conditions and other pertinent factors. These risk factors are reviewed and revised by management where conditions indicate that the estimates initially applied are different from actual results. Management employs a similar process with respect to unfunded lending commitments. Based on this evaluation, management believes that the allowance for credit losses, as of September 30, 2007, is appropriate.

A portion of the allowance for loan and lease losses is not allocated to any specific segment of the loan portfolio. This non-specific allowance, also referred to as unallocated allowance, is maintained for two primary reasons: (i) there exists an inherent subjectivity and imprecision to the analytical processes employed, and (ii) the prevailing business environment, as it is affected by changing economic conditions and various external factors, may impact the portfolio in ways currently unforeseen. Management, therefore, has established and maintains a non-specific allowance for loan and lease losses. The amount of this measurement imprecision allocation was \$918,000 at September 30, 2007, compared to \$907,000 at December 31, 2006.

With respect to changes within the allocation of the allowance for loan and lease losses, commercial loans and leases increased on a net basis reflecting increased growth as well as reassessment of risk within leases. The change in the allocation attributable to residential mortgage loans was primarily reflective of lower balances. The allocation related to consumer loans declined as a result of reassessment of risk within home equity loans, while the unallocated portion of the allowance for loan and lease losses remained consistent with the amount from the prior year-end.

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

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Results of Operations - Executive Overview

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

(In thousands, except per share data)	For the three-month periods ended				
	September 30, 2007	June 30, 2007	March 31, 2007	December 31, 2006	September 30, 2006
Income statement data:					
Net interest income	\$10,265	\$10,292	\$10,228	\$10,173	\$10,676
Noninterest income	(a)	2,664	2,562	2,324	(a)

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	2,856				1,544
				(b)	
Noninterest expense	9,492	9,624	9,511		9,504
				8,674	
Net income	2,278	2,194	2,178	2,537	1,643
Per share data:					
Diluted earnings per share	\$ 0.46	\$ 0.44	\$ 0.44	\$ 0.51	\$ 0.33
Dividends per common share	0.16	0.15	0.15	0.15	0.15
Operating ratios:					
Net interest margin	2.91%	2.97%	2.97%	2.91%	3.08%
Return on average assets	0.61%	0.60%	0.61%	0.69%	0.45%
Return on average equity	7.79%	7.63%	7.79%	9.11%	6.10%
Efficiency ratio	72.34%	74.28%	74.36%	69.41%	77.78%

- (a) Noninterest income includes gains on available for sale securities of \$254,000 in the three-month period ended September 30, 2007 compared to losses on available for sale securities of \$858,000 for the three-month period ended September 30, 2006.
- (b) Noninterest expense for the three-month period ended December 31, 2006 reflects the recovery of \$803,000 of insurance proceeds relating to a loss on note receivable incurred in the three-month period ended March 31, 2006.

The Company's 2007 third quarter net income of \$2.3 million, increased by \$84,000, or 3.8%, from the prior quarter (three months ended June 30, 2007). Net income was up \$635,000, or 38.7%, on a comparative quarter basis (as compared to the three months ended September 30, 2006). Diluted earnings per common share ("EPS") was up 4.5% on a linked-quarter basis (as compared to the three months ended June 30, 2007) and increased 39.4% as compared to the same quarter a year ago.

The Company's third quarter 2007 and 2006 GAAP earnings and GAAP EPS were affected by several non-core items. In September 2007, the Company redeemed \$5.2 million of subordinated deferrable interest debentures, which were held by BRI Statutory Trust II. This redemption resulted in the recognition of \$137,000 of additional interest expense related to previously unamortized debt issuance costs. Additionally, in the 2007 third quarter, the Company realized \$254,000 of gains on available for sale securities, whereas the Company incurred a loss of \$858,000 in the 2006 third quarter as the Company restructured a portion of its investment portfolio. Also, in 2006, the FHLB amended its dividend schedule. As a result, the Bank received approximately six months' worth of income on its investment in the FHLB during the third quarter of 2006.

To provide additional analysis regarding the Company's operating results, the tables on the following page set forth certain non-GAAP information relating to the reconciliation of GAAP net income, EPS and related operating ratios to pro forma amounts as described below. Management believes this information is useful to the investor in comparing the Company's operating results to those from prior periods. This information should not be viewed as a substitute for operating results determined in accordance with GAAP, nor is it necessarily comparable to non-GAAP information which may be presented by other companies.

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The following tables summarize the impact of certain non-core items for the periods indicated below:

(In thousands, except per share data)	Quarter Ended September 30, 2007	Quarter Ended June 30, 2007	Quarter Ended September 30, 2006
Net income (GAAP)	\$2,278	\$2,194	\$1,643
Adjust for:			
AFS security (gains) losses, net of tax	(165)	--	558
Amortization of debt issuance costs, net of tax	89	--	--
FHLB dividend, net of tax	--	--	(148)
Pro forma net income	\$2,202	\$2,194	\$2,053
Diluted earnings per share (GAAP)	\$0.463	\$0.442	\$0.333
Effect of:			
AFS security (gains) losses, net of tax	(0.034)	--	0.113
Amortization of debt issuance costs, net of tax	0.018	--	--
FHLB dividend, net of tax	--	--	(0.030)
Pro forma diluted earnings per share	\$0.447	\$0.442	\$0.416

Quarter Ended September 30, 2007

	Net Interest Margin	Return on Average Assets	Return on Average Equity	Efficiency Ratio
GAAP ratios	2.91%	0.61%	7.79%	72.34%
Effect of:				
AFS security (gains) losses, net of tax	--	-0.04%	-0.56%	1.36%
Amortization of debt issuance costs, net of tax	0.04%	0.02%	0.30%	-0.71%
FHLB dividend, net of tax	--	--	--	--
Pro forma ratios	2.95%	0.59%	7.53%	72.99%

Quarter Ended June 30, 2007

	Net Interest Margin	Return on Average Assets	Return on Average Equity	Efficiency Ratio
GAAP ratios	2.97%	0.60%	7.63%	74.28%
Effect of:				

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AFS security (gains) losses, net of tax	--	--	--	--
Amortization of debt issuance costs, net of tax	--	--	--	--
FHLB dividend, net of tax	--	--	--	--
Pro forma ratios	2.97%	0.60%	7.63%	74.28%

Quarter Ended September 30, 2006

	Net Interest Margin	Return on Average Assets	Return on Average Equity	Efficiency Ratio
GAAP ratios	3.08%	0.45%	6.10%	77.78%
Effect of:				
AFS security (gains) losses, net of tax	--	0.15%	2.08%	-5.38%
Amortization of debt issuance costs, net of tax	--	--	--	--
FHLB dividend, net of tax	-0.07%	-0.04%	-0.55%	1.56%
Pro forma ratios	3.01%	0.56%	7.63%	73.96%

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Pro forma earnings for the third quarter of 2007 were consistent with the second quarter of 2007. On a year-over-year basis, pro forma net income for the third quarter of 2007 increased \$149,000 (up 7.3%) and EPS increased \$0.03 per share (up 7.5%) as compared to the pro forma amounts for the third quarter of 2006. The Company has countered the effects of net interest margin compression of 6 basis points ("bps") through expense control and organic noninterest income growth.

The third quarter 2007 pro forma net interest income increased by \$110,000, or 1.1%, as compared to the second quarter of 2007. The yield on earning assets and cost of liabilities rose nominally with increases of 5 bps and 8 bps, respectively. Increases in average earning asset volume compensated for increases in the costs of deposits.

Compared to the third quarter of 2006, net interest income decreased by \$46,000, or 0.4%, on a pro forma basis. Increased yields on investment securities and MBSs of 87 bps and 29 bps reflect the restructuring of a portion of the Company's available for sale security portfolio in the prior year third quarter. Overall, yields on earning assets rose 23 bps, while the cost of liabilities increased 38 bps. Within the overall cost of liabilities were comparative increases in savings account and CD costs of 58 bps. The Company mitigated the net decrease in pro forma net interest margin of 6 bps through higher volume. In comparison to the same period a year ago, movements in the yield curve and competition for deposits, loans and customers in our market area resulted in increases in cost of funds outpacing increases in earning asset yields.

Noninterest income for the third quarter of 2007 decreased on a linked-quarter basis by \$62,000. Volume related decreases on loan related fees (down \$75,000) and net gains on lease sales and commissions on loans originated for others (down \$41,000) were slightly larger than increases in other income on a net basis. In comparison to the 2006 third quarter, noninterest income was up \$200,000 for the 2007 third quarter. Net gains on lease sales and commissions on loans originated for others in the third quarter 2007 were up \$201,000.

Also, increases in income from bank-owned life insurance and service charges on deposit accounts in the 2007 third quarter offset the minor declines in loan related fees, commissions from nondeposit investment products and other income compared to the same period a year ago.

Noninterest expenses for the current quarter were down on a linked-quarter basis by \$132,000, or 1.4%, with decreases in professional services, marketing and data processing costs. Third quarter 2007 noninterest expenses were flat with a net decrease of \$12,000, or 0.1% compared to the third quarter of 2006. Professional services costs savings of \$265,000, or 37.3%, from lower investor relations costs and other more moderate expense decreases offset the net increase in salaries and benefits of \$374,000, or 7.6%, which was attributable to timing differences in salary and benefit accruals in the current year third quarter.

The Company's key operating ratios (return on average assets, return on average equity, and efficiency ratio) for the third quarter of 2007 were consistent with the second quarter of 2007 and the third quarter of 2006. Throughout the remainder of 2007, management will continue to focus on expense control as part of its efforts to improve earnings and build shareholder value despite the pressure on the net interest margin.

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

Net Interest Income

Net interest income for the quarter ended September 30, 2007 was down \$411,000, or 3.8%, from the \$10.7 million earned in the third quarter of 2006. Similarly, the net interest margin for the third quarter of 2007 of 2.91% decreased from the net interest margin for the 2006 period of 3.08%. Average earning assets were \$22.4 million, or 1.6%, higher, and average interest-bearing liabilities were \$11.2 million, or 1.0%, higher, than the comparable period a year earlier.

Two non-core items contributed to the decrease in net interest income and net interest margin between the two three-month periods. In September 2007, the Company redeemed \$5.2 million of subordinated deferrable interest debentures, which resulted in \$137,000 of additional interest expense from previously unamortized debt issuance costs. In 2006, the FHLB deferred the declaration of its normal dividend for the second quarter of 2006. As a result, the Bank received approximately six months' worth of income on its investment in the FHLB during the third quarter of 2006, resulting in an additional \$228,000 of pretax

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income. The two items comprised \$365,000 and 11 bps of the change in net interest income and net interest margin, respectively. The remaining net interest income decrease of \$46,000 and margin decrease of 6 bps were attributable to movements in the yield curve and competition for deposits, loans and customers in our market area.

Average Balances, Yields and Costs - The following table sets forth certain information relating to the Company's average balance sheet and reflects the average yield on assets and average cost of liabilities for the three month periods indicated. Such yields and costs are derived by dividing income or expense by the average balance of assets or liabilities. Average balances are derived from daily balances and include nonperforming loans. Available for sale securities are stated at amortized cost.

(In thousands)

For the three months ended September 30,

2007

2006

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Assets	Average Balance	Interest Earned/ Paid	Average Yield	Average Balance	Interest Earned/ Paid	Average Yield
Earning assets:						
Overnight investments	\$ 27,692	\$ 365	5.24%	\$ 5,941	\$ 80	5.32%
Investment securities	122,573	1,577	5.15%	156,769	1,679	4.28%
Mortgage-backed securities	215,935	2,620	4.85%	210,201	2,394	4.56%
Stock in the FHLB	15,671	254	6.43%	16,530	456	10.94%
Loans receivable:						
Commercial loans and leases	549,318	10,200	7.38%	491,059	9,204	7.44%
Residential mortgage loans	254,082	3,427	5.39%	282,602	3,771	5.34%
Consumer and other loans	221,897	3,507	6.27%	221,690	3,433	6.14%
Total earning assets	1,407,168	21,950	6.21%	1,384,792	21,017	6.04%
Cash and due from banks	27,568			22,928		
Allowance for loan and lease losses	(12,490)			(12,178)		
Premises and equipment	14,410			14,878		
Goodwill, net	11,317			11,317		
Accrued interest receivable	6,111			5,996		
Bank-owned life insurance	23,752			20,807		
Prepaid expenses and other assets	8,761			9,652		
Total assets	\$1,486,597			\$1,458,192		
Liabilities and Shareholders' Equity						
Interest-bearing liabilities:						
Deposits:						
NOW accounts	\$ 61,616	99	0.64%	\$ 66,191	76	0.46%
Money market accounts	5,939	40	2.67%	8,024	44	2.15%
Savings accounts	383,669	2,955	3.06%	358,447	2,245	2.48%
Certificate of deposit	381,624	4,479	4.66%	345,972	3,560	4.08%

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accounts						
Overnight and short-term borrowings	57,988	703	4.82%	49,446	639	5.12%
Wholesale repurchase agreements	10,000	136	5.32%	20,000	231	4.51%
FHLB borrowings	244,144	2,767	4.50%	285,413	3,171	4.41%
Subordinated deferrable interest debentures	18,278	506	11.07%	18,558	375	8.09%
	<hr/>			<hr/>		
Total interest-bearing liabilities	1,163,258	11,685	3.99%	1,152,051	10,341	3.56%
	<hr/>			<hr/>		
Noninterest-bearing deposits	185,189			180,878		
Other liabilities	22,064			18,491		
	<hr/>			<hr/>		
Total liabilities	1,370,511			1,351,420		
Shareholders' Equity:	116,086			106,772		
	<hr/>			<hr/>		
Total liabilities and shareholders' equity	\$1,486,597			\$1,458,192		
	<hr/>			<hr/>		
Net interest income		\$10,265			\$10,676	
		<hr/>			<hr/>	
Net interest rate spread			2.22%			2.48%
Net interest rate margin			2.91%			3.08%

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Rate/Volume Analysis - The following table sets forth certain information regarding changes in the Company's interest income and interest expense for the periods indicated. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to (i) changes in rate (changes in rate multiplied by old average balance) and (ii) changes in volume (changes in average balances multiplied by old rate). The net change attributable to the combined impact of rate and volume was allocated proportionally to the individual rate and volume changes.

	Three Months Ended September 30, 2007 vs. 2006		
	Increase/(decrease) due to		
(In thousands)	<hr/>	<hr/>	<hr/>
	Rate	Volume	Total

Interest income:

Overnight investments	\$ (1)	\$ 286	\$ 285
Investment securities	317	(419)	(102)
Mortgage-backed securities	154	72	226
Stock in the FHLB	(179)	(23)	(202)
Commercial loans and leases	(164)	1,160	996
Residential mortgage loans	40	(384)	(344)
Consumer and other loans	83	(9)	74
	<u>250</u>	<u>683</u>	<u>933</u>
Total interest income	250	683	933

Interest expense:

NOW accounts	28	(5)	23
Money market accounts	9	(13)	(4)
Savings accounts	543	167	710
Certificate of deposit accounts	530	389	919
Overnight and short-term borrowings	(40)	104	64
Wholesale repurchase agreements	35	(130)	(95)
FHLB borrowings	62	(466)	(404)
Subordinated deferrable interest debentures	137	(6)	131
	<u>1,304</u>	<u>40</u>	<u>1,344</u>
Total interest expense	1,304	40	1,344
Net interest income	<u>\$ (1,054)</u>	<u>\$ 643</u>	<u>\$ (411)</u>

Interest Income - Investments - Total investment income (consisting of interest on overnight investments, investment securities and MBSs and dividends on FHLB stock) was \$4.8 million for the quarter ended September 30, 2007, compared to \$4.6 million for the 2006 period. The increase in total investment income was \$207,000, or 4.5%. Investment income for the current quarter benefited from the higher-yielding securities the Company purchased as part of the investment portfolio restructuring conducted in the third quarter of 2006.

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

Interest Income - Loans and Leases - Interest from loans and leases was \$17.1 million for the quarter ended September 30, 2007, and represented a yield on total loans and leases of 6.65%. This compares to \$16.4 million of interest, and a yield of 6.56%, for the third quarter of 2006. Increased interest income resulting from the growth in the average balance of loans and leases of \$29.9 million, or 3.0%, was augmented by an increase in the yield on loans and leases of 9 bps.

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The average balance of the various components of the loan and lease portfolio changed from the third quarter of 2006 as follows: commercial loans and leases increased \$58.3 million, or 11.9%. Consumer and other loans remained relatively unchanged, with an increase of \$207,000, or 0.1%. Residential mortgage loans decreased \$28.5 million, or 10.1%. Changes in the average yields from the third quarter of 2006 were as

follows: commercial loans and leases decreased 6 bps, to 7.38%, and consumer and other loans increased 13 bps, to 6.27%, while residential mortgage loans increased to 5.39%. The yields on loans and leases in the current quarter were impacted by nonaccrual interest recognition as well as repricing of existing variable rate assets.

Interest Expense - Deposits and Borrowings - Interest paid on deposits and borrowings increased \$1.3 million, or 13.0%, to \$11.7 million for the three months ended September 30, 2007, up from \$10.3 million for the same period during 2006. The overall average cost for interest-bearing liabilities increased 43 bps to 3.99% for the third quarter of 2007, compared to 3.56% for the third quarter of 2006. The average balance of total interest-bearing liabilities remained relatively unchanged at \$1.2 billion for the three months ended September 30, 2007 and 2006.

The growth in deposit average balances was centered primarily in CDs (up \$35.7 million, or 10.3%) and savings accounts (up \$25.2 million, or 7.0%). These increases were somewhat offset by decreases in lower-costing NOW accounts (down \$4.6 million, or 6.90%) and money market accounts (down \$2.1 million, or 26.0%).

Borrowings decreased as compared to the third quarter of 2006, with increases in customer short-term borrowings (up \$8.5 million, or 17.3%) surpassed by larger decreases in FHLB funding (down \$41.3 million, or 14.5%), as well as wholesale repurchase agreements (down \$10.0 million, or 50.0%). The average balance of subordinated deferrable interest debentures remained largely unchanged between the two periods (down \$280,000, or 15%) as the Company's redemption of the \$5.2 million of debentures held by BRI Statutory Trust II occurred at the end of September 2007. This redemption, however, resulted in \$137,000 of additional interest expense for the three month period ended September 30, 2007 from previously unamortized debt issuance costs.

The rise in deposit and borrowing costs can be attributed to a number of factors. Customer demand remains strong for higher-yielding deposit products, due in part to relatively high short-term rates. Competition for deposits continues to be strong. Additionally, bank and non-bank advertising continues to be prevalent in our local market area, which has increased customer awareness of attractive rates. Moreover, online banking has enabled customers to more actively manage their finances and has facilitated the movement of available funds from demand deposit accounts and lower-yielding deposit accounts into higher-yielding deposit products. In an effort to attract and retain customers and deposit relationships, the Bank has offered higher-yielding savings accounts in addition to the normally higher-yielding CDs.

Excluding the additional interest expense associated with the redemption of the BRI Statutory Trust II debentures, costs rose marginally during the current quarter for long-term borrowings. Fluctuations in the yield curve contributed to this overall rise in interest costs, but also produced savings in short-term borrowing costs. Overall, the Company's liability costs continue to be dependent upon a number of factors including general economic conditions, national and local interest rates, competition in the local deposit marketplace, interest rate tiers offered and the Company's cash flow needs.

Provision for Loan and Lease Losses

The provision for loan and lease losses was \$290,000 for the quarter ended September 30, 2007, down \$110,000 from the third quarter of 2006. The Bank made additions to the allowance for loan and lease losses during the third quarter of 2007 in response to growth of the commercial loan and lease portfolio and general concern for economic conditions. The primary reasons for the change in the provision for loan and lease losses compared to the third quarter of 2006 were lower relative growth in commercial loans and a reassessment of risk within the components of the loan and lease portfolio.

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

Noninterest Income

Total noninterest income increased \$1.3 million, or 85.0%, to \$2.9 million for the third quarter of 2007, from \$1.5 million for the third quarter of 2006. Realized gains and losses on available for sale securities was the primary driver of this change with gains of \$254,000 in the 2007 third quarter compared to losses of \$858,000 in the 2006 third quarter as the Company restructured a portion of its investment portfolio during that period. Additionally, net gains on lease sales and commissions on loans originated for others grew by \$201,000, or 213.8%, compared to the same quarter a year ago due to higher volume. Income from bank-owned life insurance ("BOLI") benefited from the tax-free exchange the Company entered into in the fourth quarter of 2006 and the additional purchases of BOLI made during 2006, with an overall increase of \$65,000, or 33.0%. Service charges on deposit accounts increased by \$58,000, or 4.4%, compared to the third quarter of 2006. These increases were offset by volume based decreases in commissions on nondeposit investment products in the third quarter of 2007 (down \$34,000, or 19.0%) and loan related fees (down \$43,000, or 27.0%). Additionally, other income decreased by \$47,000, or 10.7%, mainly due to lower credit card commissions compared to the prior year third quarter.

Noninterest Expense

Noninterest expense for the third quarter of 2007 of \$9.5 million was relatively unchanged compared to the third quarter of 2006, with an overall decrease of \$12,000, or 0.1%. In the 2007 third quarter, professional services expenses decreased \$265,000, or 37.3%, primarily reflecting a decrease in investor relation costs. The Company also realized savings in data processing costs (down \$50,000, or 6.7%), marketing (down \$36,000, or 9.4%), and loan servicing costs (down \$25,000, or 10.2%). Partially offsetting these items were increases in salaries and benefits costs (up \$374,000, or 7.6%), largely due to timing differences in salary and benefit accruals. Additionally, loan workout expense increased \$34,000, or 377.8%. Other miscellaneous expenses decreased by \$37,000, or 3.0%, for the third quarter of 2007 compared to the same period a year ago with savings from increased operating efficiencies. The Company's efficiency ratio improved from the third quarter 2006 pro forma ratio of 73.96% to 72.99% for the third quarter of 2007. However, these efficiency ratios continue to be negatively impacted by the compression in the net interest margin, which has partially negated cost savings realized.

Income Tax Expense

Income tax expense of \$1.1 million was recorded for the three months ended September 30, 2007, compared to \$673,000 for the same period during 2006. This represented total effective tax rates of 31.8% and 29.1%, respectively. Tax-favored income from BOLI, along with the Company's utilization of a Rhode Island passive investment company, has reduced the effective tax rate from the 40.9% combined statutory federal and state tax rates.

Results of Operations - Comparison of the Nine Months Ended September 30, 2007 and 2006

General

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Net income for the first nine months of 2007 increased \$1.5 million, or 28.5%, to \$6.7 million, from \$5.2 million for the first nine months of 2006. EPS increases in a similar manner, with an increase of \$0.29 per share, or 27.6%. These two periods include several non-core items: additional interest expense from previously unamortized debt issuance costs recognized in connection with the redemption of subordinated deferrable interest debentures in September 2007, losses on available for sale securities from the investment

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portfolio restructuring in September 2006 (whereas the Company realized gains on available for sale securities in 2007) and a loss incurred on a note receivable in the first quarter of 2006.

To provide additional analysis regarding the Company's operating results, the tables below set forth certain non-GAAP information relating to the reconciliation of GAAP net income, EPS and related operating ratios to pro forma amounts as described below. Management believes this information is useful to the investor in comparing the Company's operating results to those from prior periods. This information should not be viewed as a substitute for operating results determined in accordance with GAAP, nor is it necessarily comparable to non-GAAP information which may be presented by other companies.

The following tables summarize the impact of certain non-core items for the periods indicated below:

	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006
(In thousands, except per share data)		
Net income (GAAP)	\$6,650	\$5,174
Add back:		
AFS security (gains) losses, net of tax	(165)	558
Amortization of debt issuance costs, net of tax	89	--
Note receivable loss, net of tax	--	564
Pro forma net income	\$6,574	\$6,296
Diluted earnings per share (GAAP)	\$1.34	\$1.05
Effect of:		
AFS security (gains) losses, net of tax	(0.03)	0.11
Amortization of debt issuance costs, net of tax	0.02	--
Note receivable loss, net of tax	--	0.12
Pro forma, diluted earnings per share	\$1.33	\$1.28

Nine Months Ended September 30, 2007				Nine Months Ended September 30, 2006			
Net Interest	Return on	Return on	Efficiency Ratio	Net Interest	Return on	Return on	Efficiency Ratio

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	Margin	Average Assets	Average Equity		Margin	Average Assets	Average Equity	
GAAP ratios	2.95%	0.61%	7.74%	73.65%	3.11%	0.48%	6.55%	77.62%
Effect of:								
AFS security (gains) losses, net of tax	--	-0.02%	-0.19%	0.48%	--	0.05%	0.71%	-2.22%
Amortization of debt issuance costs, net of tax	0.01%	0.01%	0.10%	-0.25%	--	--	--	--
Note receivable loss, net of tax	--	--	--	--	--	0.05%	0.71%	-1.66%
Pro forma ratios	2.96%	0.60%	7.65%	73.88%	3.11%	0.58%	7.97%	73.74%

On a pro forma basis, net income increased by \$278,000, or 4.4%, and EPS increased \$0.05 per share, or 3.9%. Noninterest income increased \$306,000, or 4.1%, while noninterest expenses dropped \$558,000, or 1.9%. Provision for loan losses decreased by \$612,000, or 55.5%, primarily as a result of lower commercial loan growth and decreased charge-offs. These gains were partially offset by a decline in pro forma net interest income of \$1.1 million, or 3.5%. The net interest margin decreased 15 bps, while total average earning assets increased by \$17.8 million.

Net Interest Income

For the nine months ended September 30, 2007, net interest income was \$30.8 million, compared to \$32.1 million for the 2006 period. The net interest margin for the first nine months of 2007 was 2.95%, down from the net interest margin for the 2006 period of 3.11%. The decrease in net interest income of \$1.3 million, or 4.0%, and margin decrease of 16 bps were attributable to the flat-to-inverted shape of the yield

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curve, changes in short-term rates, as well as competition for deposits, loans and customers in our market area. Additionally, in September 2007, the Company redeemed \$5.2 million of subordinated deferrable interest debentures, which resulted in an additional \$137,000 of interest expense relating to unamortized debt issuance costs. Average earning assets were \$17.8 million, or 1.3%, higher, and average interest-bearing liabilities were \$5.5 million, or 0.5%, higher than the comparable period a year earlier.

Average Balances, Yields and Costs - The following table sets forth certain information relating to the Company's average balance sheet and reflects the average yield on assets and average cost of liabilities for the nine month periods indicated. Such yields and costs are derived by dividing income or expense by the average balance of assets or liabilities. Average balances are derived from daily balances and include nonperforming loans. Available for sale securities are stated at amortized cost.

(In thousands)

Nine Months Ended September 30,

	2007	2006
Assets		

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	Average Balance	Interest Earned/ Paid	Average Yield	Average Balance	Interest Earned/ Paid	Average Yield
Earning assets:						
Overnight investments	\$ 20,891	\$ 837	5.36%	\$ 4,179	\$ 157	5.01%
Investment securities	116,756	4,444	5.08%	158,260	5,074	4.27%
Mortgage-backed securities	227,401	8,223	4.82%	221,300	7,571	4.56%
Stock in the FHLB	15,741	800	6.79%	16,454	667	5.42%
Loans receivable:						
Commercial loans and leases	533,579	29,440	7.37%	462,973	25,169	7.27%
Residential mortgage loans	258,581	10,374	5.35%	294,328	11,750	5.32%
Consumer and other loans	219,385	10,249	6.25%	217,085	9,786	6.03%
Total earning assets	1,392,334	64,367	6.17%	1,374,579	60,174	5.85%