

Edgar Filing: SLADES FERRY BANCORP - Form 10-Q

SLADES FERRY BANCORP  
Form 10-Q  
August 11, 2006

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

FORM 10-Q

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

For the quarter ended June 30, 2006  
-----

Commission file number 000-23904  
-----

SLADE'S FERRY BANCORP.  
-----

(Exact name of registrant as specified in its character)

Massachusetts  
-----

04-3061936  
-----

(State or other jurisdiction of  
incorporation or organization)

(I.R.S. Employer  
Identification Number)

100 Slade's Ferry Avenue  
Somerset, Massachusetts  
-----

02726  
-----

(Address of principal executive offices)

(Zip code)

(508)-675-2121  
-----

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports  
required to be filed by Section 13 or 15(d) of the Securities Exchange Act of  
1934 during the preceding 12 months, and (2) has been subject to such filing  
requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an  
accelerated filer, or a non-accelerated filer. See definition of "accelerated  
filer and large accelerated filer" in rule 12b-2 of the Exchange Act. (Check  
one):

Large Accelerated Filer  Accelerated Filer  Non Accelerated Filer

Indicate by check mark whether the registrant is a shell company (as defined in  
Rule 12b-2 of the Exchange Act).

Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of  
common stock, as of the latest practical date:

Common stock (\$0.01 par value) 4,171,990 outstanding shares as of July 31, 2006.  
-----

Edgar Filing: SLADES FERRY BANCORP - Form 10-Q

TABLE OF CONTENTS  
PART I

ITEM 1 - Financial Statements (Unaudited).....

- \* Consolidated Balance Sheets - June 30, 2006 and December 31, 2005
- \* Consolidated Statements of Income - Six Months Ended June 30, 2006 and 2005
- \* Consolidated Statements of Income - Three Months Ended June 30, 2006 and 2005
- \* Consolidated Statement of Changes in Stockholder's Equity - Six Months Ended June 30, 2006
- \* Consolidated Statements of Cash Flows - Six Months Ended June 30, 2006 and 2005
- \* Notes to 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

ITEM 1 - Legal Proceedings.....

ITEM 1A - Risk Factors.....

ITEM 2 - Unregistered Sales of Equity 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 - Exhibits.....

ITEM 1

FINANCIAL STATEMENTS

SLADE'S FERRY BANCORP. AND SUBSIDIARY  
CONSOLIDATED BALANCE SHEETS  
(Unaudited)

|   | June 30, 2006  | December 31, 2005 |
|---|----------------|-------------------|
|   | -----          | -----             |
|   | (In thousands) |                   |
| Assets  |                |                   |
| Cash and due from banks                           | \$ 22,319      | \$ 18,319         |
| Interest-bearing demand deposits with other banks | 970            | 970               |
| Federal funds sold                                | 6,200          | 6,200             |
|   | -----          | -----             |
| Cash and cash equivalents                         | 29,489         | 25,489            |

Edgar Filing: SLADES FERRY BANCORP - Form 10-Q

|  |           |      |
|--|-----------|------|
| Interest-bearing certificates of deposit with other banks  | 100       |      |
| Securities available for sale  | 88,744    | 9    |
| Securities held to maturity (fair value approximates of \$26,275 as of June 30, 2006 and \$28,858 as of December 31, 2005)   | 27,235    | 2    |
| Federal Home Loan Bank stock, at cost  | 6,304     |      |
| Loans, net of allowance for loan losses of \$4,366 at June 30, 2006 and \$4,333 at December 31, 2005   | 426,678   | 40   |
| Premises and equipment, net  | 5,746     |      |
| Goodwill   | 2,173     |      |
| Accrued interest receivable  | 2,091     |      |
| Bank-owned life insurance  | 12,097    | 1    |
| Deferred tax assets, net   | 2,846     |      |
| Other assets   | 1,850     |      |
|  | -----     | ---  |
|  | \$605,353 | \$58 |
|  | =====     | ===  |
| Liabilities and Stockholders' Equity   |           |      |
| Deposits:  |           |      |
| Noninterest-bearing  | \$ 80,710 | \$ 8 |
| Interest-bearing   | 349,358   | 33   |
|  | -----     | ---  |
| Total deposits   | 430,068   | 41   |
| Short-term borrowings  | 10,000    |      |
| Long-term borrowings   | 93,043    | 10   |
| Subordinated debentures  | 10,310    | 1    |
| Due to broker  | 9,509     |      |
| Accrued expenses and other liabilities   | 2,575     |      |
|  | -----     | ---  |
| Total liabilities  | 555,505   | 53   |
| Stockholders' equity:  |           |      |
| Common stock, par value \$0.01 per share; authorized 10,000,000 shares; issued and outstanding 4,164,042 shares at June 30, 2006 and 4,132,200 shares at December 31, 2005 | 42        |      |
| Additional paid-in capital   | 31,608    | 3    |
| Retained earnings  | 19,782    | 1    |
| Accumulated other comprehensive loss   | (1,484)   | (    |
| Unearned compensation  | (100)     |      |
|  | -----     | ---  |
| Total stockholders' equity   | 49,848    | 4    |
|  | -----     | ---  |
|  | \$605,353 | \$58 |
|  | =====     | ===  |

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

SLADE'S FERRY BANCORP. AND SUBSIDIARY  
CONSOLIDATED STATEMENTS OF INCOME  
(Unaudited)

Six Months Ended June 30,  
2006                      2005  
-----                      -----  
(In thousands, except per share)

Edgar Filing: SLADES FERRY BANCORP - Form 10-Q

|  |           |           |
|--|-----------|-----------|
| Interest and dividend income:  |           |           |
| Interest and fees on loans   | \$ 13,120 | \$ 10,993 |
| Interest and dividends on securities:                                |           |           |
| Taxable  | 2,550     | 2,430     |
| Tax-exempt   | 134       | 175       |
| Interest on federal funds sold                                       | 64        | 157       |
| Other interest   | 18        | 11        |
|  | -----     | -----     |
| Total interest and dividend income                                   | 15,886    | 13,766    |
| Interest expense:  |           |           |
| Interest on deposits   | 4,167     | 2,616     |
| Interest on Federal Home Loan Bank advances                          | 2,365     | 1,985     |
| Interest on subordinated debentures                                  | 394       | 291       |
|  | -----     | -----     |
| Total interest expense   | 6,926     | 4,892     |
|  | -----     | -----     |
| Net interest and dividend income                                     | 8,960     | 8,874     |
| Provision for loan losses  | 39        | 65        |
|  | -----     | -----     |
| Net interest income, after provision for loan losses                 | 8,921     | 8,809     |
| Noninterest income:  |           |           |
| Service charges on deposit accounts                                  | 659       | 420       |
| Gain on sales of assets  | --        | 51        |
| Gain (loss) on sales and calls of available-for-sale securities, net | (169)     | 17        |
| Increase in cash surrender value of life insurance policies          | 213       | 258       |
| Other income   | 546       | 363       |
|  | -----     | -----     |
| Total noninterest income   | 1,249     | 1,109     |
| Noninterest expense:   |           |           |
| Salaries and employee benefits                                       | 4,398     | 4,095     |
| Occupancy and equipment expense                                      | 983       | 809       |
| Professional fees  | 800       | 614       |
| Marketing expense  | 187       | 328       |
| Other expense  | 1,334     | 1,091     |
|  | -----     | -----     |
| Total noninterest expense  | 7,702     | 6,937     |
|  | -----     | -----     |
| Income before income taxes   | 2,468     | 2,981     |
| Provision for income taxes   | 935       | 1,033     |
|  | -----     | -----     |
| Net income   | \$ 1,533  | \$ 1,948  |
|  | =====     | =====     |
| Earnings per share:  |           |           |
| Basic  | \$ 0.37   | \$ 0.48   |
|  | =====     | =====     |
| Diluted  | \$ 0.37   | \$ 0.47   |
|  | =====     | =====     |
| Average common shares outstanding:                                   |           |           |
| Basic  | 4,151,091 | 4,094,939 |
|  | =====     | =====     |
| Diluted  | 4,168,271 | 4,123,796 |
|  | =====     | =====     |

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

Edgar Filing: SLADES FERRY BANCORP - Form 10-Q

SLADE'S FERRY BANCORP. AND SUBSIDIARY  
CONSOLIDATED STATEMENTS OF INCOME  
(Unaudited)

|  | Three Months Ended June 30       |          |
|--|----------------------------------|----------|
|  | 2006                             | 2005     |
|  | ----                             | ----     |
|  | (In thousands, except per share) |          |
| Interest and dividend income:  |                                  |          |
| Interest and fees on loans   | \$ 6,685                         | \$ 5,727 |
| Interest and dividends on securities:                                |                                  |          |
| Taxable  | 1,217                            | 1,199    |
| Tax-exempt   | 65                               | 84       |
| Interest on federal funds sold                                       | 53                               | 92       |
| Other interest   | 10                               | 7        |
|  | -----                            | -----    |
| Total interest and dividend income                                   | 8,030                            | 7,109    |
| Interest expense:  |                                  |          |
| Interest on deposits   | 2,256                            | 1,457    |
| Interest on Federal Home Loan Bank advances                          | 1,209                            | 1,074    |
| Interest on subordinated debentures                                  | 170                              | 155      |
|  | -----                            | -----    |
| Total interest expense   | 3,635                            | 2,686    |
|  | -----                            | -----    |
| Net interest and dividend income                                     | 4,395                            | 4,423    |
| Provision for loan losses  | --                               | 15       |
|  | -----                            | -----    |
| Net interest income, after provision for loan losses                 | 4,395                            | 4,408    |
| Noninterest income:  |                                  |          |
| Service charges on deposit accounts                                  | 352                              | 212      |
| Gain on sales of assets  | --                               | 11       |
| Gain (loss) on sales and calls of available-for-sale securities, net | (172)                            | 15       |
| Increase in cash surrender value of life insurance policies          | 106                              | 111      |
| Other income   | 260                              | 191      |
|  | -----                            | -----    |
| Total noninterest income   | 546                              | 540      |
| Noninterest expense:   |                                  |          |
| Salaries and employee benefits                                       | 2,287                            | 2,120    |
| Occupancy and equipment expense                                      | 490                              | 400      |
| Professional fees  | 388                              | 307      |
| Marketing expense  | 109                              | 229      |
| Other expense  | 678                              | 566      |
|  | -----                            | -----    |
| Total noninterest expense  | 3,952                            | 3,622    |
|  | -----                            | -----    |
| Income before income taxes   | 989                              | 1,326    |
| Provision for income taxes   | 363                              | 478      |
|  | -----                            | -----    |
| Net income   | \$ 626                           | \$ 848   |
|  | =====                            | =====    |
| Earnings per share:  |                                  |          |
| Basic  | \$ 0.15                          | \$ 0.21  |
|  | =====                            | =====    |
| Diluted  | \$ 0.15                          | \$ 0.21  |
|  | =====                            | =====    |

Edgar Filing: SLADES FERRY BANCORP - Form 10-Q

Average common shares outstanding:

|         |           |           |
|---------|-----------|-----------|
| Basic   | 4,156,481 | 4,112,969 |
|         | =====     | =====     |
| Diluted | 4,170,610 | 4,132,712 |
|         | =====     | =====     |

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

5

SLADE'S FERRY BANCORP. AND SUBSIDIARY  
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY  
(Unaudited)

|  | Shares of<br>Common<br>Stock | Common<br>Stock | Additional<br>Paid-in<br>Capital | Retained<br>Earnings | Accumulat<br>Other<br>Comprehens<br>Loss |
|--|------------------------------|-----------------|----------------------------------|----------------------|--|
| -----                                  |                              |                 |                                  |                      |  |
| (In thousands, except per share data)  |                              |                 |                                  |                      |  |
| Balance at December 31, 2005           | 4,132,200                    | \$ 41           | \$31,014                         | \$18,998             | \$(1,198)                                |
| Comprehensive income:                  |                              |                 |                                  |                      |  |
| Net income                             | -                            | -               | -                                | 1,533                | -  |
| Other comprehensive loss               | -                            | -               | -                                | -                    | (286)                                    |
| Comprehensive income                   |                              |                 |                                  |                      |  |
| Issuance of common stock               | 16,842                       | -               | 302                              | -                    | -  |
| Stock options exercised                | 28,000                       | 1               | 304                              | -                    | -  |
| Tax benefit of stock options exercised | -                            | -               | 82                               | -                    | -  |
| Stock-based compensation               | -                            | -               | 136                              | -                    | -  |
| Purchase of treasury stock             | (13,000)                     | -               | (230)                            | -                    | -  |
| Unearned compensation                  | -                            | -               | -                                | -                    | -  |
| Dividends declared (\$.18 per share)   | -                            | -               | -                                | (749)                | -  |
|  | -----                        |                 |                                  |                      |  |
| Balance at June 30, 2006               | 4,164,042                    | \$ 42           | \$31,608                         | \$19,782             | \$(1,484)                                |
|  | =====                        |                 |                                  |                      |  |

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

6

SLADE'S FERRY BANCORP. AND SUBSIDIARY  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)

|  |                                |
|--|--------------------------------|
|  | Six Months Ended June          |
|  | -----                          |
|  | 2006                      2005 |

Edgar Filing: SLADES FERRY BANCORP - Form 10-Q

|   | -----          | -----   |
|---|----------------|---------|
|   | (In thousands) |         |
| Cash flows from operating activities:   |                |         |
| Net income  | \$ 1,533       | \$ 1,94 |
| Adjustments to reconcile net income to net cash provided by operating activities: |                |         |
| Amortization, net of accretion of securities                                      | 65             | 15      |
| Loss (gain) on sales and calls of available-for-sale securities, net              | 169            | (1      |
| Change in net deferred loan fees  | (10)           | 4       |
| Provision for loan losses   | 39             | 6       |
| Deferred tax provision (benefit)  | (491)          | 12      |
| Depreciation and amortization   | 439            | 39      |
| Gain on sale of assets  | --             | (5      |
| Increase in cash surrender value of life insurance                                | (213)          | (24     |
| Stock-based compensation  | 136            | -       |
| Net change in:  |                |         |
| Other assets  | 67             | 14      |
| Accrued interest receivable   | 224            | (21     |
| Other liabilities   | (463)          | 51      |
|   | -----          | -----   |
| Net cash provided by operating activities   | 1,495          | 2,85    |
|   | -----          | -----   |
| Cash flows from investing activities:   |                |         |
| Activity in available-for-sale securities:  |                |         |
| Purchases   | (6,440)        | (20,76  |
| Sales   | 15,196         | 1,82    |
| Maturities, calls and paydowns  | 5,611          | 6,54    |
| Activity in held-to-maturity securities:  |                |         |
| Maturities, calls and paydowns  | 2,046          | 4,25    |
| Purchases of Federal Home Loan Bank stock   | --             | (1,25   |
| Loan principal originations, net  | (17,097)       | (29,20  |
| Recoveries of loans previously charged off, net                                   | --             | 5       |
| Capital expenditures  | (268)          | (1,04   |
| Proceed from sale of property and equipment                                       | --             | 2       |
| Proceeds from sale of investment real estate                                      | --             | 65      |
| Redemption of life insurance policy   | --             | 12      |
|   | -----          | -----   |
| Net cash used in investing activities   | (952)          | (38,78  |
|   | -----          | -----   |

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

SLADE'S FERRY BANCORP. AND SUBSIDIARY  
CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)  
(Unaudited)

|                                       | Six Months Ended June |       |
|---------------------------------------|-----------------------|-------|
|                                       | -----                 | ----- |
|                                       | 2006                  | 2005  |
|                                       | -----                 | ----- |
|                                       | (In thousands)        |       |
| Cash flows from financing activities: |                       |       |

Edgar Filing: SLADES FERRY BANCORP - Form 10-Q

|   |           |          |
|---|-----------|----------|
| Net increase (decrease) in noninterest-bearing deposits | \$ 5      | \$ (2,63 |
| Net increase in interest-bearing deposits               | 14,217    | 9,37     |
| Short-term advances from Federal Home Loan Bank         | 43,000    | -        |
| Long-term advances from Federal Home Loan Bank          | --        | 20,00    |
| Payments on Federal Home Loan Bank short-term advances  | (40,000)  | -        |
| Payments on Federal Home Loan Bank long-term advances   | (7,822)   | (20      |
| Proceeds from issuance of common stock                  | 302       | 31       |
| Stock options exercised                                 | 305       | 31       |
| Purchase of treasury stock                              | (230)     | -        |
| Unearned compensation                                   | (100)     | -        |
| Dividends paid  | (749)     | (73      |
|   | -----     | -----    |
| Net cash provided by financing activities               | 8,928     | 26,41    |
|   | -----     | -----    |
| Net increase (decrease) in cash and cash equivalents    | 9,471     | (9,50    |
| Cash and cash equivalents at beginning of period        | 20,018    | 35,19    |
|   | -----     | -----    |
| Cash and cash equivalents at end of period              | \$ 29,489 | \$ 25,68 |
|   | =====     | =====    |
| Supplemental disclosures:                               |           |          |
| Interest paid   | \$ 7,105  | \$ 4,77  |
| Income taxes paid                                       | \$ 475    | \$ 88    |
| Non-cash disclosure:                                    |           |          |
| Due to broker   | \$ 9,509  | \$ -     |

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

8

SLADE'S FERRY BANCORP. AND SUBSIDIARY  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
June 30, 2006

NOTE A - BASIS OF PRESENTATION  
-----

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and the instructions to Form 10-Q and, accordingly, do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of the management of Slade's Ferry Bancorp. (the "Company"), all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the six months ended June 30, 2006 are not necessarily indicative of the results that may be expected for the year ending December 31, 2006.

The year-end consolidated financial data was derived from audited financial statements, but does not include all disclosures required by GAAP. This Form 10-Q should be read in conjunction with the Company's Annual Report filed on Form 10-K for the year ended December 31, 2005.

NOTE B - ACCOUNTING POLICIES  
-----

The accounting principles followed by Slade's Ferry Bancorp. and subsidiary and the methods of applying these principles which materially affect the



## Edgar Filing: SLADES FERRY BANCORP - Form 10-Q

determination of financial position, results of operations, or changes in financial position are consistent with those used for the year ended December 31, 2005, except for the adoption of Statement of Financial Accounting Standards No. 123(R), Share-Based Payment, ("SFAS 123 (R)" or the "Statement") effective January 1, 2006 applicable to the Company's stock-based employee compensation plans. See Note C.

The consolidated financial statements include the accounts of Slade's Ferry Bancorp., its wholly-owned subsidiary, Slade's Ferry Trust Company (the "Bank") and the Bank's wholly-owned subsidiaries. All significant inter-company balances and transactions have been eliminated in consolidation. The Company accounts for its wholly-owned subsidiary, Slade's Ferry Statutory Trust I, using the equity method.

Slade's Ferry Statutory Trust I, a subsidiary of the Company, was formed on March 17, 2004 to sell capital securities to the public through a third party trust pool. In accordance with Financial Accounting Standards Board ("FASB") Interpretation No. 46R, "Consolidation of Variable Interest Entities" ("FIN 46R"), the subsidiary has not been included in the consolidated financial statements.

Slade's Ferry Loan Company was dissolved in early 2005.

### NOTE C - STOCK BASED COMPENSATION

-----

The Company adopted Statement of Financial Accounting Standards No. 123(R), Share-Based Payment, ("SFAS 123(R)" or the "Statement") effective January 1, 2006 applicable to the Company's stock-based employee compensation plans. The Company's stock-based compensation plans are described in Note 15 to the Company's consolidated financial statements included in its Form 10-K for the year ended December 31, 2005. No changes have been made to the plans during the six months ended June 30, 2006. In accordance with SFAS No. 123(R), for the six months ended June 30, 2006, the Company has expensed, on a straight line basis, the previously unrecognized compensation costs related to the non-vested portion of awards granted and outstanding as of January 1, 2006 based on the grant-date fair value of those awards as calculated under the original provisions of Statement No. 123. Fair value has been determined using Black-Scholes option-pricing

9

model. Compensation costs are now being recognized over the period the employee is required to provide services to obtain the award. The impact of adopting SFAS No. 123(R) was a reduction of income before income taxes of \$136,000 and a reduction of net income by \$98,000 for the six months ended June 30, 2006. Basic and diluted earnings per share were reduced by \$0.02 and \$0.03 per share, respectively. The impact of adopting SFAS No. 123(R) was a reduction of income before income taxes of \$70,000 and a reduction of net income of \$51,000 for the three months ended June 30, 2006. Basic and diluted earnings per share were reduced by \$0.01 per share.

Prior to the adoption of SFAS No. 123(R), the Company accounted for the plans under the recognition and measurement principles of Accounting Principle Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," and related Interpretations. Accordingly, no stock-based employee compensation cost was reflected in net income, as all options granted under the plans had an exercise price equal to the market value of the underlying common stock on the date of grant.

A summary of the status of the Company's stock option plans (shares in

## Edgar Filing: SLADES FERRY BANCORP - Form 10-Q

thousands) are presented below:

| Options                      | Shares Available<br>for Grant | Stock Options Outstanding |                                    |
|------------------------------|-------------------------------|---------------------------|------------------------------------|
| -----                        | -----                         | Shares                    | Weighted-Average<br>Exercise Price |
| -----                        | -----                         | -----                     | -----                              |
| Balance at December 31, 2005 | 164                           | 255                       | \$15.92                            |
| Granted                      | (8)                           | 8                         | 18.40                              |
| Stock options exercised      | -                             | (28)                      | 10.89                              |
| Shares vested                | -                             | -                         | -                                  |
| Forfeited or expired         | -                             | (4)                       | 14.18                              |
|                              | ---                           | ---                       |                                    |
| Balance at June 30, 2006     | 156                           | 231                       |                                    |
|                              | ===                           | ===                       |                                    |

The weighted-average grant-date fair value of options granted during the six months ended June 30, 2006 was \$18.40. The total intrinsic value of options exercised during the six months ended June 30, 2006 was \$325,000.

A summary of options outstanding (shares in thousands) at June 30, 2006 is as follows:

|   | Stock Options |             |
|---|---------------|-------------|
|   | Outstanding   | Exercisable |
| -----   | -----         | -----       |
| Total number of shares                                  | 231           | 203         |
| Weighted average exercise price                         | \$ 18.18      | \$ 18.03    |
| Aggregate intrinsic value (in thousands)                | \$ 4,198      | \$ 3,360    |
| Weighted average remaining contractual term (in months) | 11            | 11          |

10

The fair value of each option award is estimated on the date of grant based on a number of factors including volatilities, dividends, and expected terms. Listed below is a summary of the factors we employed:

|                             | June 30, 2006 |
|-----------------------------|---------------|
| -----                       | -----         |
| Expected volatility         | 24% - 33%     |
| Weighted-average volatility | 29%           |
| Expected dividends          | 1.90%         |
| Expected term (in years)    | 5 - 10        |
| Risk-free rate              | 3.98% - 5.22% |

The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of Statement of Financial Accounting Standards ("SFAS") Statement No. 123(R), "Accounting for Stock-Based Compensation," to stock-based employee compensation for the three and six months ended June 30, 2005.

[OBJECT OMITTED]

Edgar Filing: SLADES FERRY BANCORP - Form 10-Q

|  |             | Three Months Ended<br>June 30,<br>2005 | Six Months Ended<br>June 30,<br>2005 |
|--|-------------|--|--------------------------------------|
|  |             | -----                                  | -----                                |
| (In thousands, except per share data)  |             |  |                                      |
| Net income, as reported  |             | \$ 848                                 | \$1,948                              |
| Deduct: stock-based employee compensation expense<br>determined under fair value method, net of<br>related tax effects |             | 26                                     | 63                                   |
| Net income, pro forma  |             | \$ 822<br>=====                        | \$1,885<br>=====                     |
| Earnings per share - basic   | As reported | \$0.21<br>=====                        | \$0.48<br>=====                      |
|  | Pro forma   | \$0.20<br>=====                        | \$0.46<br>=====                      |
| Earnings per share - assuming dilution   | As reported | \$0.21<br>=====                        | \$0.47<br>=====                      |
|  | Pro forma   | \$0.20<br>=====                        | \$0.46<br>=====                      |

11

NOTE D - PENSION PLAN

-----  
The components of net periodic pension expense (income) are as follows:

|                                       | Three Months Ended June 30, |                 | Six Months     |
|---------------------------------------|-----------------------------|-----------------|----------------|
|                                       | 2006                        | 2005            | 2006           |
| -----                                 |                             |                 |                |
| (In thousands)                        |                             |                 |                |
| Interest cost                         | \$ 16                       | \$ 21           | \$ 33          |
| Expected return on plan assets        | (29)                        | (37)            | (58)           |
| Settlements                           | 133                         | -               | 133            |
| Recognized net actuarial loss         | 8                           | 9               | 15             |
| Net periodic benefit expense (income) | \$128<br>=====              | \$ (7)<br>===== | \$123<br>===== |

The Company previously disclosed in its consolidated financial statements for the year ended December 31, 2005 that it expects to make no contributions to the plan in 2006.

12

# Edgar Filing: SLADES FERRY BANCORP - Form 10-Q

## ITEM 2

### MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Slade's Ferry Bancorp., a Massachusetts corporation, is a bank holding company headquartered in Somerset, Massachusetts with consolidated assets of \$605.4 million, consolidated net loans and leases of \$426.7 million, consolidated deposits of \$430.1 million and consolidated shareholders' equity of \$49.8 million as of June 30, 2006. We conduct our business principally through our wholly-owned subsidiary, Slade's Ferry Trust Company (referred to herein as the "Bank"), a Massachusetts-chartered trust company. Our common stock is quoted on the Nasdaq Capital Market under the symbol "SFBC."

#### FORWARD-LOOKING STATEMENTS

-----

This Form 10-Q contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including statements regarding the strength of the company's capital and asset quality. Such statements may be identified by words such as "believes," "will," "expects," "project," "may," "could," "developments," "strategic," "launching," "opportunities," "anticipates," "estimates," "intends," "plans," "targets" and similar expressions. These statements are based upon the current beliefs and expectations of Slade's Ferry Bancorp.'s management and are subject to significant risks and uncertainties. Actual results may differ materially from those set forth in the forward-looking statements as a result of numerous factors.

The following factors, among others, could cause actual results to differ materially from the anticipated results or other expectations expressed in our forward-looking statements:

- (1) enactment of adverse government regulation;
- (2) competitive pressures among depository and other financial institutions may increase significantly and have an effect on pricing, spending, third-party relationships and revenues;
- (3) the strength of the United States economy in general and specifically the strength of the New England economies may be different than expected, resulting in, among other things, a deterioration in overall credit quality and borrowers' ability to service and repay loans, or a reduced demand for credit, including the resultant effect on the our loan portfolio, levels of charge-offs and non-performing loans and allowance for loan losses;
- (4) changes in the interest rate environment may reduce interest margins and adversely impact net interest income; and
- (5) changes in assumptions used in making such forward-looking statements.

Should one or more of these risks materialize or should underlying beliefs or assumptions prove incorrect, Slade's Ferry Bancorp.'s actual results could differ materially from those discussed.

All subsequent written and oral forward-looking statements attributable to Slade's Ferry Bancorp. or any person acting on its behalf are expressly qualified in their entirety by the cautionary statements set forth above. Slade's Ferry Bancorp. does not intend or undertake any obligation to update any forward-looking statement to reflect circumstances or events that occur after the date the forward-looking statements are made.

As used throughout this report, the terms "we," "our," "us," or the "Company"

## Edgar Filing: SLADES FERRY BANCORP - Form 10-Q

refer to Slade's Ferry Bancorp. and its consolidated subsidiary, unless the context otherwise requires.

13

### CRITICAL ACCOUNTING POLICIES

-----

Our significant accounting policies are incorporated by reference to Note 1 to our Consolidated Financial Statements filed within Form 10-K for the year ended December 31, 2005. In preparing consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses and other-than-temporary impairment losses.

Allowance for loan losses. The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

Other than temporary impairment. In estimating other-than-temporary-impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

### COMPARISON OF FINANCIAL CONDITION AT JUNE 30, 2006 AND DECEMBER 31, 2005

-----

#### GENERAL

-----

Total assets increased by \$19.5 million, or 3.3%, from \$585.9 million at December 31, 2005 to \$605.4 million at June 30, 2006. Total net loans increased by \$17.1 million, or 4.2%, from \$409.6 million to \$426.7 million. Deposits increased by \$14.2 million, or 3.4%, from \$415.8 million to \$430.1 million. The increase in deposits was partially offset by a decrease in Federal Home Loan Bank advances of \$4.8 million.

#### CASH AND CASH EQUIVALENTS

-----

Cash and cash equivalents increased by \$9.5 million, from \$20.0 million at December 31, 2005 to \$29.5 million at June 30, 2006. This increase was due primarily to uninvested proceeds from an investment exchange at June 30, 2006 (see "Investment Portfolio", below).

## Edgar Filing: SLADES FERRY BANCORP - Form 10-Q

### INVESTMENT PORTFOLIO

-----

The main objectives of our investment portfolio are to achieve a competitive rate of return over a reasonable time period and to provide liquidity.

14

Our total investment portfolio decreased from \$129.9 million at December 31, 2005 to \$122.3 million at June 30, 2006, a decrease of 5.9%. The decrease is the result of sales, maturities, calls and paydowns of certain state and municipal obligations and mortgage-backed securities. Those funds were used to provide liquidity for current loan growth.

An overriding investment strategy is to allow the investment portfolio to decrease through normal paydowns and maturities and reinvest these funds into higher yielding loans or investments. At June 30, 2006, the portfolio duration was approximately 3.1 years which was within our investment policy limit of 5 years. We do not purchase investments with imbedded derivative characteristics, or free-standing derivative instruments such as swaps, options, or futures.

### SECURITIES AVAILABLE FOR SALE

Securities not designated as held-to-maturity are designated as available for sale. Although we do not anticipate the sale of these securities, the designation as available for sale allows the flexibility to alter the investment strategy and sell these securities when conditions warrant. Additionally, marketable equity securities that have no maturity date must be designated as available-for-sale. These securities are carried at fair value. The available-for-sale securities portfolio includes obligations and mortgage-backed securities of government-sponsored enterprises, corporate debt and equity securities. Available-for-sale securities decreased from \$94.3 million at December 31, 2005 to \$88.7 million at June 30, 2006.

On June 20, 2006, the Board of Directors approved a strategy to restructure the available-for-sale investment portfolio through the sale of approximately \$14.5 million of low-yielding obligations of government-sponsored enterprises. Realized losses amounted to \$176,000 or 1.2% of the underlying cost basis of these securities. All purchases and sales relating to this reinvestment strategy were reflected in the financial statements as of June 30, 2006.

The following table shows the amortized cost basis and fair value of securities available for sale at June 30, 2006 and December 31, 2005.

|                                  | June 30, 2006     |               | December 31, 2005 |               |
|----------------------------------|-------------------|---------------|-------------------|---------------|
|                                  | Amortized<br>Cost | Fair<br>Value | Amortized<br>Cost | Fair<br>Value |
| -----                            |                   |               |                   |               |
| -----                            |                   |               |                   |               |
| (In thousands)                   |                   |               |                   |               |
| Debt Securities:                 |                   |               |                   |               |
| Government-sponsored enterprises | \$34,450          | \$33,504      | \$50,443          | \$49,581      |
| Corporate                        | 9,517             | 9,057         | 9,564             | 9,014         |
| Mortgage-backed                  | 42,640            | 41,867        | 31,574            | 31,232        |
|                                  | -----             | -----         | -----             | -----         |

Edgar Filing: SLADES FERRY BANCORP - Form 10-Q

|                                     |          |          |          |          |
|-------------------------------------|----------|----------|----------|----------|
| Total debt securities               | 86,607   | 84,428   | 91,581   | 89,827   |
|                                     | -----    | -----    | -----    | -----    |
| Marketable equity securities        | 3,306    | 3,151    | 3,426    | 3,271    |
| Mutual funds                        | 1,215    | 1,165    | 1,205    | 1,200    |
|                                     | -----    | -----    | -----    | -----    |
| Total securities available for sale | \$91,128 | \$88,744 | \$96,212 | \$94,298 |
|                                     | =====    | =====    | =====    | =====    |

15

SECURITIES HELD TO MATURITY

The held-to-maturity portfolio consists of mortgage-backed securities and securities issued by states and municipalities. These securities are carried at amortized cost. Held-to-maturity securities decreased from \$29.3 million at December 31, 2005 to \$27.2 million at June 30, 2006. Management has designated these mortgage-backed securities to secure advances from the FHLB. We have the positive intent and ability to hold these securities to maturity.

The following table shows the amortized cost basis and fair value of securities held to maturity at June 30, 2006 and December 31, 2005.

|                                   | June 30, 2006     |               | December 31, 2005 |               |
|-----------------------------------|-------------------|---------------|-------------------|---------------|
|                                   | Amortized<br>Cost | Fair<br>Value | Amortized<br>Cost | Fair<br>Value |
|                                   | -----             | -----         | -----             | -----         |
|                                   | (In thousands)    |               |                   |               |
| State and municipal obligations   | \$ 6,098          | \$ 6,164      | \$ 6,766          | \$ 6,892      |
| Mortgage-backed securities        | 21,137            | 20,111        | 22,540            | 21,966        |
|                                   | -----             | -----         | -----             | -----         |
| Total securities held to maturity | \$27,235          | \$26,275      | \$29,306          | \$28,858      |
|                                   | =====             | =====         | =====             | =====         |

LOANS

-----

Our loan portfolio consists primarily of residential and commercial real estate loans, construction and land development loans, commercial loans, home equity lines of credit and consumer loans originated primarily in our market area. There are no foreign loans outstanding. Interest rates charged on loans are affected principally by the demand for such loans, the supply of money available for lending purposes and the rates offered by the our competitors. Total net loans were 70.5% of total assets at June 30, 2006, as compared to 69.9% of total assets at December 31, 2005.

MULTI-FAMILY AND COMMERCIAL REAL ESTATE LENDING

We originate multi-family and commercial real estate loans that are generally secured by five or more unit apartment buildings and properties used for business purposes, such as small office buildings, restaurants or retail facilities. Loans secured by multi-family and commercial real estate properties

## Edgar Filing: SLADES FERRY BANCORP - Form 10-Q

generally involve larger principal amounts and a greater degree of risk than one-to-four family residential mortgage loans. Because payments on loans secured by multi-family and commercial real estate properties are often dependent on successful operation or management of the properties, repayment of such loans may be subject to adverse conditions in the real estate market or the economy. We seek to minimize these risks through our underwriting standards.

Multi-family and commercial real estate loans totaled \$211.3 million and comprised 49.0% of the total gross loan portfolio at June 30, 2006. At December 31, 2005, the multi-family and commercial real estate loan portfolio totaled \$213.8 million, or 51.6% of total gross loans.

16

### RESIDENTIAL LENDING

We currently offer fixed-rate, one-to-four family mortgage loans with terms from 10 to 30 years and a number of adjustable-rate mortgage ("ARM") loans with terms of up to 30 years and interest rates that adjust every one or three years from the outset of the loan.

We generally underwrite our residential real estate loans to comply with secondary market standards established by the Federal National Mortgage Association. Although loans are underwritten to standards that make them readily saleable, we have not chosen to sell these loans. Rather, we maintain them in our portfolio, consistent with our income and interest rate risk management targets.

Residential real estate loans totaled \$127.0 million and comprised 29.4% of the total gross loan portfolio at June 30, 2006. At December 31, 2005, the residential real estate loan portfolio totaled \$120.3 million, or 29.1% of total gross loans. Due to competitive pricing, our residential loan portfolio continues to increase.

### COMMERCIAL LOANS

Commercial business loans consist of loans and lines predominantly collateralized by inventory, furniture and fixtures, and accounts receivable. In assessing the collateral for this type of loan, we apply a 50% liquidation value to inventories; 25% to furniture, fixtures and equipment; and 70% to accounts receivable less than 90 days of the invoice date.

Commercial loans totaled \$50.0 million and comprised 11.6% of the total gross loan portfolio at June 30, 2006. At December 31, 2005, the commercial loan portfolio totaled \$38.1 million, or 9.2% of total gross loans. With the implementation of our loan portfolio management team, our commercial loan officers are able to concentrate their efforts on this aspect of business development.

### CONSTRUCTION LENDING

Fixed-rate construction loans are originated for the development of one-to-four family residential properties. Although we do not generally make loans secured by raw land, our policies permit the origination of such loans. Construction loan proceeds are disbursed periodically in increments as construction progresses and as inspections by an independent construction specialist warrant.

Construction and land development loans totaled \$23.3 million and comprised 5.4% of total gross loan portfolio at June 30, 2006. At December 31, 2005, the



## Edgar Filing: SLADES FERRY BANCORP - Form 10-Q

construction and land development loans totaled \$21.5 million or 5.2% of total gross loans. Again with the implementation of our loan portfolio management team, our commercial loan officers are able to manage their efforts on business development.

### HOME EQUITY LINES OF CREDIT

Home equity lines of credit are secured by second mortgages on owner-occupied, one-to-four family residences located in our primary market area. Interest rates on our home equity lines of credit are generally indexed to the Wall Street Journal Prime Rate and adjust on a monthly basis.

Home equity lines of credit totaled \$17.1 million and comprised 4.0% of the total gross loan portfolio at June 30, 2006. At December 31, 2005, home equity lines of credit totaled \$17.9 million, or 4.3% of total gross loans.

17

### CONSUMER LENDING

Consumer loans secured by rapidly depreciable assets such as recreational vehicles and automobiles entail greater risks than one-to-four family residential mortgage loans. Consumer loans are typically made based on the borrower's ability to repay the loan through continued financial stability. We endeavor to minimize risk by reviewing the borrower's repayment history on past debts, and assessing the borrower's ability to meet existing obligations on the proposed loan. Consumer loans are both secured and unsecured borrowings. Consumer loans totaled \$2.7 million and comprised 0.6% of the total gross loan portfolio at June 30, 2006. At December 31, 2005, the consumer loans totaled \$2.6 million, or 0.6% of total gross loans.

The following table summarizes our loan portfolio by category at June 30, 2006 and December 31, 2005.

|  | June 30, 2006          | December 31, 2005 | Perc<br>Increase |
|--|------------------------|-------------------|------------------|
|  | -----                  | -----             | -----            |
|  | (Dollars in thousands) |                   |                  |
| Real estate mortgage loans:            |                        |                   |                  |
| Commercial                             | \$211,280              | \$213,815         | -                |
| Residential                            | 126,943                | 120,345           |                  |
| Construction and land development      | 23,359                 | 21,490            |                  |
| Home equity lines of credit            | 17,122                 | 17,915            | -                |
| Commercial, financial and agricultural | 50,015                 | 38,111            | 3                |
| Consumer loans                         | 2,671                  | 2,623             |                  |
|  | -----                  | -----             | -----            |
| Total loans                            | 431,390                | 414,299           |                  |
| Less: Allowance for loan losses        | (4,366)                | (4,333)           |                  |
| Net deferred loan fees                 | (346)                  | (356)             | -                |
|  | -----                  | -----             | -----            |
| Loans, net                             | \$426,678              | \$409,610         | =                |
|  | =====                  | =====             | =====            |

The increases in the loan portfolio are the result of the continued demand by small businesses for commercial and industrial loans and the normal origination process for residential loans. These increases were partially offset by a weaker overall general market environment relating to commercial real estate

## Edgar Filing: SLADES FERRY BANCORP - Form 10-Q

and home equity lines of credit.

The following table presents information with respect to non-performing loans at the dates indicated.

|  | At June 30, 2006       | At December 31, 2006 |
|--|------------------------|----------------------|
|  | -----                  | -----                |
|  | (Dollars in thousands) |                      |
| Non-accrual loans  | \$ 441                 | \$ 441               |
| Loans 90 days or more past due and still accruing            | -                      | -                    |
|  | -----                  | -----                |
| Total non-performing loans                                   | \$ 441                 | \$ 441               |
|  | =====                  | =====                |
| Percentage of non-accrual loans to total loans               | 0.10%                  | 0.10%                |
| Percentage of allowance for loan losses to non-accrual loans | 990.02%                | 990.02%              |

18

The \$441,000 in non-accrual loans as of June 30, 2006 consists of \$402,000 of commercial real estate loans, \$34,000 of residential real estate loans and \$5,000 of consumer loans. There were no restructured or impaired loans included in non-accrual loans for the six months ended June 30, 2006.

It is our policy to manage our loan portfolio in order to recognize problem loans at an early stage and thereby minimize loan losses. Loans are considered delinquent when any payment of principal or interest is one month or more past due. We generally commence collection procedures when accounts are 15 days past due. Generally, when a loan becomes past due 90 days or more, management discontinues the accrual of interest and reverses previously accrued interest, unless the credit is well-secured and in process of collection. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured. When a loan, or any portion of a loan, is determined to be uncollectible, it is charged off to the Allowance for Loan Losses. If applicable, any real estate securing the loan is acquired through foreclosure, and recorded as Other Real Estate Owned at the then fair market value, and thereby reducing the amount required to be charged against the Allowance for Loan Losses.

Management defines non-performing loans to include non-accrual loans, loans past due 90 days or more and still accruing, and restructured loans not performing in accordance with amended terms.

Statement of Financial Accounting Standards No. 114 "Accounting by Creditors for Impairment of a Loan" ("SFAS No. 114") applies to all loans except large groups of smaller-balance homogeneous loans that are collectively evaluated for impairment. For loans that are classified as impaired an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loans is lower than the carrying value of that loan. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. We do not separately identify consumer loans for

## Edgar Filing: SLADES FERRY BANCORP - Form 10-Q

impairment disclosures. A loan is considered impaired when, based on current information and events, it is probable that we will be unable to collect the scheduled payments of principle or interest when due according to the contractual terms of the loan agreement.

19

### ANALYSIS OF ALLOWANCE FOR LOAN LOSSES

The table below illustrates the changes in the Allowance for Loan Losses for the periods indicated.

|   | Six Months Ended June 30, |         |
|---|---------------------------|---------|
|   | 2006                      | 2005    |
|   | ----                      | ----    |
|   | (Dollars in thousands)    |         |
| Balance at beginning of period  | \$4,333                   | \$4,101 |
| Charge-offs:  |                           |         |
| Real estate mortgage loans:   |                           |         |
| Commercial  | -                         | -       |
| Residential   | -                         | -       |
| Home equity lines of credit   | -                         | -       |
| Commercial, financial and agricultural loans                            | -                         | -       |
| Consumer  | 6                         | -       |
|   | -----                     | -----   |
|   | 6                         | -       |
|   | -----                     | -----   |
| Recoveries:   |                           |         |
| Real estate mortgage loans:   |                           |         |
| Commercial  | -                         | -       |
| Residential   | -                         | -       |
| Home equity lines of credit   | -                         | 16      |
| Commercial, financial and agricultural loans                            | -                         | 32      |
| Consumer  | -                         | 9       |
|   | -----                     | -----   |
|   | -                         | 57      |
|   | -----                     | -----   |
| Net loan recoveries (charge-offs)                                       | (6)                       | 57      |
| Provision for loan losses   | 39                        | 65      |
|   | -----                     | -----   |
| Balance at end of period  | \$4,366                   | \$4,223 |
|   | =====                     | =====   |
| Allowance for loan losses as a percent of loans                         | 1.02%                     | 1.08%   |
|   | =====                     | =====   |
| Ratio of net loan recoveries (charge-offs) to average loans outstanding | 0.00%                     | -0.01%  |
|   | =====                     | =====   |

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

## Edgar Filing: SLADES FERRY BANCORP - Form 10-Q

The allowance consists of specific, general and unallocated components. For such loans that are classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

20

As the composition of the loan portfolio gradually changes and diversifies from higher credit risk weighted loans, such as commercial real estate and commercial, to residential and home equity loans, a lower overall reserve allowance rate will be required. After thorough review and analysis of the adequacy of the loan loss allowance, management determined a provision for losses of \$39,000 was required for the six months ended June 30, 2006 as compared to a provision of \$65,000 for the six months ended June 30, 2005. The allowance for loan losses as a percentage of total loans outstanding declined from 1.05% at December 31, 2005 to 1.01% at June 30, 2006. The decline in the provision for loan losses in 2006, as compared to the same period in 2005, was primarily attributable to refinements in calculating the risk components inherent in our loan portfolio. These refinements in the allocated risk factors attributable to all loan pools were finalized in the second quarter of 2006.

This table below shows an allocation of the allowance for loan losses at the dates indicated. The unallocated portion of the allowance for loan losses is reflected in the allocation for real estate mortgage loans.

|                          | June 30, 2006 |  | December 31,                               |
|--------------------------|---------------|--|--|
|                          | Amount        | Percent of Loans in<br>Each Category to<br>Total Loans | Amount                                     |
|                          |               |  | Percent<br>in Each<br>Category<br>to Total |
| (Dollars in thousands)   |               |  |  |
| Commercial               | \$ 775        | 11.6%  | \$ 905                                     |
| Real estate construction | 247           | 5.4%   | 248  |
| Real estate mortgage     | 3,157         | 82.4%  | 3,056                                      |
| Consumer                 | 187           | 0.6%   | 124  |
|                          | \$4,366       | 100.0%   | \$4,333                                    |
|                          |               |  |  |

21

DEPOSITS

## Edgar Filing: SLADES FERRY BANCORP - Form 10-Q

-----

We continue our efforts to competitively price deposit products and develop and maintain relationship banking with our customers. The flow of deposits is influenced significantly by general economic conditions, changes in money market rates, prevailing interest rates and competition from local branches of nationwide and regional banks as well as local banks and credit unions. Our total deposits increased from \$415.8 million at December 31, 2005 to \$430.1 million at June 30, 2006, an increase of \$14.2 million or 3.4%. The increase in total deposits was primarily attributable to increases in term deposits. A \$10.0 million certificate of deposit from the Commonwealth of Massachusetts that is to be used to assist in promoting job growth through loans to qualifying small businesses, and other reinvestments from lower-yielding deposit products made up the majority of this increase.

The following table presents deposits by category at June 30, 2006 and December 31, 2005.

|  | June 30, 2006          | December 31, 2005 | Percentage<br>Increase/ (Decrease) |
|--|------------------------|-------------------|------------------------------------|
|  | -----                  |                   |                                    |
|  | (Dollars in thousands) |                   |                                    |
| Demand deposits                        | \$ 80,710              | \$ 80,705         | 0.01%                              |
| NOW                                    | 53,118                 | 55,493            | -4.28%                             |
| Regular and other savings              | 82,288                 | 87,146            | -5.57%                             |
| Money market deposits                  | 27,595                 | 29,835            | -7.51%                             |
|  | -----                  | -----             | -----                              |
| Total non-certificate accounts         | 243,711                | 253,179           | -3.74%                             |
|  | -----                  | -----             | -----                              |
| Term certificates less than \$100,000  | 120,723                | 116,861           | 3.30%                              |
| Term certificates of \$100,000 or more | 65,634                 | 45,806            | 43.29%                             |
|  | -----                  | -----             | -----                              |
| Total certificate accounts             | 186,357                | 162,667           | 14.56%                             |
|  | -----                  | -----             | -----                              |
| Total deposits                         | \$430,068              | \$415,846         | 3.42%                              |
|  | =====                  | =====             | =====                              |

### BORROWINGS

-----

Short- and long-term advances from the Federal Home Loan Bank of Boston totaling \$103.0 million at June 30, 2006, as compared to \$107.9 million at December 31, 2005, a decrease of \$4.8 million or 4.5%. Our strategy is to utilize advances from the Federal Home Loan Bank in conjunction with the investment portfolio runoffs to fund loans as required. There was no change in the balance of our subordinated debentures.

### COMPARISON OF RESULTS OF OPERATIONS FOR THE SIX MONTHS ENDED

-----  
 JUNE 30, 2006 AND 2005  
 -----

## Edgar Filing: SLADES FERRY BANCORP - Form 10-Q

### GENERAL

-----

Net income decreased from \$1.9 million or \$0.47 per share on a diluted basis, for the six months ended June 30, 2005 to \$1.5 million or \$0.37 per share on a diluted basis, for the six months ended June 30, 2006, a decrease of 21.30%. Net interest and dividend income increased by \$86,000 or 1.00%, from \$8.9 million to \$9.0 million when comparing the six months ended June 30, 2005 and 2006. Over the same period, the provision for loan losses decreased from \$65,000 to \$39,000. Non-interest income increased by \$140,000 or 12.62% from \$1.1 million to \$1.2 million for the six months ended June 30, 2005 and 2006. Non-interest expenses increased by \$765,000 or 11.03%, from \$6.9 million for the six months ended June 30, 2005 to \$7.7 million for the six months ended June 30, 2006.

### INTEREST INCOME

-----

Our operating performance is dependent on net interest and dividend income, the difference between interest and dividend income earned on loans and investments and interest expense paid on deposits and borrowed funds. The level of net interest income and dividend income is significantly impacted by factors such as economic conditions, interest rates, asset/liability management, and strategic planning.

Interest and dividend income increased by \$2.1 million or 15.40%, to \$15.9 million for the six months ended June 30, 2006 from \$13.8 million for the six months ended June 30, 2005. This increase is attributable to the growth in the loan portfolio and higher yields on loans. The average balance of loans increased by \$35.5 million or 9.23% and the yield on the loan portfolio increased from 5.76% for the six months ended June 30, 2005 to 6.30% for the six months ended June 30, 2006. The increase was principally the result of a greater volume and higher rates earned on commercial and real estate loans reflecting current market conditions. Interest and dividends on investments decreased by \$29,000, on a fully taxable equivalent basis, for the six months ended June 30, 2006 compared to the six months ended June 30, 2005, respectively. The decrease was due to a combination of higher rates and reduced average balances, and the lack of a second quarter dividend declaration by the Federal Home Loan Bank of Boston. Based on preliminary information from the Federal Home Loan Bank, it is expected that this dividend will be declared in the third quarter of 2006.

### INTEREST EXPENSE

-----

Total interest expense increased by \$2.0 million or 41.58%, from \$4.9 million for the six months ended June 30, 2005 to \$6.9 million for the six months ended June 30, 2006. Market interest rates and our own deposit rates have also increased. Interest on deposits increased by \$1.6 million or 59.29% when comparing the six months ended June 30, 2006 and 2005. In response to competitive pressures and the rising rate environment, we raised rates on certain deposit products with the most significant increases in certificate of deposit and certain money-market based products. As a result of the rate increases, the weighted average cost of deposits increased from 1.66% for the six months ended June 30, 2005 to 2.49% for the six months ended June 30, 2006. Interest expense associated with the Federal Home Loan Borrowings increased by \$380,000 due to a combination of rate increases and volume increases related to the need to fund loan growth. Interest expense associated with subordinated debentures increased by \$103,000, the result of increased market interest rates. The debentures carry an adjustable rate of interest tied to the three-month LIBOR rate.

## NET INTEREST MARGIN

As a result of the current interest rate environment and our corresponding rate increases on deposit accounts, the net interest margin has compressed 15 basis points from 3.46% for the six months ended June 30, 2005 to 3.31% at June 30, 2006. The compression in net interest margin was mostly due to the rise in short term rates and the prolonged flatness of the yield curve, which has reduced the gap between short and intermediate-term interest rates and the spread between what banks earn on loans and securities and pay on deposits and borrowings.

## PROVISION FOR LOAN LOSSES

After thorough review and analysis of the adequacy of the loan loss reserve, management deemed it prudent to provide \$39,000 for possible loan losses for the six months ended June 30, 2006 compared to \$65,000 for possible loan losses for the six months ended June 30, 2005. The decline in the provision for loan losses in 2006 was attributable to continued improvements in the overall loan quality, combined with the refinements made in the allocated risk factors attributable to all components of our loan portfolio, during the six months ended June 30, 2006, as compared to the same period in 2005.

The following table sets forth our average assets, liabilities, and stockholders' equity, interest income earned and interest paid, average rates earned and paid, net interest spread and the net interest margin for the six months ended June 30, 2006 and 2005. Average balances reported are daily averages.

|                                | Six Months Ended June 30, |                            |                 |                    |
|--------------------------------|---------------------------|----------------------------|-----------------|--------------------|
|                                | 2006                      |                            |                 |                    |
|                                | Average<br>Balance        | Interest<br>Income/Expense | Average<br>Rate | Average<br>Balance |
| Assets:                        | (Dollars in thousands)    |                            |                 |                    |
| Interest earning assets (2)    |                           |                            |                 |                    |
| Loans:                         |                           |                            |                 |                    |
| Commercial                     | \$ 44,416                 | \$ 1,658                   | 7.53%           | \$ 30,272          |
| Commercial real estate         | 228,745                   | 7,319                      | 6.45%           | 220,402            |
| Residential real estate        | 144,352                   | 4,066                      | 5.68%           | 131,579            |
| Consumer                       | 2,557                     | 77                         | 6.07%           | 2,312              |
| Total loans                    | 420,070                   | 13,120                     | 6.30%           | 384,565            |
| Federal funds sold             | 2,738                     | 64                         | 4.71%           | 12,606             |
| Taxable debt securities        | 109,752                   | 2,394                      | 4.40%           | 106,927            |
| Tax-exempt debt securities (1) | 6,260                     | 208                        | 6.69%           | 8,127              |
| Marketable equity securities   | 4,355                     | 74                         | 3.43%           | 4,809              |
| FHLB stock                     | 6,304                     | 82                         | 2.62%           | 5,485              |

Edgar Filing: SLADES FERRY BANCORP - Form 10-Q

|                               |           |        |       |           |
|-------------------------------|-----------|--------|-------|-----------|
| Other investments             | 650       | 18     | 5.58% | 775       |
| -----                         |           |        |       |           |
| Total interest earning assets | 550,129   | 15,960 | 5.85% | 523,294   |
| Allowance for loan losses     | (4,358)   | -----  |       | (4,163)   |
| Deferred loan fees            | (330)     |        |       | (401)     |
| Cash and due from banks       | 12,951    |        |       | 18,311    |
| Other assets                  | 26,229    |        |       | 25,575    |
| -----                         |           |        |       |           |
|                               | \$584,621 |        |       | \$562,616 |
| =====                         |           |        |       |           |

Liabilities and Stockholders' Equity:

|                                    |           |        |       |           |
|------------------------------------|-----------|--------|-------|-----------|
| Interest bearing liabilities       |           |        |       |           |
| Savings accounts                   | \$ 83,637 | \$ 529 | 1.28% | \$ 91,619 |
| NOW accounts                       | 56,715    | 361    | 1.28% | 48,242    |
| Money market accounts              | 26,898    | 258    | 1.93% | 37,311    |
| Time deposits                      | 169,791   | 3,019  | 3.59% | 141,333   |
| FHLB advances                      | 110,998   | 2,365  | 4.30% | 104,460   |
| Subordinated debt                  | 10,310    | 394    | 7.71% | 10,310    |
| -----                              |           |        |       |           |
| Total interest bearing liabilities | 458,349   | 6,926  | 3.05% | 433,275   |
| Demand deposits                    | 73,868    | -----  |       | 79,334    |
| Other liabilities                  | 842       |        |       | 2,594     |
| -----                              |           |        |       |           |
| Total liabilities                  | 533,059   |        |       | 515,203   |
| Total stockholders' equity         | 51,562    |        |       | 47,413    |
| -----                              |           |        |       |           |
|                                    | \$584,621 |        |       | \$562,616 |
| =====                              |           |        |       |           |

|                     |          |       |  |
|---------------------|----------|-------|--|
| Net interest income | \$ 9,034 |       |  |
| =====               |          |       |  |
| Net interest spread |          | 2.80% |  |
| =====               |          |       |  |
| Net interest margin |          | 3.31% |  |
| =====               |          |       |  |

- (1) On a fully taxable basis based on tax rate of 35.0% for 2006 and 2005. Interest income on income includes a fully taxable equivalent adjustment of \$74,000 in 2006 and \$96,000 in 2005.
- (2) Average balance includes non-accruing loans. The effect of including such loans, although not the average rate earned on the Company's loans.

25

The following table presents the changes in components of net interest income for the six months ended June 30, 2006 and 2005, which are the result of changes in interest rates and the changes that the result of changes in volume of the underlying asset or liability. Changes that are attributable to the changes in both rate and volume have been allocated equally to rate and volume.

|                        |  |                  |                |
|------------------------|--|------------------|----------------|
|                        | Six Months Ended June 30,<br>2006 vs. 2005 Increase (Decrease) |                  |                |
|                        | -----  |                  |                |
|                        | Total<br>Change  | Due to<br>Volume | Due to<br>Rate |
|                        | -----  |                  |                |
|                        | (In thousands)   |                  |                |
| Commercial loans       | \$ 751   | \$ 492           | \$ 259         |
| Commercial real estate | 758  | 255              | 503            |



## Edgar Filing: SLADES FERRY BANCORP - Form 10-Q

|                              |       |        |          |
|------------------------------|-------|--------|----------|
| Residential real estate      | 609   | 349    | 260      |
| Consumer loans               | 9     | 7      | 2        |
| Federal funds sold           | (93)  | (177)  | 84       |
| Taxable debt securities      | 159   | 60     | 99       |
| Tax-exempt debt securities   | (63)  | (62)   | (1)      |
| Marketable equity securities | (9)   | (8)    | (1)      |
| FHLB Stock                   | (30)  | 14     | (44)     |
| Other investments            | 7     | (3)    | 10       |
|                              | ----- |        |          |
| Total interest income        | 2,098 | 927    | 1,171    |
|                              | ----- |        |          |
| Savings accounts             | 61    | (46)   | 107      |
| NOW accounts                 | 130   | 45     | 85       |
| Money market accounts        | 40    | (80)   | 120      |
| Time deposits                | 1,320 | 391    | 929      |
| FHLB advances                | 380   | 129    | 251      |
| Subordinated debt            | 103   | -      | 103      |
|                              | ----- |        |          |
| Total interest expense       | 2,034 | 439    | 1,595    |
|                              | ----- |        |          |
| Net interest income          | \$ 64 | \$ 488 | \$ (424) |
|                              | ===== |        |          |

### NON-INTEREST INCOME

-----

Non-interest income increased from \$1.1 million for the six months ended June 30, 2005 to \$1.2 million for the six months ended June 30, 2006, an increase of \$140,000 or 12.6%. Service charges on deposit accounts increased by \$239,000 or 56.9% from \$420,000 for the six months ended June 30, 2005 to \$659,000 for the six months ended June 30, 2006. This was the result of an increase in overdraft fees with the implementation of an overdraft protection program partially offset by a decrease in service charges on checking accounts. For the six months ended June 30, 2006, and in accordance with the previously-mentioned investment portfolio restructuring strategy, we recognized losses on the sale of securities, including certain low-yielding investments in order to acquire higher yielding assets, in the amount of \$169,000 when compared to a gain of \$17,000 for the six months ended June 30, 2005. Cash surrender value increases pertaining to bank-owned life insurance policies decreased \$45,000 to \$213,000 for the six months ended June 30, 2006 from \$258,000 for the six months ended June 30, 2005. Additionally, other income increased from \$363,000 for the six months ended June 30, 2005 to \$546,000 for the six months ended June 30, 2006, primarily as a result of increased commissions earned on the sale of non-deposit investment products, combined with increased volumes in official check fees and debit card income.

26

### NON-INTEREST EXPENSE

-----

Non-interest expense increased from \$6.9 million for the six months ended June 30, 2005 to \$7.7 million for the six months ended June 30, 2006, an increase of \$765,000 or 11.0%. Salaries and employee benefits increased by \$303,000 or 7.4%, from \$4.1 million for the six months ended June 30, 2005 to \$4.4 million for the six months ended June 30, 2006. The increase in salaries and benefits includes the adoption of SFAS 123(R) effective January 1, 2006 applicable to the Company's stock-based employee compensation plan which resulted in the recognition of \$136,000 in expense, and settlement accounting recognized on the Bank's defined benefit pension plan totaling \$133,000. Occupancy and equipment

## Edgar Filing: SLADES FERRY BANCORP - Form 10-Q

expense for the six months ended June 30, 2006 increased \$174,000 to \$983,000 as compared to \$809,000 for the six months ended June 30, 2005. The increase was the result of additional depreciation expense incurred from both the Assonet branch that was opened April 2005 and the upgrade in software associated with the modernization of teller and platform systems. Professional fees increased \$186,000 due primarily to the outsourcing of our internal audit function commencing January 1, 2006 and consultations regarding accounting and regulatory matters. Marketing expense decreased \$141,000 to \$187,000 for the six months ended June 30, 2006 from \$328,000 for the six months ended June 30, 2005 which is attributable to the timing of certain advertising and community sponsorship initiatives in 2006. Other expense increased \$243,000 or 22.3% from \$1.1 million for the six months ended June 30, 2005 to \$1.3 million for the six months ended June 30, 2006. This increase was due to the increased volume of internet banking and cash management fees, increased postage cost, the outsourcing of our courier service, and the increase of meetings and committee fees for two additional Board members when compared to June 30, 2005.

### PROVISION FOR INCOME TAXES

-----

Income before income taxes was \$3.0 million for the six months ended June 30, 2005 as compared to \$2.5 million for the six months ended June 30, 2006. Provision for income taxes totaled \$1.0 million and \$935,000 for the six months ended June 30, 2005 and 2006, respectively, representing effective tax rates of 34.65% and 37.88%, respectively. The increase in the overall tax rate was due to a decline in income for the Bank's subsidiaries which are taxed at a lower state tax rate, a decline in federally exempt municipal income and a decrease in cash surrender value of life insurance, which is tax-exempt income, recognized in the six months ended June 30, 2006 compared to 2005.

27

### COMPARISON OF RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED

-----

JUNE 30, 2006 AND 2005

-----

#### GENERAL

-----

Net income decreased from \$848,000 or \$0.21 per share on a diluted basis, for the three months ended June 30, 2005 to \$626,000 or \$0.15 per share on a diluted basis, for the three months ended June 30, 2006, a decrease of 26.2%. Net interest and dividend income remained stable when comparing the three months ended June 30, 2005 and 2006. The provision for loan losses decreased by \$15,000 for the three months ended June 30, 2006. Non-interest income increased by \$6,000 or 1.1% from \$540,000 to \$546,000 for the three months ended June 30, 2005 and 2006. Non-interest expense increased by \$330,000 or 9.1%, from \$3.6 million for the three months ended June 30, 2005 to \$4.0 million for the three months ended June 30, 2006.

#### INTEREST INCOME

-----

Our operating performance is dependent on net interest and dividend income, the difference between interest and dividend income earned on loans and investments and interest expense paid on deposits and borrowed funds. The level of net interest income and dividend income is significantly impacted by factors such as economic conditions, interest rates, asset/liability management, and strategic planning.

## Edgar Filing: SLADES FERRY BANCORP - Form 10-Q

Interest and dividend income increased by \$921,000 or 13.0%, from \$7.1 million for the three months ended June 30, 2005 to \$8.0 million for the three months ended June 30, 2006. This increase can be attributed to both the growth in the loan portfolio as well as an increase in yields on loans. The average balance of loans increased by \$29.6 million or 7.52% and an increase in yield on the loan portfolio from 5.84% for the three months ended June 30, 2005 to 6.34% for the three months ended June 30, 2006. The increase was the result of a greater volume and higher rates earned on commercial and real estate loans reflecting current market conditions. Interest and dividends on investments decreased by \$45,000, on a fully taxable equivalent basis, for the three months ended June 30, 2006 compared to the three months ended June 30, 2005. The decrease was due to a combination of higher rates off set by a reduction in average balances, and the lack of a second quarter dividend declaration by the Federal Home Loan Bank of Boston. Preliminary indications from the Federal Home Loan Bank are that this dividend will be declared in the third quarter of 2006.

### INTEREST EXPENSE

-----

Total interest expense increased by \$949,000 or 35.33%, from \$2.7 million for the three months ended June 30, 2005 to \$3.6 million for the three months ended June 30, 2006. In response to competitive pressures and the rising rate environment, we raised rates on certain deposit products with the most significant increases in certificate of deposit and certain money-market based products. As a result of the rate increases, the weighted average cost of deposits increased from 1.82% for the three months ended June 30, 2005 to 2.65% for the three months ended June 30, 2006. The interest expense on Federal Home Loan Bank borrowings increased \$135,000 during this same time period due primarily to associated rate increases. Interest expense associated with subordinated debentures increased by \$15,000, the result of increased market interest rates. The debentures carry an adjustable rate of interest tied to the three-month LIBOR rate.

28

### NET INTEREST MARGIN

-----

As a result of the current interest rate environment and our corresponding rate increases on deposit accounts, the net interest margin has compressed 14 basis points from 3.36% for the three months ended June 30, 2005 to 3.22% at June 30, 2006. The compression in net interest margin was mostly due to the rise in short term rates and the prolonged flatness of the yield curve, which has reduced the gap between short and intermediate-term interest rates and the spread between what banks earn on loans and securities and pay on deposits and borrowings.

### PROVISION FOR LOAN LOSSES

-----

After thorough review and analysis of the adequacy of the loan loss reserve, management deemed it prudent to provide no provision for possible loan losses for the three months ended June 30, 2006 compared to \$15,000 for possible loan losses for the three months ended June 30, 2005. The decline in the provision for loan losses in 2006 was attributable to continued improvements in the overall loan quality, combined with refinements made in the allocated risk factors attributable to all components of our loan portfolio, during the three months ended June 30, 2006, as compared to the same period in 2005.

29

## Edgar Filing: SLADES FERRY BANCORP - Form 10-Q

The following table sets forth our average assets, liabilities, and stockholders' equity, interest income earned and interest paid, average rates earned and paid, net interest spread and the net interest margin for the three months ended June 30, 2006 and 2005. Average balances reported are daily averages.

|                                    | Three Months Ended June 30, |                            |                 |                        |
|------------------------------------|-----------------------------|----------------------------|-----------------|------------------------|
|                                    | -----                       |                            |                 |                        |
|                                    | 2006                        |                            |                 |                        |
|                                    | Average<br>Balance          | Interest<br>Income/Expense | Average<br>Rate | Average<br>Balance     |
|                                    |                             |                            |                 | -----                  |
| Assets:                            |                             |                            |                 | (Dollars in thousands) |
| -----                              |                             |                            |                 |                        |
| Interest earning assets (2)        |                             |                            |                 |                        |
| Loans:                             |                             |                            |                 |                        |
| Commercial                         | \$ 46,111                   | \$ 885                     | 7.70%           | \$ 32,019              |
| Commercial real estate             | 228,558                     | 3,710                      | 6.51%           | 224,863                |
| Residential real estate            | 145,725                     | 2,051                      | 5.65%           | 134,281                |
| Consumer                           | 2,565                       | 39                         | 6.10%           | 2,225                  |
| -----                              |                             |                            |                 |                        |
| Total loans                        | 422,959                     | 6,685                      | 6.34%           | 393,388                |
| Federal funds sold                 | 4,387                       | 53                         | 4.85%           | 13,051                 |
| Taxable debt securities            | 108,068                     | 1,182                      | 4.39%           | 107,093                |
| Tax-exempt debt securities (1)     | 6,099                       | 102                        | 6.68%           | 7,787                  |
| Marketable equity securities       | 4,344                       | 35                         | 3.23%           | 4,653                  |
| FHLB stock                         | 6,304                       | -                          | 0.00%           | 5,905                  |
| Other investments                  | 650                         | 10                         | 6.17%           | 799                    |
| -----                              |                             |                            |                 |                        |
| Total interest earning assets      | 552,811                     | 8,067                      | 5.85%           | 532,676                |
| -----                              |                             |                            |                 |                        |
| Allowance for loan losses          | (4,373)                     |                            |                 | (4,205)                |
| Deferred loan fees                 | (310)                       |                            |                 | (486)                  |
| Cash and due from banks            | 13,932                      |                            |                 | 18,115                 |
| Other assets                       | 26,432                      |                            |                 | 25,057                 |
| -----                              |                             |                            |                 |                        |
|                                    | \$ 588,492                  |                            |                 | \$ 571,157             |
| =====                              |                             |                            |                 | =====                  |
| Liabilities and Stockholders'      |                             |                            |                 |                        |
| -----                              |                             |                            |                 |                        |
| Equity:                            |                             |                            |                 |                        |
| Interest bearing liabilities       |                             |                            |                 |                        |
| Savings accounts                   | \$ 82,199                   | \$ 272                     | 1.33%           | \$ 93,492              |
| NOW accounts                       | 57,648                      | 188                        | 1.31%           | 26,789                 |
| Money market accounts              | 25,709                      | 149                        | 2.32%           | 56,829                 |
| Time deposits                      | 175,539                     | 1,647                      | 3.76%           | 144,393                |
| FHLB advances                      | 110,802                     | 1,209                      | 4.38%           | 110,118                |
| Subordinated debt                  | 10,310                      | 170                        | 6.61%           | 10,310                 |
| -----                              |                             |                            |                 |                        |
| Total interest bearing liabilities | 462,207                     | 3,635                      | 3.15%           | 441,931                |
| -----                              |                             |                            |                 |                        |
| Demand deposits                    | 73,494                      |                            |                 | 79,401                 |
| Other liabilities                  | 707                         |                            |                 | 2,388                  |

Edgar Filing: SLADES FERRY BANCORP - Form 10-Q

|                            |            |            |
|----------------------------|------------|------------|
| Total liabilities          | 536,408    | 523,720    |
| Total stockholders' equity | 52,084     | 47,437     |
|                            | \$ 588,492 | \$ 571,157 |

|                     |          |       |
|---------------------|----------|-------|
| Net interest income | \$ 4,432 |       |
| Net interest spread |          | 2.70% |
| Net interest margin |          | 3.22% |

- (1) On a fully taxable basis based on tax rate of 35.0% for 2006 and 2005. Interest income on income includes a fully taxable equivalent adjustment of \$37,000 in 2006 and \$45,000 in 2005.
- (2) Average balance includes non-accruing loans. The effect of including such loans, although not the average rate earned on the Company's loans.

30

The following table presents the changes in components of net interest income for the three months ended June 30, 2006 and 2005, which are the result of changes in interest rates and the changes that the result of changes in volume of the underlying asset or liability. Changes that are attributable to the changes in both rate and volume have been allocated equally to rate and volume.

|                              | Three Months Ended June 30,<br>2006 vs. 2005 Increase (Decrease) |                  |                |
|------------------------------|--|------------------|----------------|
|                              | Total<br>Change  | Due to<br>Volume | Due to<br>Rate |
|                              | (In thousands)   |                  |                |
| Commercial loans             | \$ 395   | \$ 251           | \$ 144         |
| Commercial real estate       | 296  | 57               | 239            |
| Residential real estate      | 265  | 157              | 108            |
| Consumer loans               | 3  | 5                | (2)            |
| Federal funds sold           | (39)   | (83)             | 44             |
| Taxable debt securities      | 69   | 10               | 59             |
| Tax-exempt debt securities   | (28)   | (28)             | -              |
| Marketable equity securities | 12   | (2)              | 14             |
| FHLB Stock                   | (63)   | 2                | (65)           |
| Other investments            | 3  | (2)              | 5              |
| <b>Total interest income</b> | <b>913</b>   | <b>367</b>       | <b>546</b>     |
| Savings accounts             | 8  | (35)             | 43             |
| NOW accounts                 | 37   | 137              | (100)          |
| Money market accounts        | 50   | (117)            | 167            |
| Time deposits                | 704  | 233              | 471            |
| FHLB advances                | 135  | 7                | 128            |
| Subordinated debt            | 15   | -                | 15             |

## Edgar Filing: SLADES FERRY BANCORP - Form 10-Q

|                        |         |        |          |
|------------------------|---------|--------|----------|
| Total interest expense | 949     | 225    | 724      |
| Net interest income    | \$ (36) | \$ 142 | \$ (178) |
|                        |         |        |          |

### NON-INTEREST INCOME

-----

Non-interest income increased from \$540,000 for the three months ended June 30, 2005 to \$546,000 for the three months ended June 30, 2006, an increase of \$6,000 or 1.11%. Increases in service charges on deposit accounts and increases in the volumes of official check fees and debit card income were offset primarily by recognized losses on the sale of securities, including certain low-yielding investments in order to acquire higher yielding assets, in accordance with the previously-mentioned investment portfolio restructuring strategy.

### NON-INTEREST EXPENSE

-----

Non-interest expense increased from \$3.6 million for the three months ended June 30, 2005 to \$4.0 for the three months ended June 30, 2006, an increase of \$330,000 or 9.11%. Salaries and employee benefits increased by \$167,000 or 7.88%, from \$2.1 million for the three months ended June 30, 2005 to \$2.3 million for the three months ended June 30, 2006. The increase in salaries and benefits includes the adoption of SFAS 123(R) effective January 1, 2006 applicable to the Company's stock-based employee compensation plan which resulted in the recognition of \$71,000 in expense and settlement accounting recognized on the Bank's defined benefit pension plan totaling \$133,000, which were partially offset by other reductions in salary expense with associated benefit costs due to outsourcing initiatives. Occupancy and equipment expense for the three months

31

ended June 30, 2006 increased \$90,000 to \$490,000 as compared to \$400,000 for the three months ended June 30, 2005. The increase was the result of additional depreciation expense incurred from both the Assonet branch that was opened April 2005 and the upgrade in software associated with the modernization of teller and platform systems. Professional fees increased \$81,000 as a result of outsourcing the internal audit function commencing January 1, 2006. Marketing expense decreased \$120,000 to \$109,000 for the three months ended June 30, 2006 from \$229,000 for the three months ended June 30, 2005 which is attributable to the timing of certain advertising and community sponsorship initiatives in 2006. Other expense increased \$112,000 or 19.79% from \$566,000 for the three months ended June 30, 2005 to \$678,000 for the three months ended June 30, 2006. The increase in other expense was due to the recognition of \$42,000 of losses due to implementation of an overdraft protection program combined with expenses attributable to the increased volumes of internet banking and cash management fees, postal cost increases, the outsourcing of our courier service, and the increase of meetings and committee fees for two additional Board of Director members when compared to the three months ended June 30, 2005.

### PROVISION FOR INCOME TAXES

-----

Income before income taxes was \$1.3 million for the three months ended June 30, 2005 as compared to \$1.0 million for the three months ended June 30, 2006. Provision for income taxes totaled \$478,000 and \$363,000 million for the three

## Edgar Filing: SLADES FERRY BANCORP - Form 10-Q

months ended June 30, 2005 and 2006, respectively, representing effective tax rates of 36.05% and 36.70%, respectively. The increase in the overall tax rate was due to a decline in income for the Bank's subsidiaries which are taxed at a lower state tax rate, a decline in federally exempt municipal income and a decrease in the cash surrender value of life insurance, which is tax-exempt income, recognized in the three months ended 2006 compared to 2005.

32

### LIQUIDITY

-----

Our principal sources of funds are customer deposits, amortization and payoff of existing loan principal, and sales, amortization or maturities of various investment securities. The Bank is a voluntary member of the Federal Home Loan Bank of Boston (the "FHLB") and as such, may take advantage of the FHLB's borrowing programs to enhance liquidity and leverage its favorable capital position. The Bank also may draw on lines of credit at the FHLB or the Federal Reserve Board (the "FRB"), and enter into repurchase or reverse repurchase agreements with authorized brokers. These various sources of liquidity are used to fund withdrawals, new loans, and investments.

Management seeks to promote deposit growth while controlling the cost of funds. Sales-oriented programs to attract new depositors and the cross-selling of various products to its existing customer base are currently in place. Management reviews, on an ongoing basis, possible new products, with particular attention to products and services, which will aid in retaining our base of lower-costing deposits.

Maturities and sales of investment securities provide us with liquidity. Our policy of purchasing shorter-term debt securities reduces market risk in the bond portfolio while providing significant cash flow. For the six months ended June 30, 2006, cash flow from maturities of securities was \$7.7 million and the proceeds from sales of securities totaled \$15.1 million. In comparison maturities of securities aggregated \$10.8 million, and the proceeds from sales of securities aggregated \$1.8 million for the six months ended June 30, 2005. Purchases of securities for the six months ended June 30, 2006 totaled \$6.4 million without the due to broker amount reflected on the June 30, 2006 balance sheet as compared to \$20.8 million at June 30, 2005.

Amortization and pay-offs of the loan portfolio also provide us with significant liquidity. Traditionally, amortization and pay-offs are reinvested into loans.

We have also used borrowed funds as a source of liquidity. At June 30, 2006, the Bank's outstanding borrowings from the Federal Home Loan Bank of Boston were \$103.0 million. The Bank has the capacity to borrow in excess of additional \$40.0 million at the Federal Home Loan Bank.

Loan originations for the six months ended June 30, 2006 totaled \$58.4 million. Commitments to originate loans at June 30, 2006 were \$6.5 million, excluding unadvanced construction funds totaling \$16.6 million, unadvanced commercial lines of credit totaling \$18.2 million and unadvanced home equity lines totaling \$16.7 million. Management believes that adequate liquidity is available to fund loan commitments utilizing deposits, loan amortization, maturities of securities, or borrowings.

Liquidity declined marginally during the six months ended June 30, 2006 due primarily to a greater reliance on Federal Home Loan Bank borrowings.

### CAPITAL

-----

At June 30, 2006, our total shareholders' equity was \$49.8 million, an increase of \$993,000 from \$48.9 million at December 31, 2005. Additions to shareholders' equity consisted primarily of net income of \$1.5 million for the six months ended June 30, 2006. In addition, there were 16,842 shares issued at a value of \$302,000, pursuant to our Dividend Reinvestment Program, in lieu of cash dividends or for optional cash contributions. Furthermore, stock option exercises resulted in the issuance of 28,000 shares common stock at a value of \$305,000, including a tax benefit compensation expense of \$82,000 and stock-based compensation of \$136,000. These additions were offset by dividends declared of \$749,000, the purchase of treasury stock of \$230,000, the contribution of \$100,000 to a trust for the purchase of our common stock and an accumulated other comprehensive loss of \$286,000.

33

In May 2006, the Board authorized the purchase of 50,000 shares of common stock to be held in trust for future restricted stock awards under the 2004 Equity Incentive Plan. The \$100,000, which is reflected on our balance sheet as unearned compensation under stockholder's equity has been contributed to the trust to fund the purchase of some of these shares. No shares have been awarded to date.

Under the requirements for Risk Based and Leverage Capital of the federal banking agencies, a minimum level of capital will vary among banks based on safety and soundness of operations. Risk Based Capital ratios are calculated with reference to risk-weighted assets, which include both on and off balance sheet exposure.

In addition to meeting the required levels, the Company's and the Bank's capital ratios met the criteria of the well-capitalized category established by the federal banking agencies at June 30, 2006 and at December 31, 2005. The Tier I Capital leverage ratio and Tier I Capital to risk weighted assets ratio for Slade's Ferry Bancorp are 10.11% and 14.97%, respectively, at June 30, 2006. Slade's Ferry Bancorp's Tier I Capital leverage ratio and Tier I Capital to risk weighted assets ratio at December 31, 2005 were 10.07% and 14.66%, respectively. The Tier I Capital leverage ratio and Tier I Capital to risk weighted assets ratio for the Bank are 8.73% and 12.00%, respectively, at June 30, 2006. The Bank's Tier I Capital leverage ratio and Tier I Capital to risk weighted assets ratio at December 31, 2005 were 8.56% and 12.51%, respectively.

34

OFF-BALANCE SHEET ARRANGEMENTS

-----

We do not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to investors.

35

ITEM 3

QUANTATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We consider interest rate risk to be a significant market risk as it could



## Edgar Filing: SLADES FERRY BANCORP - Form 10-Q

potentially have an effect on our financial condition and results of operation. The definition of interest rate risk is the exposure of our earnings to adverse movements in interest rates, arising from the differences in the timing of repricing of assets and liabilities; the differences in the various pricing indices inherent in our assets and liabilities; and the effects of overt and embedded options in our assets and liabilities. Our Asset/Liability Committee, comprised of the executive management, is responsible for managing and monitoring interest rate risk, and reviewing with the Board of Directors, at least quarterly, the interest rate risk positions, the impact changes in interest rates would have on net interest income, and the maintenance of interest rate risk exposure within approved guidelines.

The potentially volatile nature of market interest rates requires us to manage interest rate risk on an active and dynamic basis. Our objective is to reduce and control the volatility of net interest income to within tolerance levels established by the Board of Directors, by managing the relationship of interest-earning assets and interest-bearing liabilities. In order to manage this relationship, the Asset/Liability Committee utilizes an income simulation model to measure the net interest income at risk under differing interest rate scenarios. Additionally, the Committee uses Economic Value of Equity ("EVE") analysis to measure the effects of changing interest rates on the market values of rate-sensitive assets and liabilities, taken as a whole. The Board of Directors and management believe that static measures of timing differences, such as "gap analysis", do not accurately assess the levels of interest rate risk inherent in our balance sheet. Gap analysis does not reflect the effects of overt and embedded options on net interest income, given a shift in interest rates, nor does it take into account basis risk, the risk arising from using various different indices on which to base pricing decisions.

The income simulation model currently utilizes a 200 basis point increase and decrease in interest rate shocks. The interest rate movements used assume an instant and parallel change in interest rates and no implementation of any strategic plans are made in response to the change in rates. Prepayment speeds for loans are based on median dealer forecasts for each interest rate scenario.

The Board of Directors has established a risk limit of a 5.00% change in net interest income for each 100 basis point shift in market interest rates. The limit provides an internal tolerance level to control interest rate risk. We are within our policy-mandated risk limit for net interest income at risk.

The following table reflects our estimated exposure as a percentage of net interest income and the change in basis points for the next twelve months, assuming an immediate change in interest rates set forth below:

| Rate Change<br>(Basis Points) | Estimated Exposure as a Percentage<br>of Net Interest Income | Change<br>(Basis Points) |
|-------------------------------|--|--------------------------|
| +200                          | -10.90%  | (19)                     |
| -200                          | 2.77%  | 6                        |

36

Additionally we use the model to estimate the effects of changes in interest rates on our EVE. EVE represents our theoretical market value, given the rate shocks applied in the model. The Board of Directors has established a risk limit for EVE which provides that the EVE will not fall below 6.00%, the FDIC's minimum capital level to be classified as "well capitalized". We are within our risk limit for EVE.

The following table presents the changes in EVE given rate shocks.

## Edgar Filing: SLADES FERRY BANCORP - Form 10-Q

| Rate Change<br>(Basis Points) | Economic Value<br>of Equity | Change from<br>Flat Rates |
|-------------------------------|-----------------------------|---------------------------|
| Flat                          | 12.97%                      | N/A                       |
| +200                          | 11.55%                      | -1.42%                    |
| -200                          | 13.07%                      | 0.10%                     |

37

### ITEM 4

#### CONTROLS AND PROCEDURES

##### (a) Evaluation of Disclosure Controls and Procedures

As required by Rule 13a-15 under the Securities Exchange Act of 1934, as of the end of the period covered by this report, the Company carried out an evaluation under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of June 30, 2006 to ensure that information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is (i) recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms and (ii) accumulated and communicated to the Company's management, including its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding disclosure. In connection with the rules regarding disclosure and control procedures, we intend to continue to review and document our disclosure controls and procedures, including our internal controls and procedures for financial reporting, and may from time to time make changes aimed at enhancing their effectiveness and to ensure that our systems evolve with our business.

##### (b) Changes in Internal Controls over Financial Reporting

There were no changes in the Company's internal controls over financial reporting identified in connection with the Company's evaluation of its disclosure controls and procedures that occurred during the Company's last fiscal quarter that have materially affected, or are reasonably likely to materially affect the Company's internal control over financial reporting.

38

### PART II

#### OTHER INFORMATION

##### ITEM 1

#### LEGAL PROCEEDINGS

None.

##### ITEM 1A

# Edgar Filing: SLADES FERRY BANCORP - Form 10-Q

## RISK FACTORS

There have been no material changes to the risk factors that are included in our Annual Report on Form 10-K for the year ended December 31, 2005 that could affect our business, results of operations or financial condition.

## ITEM 2

### UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

This table provides certain information with respect to our purchase of our common stock during the three months ended June 30, 2006.

| Period                               | (a) Total Number of Shares Purchased | (b) Average Price Paid per Share | (c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs |
|--------------------------------------|--------------------------------------|----------------------------------|--|
| April 1, 2006 through April 30, 2006 | -                                    | N/A                              | -  |
| May 1, 2006 through May 31, 2006     | 6,000 (2)                            | \$ 17.40                         | -  |
| June 1, 2006 through June 30, 2006   | 5,000 (2)                            | \$ 17.01                         | -  |
| Total                                | 11,000                               | \$ 17.22                         | -  |

(1) On July 18, 2006 the Company announced a stock repurchase plan pursuant to which the Company to 208,036 shares of its outstanding common stock. The shares shown in this table were not r to this plan.

(2) These shares were purchased privately negotiated sales.

39

## ITEM 3

### DEFAULTS UPON SENIOR SECURITIES

None.

## ITEM 4

### SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

The Annual Meeting of the Company's Shareholders was held on May 17, 2006 with the following mater being voted upon and with the indicated results:

ELECTION OF DIRECTORS FOR TERMS EXPIRING IN 2009

Votes

Edgar Filing: SLADES FERRY BANCORP - Form 10-Q

| Nominee             | For       | Withheld |
|---------------------|-----------|----------|
| Peter G. Collias    | 3,008,394 | 30,212   |
| Melvyn A. Holland   | 2,995,917 | 42,689   |
| Jean F. MacCormack  | 3,010,035 | 28,571   |
| Shaun O'Hearn, Sr.  | 2,998,389 | 40,217   |
| Carl Ribeiro        | 3,011,199 | 27,407   |
| William J. Sullivan | 2,997,201 | 41,405   |

ITEM 5

OTHER INFORMATION

None.

ITEM 6

EXHIBITS

Exhibits: See exhibit index.

40

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.

SLADE'S FERRY BANCORP.

(Registrant)

August 11, 2006

(Date)

/s/ Mary Lynn D. Lenz

Mary Lynn D. Lenz  
President and  
Chief Executive Officer

August 11, 2006

(Date)

/s/ Deborah A. McLaughlin

Deborah A. McLaughlin  
Executive Vice President  
Chief Financial Officer and Chief  
Operations Officer

41

EXHIBIT INDEX

## Edgar Filing: SLADES FERRY BANCORP - Form 10-Q

| Exhibit No.<br>----- | Description<br>-----  |
|----------------------|---|
| 3.1                  | Amended and Restated Articles of Incorporation of Slade's Ferry Bancorp.  |
| 3.2                  | Amended and Restated Bylaws of Slade's Ferry Bancorp.   |
| 3.3                  | Articles of Amendment to the Amended and Restated Articles of Incorporation of Slade's Ferry Bank   |
| 10.1                 | Slade's Ferry Bancorp. 1996 Stock Option Plan, as amended   |
| 10.2                 | Supplemental Executive Retirement Agreement between Slade's Ferry Bancorp. and Manuel J. Tavares  |
| 10.3                 | Form of Director Supplemental Retirement Program Director Agreement, Exhibit 1 thereto (Slade's Ferry Trust Company Director Supplemental Retirement Program Plan) and Endorsement Method Split Dollar Plan Agreement thereunder. |
| 10.4                 | Form of Directors' Paid-up Insurance Policy (part of the Director Supplemental Retirement Program).   |
| 10.5                 | Supplemental Executive Retirement Agreement between Slade's Ferry Bancorp. and Mary Lynn D. Lenz  |
| 10.6                 | Employment Agreement between Slade's Ferry Bancorp. and Mary Lynn D. Lenz   |
| 10.7                 | Employment Agreement between Slade's Ferry Bancorp. and Deborah A. McLaughlin   |
| 10.8                 | Employment Agreement between Slade's Ferry Bancorp. and Manuel J. Tavares   |
| 10.9                 | Form Change of Control Agreement  |
| 10.10                | Severance Pay Plan  |
| 10.11                | Slade's Ferry Bancorp. 2004 Equity Incentive Plan   |
| 11.1                 | Statement Regarding Computation of Per Share Earnings   |
| 14.1                 | Code of Ethics  |
| 31.1                 | Rule 13a-14(a)/15d-14(a) Certification of the CEO   |
| 31.2                 | Rule 13a-14(a)/15d-14(a) Certification of the CFO   |
| 32.1                 | Section 1350 Certification of the CEO   |
| 32.2                 | Section 1350 Certification of the CFO   |
| (1)                  | Incorporated by reference to the Registrant's Registration Statement on Form SB-2 filed with the Commission on April 14, 1997.  |
| (2)                  | Incorporated by reference to the Registrant's Form 8-K filed with the Commission on June 22, 2006.  |
| (3)                  | Incorporated by reference to the Registrant's Form 8-K filed with the Commission on December 21, 2004.  |
| (4)                  | Incorporated by reference to the Registrant's Form 10-Q/A for the quarter ended June 30, 1999   |
| (5)                  | Incorporated by reference to the Registrant's Form 10-K/ASB for the fiscal year ended December 31, 1996.  |
| (6)                  | Incorporated by reference to Exhibit 10 to the Registrant's Form 10-Q/A for the quarter ended March 31, 1999.   |

## Edgar Filing: SLADES FERRY BANCORP - Form 10-Q

- (7) Incorporated by reference to Exhibit 10 to the Registrant's Form 10-Q/ASB for the quarter ended June 30, 1998.

42

- (8) Incorporated by reference to Exhibit 10.10 to the Registrant's Form 10-Q/A for the quarter ended March 31, 2003.
- (9) Incorporated by reference to Exhibit 10.11 to the Registrant's Form 10-Q/A for the quarter ended June 30, 2004.
- (10) Incorporated by reference to Exhibit 10.7 to the Registrant's Form 10-Q/A for the quarter ended September 30, 2004.
- (11) Incorporated by reference to Exhibit 10.8 to the Registrant's Form 10-Q/A for the quarter ended September 30, 2004.
- (12) Incorporated by reference to the Registrant's Form 8-K filed with the Commission on January 2005.
- (13) Incorporated by reference to the Registrant's Form 8-K filed with the Commission on January 2005.
- (14) Incorporated by reference to Appendix C to the Registrant's Proxy Statement filed on April 9, 2004.
- (15) Incorporated by reference to the Registrant's Form 10-K for the fiscal year ended December 31, 2003.

43