

PORT FINANCIAL CORP
Form 10-Q
May 15, 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 March 31, 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 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 May 8, 2002</u>
Common Stock, Par value \$.01	5,644,106

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Part I - FINANCIAL INFORMATION

Item 1. Financial Statements

Port Financial Corp.
Consolidated Balance Sheets
(Unaudited)

March 31, December 31,
2002 2001

(In Thousands, Except Share
Amounts)

ASSETS

Cash and due from banks	\$ 16,137	\$ 14,170
Federal funds sold	13,280	12,825
Other interest bearing cash equivalents	<u>792</u>	<u>9,249</u>
Total cash and cash equivalents	30,209	36,244
Certificates of deposit	2,159	2,126
Investment securities held to maturity, at amortized cost (Fair value of \$37,937 in 2002 and \$14,625 in 2001)	38,098	14,444
Investment securities available for sale, at fair value	292,228	265,495
Federal Home Loan Bank Stock, at cost	7,660	6,273
Savings Bank Life Insurance Stock, at cost	1,934	1,934
Loans held for sale	2,825	1,571
Loans, net	823,158	774,649
Banking premises and equipment, net	23,376	23,430
Accrued interest receivable	6,594	5,452
Other assets	<u>6,300</u>	<u>6,592</u>
Total assets	<u>\$1,234,541</u>	<u>\$1,138,210</u>

LIABILITIES AND STOCKHOLDERS' EQUITY

Deposits	\$ 966,532	\$ 884,529
Federal Home Loan Bank advances	135,200	115,249
Mortgagors' escrow payments	4,519	3,990
Accrued expenses and other liabilities	<u>8,700</u>	<u>11,044</u>
Total liabilities	<u>1,114,951</u>	<u>1,014,812</u>

Commitments and Contingencies (Note 2)

Stockholders' Equity:

Preferred stock, \$.01 par value-
Authorized - 5,000,000 shares

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Issued and outstanding - no shares	-	-
Common stock, \$.01 par value -		
Authorized - 30,000,000 shares		
Issued - 7,442,818 shares at March 31, 2002		
and December 31, 2001	74	74

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Port Financial Corp.
Consolidated Balance Sheets - (Continued)
(Unaudited)

	March 31, <u>2002</u>	December 31, <u>2001</u>
(In Thousands, Except Share Amounts)		
Additional paid-in capital	71,318	70,879
Treasury stock, at cost - 1,799,112 and 1,639,212 shares	(40,183)	(35,095)
Unearned compensation - Recognition and Retention Plan	(3,486)	(3,339)
Unearned compensation - ESOP	(6,963)	(7,026)
Retained earnings	93,955	91,652
Accumulated other comprehensive income	<u>4,875</u>	<u>6,253</u>
Total stockholders' equity	<u>119,590</u>	<u>123,398</u>
Total liabilities and stockholders' equity	<u>\$1,234,541</u>	<u>\$1,138,210</u>

See the accompanying notes to the unaudited consolidated financial statements.

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

	Three Months Ended <u>March 31,</u>	
	<u>2002</u>	<u>2001</u>
Interest and dividend income:		
Interest on loans	\$14,314	\$13,540
Interest and dividends on investment securities	4,269	3,103
Interest on other cash equivalents	76	841
Interest on certificates of deposit	<u>33</u>	<u>31</u>
Total interest and dividend income	<u>18,692</u>	<u>17,515</u>
Interest expense:		
Interest on deposits	6,695	9,078
Interest on borrowed funds	<u>1,435</u>	<u>575</u>
Total interest expense	<u>8,130</u>	<u>9,653</u>
Net interest income	10,562	7,862

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Provision for loan losses	300	200
Noninterest income:		
Customer service fees	326	292
Gain on sale of investment securities	72	-
Gain on sale of loans, net	115	153
Loan servicing fee income	81	117
Gain on sale of deposits	-	529
Other income	<u>520</u>	<u>310</u>
Total noninterest income	<u>1,114</u>	<u>1,401</u>
Noninterest expense:		
Compensation and employee benefits	4,039	3,467
Occupancy and equipment expense	885	875
Data processing service fees	575	500
Marketing and investor relations	425	274
Other noninterest expense	<u>992</u>	<u>1,042</u>
Total noninterest expenses	<u>6,916</u>	<u>6,158</u>
Income before provision for income taxes	4,460	2,905
Provision for income taxes	<u>1,632</u>	<u>1,005</u>
Net income	<u>\$ 2,828</u>	<u>\$ 1,900</u>
Earnings per share:		
Basic	\$ 0.57	\$ 0.29
Diluted	\$ 0.55	\$ 0.28
Weighted average shares outstanding:		
Basic	4,956,737	6,659,922
Diluted	5,184,197	6,728,501

See the accompanying notes to the unaudited consolidated financial statements

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Port Financial Corp.
Consolidated Statement of Changes in Stockholders' Equity
For The Three Months Ending March 31, 2002
(In Thousands)
(Unaudited)

	Common <u>Stock</u>	Additional <u>Paid-In Capital</u>	Treasury <u>Stock</u>	Unearned <u>Compensation ESOP/RRP</u>	Retained <u>Earnings</u>	Accumulated <u>Other Comprehensive Income</u>	<u>Total</u>
Balance at December 31, 2001	\$74	\$70,879	\$(35,095)	\$(10,365)	\$91,652	\$6,253	\$123,398
Net income	-	-	-	-	2,828	-	2,828
Change in unrealized gain on securities	-	-	-	-	-	(1,568)	(1,568)

available for sale, net of taxes \$(839)	-	-	-	-	-	(42)	(42)
Less reclassification of securities gains included in net income, net of taxes \$30	-	-	-	-	-	232	232
Change in fair market value of swap agreement, net of taxes \$161	-	-	(5,188)	-	-	-	(5,188)
Purchase of treasury stock	-	(26)	100	-	-	-	74
Exercise of stock options	-	381	-	(381)	-	-	-
Grant of RRP stock awards	-	84	-	297	-	-	381
Amortization of unearned compensation	-	-	-	-	(525)	-	(525)
Cash dividends - \$.10 per share	-	-	-	-	-	-	-
Balance at March 31, 2002	<u>\$74</u>	<u>\$71,318</u>	<u>\$(40,183)</u>	<u>\$(10,449)</u>	<u>\$93,955</u>	<u>\$4,875</u>	<u>\$119,590</u>

See the accompanying notes to the unaudited consolidated financial statements

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

	Three months Ended <u>March 31,</u>	
	<u>2002</u>	<u>2001</u>
Cash Flows from Operating Activities:		
Net income	\$2,828	\$1,900
Adjustments to reconcile net income to net cash provided by operating activities:		

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Provision for loan losses	300	200
Depreciation and amortization	446	500
Net gain from sales of available-for-sale investment securities	(72)	-
Amortization of premiums on investment securities, net	112	38
Increase in cash surrender value of life insurance policies	(48)	(49)
Gain on loan sales, net	(115)	(153)
Proceeds from sale of loans	7,709	11,283
Loans originated for sale	(8,848)	(13,141)
Gain on sale of branch deposits	-	(529)
Amortization of unearned compensation	381	313
Decrease in other assets	291	567
Increase in accrued interest receivable	(1,142)	140
Increase in prepaid deferred tax provision	(334)	(122)
Decrease in deferred loan fees	(329)	(13)
(Decrease) increase in accrued expenses and other liabilities	<u>(2,344)</u>	<u>894</u>
Net cash provided by operating activities	<u>(1,165)</u>	<u>1,828</u>

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Cash Flows from Investing Activities:

Proceeds from sales, maturities and principal repayments of securities available-for-sale	21,284	31,779
Purchases of securities available-for-sale	(50,525)	(8,083)
Proceeds from sales, maturities and principal repayments of securities held-to-maturity	7,340	5,159
Purchases of securities held-to-maturity	(31,005)	-
Proceeds from maturities of certificates of deposit	-	-
Purchase of certificates of deposit	(33)	(2,029)
Purchase of FHLB stock	(1,387)	(776)
Purchase of premises and equipment	(392)	(394)
Loan originations, net	(47,000)	5,828
Recoveries of loans previously charged-off	<u>4</u>	<u>3</u>
Net cash used in investing activities	<u>(101,714)</u>	<u>31,487</u>

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

Three months Ended
March 31,

2002 2001

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Cash Flows from Financing Activities:

Increase (decrease) in certificates of deposit		
Decrease in certificate of deposits due to sale of branch deposits	28,671	(1,422)
Increase in demand deposits, NOW accounts and savings accounts	-	(5,958)
Decrease in demand deposits, NOW accounts and savings accounts due to sale of branch deposits	53,332	5,133
Increase in mortgagors' escrow payments	-	(10,163)
Increase in Federal Home Loan Bank advances	529	480
Exercise of stock options	19,951	2,915
Cash dividends	74	-
RRP stock purchases	(525)	(372)
Treasury stock purchases	-	(5,453)
	<u>(5,188)</u>	<u>(191)</u>
Net cash provided by financing activities	<u>96,844</u>	<u>(15,031)</u>
)
Net (Decrease) Increase in Cash and Cash Equivalents	(6,035)	18,284
Cash and Cash Equivalents, beginning of year	<u>36,244</u>	<u>70,267</u>
Cash and Cash Equivalents, end of period	<u>\$30,209</u>	<u>\$88,551</u>

Supplemental Disclosures of Cash Flow Information:

Cash paid for interest	<u>\$ 7,851</u>	<u>\$ 9,617</u>
Cash paid for income taxes	<u>\$ 3,404</u>	<u>\$ 47</u>

See the accompanying notes to the unaudited consolidated financial statements.

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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. holds mortgage-backed securities and

certain mortgage loans originated by the Bank. 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 generally accepted accounting principles 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 generally accepted accounting principles for complete financial statements. The preparation of financial statements in conformity with generally accepted accounting principles 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.

2) Commitments and Contingencies

At March 31, 2002, the Company had outstanding commitments to originate loans amounting to approximately \$28.7 million, and unadvanced funds on construction loans and lines of credit amounting to approximately \$1.6 million and \$180.6 million, respectively.

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3) Earnings Per Share

Basic earnings per share is computed by dividing net income by the weighted-average number of common stock 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 <u>March 31,</u>	
	<u>2002</u>	<u>2001</u>
	(Dollars in thousands)	
	<u>\$ 2,828</u>	<u>\$ 1,900</u>
Net income		
Weighted average common shares outstanding	4,956,737	6,659,922
Dilutive effect of common stock equivalents	<u>227,460</u>	<u>68,579</u>

	<u>5,184,197</u>	<u>6,728,501</u>
Weighted average common and common equivalent shares outstanding		
Basic earnings per share	\$ 0.57	\$ 0.29
Dilutive effect of common stock equivalents	<u>(0.02)</u>	<u>(0.01)</u>
Diluted earnings per share	<u>\$ 0.55</u>	<u>\$ 0.28</u>

As of March 31, 2002 options to purchase 400 shares of common stock 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 quarter, the Company completed its fifth 5% stock repurchase program, with a final purchase of 30,000 shares on February 19, 2002. On February 20, 2002 it announced its sixth 5% repurchase program to purchase 288,855 shares. As of March 31, 2002, the Company had purchased 134,500 shares under this program at an average price of \$31.89.

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5) Loans

The loan portfolio consisted of the following (unaudited):

	<u>March 31</u> <u>2002</u>	<u>December 31,</u> <u>2001</u>
(In Thousands)		
Real estate loans-		
Residential	\$461,436	\$411,630
Commercial	268,329	265,854
Home equity lines of credit	87,369	90,105
Construction and land	<u>10,835</u>	<u>11,442</u>
Total real estate loans	827,969	779,031
Commercial	883	653
Consumer	<u>3,921</u>	<u>4,286</u>
Total loans		
	832,773	783,970
Less-Allowance for loan losses	<u>9,615</u>	<u>9,321</u>
Total loans, net	<u>\$823,158</u>	<u>\$774,649</u>

6) Deposits

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

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	March 31 <u>2002</u>	December 31, <u>2001</u>
	(In Thousands)	
Demand deposit accounts	\$ 51,642	\$ 54,242
NOW accounts	126,024	112,521
Regular savings accounts	59,910	55,963
Money market accounts	<u>373,168</u>	<u>334,686</u>
Total noncertificate accounts	<u>610,744</u>	<u>557,412</u>
Term certificates-		
Term certificates less than \$100,000	265,584	249,631
Term certificates of \$100,000 and over	<u>90,204</u>	<u>77,486</u>
Total term certificate accounts	<u>355,788</u>	<u>327,117</u>
Total deposits	<u>\$966,532</u>	<u>\$884,529</u>

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7) Business Segments

SFAS No. 131, *Disclosure About Segments of an Enterprise and Related Information*, establishes standards for reporting segments of a business enterprise. Operating segments are components of an enterprise, which are evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. The Company's chief operating decision maker is the Chairman and Chief Executive Officer. The Company has identified its reportable operating business segment as community banking based on products and services provided to the customer. The Company's community banking business segments consist of commercial banking and retail banking. The community banking business segment derives its revenues from a wide range of banking services, including lending activities, acceptance of demand, saving and time deposits, mortgage lending and sales and servicing income from investors. Nonreportable operating segments of the Company's operations that do not have similar characteristics to the community banking operations and do not meet the quantitative thresholds requiring disclosure are included in the Other category in the disclosure of business segments below. These nonreportable segments include Parent Company financial information. Consolidation adjustments are included in the consolidation adjustments category. The consolidation adjustments reflect certain eliminations of cash and Parent Company investments in subsidiaries.

The accounting policies used in the disclosure of business segments are the same as those described in the summary of significant accounting policies.

Reportable segments and reconciliation to consolidated financial information is as follows:

<u>Community Banking</u>	<u>Other</u>	<u>Consolidation Adjustments</u>	<u>Consolidated</u>
		(Unaudited)	
		(In Thousands)	

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March 31, 2002:

Investment securities available-
for-sale and held-to-maturity

Loans, net	\$ 313,457	\$ 34,240	\$ (17,371)	\$ 330,326
Total assets	823,158	7,136	(7,136)	823,158
Total deposits (1)	1,215,928	137,369	(118,756)	1,234,541
Total liabilities	971,051	-	-	971,051
Total interest and dividend income	1,119,023	6,300	(10,372)	1,114,951
Total interest expense	18,165	671	(144)	18,692
Net interest income	8,262	12	(144)	8,130
Provision for loan losses	9,903	659	-	10,562
Total noninterest income	300	-	-	300
Total noninterest expense	1,114	-	-	1,114
Net income	6,418	498	-	6,916
	2,716	112	-	2,828

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<u>Community Banking</u>	<u>Other</u>	<u>Consolidation Adjustments</u>	<u>Consolidated</u>
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(Unaudited)
(In Thousands)

March 31, 2001:

Investment securities available-
for-sale and held-to-maturity

Loans, net	\$141,666	\$44,880	\$(10,414)	\$176,132
Total assets	681,299	7,206	(7,206)	681,299
Total deposits (1)	948,476	160,313	(115,107)	993,682
Total liabilities	797,892	-	-	797,892
Total interest and dividend income	851,553	2,506	(9,564)	844,495
Total interest expense	16,645	1,386	(516)	17,515
Net interest income	9,797	-	(144)	9,653
Provision for loan losses	6,848	1,386	(372)	7,862
Total noninterest income	200	-	-	200
Total noninterest expense	1,401	-	-	1,401
Net income	5,849	309	-	6,158
	1,431	841	(372)	1,900

(1) Includes mortgagors' escrow payments

8) New Accounting Pronouncements

SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," was issued in September 2000. SFAS No. 140 is a replacement of SFAS No. 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." Most of the provisions of SFAS No. 125 were carried forward to SFAS No. 140 without reconsideration by the Financial Accounting Standards Board, and some were changed only in minor ways. In issuing SFAS No. 140, the FASB included issues and decisions that had been addressed and

determined since the original publication of SFAS No. 125. SFAS No. 140 is effective for transfers after March 31, 2001. The adoption of SFAS No. 140 did not have a significant impact on the financial position or results of operations of the Company.

In July 2001, the FASB issued SFAS No. 141, "Business Combinations." SFAS No. 141 eliminates the pooling of interests method of accounting for business combinations and requires that the purchase method of accounting be used for all business combinations. This statement is effective for business combinations initiated after July 1, 2001. The adoption of this statement did not have any impact on its consolidated financial position or results of operations.

In July 2001, the FASB issued SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 142 changes the accounting for goodwill from an amortization method to an impairment-only approach. Amortization of goodwill, including goodwill recorded in past business combinations, will cease upon adoption of this statement. Adoption of this statement did not impact the Company as the Company has not recorded goodwill or other intangible assets.

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In June 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations." This statement addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets, and the associated asset retirement costs. This statement is effective for financial statements issued for fiscal years beginning after June 15, 2002. Management does not believe that the adoption of this statement will have a material effect on the Company's financial condition.

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," which supersedes SFAS No. 121 and portions of APB Opinion No. 30 and was effective for the Company as of January 1, 2002. This statement addresses the recognition of an impairment loss for long-lived assets to be held and used, or disposed of by sale or otherwise. The adoption of this statement did not have a material effect on the Company's financial condition.

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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 was 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 ten 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 has announced its plan to open a new branch office in Brookline, Massachusetts during the second quarter of 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

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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 March 31, 2002 and December 31, 2001

Total assets increased by \$96.3 million, from \$1.14 billion at December 31, 2001 to \$1.23 billion at March 31, 2002. This growth included an increase in gross loans totaling \$48.8 million and a net increase in cash, cash equivalents and investment securities totaling \$45.8 million.

Growth in the loan portfolio consisted almost entirely of loans secured by residential real estate. The residential mortgage portfolio grew by \$49.8 million, the commercial real estate portfolio grew by \$2.5 million, and other segments of the portfolio declined by a net \$3.5 million. The residential mortgage growth reflects the refinancing demand in a low interest rate environment as well as the strong purchase market for residential property in the Boston area.

Non-performing assets totaled \$549,000 and \$133,000 at March 31, 2002 and December 31, 2001, respectively. The increase in non-performing assets relates to a commercial real estate loan with a balance of \$444,000, fully secured by property in Cambridge. The remaining balance of non-performing assets at March 31, 2002 consists of student loans.

The allowance for possible loan losses was \$9.6 million at March 31, 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. The Company continues to apply its consistent, systematic methodology for measuring the adequacy of the allowance for loan losses.

Deposits at March 31, 2002 totaled \$966.5 million, an increase of \$82.0 million from \$884.5 million at December 31, 2001. This increase consisted of \$38.5 million in money market accounts, \$28.7 million in time deposits, \$10.9 million in checking accounts, and \$3.9 million in savings accounts. During the first quarter of 2002, the Bank

continued to feature its relationship deposit products, offering premium rates on money market and certain time deposits to its Premier Checking or Money Manager checking accounts.

The \$3.8 million decline in stockholders' equity to \$119.6 million at March 31, 2002 from \$123.4 million at December 31, 2001 is the result of the Company's stock repurchase of 164,500 shares at an average price of \$31.54, totaling \$5.2 million during the first quarter ended March 31, 2002, and a \$1.4 million reduction in accumulated other comprehensive income, primarily due to a \$1.6 million (net of tax) change in unrealized gains on securities available for sale. The decline in stockholders' equity was partially offset by a \$2.3 million increase in retained earnings.

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Comparison of Operating Results for the Three Months Ended March 31, 2002 and 2001

Net income for the quarter ended March 31, 2002 was \$2.8 million, or \$.55 per diluted share, compared to \$1.9 million, or \$.28 per diluted share, for the comparable prior year period. The 2002 period included a \$72,000 gain on sale of investment securities; the 2001 period included a \$529,000 gain on sale of deposits. The after-tax effects of these two transactions were \$42,000 and \$312,000 respectively.

Interest Income

Interest income increased \$1.2 million, or 6.7%, to \$18.7 million. This increase reflected the 19.4% growth in the average balance of interest-earning assets to \$1.1 billion in the first quarter of 2002, from \$939.3 million in the comparable 2001 period. Partially offsetting the effect of earning asset growth was an 83 basis point decline in yield, the result of market rate reductions during 2001.

Interest on loans increased \$774,000 as higher average loan balances, which increased \$120.5 million over the 2001 quarter, more than offset a 78 basis point decline in the average yield.

Income from short-term investments and investment securities rose \$403,000. The average balances of cash, cash equivalents and investment securities in the 2002 period were \$61.6 million higher than the average balances in the first quarter of 2001. The lower interest rate environment reduced the average yield on these assets to 5.70%, 78 basis points lower in the 2002 period compared with the same period in the prior year.

Interest Expense

Total interest expense for the three months ended March 31, 2002 was \$8.1 million, down \$1.5 million from the same period in 2001. Interest expense on deposit accounts declined \$2.4 million as a result of significantly lower rates on interest-bearing deposits. The average cost of interest-bearing deposits was 3.13% in the 2002 period, a reduction of 179 basis points from the comparable 2001 quarter, during which the Company was promoting its Real Savings money market account with a rate of 6.25% guaranteed through March 31, 2001. The decline in deposit rates also reflects the general reduction in market rates that occurred through 2001.

An \$81.7 million increase in the average balance of borrowings resulted in a borrowing expense of \$1.4 million for the three months ended March 31, 2002 compared with \$575,000 in the first quarter of 2001. The average cost of borrowings declined by 151 basis points from 6.38% in the first quarter of 2001 compared to 4.87% in the first quarter of 2002.

Net Interest Income

Net interest income increased 34.3%, or \$2.7 million, in the first quarter of 2002 as compared to the same period last year. The net interest margin was 3.82%, up from 3.40% in the 2001 quarter. The interest rate spread was 3.28% in the

quarter ended March 31, 2002, compared with 2.47% during the same period last year.

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Provision for Possible Loan Losses

The Company recorded a provision for loan losses of \$300,000 for the quarter ended March 31, 2002 and \$200,000 in the same quarter of 2001. The higher provision reflects the growth in portfolio loan balances in the 2002 period.

The Company establishes provisions for loan losses, which are charged to operations, in order to maintain an allowance for loan losses at a level which is deemed to be appropriate based upon an assessment of a number of factors. These factors include prior loss experience, industry standards, past due loans, economic conditions, the volume and type of loans in the Bank's portfolio and other factors related to the collectibility of the Bank's loan portfolio.

Non-Interest Income

Non-interest income of \$1.1 million in the 2002 quarter includes a gain on the sale of investment securities totaling \$72,000. The 2001 period included a \$529,000 gain on sale of deposits. Excluding these gains, non-interest income increased \$170,000, or 19.5%, to \$1.0 million for the three months ended March 31, 2002 compared to \$872,000 in the same period last year. Fee income from the sales of investment products represented the largest portion of the increase, totaling \$194,000 in this year's first quarter compared to \$7,000 in the first quarter of 2001. The Company began expanding its team of investment advisors as well as its product offerings in the second quarter of 2001. Customer service fees of \$326,000 increased \$34,000 in the first quarter of 2002 over the 2001 quarter, largely due to the increased number of checking accounts and fees derived from activity in those accounts. Loan sale gains of \$115,000 represents a decrease of \$38,000 from the 2001 period. These gains are generated from the sale of fixed-rate residential mortgages; during the 2002 period, mortgage application volume was skewed towards lower rate adjustable rate products.

Non-Interest Expense

Non-interest expense increased \$758,000, or 12.3%, to \$6.9 million for the first quarter of 2002, compared to \$6.2 million in the 2001 period. Compensation and benefits expense represented the largest portion of that increase, up \$572,000. The increase reflects higher commissions paid to mortgage originators and investment sales representatives, as well as higher costs of stock benefit plans, which increase as the market price of the Company's stock rises.

Data processing expense rose \$75,000 as a result of the higher level of activity coming from transaction accounts and the cost of the internet banking service. Marketing expenses, which were \$151,000 above the 2001 period, reflected the cost of deposit promotions, as well as promotional costs for the new Brookline branch, which is scheduled to open during the second quarter of 2002.

The annualized expense ratio, the ratio of non-interest expense to average assets, was 2.41% for the three months ended March 31, 2002 compared to 2.53% in the 2001 period.

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Provision for Income Taxes

The Company's effective tax rate for the March 31, 2002 quarter was 36.6% as compared to 34.6% for the 2001 period. The Company has moved into a higher federal tax bracket as a result of the increase in its taxable income.

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The following tables set forth information relating to Port's financial condition and net interest income at and for the three months ending March 31, 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 the annualized interest income by the average balance of interest-earning assets and the annualized 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 Three months Ending March 31, 2002 and 2001

	<u>2002</u>			<u>2001</u>		
	<u>Average</u> <u>Balance</u>	<u>Interest</u>	Average <u>Yield/</u> <u>Cost</u>	<u>Average</u> <u>Balance</u>	<u>Interest</u>	Average <u>Yield/</u> <u>Cost</u>
	(Dollars in thousands)					
Assets:						
Interest earning assets:	\$ 19,065	\$ 76	1.62%	\$ 61,780	\$ 841	5.52%
Short term investments(1)	2,127	33	6.29%	2,016	31	6.24%
Certificates of deposit	286,334	4,269	5.97%	182,172	3,103	6.83%
Investment securities(2)	<u>813,910</u>	<u>14,314</u>	<u>7.03%</u>	<u>693,370</u>	<u>13,540</u>	<u>7.81%</u>
Loans(3)	1,121,436	18,692	<u>6.63%</u>	939,338	17,515	<u>7.46%</u>
Total interest earning	(9,457)			(8,134)		
assets	<u>53,467</u>			<u>54,213</u>		
Allowance for loan losses	<u>1,165,446</u>			<u>985,417</u>		
Total noninterest earning						
assets						
Total assets						
Liabilities and Equity:						
Interest bearing liabilities:	108,915	312	1.16%	65,616	163	1.01%
NOW accounts	58,194	210	1.46%	52,085	226	1.76%
Savings accounts	355,896	2,248	2.56%	325,592	4,222	5.26%
Money market deposit	<u>344,633</u>	<u>3,925</u>	<u>4.62%</u>	<u>305,388</u>	<u>4,467</u>	<u>5.93%</u>
accounts	867,638	6,695	3.13%	748,681	9,078	4.92%
Certificate of deposit	<u>117,761</u>	<u>1,435</u>	<u>4.87%</u>	<u>36,063</u>	<u>575</u>	<u>6.38%</u>
accounts	985,399	8,130	<u>3.35%</u>	784,744	9,653	<u>4.99%</u>
Total interest bearing	52,659			47,553		
deposits	<u>8,874</u>			<u>7,715</u>		
Borrowed funds	61,533			55,268		

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Total interest bearing liabilities	1,046,932	840,012		
Noninterest bearing deposits	<u>118,514</u>	<u>145,405</u>		
Other noninterest bearing liabilities	<u>\$1,165,446</u>	<u>\$985,417</u>		
Total noninterest bearing liabilities			<u>\$10,562</u>	<u>\$7,862</u>
Total liabilities			3.28%	2.47%
Stockholders' equity/retained earnings			3.82%	3.40%
Total liabilities and stockholders' equity/retained earnings			113.76	119.64
Net interest income				
Net Interest rate spread				
(4) Net interest margin (5)				
Ratio of average interest-earning assets to average interest-bearing liabilities				

- (1) Short term investments includes federal funds sold.
- (2) All investments 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:

- * 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 March 31, 2002
Net Interest Income Increase/(Decrease)

Due to

Volume Rate Net

(In thousands)

Interest earning assets:

	\$ (378)	\$ (387)	\$ (765)
Short term investments	2	-	2
Certificates of deposit	3,526	(2,360)	1,166
Investment securities	<u>7,362</u>	<u>(6,588)</u>	<u>774</u>
Loans	<u>10,512</u>	<u>(9,335)</u>	<u>1,177</u>
Total interest earning assets			

Interest bearing liabilities:

	122	27	149
NOW accounts	121	(137)	(16)
Savings accounts	2,396	(4,370)	(1,974)
Money market deposit accounts	2,743	(3,285)	(542)
Certificate of deposit accounts	<u>1,765</u>	<u>(905)</u>	<u>860</u>
Borrowed funds	<u>7,147</u>	<u>(8,670)</u>	<u>(1,523)</u>
Total interest bearing liabilities			

Change in net interest income	<u>\$ 3,365</u>	<u>\$ (665)</u>	<u>\$ 2,700</u>
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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 March 31, 2002 was approximately \$179.2 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 March 31, 2002, the Company exceeded each of the applicable regulatory capital requirements. The Company's leverage Tier 1 capital was \$114.7 million, or 17.2% of risk-weighted assets, and 9.8% of average assets. The Company had a risk-based total capital of \$125.9 million and a risk-based capital ratio of 18.9%.

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 three month periods ended March 31, 2002 and March 31, 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 March 31, 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.

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<u>As of March 31, 2003</u>		
(Dollars in thousands)		
Changes in Interest Rates (Basis Points)	Net Interest Income	% Change
+200	40,571	-6.71%
0	43,487	-
-200	45,631	4.93%

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 March 31, 2002, the Company was receiving a variable rate of 1.854% and paying a fixed rate of 4.10% on this swap. The fair value of the swap of \$19,000 was recorded as a liability with changes in the fair value recorded in accumulated other comprehensive income.

Part II - OTHER INFORMATION

Item 1. Legal Proceedings

None

Item 2. Changes in Securities and Use of Proceeds

None

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Item 3. Defaults Upon Senior Securities

None

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

None

Item 5. Other Information

None

Item 6. Reports on Form 8-K

None

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

May 8, 2002