

PORT FINANCIAL CORP
Form 10-Q
November 14, 2002

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2002

OR

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

For the transition period from _____ to _____

Commission file number 000-29343

Port Financial Corp.

(Exact name of registrant as specified in its charter)

Massachusetts

04-1145480

(State or other jurisdiction of
incorporation or organization)

(I.R.S. Employer
Identification No.)

1380 Soldiers Field Road, Brighton, Massachusetts 02135

(Address of principal executive offices)
(Zip Code)

(617) 779-8300

(Registrant's telephone number including area code)

N/A

(Former name, former address and former fiscal year,
if changed from last Report)

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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 requirements for the past 90 days. Yes X No ____.

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

| <u>Class</u> | <u>Outstanding at November 8, 2002</u> |
|----------------------------------|--|
| Common Stock, Par value \$.01 | 5,278,167 |

<PAGE>

TABLE OF CONTENTS

PART I -- FINANCIAL INFORMATION

Item 1 Financial Statements of Port Financial Corp.

.

Consolidated Balance Sheets (Unaudited) - September 30, 2002 and December 31, 2001

Consolidated Statements of Operations (Unaudited) - Three months ended September 30, 2002 and September 30, 2001

Consolidated Statements of Operations (Unaudited) - Nine months ended September 30, 2002 and September 30, 2001

Consolidated Statements of Changes in Stockholders' Equity (Unaudited) Nine months ended September 30, 2002 and September 30, 2001

Consolidated Statements of Cash Flows (Unaudited) - Nine months ended September 30, 2002 and September 30, 2001

Notes to Unaudited Consolidated Financial Statements

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Item 3 Quantitative and Qualitative Disclosures about Market Risk

.

Item 4. Controls and Procedures

PART II -- OTHER INFORMATION

- Item 1. Legal Proceedings
- Item 2. Changes in Securities and Use of Proceeds
- Item 3. Defaults upon Senior Securities
- Item 4. Submission of Matters to a Vote of Security Holders
- .
- Item 5. Other Information
- Item 6. Reports on Form 8-K

Signatures

<PAGE> 1

Part I - FINANCIAL INFORMATION

Item 1. Financial Statements

Port Financial Corp.
Consolidated Balance Sheets
(Dollars in Thousands, Except Share Amounts)

| | September 30, <u>2002</u> (Unaudited) | December 31, <u>2001</u> |
|--|---|-----------------------------|
| ASSETS | | |
| Cash and due from banks | \$ 13,004 | \$ 14,170 |
| Federal funds sold | 53,565 | 12,825 |
| Other interest bearing cash equivalents | <u>9,927</u> | <u>9,249</u> |
| | | |
| Total cash and cash equivalents | 76,496 | 36,244 |
| | | |
| Certificates of deposit | 2,227 | 2,126 |
| Investment securities held to maturity, at amortized cost (Fair value of \$45,574 in 2002 and \$14,625 in 2001) | 44,820 | 14,444 |
| Investment securities available for sale, at fair value | 420,020 | 265,495 |
| Federal Home Loan Bank Stock, at cost | 8,037 | 6,273 |
| Savings Bank Life Insurance Stock, at cost | 1,934 | 1,934 |
| Loans held for sale | 6,554 | 1,571 |
| Loans, net (Allowance for loan losses for \$9,951 in 2002 | | |

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| | | |
|-------------------------------------|--------------|--------------|
| and \$9,321 in 2001) | 848,092 | 774,649 |
| Banking premises and equipment, net | 23,230 | 23,430 |
| Accrued interest receivable | 6,756 | 5,452 |
| Other assets | <u>5,468</u> | <u>6,592</u> |

| | | |
|--------------|---------------------|---------------------|
| Total assets | <u>\$ 1,443,634</u> | <u>\$ 1,138,210</u> |
|--------------|---------------------|---------------------|

LIABILITIES AND STOCKHOLDERS' EQUITY

| | | |
|--|---------------|---------------|
| Deposits | \$ 1,150,951 | \$ 884,529 |
| Mortgagors' escrow payments | 4,780 | 3,990 |
| Federal Home Loan Bank advances | 157,381 | 115,249 |
| Accrued expenses and other liabilities | <u>13,482</u> | <u>11,044</u> |

| | | |
|-------------------|------------------|------------------|
| Total liabilities | <u>1,326,594</u> | <u>1,014,812</u> |
|-------------------|------------------|------------------|

Commitments and Contingencies (Note 2 and 8)

Stockholders' Equity:

Preferred stock, \$.01 par value-

Authorized - 5,000,000 shares

Issued and outstanding - no shares

- -

<PAGE> 2

Port Financial Corp.
Consolidated Balance Sheets
(Dollars in Thousands, Except Share Amounts)

| | |
|---------------|--------------|
| September 30, | December 31, |
| <u>2002</u> | <u>2001</u> |
| (Unaudited) | |

Common stock, \$0.01 par value -

Authorized - 30,000,000 shares

Issued - 7,442,818 shares at September 30, 2002

and December 31, 2001; shares outstanding

5,272,867 and 5,803,606 in 2002 and 2001, respectively

74 74

Additional paid-in capital

71,591 70,879

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| | | |
|--|---------------------|---------------------|
| Treasury stock, at cost - 2,169,951 and 1,639,212 shares | (54,369) | (35,095) |
| Unearned compensation - Recognition and Retention Plan | (2,768) | (3,339) |
| Unearned compensation - ESOP | (6,838) | (7,026) |
| Retained earnings | 98,932 | 91,652 |
| Accumulated other comprehensive income | <u>10,418</u> | <u>6,253</u> |
| | | |
| Total stockholders' equity | <u>117,040</u> | <u>123,398</u> |
| | | |
| Total liabilities and stockholders' equity | <u>\$ 1,443,634</u> | <u>\$ 1,138,210</u> |

See the accompanying notes to the unaudited consolidated financial statements.

<PAGE> 3

Port Financial Corp.
Consolidated Statements of Operations
(Dollars in Thousands Except Share and Per Share Amounts)
(Unaudited)

| | Three Months Ended <u>September 30,</u> | |
|---|--|---------------|
| | <u>2002</u> | <u>2001</u> |
| Interest and dividend income: | | |
| Interest on loans | \$ 14,842 | \$ 12,967 |
| Interest and dividends on investment securities | 6,205 | 4,076 |
| Interest on other cash equivalents | 148 | 176 |
| Interest on certificates of deposit | <u>34</u> | <u>33</u> |
| Total interest and dividend income | <u>21,229</u> | <u>17,252</u> |
| Interest expense: | | |
| Interest on deposits | 8,108 | 7,489 |
| Interest on borrowed funds | <u>1,771</u> | <u>927</u> |
| Total interest expense | <u>9,879</u> | <u>8,416</u> |
| Net interest income | 11,350 | 8,836 |
| Provision for loan losses | 50 | 325 |
| Noninterest income: | | |
| Customer service fees | 391 | 316 |
| Gain on sale of investment securities | - | 374 |

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| | | |
|--|-----------------|-----------------|
| Gain on sale of loans, net | 377 | 209 |
| Loan servicing fee income | 64 | 100 |
| Other income | <u>451</u> | <u>450</u> |
| Total noninterest income | <u>1,283</u> | <u>1,449</u> |
| Noninterest expense: | | |
| Compensation and employee benefits | 4,440 | 3,637 |
| Occupancy and equipment expense | 974 | 780 |
| Data processing service fees | 466 | 500 |
| Marketing and investor relations | 216 | 388 |
| Other noninterest expense | <u>900</u> | <u>831</u> |
| Total noninterest expenses | <u>6,996</u> | <u>6,136</u> |
| Income before provision for income taxes | 5,587 | 3,824 |
| Provision for income taxes | <u>2,082</u> | <u>1,299</u> |
| Net income | <u>\$ 3,505</u> | <u>\$ 2,525</u> |
| Earnings per share: | | |
| Basic | \$ 0.75 | \$ 0.44 |
| Diluted | \$ 0.71 | \$ 0.43 |
| Weighted average shares outstanding: | | |
| Basic | 4,667,430 | 5,792,090 |
| Diluted | 4,940,058 | 5,929,500 |

See the accompanying notes to the unaudited consolidated financial statements

<PAGE> 4

Port Financial Corp.
Consolidated Statements of Operations
(Dollars in Thousands Except Share and Per Share Amounts)
(Unaudited)

| | Nine Months Ended <u>September 30,</u> | |
|---|---|---------------|
| | <u>2002</u> | <u>2001</u> |
| Interest and dividend income: | | |
| Interest on loans | \$ 44,131 | \$ 39,497 |
| Interest and dividends on investment securities | 15,664 | 10,256 |
| Interest on other cash equivalents | 311 | 1,534 |
| Interest on certificates of deposit | <u>101</u> | <u>97</u> |
| Total interest and dividend income | <u>60,207</u> | <u>51,384</u> |

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| | | |
|--|-----------------|-----------------|
| Interest expense: | | |
| Interest on deposits | 22,163 | 24,209 |
| Interest on borrowed funds | <u>5,078</u> | <u>2,161</u> |
| Total interest expense | <u>27,241</u> | <u>26,370</u> |
| Net interest income | 32,966 | 25,014 |
| Provision for loan losses | 575 | 725 |
| Noninterest income: | | |
| Customer service fees | 1,097 | 920 |
| Gain on sale of investment securities | 72 | 374 |
| Gain on sale of loans, net | 713 | 542 |
| Loan servicing fee income | 215 | 324 |
| Gain on pension plan termination | 47 | - |
| Gain on sale of deposits | - | 529 |
| Other income | <u>1,492</u> | <u>1,301</u> |
| Total noninterest income | <u>3,636</u> | <u>3,990</u> |
| Noninterest expense: | | |
| Compensation and employee benefits | 12,846 | 10,688 |
| Occupancy and equipment expense | 2,836 | 2,456 |
| Data processing service fees | 1,540 | 1,512 |
| Marketing and investor relations | 1,181 | 951 |
| Other noninterest expense | <u>2,919</u> | <u>2,719</u> |
| Total noninterest expenses | <u>21,322</u> | <u>18,326</u> |
| Income before provision for income taxes | 14,705 | 9,953 |
| Provision for income taxes | <u>5,404</u> | <u>3,409</u> |
| Net income | <u>\$ 9,301</u> | <u>\$ 6,544</u> |
| Earnings per share: | | |
| Basic | \$ 1.93 | \$ 1.05 |
| Diluted | \$ 1.84 | \$ 1.04 |
| Weighted average shares outstanding: | | |
| Basic | 4,826,668 | 6,235,986 |
| Diluted | 5,065,596 | 6,316,763 |

See the accompanying notes to the unaudited consolidated financial statements

<PAGE> 5

Port Financial Corp.
Consolidated Statement of Changes in Stockholders' Equity

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For The Nine Months Ending September 30, 2002 and 2001

(In Thousands)

(Unaudited)

| | Common <u>Stock</u> | Additional Paid-In <u>Capital</u> | Treasury <u>Stock</u> | Unearned Compensation <u>ESOP/RRP</u> | Retained <u>Earnings</u> | Accumulated Other Comprehensive <u>Income</u> | <u>Total</u> | Comprehensive <u>Income</u> |
|--|------------------------|---|--------------------------|---|-----------------------------|--|------------------|--------------------------------|
| Balance at December 31, 2000 | \$74 | \$76,284 | \$ - | \$(11,581) | \$82,750 | \$4,526 | \$152,053 | |
| Net income | - | - | - | - | 6,544 | - | 6,544 | 6,544 |
| Change in unrealized gain on securities | | | | | | | | |
| Available for sale, net of taxes \$2,067 | - | - | - | - | - | 3,375 | 3,375 | 3,375 |
| Change in fair market value of swap | | | | | | | | |
| Agreement, net of taxes \$ (179) | - | - | - | - | - | (258) | (258) | (258) |
| Purchase of RRP stock | - | (5,453) | - | - | - | - | (5,453) | - |
| Purchase of treasury stock | - | - | (28,246) | - | - | - | (28,246) | - |
| Net forfeiture of RRP awards | - | (92) | - | 92 | - | - | - | - |
| Amortization of unearned compensation | - | 109 | - | 840 | - | - | 949 | - |
| Cash dividends - \$.17 per share | - | - | - | - | (1,080) | - | (1,080) | - |
| Balance at September 30, 2001 | <u>\$74</u> | <u>\$70,848</u> | <u>\$(28,246)</u> | <u>\$(10,649)</u> | <u>\$88,214</u> | <u>\$7,643</u> | <u>\$127,884</u> | <u>\$9,661</u> |
| Balance at December 31, 2001 | \$74 | \$70,879 | \$(35,095) | \$(10,365) | \$91,652 | \$6,253 | \$123,398 | |

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| | | | | | | | | |
|--|-------------|-----------------|-------------------|------------------|-----------------|-----------------|------------------|-----------------|
| Net income | - | - | - | - | 9,301 | - | 9,301 | \$9,301 |
| Change in unrealized gain on securities | | | | | | | | |
| Available for sale, net of taxes \$3,034 | - | - | - | - | - | 4,322 | 4,322 | 4,322 |
| Less reclassification of securities gains | | | | | | | | |
| Included in net income, net of taxes \$30 | - | - | - | - | - | (42) | (42) | (42) |
| Change in fair market value of swap | | | | | | | | |
| Agreement, net of taxes \$ (89) | - | - | - | - | - | (115) | (115) | (115) |
| Purchase of treasury stock | - | - | (19,965) | - | - | - | (19,965) | - |
| Exercise of stock options | - | (96) | 323 | - | - | - | 227 | - |
| Purchase of treasury stock for Rabbi trust | - | - | 368 | - | - | - | 368 | - |
| Grant of RRP stock awards | - | 480 | - | (480) | - | - | - | - |
| Amortization of unearned compensation | - | 328 | - | 1,239 | - | - | 1,567 | - |
| Cash dividends - \$.40 per share | <u>-</u> | <u>=</u> | <u>-</u> | <u>-</u> | <u>(2,021)</u> | <u>-</u> | <u>(2,021)</u> | <u>=</u> |
| Balance at September 30, 2002 | <u>\$74</u> | <u>\$71,591</u> | <u>\$(54,369)</u> | <u>\$(9,606)</u> | <u>\$98,932</u> | <u>\$10,418</u> | <u>\$117,040</u> | <u>\$13,466</u> |

See the accompanying notes to the unaudited consolidated financial statements

<PAGE> 6

Port Financial Corp.
Consolidated Statements of Cash Flows
(In Thousands)

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(Unaudited)

| | Nine Months Ended | |
|--|----------------------|---------------|
| | <u>September 30,</u> | |
| | <u>2002</u> | <u>2001</u> |
| Cash Flows from Operating Activities: | | |
| Net income | \$ 9,301 | \$ 6,544 |
| Adjustments to reconcile net income to net cash provided | | |
| By operating activities: | | |
| Provision for loan losses | 575 | 725 |
| Depreciation and amortization | 1,394 | 1,406 |
| Net gain from sales of available-for-sale investment securities | (72) | (374) |
| Amortization of premiums on investment securities, net | 496 | 119 |
| Increase in cash surrender value of life insurance policies | (142) | (145) |
| Gain on loan sales, net | (713) | (542) |
| Proceeds from sale of loans | 53,765 | 47,439 |
| Loans originated for sale | (58,035) | (46,687) |
| Amortization of unearned compensation | 1,567 | 949 |
| Increase in other assets | (600) | (600) |
| Increase in accrued interest receivable | (1,304) | (551) |
| Increase in prepaid deferred tax provision | (1,254) | (590) |
| Decrease in deferred loan fees | (572) | (9) |
| Increase in accrued expenses and other liabilities | <u>2,438</u> | <u>2,446</u> |
| Net cash provided by operating activities | <u>6,844</u> | <u>10,130</u> |
| Cash Flows from Investing Activities: | | |
| Proceeds from sales, maturities and principal repayments of securities | | |
| Available-for-sale | 80,059 | 60,466 |
| Purchases of securities available-for-sale | (227,613) | (160,263) |
| Proceeds from sales, maturities and principal repayments of securities | | |
| Held-to-maturity | 10,792 | 7,624 |
| Purchases of securities held-to-maturity | (41,278) | - |
| Proceeds from maturities of certificates of deposit | - | 109 |
| Purchase of certificates of deposit | (101) | (2,098) |
| Purchase of FHLB stock | (1,764) | (776) |

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| | | |
|--|------------------|------------------|
| Purchase of premises and equipment | (1,194) | (1,169) |
| Loan originations, net | (73,522) | (37,702) |
| Recoveries of loans previously charged-off | <u>76</u> | <u>60</u> |
| Net cash used in investing activities | <u>(254,545)</u> | <u>(133,749)</u> |
| |) |) |

<PAGE> 7

Port Financial Corp.
Consolidated Statements of Cash Flows (Continued)
(In Thousands)
(Unaudited)

Nine Months Ended
September 30,
2002 2001

Cash Flows from Financing Activities:

| | | |
|---|-----------------|-----------------|
| Increase in certificates of deposit | 39,001 | 13,500 |
| Decrease in certificate of deposits due to sale of branch deposits | - | (5,958) |
| Increase in demand deposits, NOW accounts and savings accounts | 227,421 | 28,107 |
| Decrease in demand deposits, NOW accounts and savings accounts due to sale of branch deposits | - | (10,163) |
| Increase in mortgagors' escrow payments | 790 | 704 |
| Increase in Federal Home Loan Bank advances | 42,132 | 76,847 |
| Exercise of stock options | 227 | - |
| Cash dividends | (2,021) | (1,080) |
| RRP stock purchases | - | (5,453) |
| Treasury stock purchases | <u>(19,597)</u> | <u>(28,246)</u> |
| |) |) |
| Net cash provided by financing activities | <u>287,953</u> | <u>68,258</u> |

| | | |
|--|---------------|---------------|
| Net Increase in Cash and Cash Equivalents | 40,252 | (55,361) |
| Cash and Cash Equivalents, beginning of year | <u>36,244</u> | <u>70,267</u> |

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| | | |
|--|------------------|------------------|
| Cash and Cash Equivalents, end of period | <u>\$ 76,496</u> | <u>\$ 14,906</u> |
| Supplemental Disclosures of Cash Flow Information: | | |
| Cash paid for interest | <u>\$ 26,734</u> | <u>\$ 26,258</u> |
| Cash paid for income taxes | <u>\$ 6,856</u> | <u>\$ 3,408</u> |

See the accompanying notes to the unaudited consolidated financial statements.

<PAGE> 8

Port Financial Corp.
Notes to the Unaudited Consolidated Financial Statements

1) Basis of Presentation

The unaudited consolidated financial statements of Port Financial Corp. ("Port" or the "Company") include the accounts of the Company and its two wholly owned subsidiaries, Cambridgeport Bank (the "Bank") and Brighton Investment Corporation. Brighton Investment Corporation invests in marketable securities. The Bank is a Massachusetts-chartered stock savings bank with its headquarters located in Cambridge, Massachusetts. The Bank has four wholly-owned subsidiaries, Temple Investment Corporation, River Investment Corporation, Cambridgeport Insurance Services, Inc. and Prospect Real Estate Investment Corp. Temple Investment Corporation and River Investment Corporation both invest in securities. Cambridgeport Insurance Services, Inc. was established in April 2000 and intends to provide insurance. Prospect Real Estate Investment Corp. is a real estate investment trust which holds certain mortgage loans originated by the Bank as well as mortgage-backed securities. In addition, the Bank is the sole member of Temple Realty LLC, which owns the Company's administrative center.

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. In the opinion of management, the unaudited consolidated financial statements presented herein reflect all adjustments (consisting only of normal adjustments) necessary for a fair presentation. Interim results are not necessarily indicative of results to be expected for the entire year. The Company believes that the disclosures are adequate to make the information presented not misleading. All significant intercompany balances and transactions have been eliminated in the accompanying consolidated financial statements.

2) Commitments

At September 30, 2002, the Company had outstanding commitments to originate loans amounting to approximately \$54.0 million, unadvanced funds on construction loans of approximately \$123,000 and unadvanced funds on lines of credit amounting to approximately \$188.6 million.

<PAGE> 9

3) Earnings Per Share

Basic earnings per share is computed by dividing net income by the weighted-average number of common shares outstanding during the period presented. In calculating basic earnings per share, the number of shares of common stock outstanding is reduced by the number of shares held by Port's Employee Stock Ownership Plan (the "ESOP") and its 2000 Recognition and Retention Plan (the "RRP") that have not been allocated or are not committed for release to participants' individual accounts. Diluted earnings per share reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed conversion. Potential common shares that may be issued by the Company relate solely to outstanding stock options and unearned RRP shares and are determined using the treasury stock method.

The following table summarizes the calculation of basic and diluted earnings per share:

| | Three Months Ended | | Nine Months Ended | |
|--|---|------------------|-------------------|------------------|
| | September 30, | | September 30, | |
| | 2002 | 2001 | 2002 | 2001 |
| | (Dollars in thousands, Except Shares and Per Share amounts) | | | |
| Net income | \$ <u>3,505</u> | \$ <u>2,525</u> | \$ <u>9,301</u> | \$ <u>6,544</u> |
| Weighted average common shares outstanding | 4,667,430 | 5,792,090 | 4,826,668 | 6,235,986 |
| Dilutive effect of common stock equivalents | <u>272,628</u> | <u>137,410</u> | <u>238,928</u> | <u>80,777</u> |
| Weighted average common and common equivalent shares outstanding | <u>4,940,058</u> | <u>5,929,500</u> | <u>5,065,596</u> | <u>6,316,763</u> |
| Basic earnings per share | \$.75 | \$ 0.44 | \$ 1.93 | \$ 1.05 |
| Dilutive effect of common stock equivalents | <u>(0.04)</u> | <u>(0.01)</u> | <u>(0.09)</u> | <u>(0.01)</u> |
| |) |) |) |) |
| Diluted earnings per share | \$ <u>0.71</u> | \$ <u>0.43</u> | \$ <u>1.84</u> | \$ <u>1.04</u> |

For the three months ended September 30, 2002 and 2001, there were 2,700 and -0- options, and for the nine months ended September 30, 2002 and 2001, there were 15,100 and -0- options, respectively, to purchase shares of common

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stock, which were excluded from the calculation of diluted earnings per share because the options exercise price was greater than the average market price of the Company's common stock for the period and their inclusion would have been anti-dilutive.

4) Stock Repurchases

During the third quarter of 2002, the Company completed its sixth stock repurchase program by purchasing 56,500 shares at an average price of \$38.33 per share. It also announced a seventh 5% repurchase program and, during the third quarter, purchased 235,325 shares at an average price of \$38.83 per share. At September 30, 2002, 39,235 shares remain to be purchased under the seventh repurchase program.

<PAGE> 10

5) Loans

The loan portfolio consisted of the following (in thousands):

| | September 30, <u>2002</u> (Unaudited) | December 31, <u>2001</u> |
|--------------------------------|---|-----------------------------|
| Real estate loans- | | |
| Residential | \$ 477,198 | \$ 411,630 |
| Commercial | 283,847 | 265,854 |
| Home equity lines of credit | 84,742 | 90,105 |
| Construction and land | <u>7,852</u> | <u>11,442</u> |
| Total real estate loans | 853,639 | 779,031 |
| Commercial | 1,387 | 653 |
| Consumer | <u>3,017</u> | <u>4,286</u> |
| Total loans | 858,043 | 783,970 |
| Less-Allowance for loan losses | <u>9,951</u> | <u>9,321</u> |
| Total loans, net | <u>\$ 848,092</u> | <u>\$ 774,649</u> |

6) Deposits

A summary of deposit balances, by type, is as follows (in thousands):

| | September 30, <u>2002</u> (Unaudited) | December 31, <u>2001</u> |
|--------------------------|---|-----------------------------|
| Demand deposit accounts | \$ 54,633 | \$ 54,242 |
| NOW accounts | 286,478 | 112,521 |
| Regular savings accounts | 64,596 | 55,963 |

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| | | |
|---|---------------------|-------------------|
| Money market accounts | <u>379,126</u> | <u>334,686</u> |
| Total noncertificate accounts | <u>784,833</u> | <u>557,412</u> |
| Term certificates- | | |
| Term certificates less than \$100,000 | 268,987 | 249,631 |
| Term certificates of \$100,000 and over | <u>97,131</u> | <u>77,486</u> |
| Total term certificate accounts | <u>366,118</u> | <u>327,117</u> |
| Total deposits | <u>\$ 1,150,951</u> | <u>\$ 884,529</u> |

<PAGE> 11

7. Real Estate Investment Trust

Prospect Real Estate Investment Corp. ("Prospect"), a subsidiary of the Bank, was established in April 2001 as a Massachusetts-chartered real estate investment trust (the "REIT"). During 2001, the Bank received dividends from Prospect. The Bank filed its 2001 state tax return on September 15, 2002 and, in accordance with the Commonwealth of Massachusetts Tax law, claimed a deduction for the dividends received from Prospect. The positive impact of the REIT dividend received deduction on the Company's 2001 reported net income was approximately \$270,000. The additional positive impact on the Company's reported net income for the first nine months of 2002 was approximately \$400,000.

The Company is aware that 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 those institutions. The institutions that received these notices have indicated their intention to appeal the assessments. There can be no assurance that the Company will receive such a notice pertaining to its 2001 tax filing. However, if it does receive such a notice, the Company intends to appeal any such assessment.

<PAGE> 11

Item 2. Management's Discussion and Analysis of Financial
Condition and Results of Operations

Forward Looking Statements

This Quarterly Report on Form 10-Q contains certain statements that may be considered 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. Port Financial Corp.'s (the "Company") actual results could differ materially from those projected in the forward-looking statements. Important factors that might cause such a difference include: changes in national or regional economic conditions; changes in loan default and charge-off rates; reductions in deposit levels necessitating increased borrowing to fund loans and investments; changes in interest rates; changes in the size and the nature of the Company's competition; and changes in the assumptions used in making such forward-looking statements. The Company disclaims any obligation to publicly announce future events or developments, which may affect the forward-looking statements contained herewith.

The following discussion and analysis should be read in conjunction with the unaudited consolidated financial statements and related notes included in this report.

General

Port Financial Corp. is a Massachusetts-chartered stock holding company, which owns all of the capital stock of Cambridgeport Bank (the "Bank"). The Company converted from a Massachusetts-chartered mutual holding company, formerly known as Cambridgeport Mutual Holding Company, to a Massachusetts-chartered stock holding company and changed its name to Port Financial Corp. and sold 7,442,818 shares of its common stock, par value \$0.01 per share, to the Company's eligible depositors, management and employees and to the Company's Employee Stock Ownership Plan ("ESOP"). Net proceeds of the stock offering were \$71.8 million. The conversion and stock offering were completed on April 11, 2000.

The Company's principal business is its investment in the Bank, a Massachusetts stock savings bank, chartered in 1853, with headquarters in the Cambridgeport neighborhood of Cambridge, Massachusetts. The Cambridgeport neighborhood is located near the Charles River, between the campuses of Harvard and MIT. The Bank is a community-oriented bank, with eleven full service banking offices and a Telebanking Center. It provides retail and business customers with value-driven products and services, including a wide variety of deposit products, investment management services, residential mortgage loans, commercial real estate loans, commercial loans and consumer loans. Most of its customers are located in the cities and towns around Cambridge, Massachusetts. The Bank's newest branch office, located in Brookline, Massachusetts opened in April, 2002.

The Bank's revenues are derived principally from interest on loans and investment securities. The Bank's primary sources of funds are deposits, scheduled amortization and prepayments of loan principal and mortgage-backed securities, maturities and calls of

<PAGE> 13

investment securities, and funds provided by operations. The Bank also uses borrowings from the Federal Home Loan Bank as a source of funds for loans, investments and other assets. The largest component of the Bank's expenses is the interest it pays on deposits.

Comparison of Financial Condition at September 30, 2002 and December 31, 2001

Total assets increased by \$305.4 million from \$1.14 billion at December 31, 2001 to \$1.44 billion at September 30, 2002. This growth included an increase in net loans totaling \$73.4 million and a net increase in cash, cash equivalents and investment securities totaling \$225.3 million. The Company's strategy is to deploy funds generated through its deposit promotions into new loans and, if deposit growth exceeds loan growth, to invest the excess in marketable securities, primarily agency-guaranteed mortgage-backed securities.

Growth in the loan portfolio consisted primarily of loans secured by residential real estate located in the Bank's primary market areas. The residential mortgage portfolio grew by \$65.6 million, while the commercial real estate portfolio grew by \$18.0 million, and other segments of the portfolio declined by a net \$9.5 million. The growth in the residential mortgage portfolio reflects the refinancing demand in a low interest rate environment as well as the strong market for purchasing residential property in the Boston area.

Non-performing assets totaled \$514,000 and \$133,000 at September 30, 2002 and December 31, 2001, respectively. The September, 2002 figure includes two residential mortgages with a combined balance of \$434,000. The remaining balance of non-performing assets at September 30, 2002 consisted of student loans in the amount of \$80,000.

The allowance for loan losses was \$10.0 million at September 30, 2002, or 1.16% of total loans. This compares to \$9.3 million and 1.19% at December 31, 2001. The Company believes that the current allowance for loan losses accurately reflects the size and level of risk in the loan portfolio, although no assurance can be made that future

additions to the allowance will not be necessary. The Company continues to apply its consistent, systematic methodology for measuring the adequacy of the allowance for loan losses.

Deposits at September 30, 2002 totaled \$1.15 billion, an increase of \$266.4 million from \$884.5 million at December 31, 2001. This increase included a \$174.3 million increase in NOW and demand deposit balances. During the 2002 period, the Bank featured its relationship deposit products, offering a premium rate of 4% on its Money Manager Checking account product, guaranteed through September 30, 2002. Deposit growth also included a \$53.1 million increase in savings and money market accounts, and a \$39.0 million increase in time deposits. This growth reflects the Company's strategic focus on building deposit relationships, including deposit promotions tied to the opening of the new Brookline branch.

Borrowings from the Federal Home Loan Bank of Boston rose \$42.1 million, to \$157.4 million at September 30, 2002 from \$115.2 million at December 31, 2001. The Company

<PAGE> 14

uses longer term borrowings to manage interest rate risk posed by holding certain loans and investment securities.

The \$6.4 million decline in stockholders' equity to \$117.0 million at September 30, 2002 from \$123.4 million at December 31, 2001 reflects primarily the cost of the Company's stock repurchases, partially offset by increases of \$7.3 million in retained earnings and \$4.2 million in accumulated other comprehensive income.

<PAGE> 15

The following tables set forth information relating to the Company's financial condition and net interest income at and for the third quarter ending September 30, 2002 and 2001 and reflect the average yield on assets and average cost of liabilities for the periods indicated. Yields and costs are derived by dividing interest income by the average balance of interest-earning assets and interest expense by the average balance of interest-bearing liabilities for the periods shown. Average balances are derived from actual daily balances over the periods indicated. Interest income includes fees earned from making changes in loan rates of terms, and fees earned when real estate loans were prepaid or refinanced.

Port Financial Corp.
Average Balance Sheet
For the Third Quarter Ending September 30,

| | <u>2002</u> | | | | <u>2001</u> | | |
|-------------------------------|----------------|-----------------|-----------------------|----------------|----------------|-----------------|-----------------------|
| | Average | | Average | | Average | | |
| | <u>Balance</u> | <u>Interest</u> | Yield/ <u>Cost</u> | Average | <u>Balance</u> | <u>Interest</u> | |
| | | | | Balance | | | |
| | | | | | <u>Balance</u> | <u>Interest</u> | Yield/ <u>Cost</u> |
| | | | | | | | |
| (Dollars in thousands) | | | | | | | |
| Assets: | | | | | | | |
| Interest earning assets: | | | | | | | |
| Short term investments(1) | \$ 37,758 | \$ 148 | 1.56% | \$ 19,685 | \$ 176 | 3.55% | |
| Certificates of deposit | 2,193 | 34 | 6.15% | 2,071 | 33 | 6.32% | |
| Investment securities(2) | 451,674 | 6,205 | 5.50% | 255,849 | 4,076 | 6.39% | |
| Loans(3) | <u>863,082</u> | <u>14,842</u> | 6.80% | <u>708,133</u> | <u>12,967</u> | 7.24% | |
| Total interest earning assets | 1,354,707 | 21,229 | 6.23% | 985,738 | 17,252 | 6.96% | |

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| | | | | | | |
|--|--------------------|-----------------|-------|--------------------|----------------|--------|
| Allowance for loan losses | (9,936) | | | (8,569) | | |
| Total noninterest earning assets | <u>55,192</u> | | | <u>49,448</u> | | |
| Total assets | <u>1,399,963</u> | | | <u>1,026,617</u> | | |
| Liabilities and Equity: | | | | | | |
| Interest bearing liabilities: | | | | | | |
| NOW accounts | 276,364 | 1,926 | 2.76% | 108,904 | 559 | 2.04% |
| Savings accounts | 63,812 | 181 | 1.13% | 54,005 | 204 | 1.50% |
| Money market deposit accounts | 366,325 | 2,257 | 2.44% | 297,642 | 2,404 | 3.20% |
| Certificate of deposit accounts | <u>364,617</u> | <u>3,744</u> | 4.07% | <u>308,847</u> | <u>4,322</u> | 5.55% |
| Total interest bearing deposits | 1,071,118 | 8,108 | 3.00% | 769,398 | 7,489 | 3.90% |
| Borrowed funds | <u>153,804</u> | <u>1,771</u> | 4.51% | <u>67,192</u> | <u>927</u> | 5.40% |
| Total interest bearing liabilities | 1,224,922 | 9,879 | 3.19% | 836,590 | 8,416 | 3.99% |
| Noninterest bearing deposits | 55,158 | | | 48,417 | | |
| Other noninterest bearing liabilities | <u>8,115</u> | | | <u>8,241</u> | | |
| Total noninterest bearing liabilities | 63,273 | | | 56,658 | | |
| Total liabilities | 1,288,195 | | | 893,248 | | |
| Stockholders' equity/retained earnings | <u>111,768</u> | | | <u>133,369</u> | | |
| Total liabilities and stockholders' equity/retained earnings | <u>\$1,399,963</u> | | | <u>\$1,026,617</u> | | |
| | | | | | | |
| Net interest income | | <u>\$11,350</u> | | | <u>\$8,836</u> | |
| Net Interest rate spread (4) | | | 3.04% | | | 2.97% |
| Net interest margin (5) | | | 3.33% | | | 3.56% |
| Ratio of average interest-earning assets to average interest-bearing liabilities | | | | 110.54 | | 117.74 |

- (1) Short term investments includes federal funds sold.
- (2) All investment securities that are considered available for sale are carried at market value, while securities that are held to maturity are held at cost
- (3) Loans are net of deferred loan origination costs (fees).
- (4) Net interest rate spread represents the difference between the weighted average yield on interest earning-assets and the weighted average cost of interest-bearing liabilities.
- (5) Net interest margin represents net interest income as a percentage of average interest-earning assets.

The following table shows how changes in interest rates and changes in the volume of interest-earning assets and interest-bearing liabilities have affected the Company's interest income and interest expense during the periods indicated. Information is provided in each category with respect to:

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- * Interest income changes attributable to changes in volume (changes in volume multiplied by prior rate);
- * Interest income changes attributable to changes in rate (changes in rate multiplied by prior volume); and
- * The net change.

The changes attributable to the combined impact of volume and rate have been allocated proportionately to the changes due to volume and the changes due to rate.

Port Financial Corp.
Rate/Volume Analysis

Three Months Ending September 30, 2002

Net Interest Income Increase/(Decrease)

Due to

| | <u>Volume</u> | <u>Rate</u> | <u>Net</u> |
|--|----------------|-------------|------------|
| | (In thousands) | | |

Interest earning assets:

| | | | |
|-------------------------|--------------|----------------|--------------|
| Short term investments | \$ 469 | \$ (497) | \$ (28) |
| Certificates of deposit | 6 | (5) | 1 |
| Investment securities | 5,654 | (3,525) | 2,129 |
| Loans | <u>6,344</u> | <u>(4,469)</u> | <u>1,875</u> |

)

| | | | |
|-------------------------------|---------------|----------------|--------------|
| Total interest earning assets | <u>12,473</u> | <u>(8,496)</u> | <u>3,977</u> |
|-------------------------------|---------------|----------------|--------------|

)

Interest bearing liabilities:

| | | | |
|---------------------------------|--------------|--------------|------------|
| NOW accounts | 1,112 | 255 | 1,367 |
| Savings accounts | 160 | (183) | (23) |
| Money market deposit accounts | 2,157 | (2,304) | (147) |
| Certificate of deposit accounts | 3,458 | (4,036) | (578) |
| Borrowed funds | <u>1,809</u> | <u>(965)</u> | <u>844</u> |

)

| | | | |
|------------------------------------|--------------|----------------|--------------|
| Total interest bearing liabilities | <u>8,696</u> | <u>(7,233)</u> | <u>1,463</u> |
|------------------------------------|--------------|----------------|--------------|

)

| | | | |
|-------------------------------|-----------------|-------------------|-----------------|
| Change in net interest income | <u>\$ 3,777</u> | <u>\$ (1,263)</u> | <u>\$ 2,514</u> |
|-------------------------------|-----------------|-------------------|-----------------|

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<PAGE> 17

Comparison of Operating Results for the Three Months Ended September 30, 2002 and 2001

Net income for the quarter ended September 30, 2002 was \$3.5 million, or \$.71 per diluted share, compared to \$2.5 million, or \$.43 per diluted share, for the third quarter of 2001. The 2001 period includes an after-tax gain of \$221,000 (\$.04 per diluted share) from the sale of equity securities.

Interest and Dividend Income

Interest income increased \$4.0 million, or 23.1%, to \$21.2 million from \$17.2 million in the third quarter of 2001. This increase reflected the \$369.0 million (37.4%) growth in the average balance of interest-earning assets to \$1.4 billion in the third quarter of 2002, from \$985.7 million in the comparable 2001 period.

Investment income rose \$2.1 million as the average balances of cash, cash equivalents and investment securities in the 2002 period were \$214.0 million, or 77.1% higher than the average balances for the third quarter of 2001. The Company has increased its portfolio of mortgage-backed securities, including one-year ARM securities guaranteed by GNMA, funding them with deposits generated by the Company's marketing promotions and branch expansion. The Company also used extended term borrowings from the Federal Home Loan Bank to fund the purchase of long term mortgage-backed securities. The lower interest rate environment reduced the yield on investment securities to 5.50%, 89 basis points lower in the 2002 period compared with the prior year.

Interest on loans increased \$1.9 million as the effect of higher average loan balances, which increased \$154.9 million over the 2001 quarter, more than offset the impact of a 44 basis point decline in the average yield on loans.

Interest Expense

Total interest expense for the three months ended September 30, 2002 was \$9.9 million, up \$1.5 million from the same period in 2001. Interest expense on deposit accounts was up \$619,000, reflecting higher cost of NOW accounts, which include the promotional Money Manager Checking account product. NOW account interest expense was \$1.9 million in the third quarter of 2002, compared to \$559,000 in the third quarter of 2001. NOW account balances averaged \$276.4 million at a cost of 2.76% in the third quarter of 2002, compared to \$108.9 million and 2.04% in the third quarter of 2001. Declining costs of time deposits, reflecting the lower interest rate environment in the 2002 period, partially offset the higher cost of NOW accounts. Time deposit costs were \$3.7 million in the third quarter of 2002, down \$578,000 from the prior year period. While the average balance of time deposits was \$55.8 million higher in the 2002 period, the average cost was 4.07% compared to 5.55% in the third quarter of 2001.

An increase of \$86.6 million in the average balance of borrowings, used primarily to fund longer term loans and investment securities, resulted in borrowing expense of \$1.8

<PAGE> 18

million compared to \$927,000 in the third quarter of 2001. The average cost of borrowings in the 2002 period was 4.51%, down 89 basis points from the previous year.

Net Interest Income

Net interest income increased 28.5%, or \$2.5 million, in the third quarter of 2002 as compared to the same period last year. The net interest margin was 3.33%, down from 3.56% in the 2001 quarter. The interest rate spread was 3.04% in the quarter ended September 30, 2002, compared with 2.97% during the same period last year.

Provision for Loan Losses

The Company recorded a provision for loan losses of \$50,000 for the quarter ended September 30, 2002 and \$325,000 in the same quarter of 2001. The lower provision reflects the slower growth in portfolio loan balances and low levels of non-performing assets during the 2002 period. Although there has been no significant increase in payment delinquencies or non-performing assets, the Company believes that the provision for loan losses is prudent, given weaknesses in the general economic environment.

Non-Interest Income

Non-interest income totaled \$1.3 million in the third quarter of 2002, down \$166,000 from \$1.4 million in the third quarter of 2001, which included a pre-tax \$374,000 gain on the sale of equity securities. Excluding this gain in 2001, non-interest income increased \$208,000, or 19.4%, compared to the third quarter of 2001. Loan sale gains of \$377,000 represents an increase of \$168,000 from the 2001 period level of \$209,000. These gains are generated from the sale of fixed rate residential mortgages. The Company sells substantially all of its 30-year fixed rate mortgages into the secondary market to reduce interest rate risk. The lower interest rate environment that prevailed in the third quarter of 2002 produced higher volumes of fixed rate mortgage originations. Customer service fees of \$391,000 represents an increase \$75,000 over the 2001 quarter, largely due to the increased number of checking accounts and fees derived from activity in those accounts.

Non-Interest Expense

Non-interest expense increased \$860,000, or 14.0%, to \$7.0 million for the third quarter of 2002, compared to \$6.1 million in the 2001 period. Compensation expense rose \$803,000, reflecting increased costs of stock benefit plans, pension plans, as well as anticipated payments under the Company's short-term incentive plan. Occupancy and equipment expense of \$974,000 represents an increase of \$194,000 from the prior year period, reflecting primarily increased rent and depreciation expense at the new Brookline branch and the renovated Harvard Square branch.

The annualized expense ratio, the ratio of non-interest expense to average assets, was 1.98% for the three months ended September 30, 2002, compared to 2.37% in the 2001 period.

Provision for Income Taxes

The Company's effective tax rate for the September 30, 2002 quarter was 37.3% as compared to 34.0% for the 2001 period. Higher consolidated taxable income has moved

<PAGE> 19

the Company into a higher federal tax bracket. Also, a larger portion of taxable income is subject to the full 10.5% state tax rate.

The following tables set forth information relating to the Company's financial condition and net interest income at and for the nine months ending September 30, 2002 and 2001 and reflect the average yield on assets and average cost of liabilities for the periods indicated. Yields and costs are derived by dividing interest income by the average balance of interest-earning assets and interest expense by the average balance of interest-bearing liabilities for the periods shown. Average balances are derived from actual daily balances over the periods indicated. Interest income includes fees earned from making changes in loan rates of terms, and fees earned when real estate loans were prepaid or refinanced.

Port Financial Corp.
Average Balance Sheet
For the Nine Months Ending September 30,

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| | <u>2002</u> | | | <u>2001</u> | | |
|--|------------------------|-----------------|----------------|------------------|-----------------|----------------|
| | Average | Average | Average | Average | Average | Average |
| | Balance | Interest | Yield/ Cost | Balance | Interest | Yield/ Cost |
| | (Dollars in thousands) | | | | | |
| Assets: | | | | | | |
| Interest earning assets: | | | | | | |
| Short term investments(1) | \$ 26,155 | \$ 311 | 1.59% | \$ 42,627 | \$ 1,534 | 4.81% |
| Certificates of deposit | 2,160 | 101 | 6.25% | 2,074 | 97 | 6.25% |
| Investment securities(2) | 367,311 | 15,664 | 5.70% | 208,119 | 10,256 | 6.59% |
| Loans(3) | <u>840,871</u> | <u>44,131</u> | 6.96% | <u>698,764</u> | <u>39,497</u> | 7.49% |
| Total interest earning assets | 1,236,497 | <u>60,207</u> | 6.46% | 951,584 | <u>51,384</u> | 7.17% |
| Allowance for loan losses | (9,708) | | | (8,339) | | |
| Total noninterest earning assets | <u>54,427</u> | | | <u>52,301</u> | | |
| Total assets | <u>1,281,216</u> | | | <u>995,546</u> | | |
| Liabilities and Equity: | | | | | | |
| Interest bearing liabilities: | | | | | | |
| NOW accounts | 185,647 | 3,124 | 2.25% | 82,541 | 940 | 1.52% |
| Savings accounts | 61,337 | 616 | 1.34% | 52,817 | 659 | 1.67% |
| Money market deposit accounts | 361,747 | 6,818 | 2.52% | 311,461 | 9,513 | 4.08% |
| Certificate of deposit accounts | <u>357,863</u> | <u>11,605</u> | 4.34% | <u>304,323</u> | <u>13,097</u> | 5.75% |
| Total interest bearing deposits | 966,594 | 22,163 | 3.07% | 751,142 | 24,209 | 4.31% |
| Borrowed funds | <u>136,888</u> | <u>5,078</u> | 4.89% | <u>49,070</u> | <u>2,161</u> | 5.81% |
| Total interest bearing liabilities | 1,103,482 | 27,241 | 3.29% | 800,212 | 26,370 | 4.40% |
| Noninterest bearing deposits | 53,912 | | | 47,785 | | |
| Other noninterest bearing liabilities | <u>8,177</u> | | | <u>7,931</u> | | |
| Total noninterest bearing liabilities | 62,089 | | | 55,716 | | |
| Total liabilities | 1,165,571 | | | 855,928 | | |
| Stockholders' equity/retained earnings | <u>115,645</u> | | | <u>139,618</u> | | |
| Total liabilities and stockholders' equity/retained earnings | <u>\$1,281,216</u> | | | <u>\$995,546</u> | | |
| Net interest income | | <u>\$32,966</u> | | | <u>\$25,014</u> | |
| Net Interest rate spread (4) | | | 3.17% | | | 2.77% |
| Net interest margin (5) | | | 3.57% | | | 3.52% |

Ratio of average interest-earning
assets

to average interest-bearing liabilities 112.00 118.85

- (1) Short term investments includes federal funds sold.
- (2) All investment securities that are considered available for sale are carried at market value, while securities that are held to maturity are held at cost.
- (3) Loans are net of deferred loan origination costs (fees).
- (4) Net interest rate spread represents the difference between the weighted average yield on interest earning-assets and the weighted Average cost of interest-bearing liabilities.
- (5) Net interest margin represents net interest income as a percentage of average interest-earning assets.

<PAGE> 20

The following table shows how changes in interest rates and changes in the volume of interest-earning assets and interest-bearing liabilities have affected the Company's interest income and interest expense during the periods indicated. Information is provided in each category with respect to:

- * Interest income changes attributable to changes in volume (changes in volume multiplied by prior rate);
- * Interest income changes attributable to changes in rate (changes in rate multiplied by prior volume); and
- * The net change.

The changes attributable to the combined impact of volume and rate have been allocated proportionately to the changes due to volume and the changes due to rate.

Port Financial Corp.
Rate/Volume Analysis

Nine Months Ending September 30, 2002

Net Interest Income Increase/(Decrease)

Due to

| <u>Volume</u> | <u>Rate</u> | <u>Net</u> |
|----------------|-------------|------------|
| (In thousands) | | |

Interest earning assets:

| | | | |
|-------------------------|--------------|----------------|--------------|
| Short term investments | \$ (448) | \$ (775) | \$ (1,223) |
| Certificates of deposit | 4 | 0 | 4 |
| Investment securities | 7,745 | (2,337) | 5,408 |
| Loans | <u>8,933</u> | <u>(4,299)</u> | <u>4,634</u> |

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| | | | |
|------------------------------------|-----------------|-----------------|-----------------|
| Total interest earning assets | <u>16,234</u> | <u>(7,411)</u> | <u>8,823</u> |
| |) | | |
| Interest bearing liabilities: | | | |
| NOW accounts | 1,577 | 607 | 2,184 |
| Savings accounts | 137 | (180) | (43) |
| Money market deposit accounts | 2,085 | (4,780) | (2,695) |
| Certificate of deposit accounts | 2,962 | (4,454) | (1,492) |
| Borrowed funds | <u>3,509</u> | <u>(592)</u> | <u>2,917</u> |
| |) | | |
| Total interest bearing liabilities | <u>10,270</u> | <u>(9,399)</u> | <u>871</u> |
| |) | | |
| Change in net interest income | <u>\$ 5,964</u> | <u>\$ 1,988</u> | <u>\$ 7,952</u> |

<PAGE> 21

Comparison of Operating Results for Nine Months Ended September 30, 2002 and 2001

Net income rose \$2.8 million, or 42.1%, to \$9.3 million for the nine months ended September 30, 2002 from \$6.5 million for the first nine months of 2001. Earnings per diluted share were \$1.84 for the first nine months of 2002 compared to \$1.04 in the 2001 period. The 2001 results include after-tax gains totaling \$533,000 from the first-quarter sale of Quincy branch deposits and the sale of equity securities during the third quarter. The 2002 results include an after-tax gain of \$42,000 from the second quarter sale of fixed income securities.

Interest and Dividend Income

Interest income was \$60.2 million, representing a \$8.8 million, or 17.2%, increase over the 2001 results. Growth in the average balance of interest-earning assets totaling \$284.9 million was the primary reason for the growth of interest income. Earnings on loans rose \$4.6 million, a result of an additional \$142.1 million in the average balance of the loan portfolio. The Company's business strategy includes expansion of its loan relationships with residential and commercial property owners in its market area. The yield on loans was 53 basis points lower in the 2002 period, a reflection of the general interest rate environment.

Income from short-term investments and investment securities increased by \$4.2 million, the result of higher average investment portfolio balances. Short term investments and investment securities averaged \$395.6 million, \$142.8 million higher than the 2001 period. The yield on investment securities in the 2002 period was 5.70%, a decrease of 89 basis points from the first nine months of 2001, largely a reflection of the actions taken by the monetary authorities to reduce interest rates throughout 2001.

Interest Expense

Interest expense increased \$871,000 to \$27.2 million in the first nine months of 2002, primarily because of interest costs on higher balances of borrowings. Interest paid on borrowed funds totaled \$5.1 million in the first nine months of 2002 compared to \$2.2 million in the 2001 period. Borrowing costs were partially offset by a \$2.0 million reduction

in interest paid on deposits.

The Company has increased its use of longer term borrowings in order to manage its interest rate risk position as well as to fund the purchase of longer term investment securities. The average balance of borrowings during the 2002 period was \$136.9 million compared to \$49.1 million in the 2001 period. The average cost of borrowings in 2002 was 4.89% compared to 5.81% in the previous year's first nine months, as a result of the lower interest rate environment in the 2002 period.

Lower average cost of interest-bearing deposits during the nine months ended September 30, 2002 was the primary reason for the decrease in interest paid on deposits. Interest-bearing deposit costs averaged 3.07% in the 2002 period compared to 4.31% last year.

<PAGE> 22

The balance of interest bearing deposits, which averaged \$966.6 million in the 2002 period, was \$215.5 million above the first nine months of 2001.

Within the deposit category, interest paid on NOW accounts rose \$2.2 million. NOW account average balances increased by \$103.1 million from \$82.5 million in the 2001 period to \$185.6 million this year, while the average cost rose from 1.52% in the first nine months of 2001 to 2.25% in the 2002 period. The Money Manager Checking marketing campaign--which commenced in March 2002 and included a promotional rate of 4% guaranteed through September 30, 2002--was the principal reason for this increase.

Interest paid on money market accounts declined \$2.7 million as lower rates offset growth in average balances. Money market average balances were \$361.7 million in the first nine months of 2002, \$50.3 million higher than the 2001 period, reflecting the growth of money market balances that resulted from the Real Savings and Premier Treasury Index money market account promotions carried out throughout much of 2001. The cost of money market deposits averaged 2.52% for the first nine months of 2002, down from 4.08% last year, reflecting the end of the promotional rates on those accounts.

Time deposit interest expense fell \$1.5 million from \$13.1 million in the first nine months of 2001 to \$11.6 million in 2002, as lower rates paid on time deposits offset growth in balances. Time deposit balances averaged \$357.9 million in 2002, representing an increase of \$53.5 million over the comparable 2001 period, while the cost declined to 4.34% from an average of 5.75% in the first nine months of 2001, a reflection of generally lower market rates prevailing during the 2002 period.

Net Interest Income

The \$8.0 million increase in net interest income represents a net interest margin of 3.57%, up 5 basis points from 3.52% in the 2001 period. The interest rate spread was 3.17% in the 2002 period, compared with 2.77% last year.

Provision for Loan Losses

The provision for loan losses of \$575,000 in the first nine months of 2002 represents a decrease of \$150,000 compared to the 2001 period, reflecting the slower growth in the loan portfolio, and low levels of non-performing assets.

Non-Interest Income

Non-interest income totaled \$3.6 million in the 2002 period, down from \$4.0 million a year earlier. The 2001 period included non-recurring, pre-tax gains totaling \$903,000, while the 2002 results included \$119,000 in non-recurring gains. Excluding the effects of these non-recurring items, non-interest income rose \$430,000, or 13.9%. Customer

service fees rose \$177,000, a result of the increased number of transaction accounts. The Company's strategy has focused on attracting more checking account customers. Gains on sales of mortgage loans increased \$171,000 to \$713,000, as a result of the lower interest rate environment during the first nine months of 2002 that produced a higher level of fixed rate loan activity. The Bank generally sells all fixed rate mortgages, servicing released, into the secondary market. Increase in fees from the sale of investment products was the primary reason for the increase in the other income category.

<PAGE> 23

Non-Interest Expense

Non-interest expense increased \$3.0 million, or 16.3%, to \$21.3 million in the 2002 period. Compensation expense rose \$2.2 million reflecting increased costs of stock benefit plans, pension plans, as well as anticipated payments under the Company's short-term incentive plan. Occupancy and equipment expense of \$2.8 million represents an increase of \$380,000 from the prior year period, reflecting primarily increased rent and depreciation expense at the new Brookline branch and the Harvard Square branch, which was expanded and renovated during the third quarter of 2001. Marketing expense of \$1.2 million represented an increase of \$230,000 over the 2001 period, as the Company actively promoted its Money Manager Checking and other retail banking products.

The annualized expense ratios for the nine-month periods were 2.23% in 2002 and 2.46% in 2001.

Provision for Income Taxes

The Company's effective tax rate for the nine months ended September 30, 2002 was 36.7% compared to 34.3% for the same 2001 period. Higher consolidated taxable income has moved the Company into a higher federal tax bracket. Also, a larger portion of taxable income is subject to the full 10.5% state tax rate.

<PAGE> 24

Liquidity and Capital Resources

The term "liquidity" refers to the Company's ability to generate adequate amounts of cash to fund loan originations, loan purchases, withdrawals of deposits and operating expenses. The Company's primary sources of liquidity are deposits, scheduled amortization and prepayments of loan principal and mortgage-backed securities, maturities and calls of investment securities and funds provided by operations. The Bank also can borrow funds from the Federal Home Loan Bank based on eligible collateral of loans and securities. The Bank's maximum borrowing capacity from the Federal Home Loan Bank at September 30, 2002 was approximately \$175.1 million, net of borrowings that were currently outstanding. In addition, the Bank can enter into reverse repurchase agreements with approved broker-dealers. Reverse repurchase agreements are agreements that allow the Bank to borrow money, using securities as collateral.

Liquidity management is both a daily and long term function of business management. The measure of a Company's liquidity is its ability to meet its cash commitments at all times with available cash or by conversion of other assets to cash at a reasonable price. Loan repayments and maturing investment securities are a relatively predictable source of funds. However, deposit flows, calls of investment securities and prepayments of loans and mortgage-backed securities are strongly influenced by interest rates, general and local economic conditions and competition in the marketplace. These factors reduce the predictability of the timing of these sources of funds. Management believes that the Company has sufficient liquidity to meet its current operating needs.

At September 30, 2002, the Company exceeded each of the applicable regulatory capital requirements. The Company's leverage Tier 1 capital was \$106.6 million, or 14.7% of risk-weighted assets, and 7.6% of average assets.

The Company had a risk-based total capital of \$119.3 million and a risk-based capital ratio of 16.5%.

See the "Consolidated Statements of Cash Flows" in the Unaudited Consolidated Financial Statements included in this Form 10-Q for the sources and uses of cash flows for operating and financing activities for the nine month periods ended September 30, 2002 and September 30, 2001.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Quantitative and qualitative information about market risk is presented in the Securities and Exchange Commission Form 10-K filed by the Company for the year ended December 31, 2001.

The table below provides quantitative information on market risk as of September 30, 2002. It sets forth the estimated changes in net interest income that would result from a 200 basis point change in interest rates over the applicable twelve-month period.

<PAGE> 25

As of September 30, 2002

(Dollars in thousands)

| Changes in Interest Rates (Basis Points) | Net Interest Income | % Change |
|--|------------------------|----------|
| +200 | 40,584 | -5.58% |
| 0 | 42,981 | - |
| -200 | 43,825 | 1.96% |

During 2001, the Company entered into an interest rate swap agreement with a notional value of \$20.0 million. The Company utilizes interest rate swaps to manage the risk associated with interest rate changes. Under the terms of the swap agreement, the Company receives payments based on the weekly average rate on three month U.S. Treasury bills in exchange for payments based on a fixed rate. The swap has a maturity of 2 years. This swap is intended to reduce the impact on net interest income from a rise in interest rates. This swap has been designated as a cash flow hedge of the variable cash flows associated with interest expense on the Treasury Index deposit accounts. As of September 30, 2002, the Company was receiving a variable rate of 1.639% and paying a fixed rate of 4.10% on this swap. The fair value of the swap of \$615,630 was recorded as a liability with changes in the fair value recorded in accumulated other comprehensive income.

Item 4. Controls and Procedures

During the 90-day period prior to the filing date of this report, management, including the Company's Chief Executive Officer 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 Chief Executive Officer 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 that 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.

<PAGE> 26

Part II -- OTHER INFORMATION

Item 1. Legal Proceedings

None

Item 2. Changes in Securities and Use of Proceeds

None

Item 3. Defaults Upon Senior Securities

None

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

None

Item 5. Other Information

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

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

Exhibit 99.1 Certifications of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act.

(b) Reports on Form 8-K

None

<PAGE> 27

SIGNATURES

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

Port Financial Corp.

(Registrant)

By: /s/ James B. Keegan
James B. Keegan
Chairman and Chief Executive Officer

By: /s/ Charles Jeffrey
Charles Jeffrey
Senior Vice President and
Chief Financial Officer

November 8, 2002

<PAGE> 28

CERTIFICATION

I, James Keegan, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Port Financial Corp.;
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

<PAGE> 29

- 6. The registrant's other certifying officer and I have indicated in this quarterly report whether or not there 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.

November 8, 2002

/s/ James B. Keegan

Chairman and Chief Executive Officer

<PAGE> 30

CERTIFICATION

I, Charles Jeffrey, certify that:

- 1. I have reviewed this quarterly report on Form 10-Q of Port Financial Corp.;
- 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

<PAGE> 31

6. The registrant's other certifying officer and I have indicated in this quarterly report whether or not there 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.

November 8, 2002

/s/ Charles Jeffrey

Senior Vice President, Chief Financial Officer
and Treasurer

<PAGE> 32