FALMOUTH BANCORP INC
Form 10QSB/A
April 07, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-QSB/A

(Mark One)

[X] QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended December 31, 2003
OR
[ ] TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _________ to _________

Commission file number 01-13465

Falmouth Bancorp, Inc.
(Exact name of small business issuer as specified in its charter)

Delaware	04-3337685
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

20 Davis Straits, Falmouth, MA 02540
(Address of principal executive offices)
(508) 548-3500
(Issuer's telephone number including area code)

N/A
(Former name, former address and former fiscal year, if changed since last Report)

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

Class	Outstanding at February 1, 2004
Common Stock, Par Value $.01	916,727

Transitional small business disclosure format (check one):
Yes _____ No X

EXPLANATORY NOTE

We hereby amend Items 1, 2, and 6 of our Form 10-QSB for the quarter ended December 31, 2003 in response to comment letters received from the Securities and Exchange Commission to: (1) revise Exhibits 31.1 and 31.2 in accordance with Item 601 of Regulation S-B, (2) explain the procedure behind our determination of the allowance for loan losses and the reduction in the loan loss ratio, (3) and (4) revise our financial statements to (i) present loans held for sale separately from total loans, (ii) to present advertising expense, printing and stationary expense and postage expense as line items in the statements of income and (iii) revise the statement of cash flows to include loans originated for resale and proceeds from those loans sold in operating activities.

INDEX TO FORM 10-QSB/A

FORWARD LOOKING STATEMENTS

This report contains certain forward looking statements consisting of estimates with respect to the financial condition, results of operations and business of Falmouth Bancorp, Inc. and Falmouth Co-operative Bank that are subject to various factors which could cause actual results to differ materially from these estimates. These factors include, but are not limited to: general and local economic conditions; changes in interest rates, deposit flows, demand for mortgages and other loans, real estate values, and competition; changes in accounting principles, policies, or guidelines; changes in legislation or regulation; and other economic, competitive, governmental, regulatory, and technological factors affecting our operations, pricing, products and services.

Any or all of our forward-looking statements in the report and in any other public statements we make may turn out to be wrong. They can be affected by inaccurate assumptions we might make or by known or unknown risks and uncertainties. Consequently, no forward-looking statement can be guaranteed.

We undertake no obligation to publicly update forward-looking statements, whether as a result of new information, future events or otherwise.

i

PART I. FINANCIAL INFORMATION

ITEM 1 FINANCIAL STATEMENTS

FALMOUTH BANCORP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

December 31, 2003 and September 30, 2003

	December 31, 2003 (Unaudited)	September 30, 2003 (Audited)
ASSETS		
Cash, due from banks and interest bearing deposits	$ 1,527,997	$ 3,335,059
Federal funds sold	2,146,192	4,037,306
Total cash and cash equivalents	3,674,189	7,372,365
Investments in available-for-sale securities (at fair value)	36,344,767	37,179,799
Investments in held-to-maturity securities (fair values of $24,709,897 as of December 31, 2003 and $32,556,554 as of September 30, 2003)	24,709,980	32,549,241
Federal Home Loan Bank stock, at cost	878,000	878,000
Loans held-for-sale (fair value of $840,474 at September 30, 2003)	-	825,677
Loans, net	87,665,181	82,493,801
Premises and equipment	1,992,932	1,911,894
Accrued interest receivable	1,395,336	1,333,910
Cooperative Central Bank Reserve Fund Deposit	395,395	395,395
Other assets	1,053,453	1,178,108
Total assets	$158,109,233	$166,118,190
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits:		
Noninterest-bearing	$ 20,579,585	$ 20,425,557
Interest-bearing	116,999,733	125,109,413
Total deposits	137,579,318	145,534,970
Securities sold under agreements to repurchase	-	-
Federal Home Loan Bank advances	2,562,070	2,582,885
Other liabilities	112,228	256,956
Total liabilities	140,253,616	148,374,811
Stockholders' equity:		
Preferred stock, par value $.01 per share, authorized 500,000 shares; none issued		
Common stock, par value $.01 per share, authorized		

2,500,000 shares; issued 1,454,750 shares	14,547	14,547
Paid-in capital	14,147,775	14,093,713
Retained earnings	13,740,559	13,858,343
Unallocated Employee Stock Ownership Plan shares	(191,068)	(213,114)
Treasury stock (538,023 shares as of December 31, 2003; 541,023 shares as of September 30, 2003)	(9,525,535)	(9,578,649)
Unearned compensation	(340,994)	(340,994)
Accumulated other comprehensive loss	10,333	(90,467)
Total stockholders' equity	17,855,617	17,743,379
Total liabilities and stockholders' equity	$158,109,233	$166,118,190

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

1

FALMOUTH BANCORP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

Three Months Ended December 31, 2003 and 2002

(Unaudited)

	December 31, 2003	December 31, 2002
Interest and dividend income:		
Interest and fees on loans	$1,252,631	$1,494,869
Interest and dividends on securities:		
Taxable	285,210	338,112
Dividends on marketable equity securities	18,908	20,447
Other interest	11,525	30,420
Total interest and dividend income	1,568,274	1,883,848
Interest expense:		
Interest on deposits	429,570	653,351
Interest on securities sold under agreement to repurchase	-	1,983
Interest on Federal Home Loan Bank advances	32,848	62,453
Total interest expense	462,418	717,787
Net interest and dividend income	1,105,856	1,166,061
Provision for loan losses	-	-
Net interest and dividend income after provision for loan losses	1,105,856	1,166,061
Other income:		
Service charges on deposit accounts	60,745	50,365

Securities gains (losses), net	16,802	(76,587)
Net gains on sales of loans	40,432	325,311
Loan servicing fees	15,112	6,600
Other income	60,524	87,800
Total other income	193,615	393,489
Other expense:		
Salaries and employee benefits	565,334	487,679
Occupancy expense	59,139	40,981
Equipment expense	52,213	44,824
Data processing expense	129,605	88,705
Directors' fees	19,365	18,610
Legal and professional fees	151,894	77,795
Writedowns of mortgage servicing rights	16,061	53,855
Advertising expense	34,970	23,369
Printing and stationary expense	23,296	18,518
Postage Expense	18,669	10,184
Other expenses	131,340	97,062
Total other expenses	1,201,886	961,582
Income before income taxes	97,585	597,968
Income taxes	96,441	222,850
Net income	$ 1,144	$ 375,118
Comprehensive income	$ 101,944	$ 537,687
Earnings per common share	$ 0.00	$ 0.43
Earnings per common share, assuming dilution	$ 0.00	$ 0.41

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

2

FALMOUTH BANCORP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

Three Months Ended December 31, 2003

(Unaudited)

Common Stock	Paid-In Capital	Retained Earnings	Unallocated Employee Stock Ownership Plan Shares	Treasury Stock	Une Compe

Balance, September 30, 2003	$14,547	$14,093,713	$13,858,343	$(213,114)	$(9,578,649)	$(34
Employee Stock Ownership Plan		41,664				
ESOP shares released				22,046		
Recognition and retention plan		25,387				
Exercise of stock options and related tax benefit		(12,989)			53,114	
Dividends declared ($.13 per share)			(118,928)			
Comprehensive income:						
Net income			1,144			
Net change in unrealized holding gain on available-for-sale securities						
Comprehensive income						
Balance, December 31, 2003	$14,547	$14,147,775	$13,740,559	$(191,068)	$(9,525,535)	$(34

Three Months Ended December 31, 2002

(Unaudited)

	Common Stock	Paid-In Capital	Retained Earnings	Unallocated Employee Stock Ownership Plan Shares	Treasury Stock	Une Compe
Balance, September 30, 2002	$14,547	$13,981,543	$13,735,221	$(301,299)	$(9,807,890)	$(47
Employee Stock Ownership Plan		32,720				
ESOP shares released				22,047		
Recognition and retention plan		26,618				
Exercise of stock options and related tax benefit		(4,152)			31,763	
Dividends declared ($.13 per share)			(117,179)			
Comprehensive income:						
Net income			375,118			
Net change in unrealized holding gain on available-for-sale securities						
Comprehensive income						
Balance, December 31, 2002	$14,547	$14,036,729	$13,993,160	$(279,252)	$(9,776,127)	$(47

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

3

FALMOUTH BANCORP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Three Months Ended December 31, 2003 and 2002

(Unaudited)

	December 31, 2003	Decem 2
Cash flows from operating activities		
Net income	$ 1,144	$
Adjustments to reconcile net income to net cash provided by operating activities:		
Realized (gains) losses on available-for-sale investment securities, net	(16,802)	
Amortization of investment securities, net	741,049	
Provision for loan loss	-	
Change in deferred loan costs net of origination fees	(1,992)	
Decrease in loans held-for-sale	825,677	
Decrease (increase) in mortgage servicing rights	23,844	(
Depreciation and amortization	45,106	
(Increase) decrease in accrued interest receivable	(61,426)	
(Increase) decrease in prepaid expenses	(72,438)	
Increase in other assets	(633)	
Recognition and retention plan (RRP)	25,387	
(Decrease) increase in accrued expenses	(81,507)	
Increase (decrease) in taxes payable	183,553	(
Increase (decrease) in accrued interest payable	4	
Decrease in other liabilities	(63,225)	(
Net cash provided by operating activities	1,547,741	
Cash flows from investing activities		
Purchases of available-for-sale securities	(1,988,046)	(6,
Proceeds from sales of available-for-sale securities	7,625	
Proceeds from maturities of available-for-sale securities	2,570,084	4,
Purchases of held-to-maturity securities	(2,025,540)	(11,
Proceeds from maturities of held-to-maturity securities	9,477,052	9,
Loan originations and principal collections, net	(5,169,588)	9,
Recoveries of previously charged off loans	200	
Capital expenditures	(126,144)	
Net cash provided by investing activities	2,745,643	5,
Cash flows from financing activities:		
Net (decrease) increase in demand deposits, NOW and savings accounts	(4,835,357)	
Net decrease in time deposits	(3,120,295)	(2,
Net increase in securities sold under agreements to repurchase	-	
Repayments of Federal Home Loan Bank long-term advances	(24,815)	
Net change in Federal Home Loan Bank short-term advances	4,000	
Redemption of preferred shares relative to minority interests	-	
Proceeds from exercise of stock options	40,125	
Employee Stock Ownership Plan	41,664	
Unallocated ESOP shares released	22,046	
Dividends paid	(118,928)	(

Net cash used in financing activities	(7,991,560)	(1,
(Decrease) increase in cash and cash equivalents	(3,698,176)	5,
Cash and cash equivalents at beginning of period	7,372,365	7,
Cash and cash equivalents at end of period	$ 3,674,189	$ 12,
Supplemental disclosures		
Interest paid	$ 462,414	$
Income taxes paid	87,112	

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

4

FALMOUTH BANCORP, INC.

AND SUBSIDIARIES

Notes to Unaudited Consolidated Financial Statements

Note 1 - Basis of Presentation

The condensed consolidated financial statements of Falmouth Bancorp, Inc. (the "Company") and its subsidiaries presented herein are unaudited and should be read in conjunction with the consolidated financial statements of the Company for the year ended September 30, 2003. The results of operations for the three-month period ended December 31, 2003 are not necessarily indicative of the results to be expected for the full year. All material intercompany balances and transactions have been eliminated in consolidation. In the opinion of management, the condensed consolidated financial statements reflect all adjustments (consisting solely of normal recurring adjustments) necessary for a fair presentation of results for the interim periods. The year-end condensed balance sheet was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the USA (GAAP).

Note 2 - Accounting Policies

The accounting and reporting policies of the Company conform to GAAP and prevailing practices within the banking industry. The interim financial information should be read in conjunction with the Company's 2003 Annual Report which is an exhibit to Form 10-KSB/A. The Form 10-KSB for the fiscal year ended September 30, 2003 was amended to segregate loans held-for sale from loans held in portfolio. This 10-QSB/A includes an additional line in the balance sheet to show the loans that are held-for-sale. Also GAAP requires that the origination and sale of loans classified as held-for-sale be reported in the operating activities section of the statement of cash flows. Previously the effects of the origination and sale of loans were presented in the investing activities section as a component of the line item "Loan originations and principal collections, net."

Management is required to make estimates and assumptions that affect amounts reported in the consolidated financial statements. Actual results could differ significantly from those estimates.

Note 3 - Impact of New Accounting Standards

Statement of Financial Accounting Standards No. 142 requires that goodwill no longer be amortized to earnings, but instead be reviewed for impairment. The amortization of goodwill ceases upon adoption of the statement. All of the provisions of SFAS No. 142 were effective for the Company beginning with its fiscal year ending September 30, 2003. The adoption of SFAS No. 142 did not have an impact on the Company's consolidated financial statements.

In August 2001, the FASB issued SFAS No. 144 "Accounting for Impairment or Disposal of Long Lived Assets." The provisions of SFAS No. 144 are required to be adopted starting with fiscal years beginning after December 15, 2001. The adoption of this statement did not have a material impact on the Company's consolidated financial statements.

In June 2003, the FASB issued SFAS No. 146 "Accounting for Costs Associated with Exit or Disposal Activities." This statement requires that a liability for a cost associated with an exit or disposal activity be recognized and measured initially at fair value only when the liability is incurred. SFAS No. 146 is effective for exit or disposal activities that are initiated after December 31, 2002. This statement did not have a material impact on the Company's consolidated financial statements.

In October 2002, the FASB issued SFAS No. 147 "Acquisitions of Certain Financial Institutions," an Amendment of SFAS Nos. 72 and 144 and FASB Interpretation No. 9 SFAS No. 72 "Accounting for Certain Acquisitions of Banking or Thrift Institutions" and FASB interpretation No. 9 "Applying APB Opinions No. 16 and 17 When a Savings and Loan Association Is Acquired in a Business Combination Accounted for by the Purchase Method" that provided interpretive guidance on the application of the purchase method to acquisitions of financial institutions. SFAS No. 147 was effective October 1, 2003. There was no impact on the Company's consolidated financial statements on adoption of this statement.

In May 2003, FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." SFAS No. 150 requires that certain financial instruments classified as equity must be classified as a liability. Most of the guidance in SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. This statement did not have any material effect on the Company's consolidated financial statements.

Note 4 - Accounting for Stock-Based Compensation.

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

6

	Three months ended December 31, 2003	Three months ended December 31, 2002
Net income	$ 1,144	$ 375,118
Stock based compensation expense determined under fair value method, net of tax benefit	(4,799)	(4,799)
Pro forma net income (loss)	$(3,655)	$ 370,319
Earnings (loss) per share:		
Basic as reported	$ 0.00	$ 0.43
Basic - pro forma	$ 0.00	$ 0.43
Diluted as reported	$ 0.00	$ 0.41
Diluted - pro forma	$ 0.00	$ 0.40

Note 5 - Dividends

On November 18, 2003, the Board of Directors of the Company declared a quarterly cash dividend of $0.13 per share of common stock, which was paid on December 23, 2003 to stockholders of record at the close of business on December 9, 2003.

Note 6 - Recent Developments

During the quarter ended December 31, 2003, the Company released 3,000 shares due to exercised employee stock options. At December 31, 2003, the Company had 538,023 treasury shares.

Note 7 - Contingency

On January 8, 2004, Independent Bank Corp. ("Independent"), INDB Sub, Inc. ("INDB") and the Company entered into an Agreement and Plan of Merger (the "Agreement") between Independent, INDB, an interim de novo wholly-owned subsidiary of Independent, and the Company. Under the terms of the Agreement, Independent will acquire the Company in a part cash, part stock transaction. The acquisition is subject to customary conditions, including shareholder and regulatory approval, and is expected to be completed mid-year 2004.

7

ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND OPERATING RESULTS

General

Falmouth Bancorp, Inc. (the "Company" or "Bancorp"), a Delaware corporation, is the holding company for Falmouth Co-operative Bank, a Massachusetts chartered stock co-operative bank, which is doing business as Falmouth Bank (the "Bank" or "Falmouth"). At December 31, 2003, there were 916,727 shares outstanding. The Company's stock trades on the American Stock Exchange under the symbol "FCB."

On January 8, 2004, the Board of Directors of the Company approved, and the Company entered into, an Agreement and Plan of Merger, dated as of January 8, 2004, between Independent Bank Corp., INDB Sub, Inc. and the Company whereby Independent will acquire the Company in a part cash, part stock transaction valued at approximately $36.9 million, including approximately $2.5 million in cash that will be paid to Company option holders in exchange for the cancellation of those options. The $36.9 million transaction value is derived by using Independent's closing price per share on January 8, 2004 of $29.00 for the stock component of the transaction. The terms of the Agreement call for half of the outstanding shares of the Company to be converted into the right to receive 1.28 shares of Independent common stock per share of Company common stock and for the other half of the outstanding shares of the Company to be purchased for $38.00 cash per share of Company common stock.

The transaction is subject to the approval of the Company's shareholders and various regulatory authorities. If approved, it is anticipated the transaction will be finalized mid-year 2004.

The Company's sole business activity is ownership of the Bank. The Company also makes investments in long and short-term marketable securities and other liquid investments. The business of the Bank consists of attracting deposits from the general public and local businesses and using these funds to originate primarily residential and commercial real estate loans located in Falmouth, Massachusetts and surrounding areas and to invest in United States Government and Agency securities. To a lesser extent, the Bank engages in various forms of consumer and home equity lending. The Bank's business strategy is to operate as a profitable community bank dedicated to financing home ownership, small business, and consumer needs in its market area and to provide personal, high quality service to its customers.

Critical Accounting Policies

The Notes to our Audited Consolidated Financial Statements for the year ended September 30, 2003, included in our Form 10-KSB/A, which was filed with the Securities and Exchange Commission on February 13, 2004, contain a summary of our significant accounting policies. We believe our policies with respect to the methodology for our determination of the allowance for loan losses, the valuation of mortgage servicing rights and asset impairment judgments, and other than temporary declines in the value of our securities, involve a higher degree of complexity and require management to make difficult and subjective judgments which often require assumptions or estimates

about highly uncertain matters. Changes in these judgments, assumptions or estimates could cause reported results to differ materially. These critical policies and their application are periodically reviewed by the Audit

Committee and the Company's Board of Directors.

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

The Company's total assets decreased by $8.0 million, or 4.8%, from $166.1 million at September 30, 2003 to $158.1 million at December 31, 2003. Total deposits decreased $8.0 million or 5.5%, from $145.5 million at September 30, 2003 to $137.6 million at December 31, 2003. This decrease was due, in part, to seasonal withdrawals from demand deposits accounts, money market accounts and certificates of deposit; and, in part, to a recent upward trend in the equities market during the period. Total net loans were $87.7 million or 63.7% of total deposits at December 31, 2003, as compared to $83.3 million or 57.2% of total deposits at September 30, 2002, representing an increase of $4.4 million for the quarter. This increase was due, in part, to the Bank's decision to selectively retain some of its current higher yielding loan production for portfolio rather than selling it on the secondary market. Investment securities were $61.9 million or 39.2% of total assets at December 31, 2003, as compared to $70.6 million or 42.5% of total assets at September 30, 2003. Investment securities decreased $8.7 million or 12.32%, in part, due to maturing and called investment securities. The proceeds were used to fund loans held for investment and deposit outflows.

Borrowed funds from the Federal Home Loan Bank of Boston decreased $21,000 from $2.6 million at September 30, 2003 to $2.6 million at December 31, 2003. The decrease was the result of normal amortization of long term borrowings combined with a short-term advance of $4,000 that was the result of normal cash management operations with FHLB.

Stockholders' equity was $17.9 million at December 31, 2003, and $17.7 million at September 30, 2003. The change in stockholders' equity was due to an increase in accumulated other comprehensive income of $101,000, changes in capital due to annual entries effecting the Bank's Employee Stock Ownership Plan, Employee Stock Option Plan and the Employee Recognition and Retention Plan of $129,000, offset, in part, by and the payment of a cash dividend of $119,000. The ratio of stockholders' equity to total assets was 11.3% at December 31, 2003, and the book value per share of common stock was $19.48 at December 31, 2003, compared to 10.7% and $19.43, respectively, at September 30, 2003.

The ratio of the allowance for loan losses to total loans was 0.86% at December 31, 2003. Management believes the allowance is adequate based upon, among other things, past loss experience, prevailing economic conditions, and the level of credit risk in the loan portfolio. However, the Bank, during its regular reviews of delinquencies and its loan portfolio, may provide additional provisions as deemed necessary to maintain a sufficient allowance for the loan loss to total loan ratio.

Net Income. The Company's net income for the three months ended December 31, 2003 was $1,000, as compared to $375,000 for the three months ended December 31, 2002. The decrease in net income of $374,000 was due, in part, to a decrease in interest and dividend income of $316,000 that was offset, in part, by a decrease in interest expense of $255,000. Other key factors included a decrease in other income of $200,000, an increase in other expenses of $240,000 and a decrease in income taxes of $126,000. The increase in other expenses was related, in part, to costs associated with potential merger activities, which totaled $91,000 in added legal and professional fees for the three-month period ended December 31, 2003. The additional costs associated with the proposed plan of merger are expected to continue to rise sharply in the next two quarters. The annualized return on average assets (ROA) for the three months ended December 31, 2003 was 0.00%, a decrease of 96 basis points, as compared to 0.96% for the same period of the prior year.

Interest and Dividend Income. Total interest and dividend income for the three months ended December 31, 2003 was $1.6 million, a decrease of $316,000, as compared to $1.9 million for the three month period ended December 31, 2002. The decrease was attributable to a decrease in interest and fees on loans of $242,000, which was the result of continuing historically low interest rates, and a decrease in loans held for investment, and a decrease in interest on debt securities, dividends on equity securities and other interest of $74,000.

Interest Expense. Total interest expense for the three months ended December 31, 2003 was $462,000 as compared to $718,000 for the same period of the prior year, a decrease of $256,000. The decrease in interest expense was primarily due to declining short term interest rates, partially offset by a $3.4 million growth in interest bearing deposits for the twelve months ended December 31, 2003.

Net Interest and Dividend Income. Net interest and dividend income was $1.1 million for the three-month period ended December 31, 2003 and $1.2 million for the three months ended December 31, 2002. The $60,000 decrease was the result of a $316,000 decrease in interest and dividend income, offset by a $255,000 decrease in interest expense. The net interest margin for the three months ended December 31, 2003 was 2.86%, a decrease of 28 basis points, as compared to 3.14% for the three months ended December 31, 2002. The decrease in net interest margin was primarily the result of a decrease in the yield on interest earning assets.

Provision for Loan Losses. Although net loans increased by $4.3 million for the three months ended December 31, 2003, primarily in 1-4 family residential loans, the Company made no additional provision to its allowance for loan losses during the quarter ended December 31, 2003, because management believed the provision to be adequate. Although the provision was deemed adequate based on the Company's delinquency and loan loss record, management believes that additional provisions may be added during the quarter ending March 31, 2004 as the loan portfolio is expected to expand slightly during the period. The expected expansion in the loan portfolio is the result of the Company's intent to place additional loans in portfolio and sell fewer 1-4 family residential loans in the secondary market.

The Company's allowance for loan loss was 0.86% of total loans at December 31, 2003 as compared to 0.91% at September 30, 2003. On December 31, 2003 the Company had no loans 60 or more days delinquent, no small commercial loans overdue and no non-performing loans.

The allowance for loan losses is maintained at a level determined to be adequate by management to absorb future charge-offs of loans deemed uncollectible. This allowance is increased by provisions charged to income and by recoveries on loans previously charged off, and reduced by benefits for loan losses credited to income and charge-offs. Arriving at an appropriate level of allowance for loan losses necessarily involves a high degree of judgment and is determined based on management's ongoing evaluation.

We maintain an allowance for loan losses at a level which we believe is sufficient to cover potential charge-offs of loans deemed to be uncollectible based on a continuous review of a variety of factors. These factors consist of the character and size of the loan portfolio, business and economic conditions, loan growth, charge-off experience, delinquency trends, non-performing loan trends and other asset quality factors. The primary means of adjusting the level of this allowance is through provisions (benefits) for loan losses, which are established and charged (credited) to income on a quarterly basis. Although we use available information to establish the appropriate level of the allowance for loan losses, future additions to the allowance may be necessary because our estimates of the potential losses in our loan portfolio are susceptible to change as a result of changes in the factors noted above. Any such increase would adversely affect our results of operations.

For the commercial business loan and commercial real estate loan portfolios, we evaluate each loan rated "substandard" or worse. On an ongoing basis, we review classified loans to ensure the accuracy of the loan classifications. Estimated reserves for each of these credits are determined by reviewing current collateral value, financial information, cash flow, payment history and trends and other relevant facts surrounding the particular credit. Provisions for losses on the remaining commercial loans are based on pools of similar loans using historical loss experience and other qualitative factors.

For the residential real estate and consumer loan portfolios, the range of reserves is calculated by applying historical charge-offs and recovery experience to the current outstanding balance in each loan category, with consideration given to loan growth over the preceding twelve months.

Other Income. Other income for the three-month period ended December 31, 2003 was $194,000, as compared to $393,000 for the three months ended December 31, 2002. The $199,000 decrease was primarily the result of an increase in service charge income of $10,000, an increase in net gains on sales of investment securities of $93,000, and an increase in loan servicing fee income of $9,000. This was offset, in part, by a decrease in gains on sales of mortgage loans of $285,000 and a decrease in other income of $27,000.

Operating Expenses. Operating expenses for the three months ended December 31, 2003 were $1,202,000, as compared to $962,000 for the three months ended December 31, 2002. The $240,000 increase was primarily due to the combination of an increase in salaries and employee benefits of $78,000, an increase in occupancy expense of $18,000, an increase in equipment expense of $7,000, and an increase in data processing expense of $41,000, an increase in legal and professional costs of $76,000, and an increase in other expenses of $57,000, combined with a decrease in the write downs of mortgage servicing assets of $38,000. The increase in legal and professional costs was primarily due to the one time additional costs associated with the proposed merger agreement of $91,000. The increase in other operating expenses can be primarily attributed to the costs associated with the Bank's newest branch, opened in Bourne, Massachusetts, in November 2003. The annualized ratio of operating expenses to average total assets for the three months ended December 31, 2003 was 3.04%, as compared to 2.53% for the three-month period ended December 31, 2002, an increase of 51 basis points.

11

Liquidity and Capital Resources

The Bank's primary sources of funds consist of deposits, repayment and prepayment of loans and mortgaged-backed securities, maturities of investments and interest-bearing deposits, and funds provided from operations. While scheduled repayments of loans and mortgage-backed securities and maturities of investment securities are predictable sources of funds, deposit flows and loan prepayments are greatly influenced by the general level of interest rates, economic conditions and competition. The Bank uses its liquidity resources principally to fund existing and future loan commitments, to fund net deposit outflows, to invest in other interest-earning assets, to maintain liquidity, and to meet operating expenses.

The Bank is required to maintain adequate levels of liquid assets. This guideline, which may be varied depending upon economic conditions and deposit flows, is based upon a percentage of deposits and short-term borrowings. The Bank has historically maintained a level of liquid assets in excess of regulatory requirements. The Bank's liquidity ratio at December 31, 2003 was 47.5%.

A major portion of the Bank's liquidity consists of short-term securities obligations. The level of these assets is dependent on the Bank's operating, investing, lending and financing activities during any given period. At December 31, 2003, regulatory liquidity totaled $65.9 million. The primary investing activities of the Bank include origination of loans and the purchase of investment securities.

Liquidity management is both a daily and long-term function of management. If the Bank requires funds beyond its ability to generate them internally, the Bank believes that it could borrow additional funds from the Federal Home Loan Bank of Boston ("FHLB"). At December 31, 2003, the Bank had outstanding advances from the FHLB in the amount of $2.6 million in short and long-term borrowings. As these advances mature, they will be repaid or re-written as long-term matched borrowings which will assist the match of rate sensitive assets to rate sensitive liabilities.

At December 31, 2003, the Bank had $5.4 million in outstanding residential and commercial commitments to originate loans, as well as $24.7 million in unadvanced loan commitments. If the Bank anticipates that it may not have sufficient funds available to meet its current loan commitments it may commence further matched borrowing from the FHLB. Certificates of deposit that are scheduled to mature in one year or less totaled $36.8 million at December 31, 2003. Based on historical experience, management believes that a significant portion of such deposits will remain with the Bank.

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

Off Balance Sheet Arrangements

The Company does not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on the Company's financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to investors.

12

PART II. OTHER INFORMATION

ITEM 6 EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibit 3.2, Amended and Restated Bylaws of Falmouth Bancorp, Inc.
Exhibit 31.1, Certification of Chief Executive Officer Furnished Pursuant to Section 302 of the Sarbanes-Oxley Act.
Exhibit 31.2, Certification of Chief Financial Officer Furnished Pursuant to Section 302 of the Sarbanes-Oxley Act.
Exhibit 32.1, Statement of Chief Executive Officer Furnished Pursuant to Section 906 of the Sarbanes-Oxley Act.
Exhibit 32.2, Statement of Chief Financial Officer Furnished Pursuant to Section 906 of the Sarbanes-Oxley Act.

(b) Reports on Form 8-K

The Company furnished a Form 8-K with the Securities and Exchange Commission, dated November 7, 2003, reporting under Item 12 a press release dated November 7, 2003 describing fourth quarter earnings.

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

FALMOUTH BANCORP, INC.
(REGISTRANT)

Date: April 5, 2004 By: / s/ Santo P. Pasqualucci

Santo P. Pasqualucci
President and Chief Executive Officer

Date: April 5, 2004 By: /s/ George E. Young, III

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