

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 quarterly period ended March 31, 2002

Commission file number 0-13814

Cortland Bancorp
(Exact name of registrant as specified in its charter)

<u>Ohio</u> (State or other jurisdiction of incorporation or organization)	<u>34-1451118</u> (I.R.S. Employer Identification Number)
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194 West Main Street, Cortland, Ohio 44410
(Address of principal executive offices) (Zip Code)

(330) 637-8040
(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 (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒ NO ☐

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

<u>Class</u>	<u>Outstanding at May 7, 2002</u>
<u>Common Stock, No Par Value</u>	<u>3,926,903 Shares</u>

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CORTLAND BANCORP AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(Amounts in thousands, except share data)

	MARCH 31, 2002	DECEMBER 31, 2001
ASSETS		
Cash and due from banks	\$ 10,436	\$ 11,970
Federal funds sold	7,300	14,750
	<hr/>	<hr/>
Total cash and cash equivalents	17,736	26,720
Investment securities available for sale (Note 2)	121,370	121,430
Investment securities held to maturity (approximate market value of \$81,161 in 2002 and \$72,155 in 2001) (Note 2)	81,735	71,994
Total loans (Note 4)	204,283	206,255
Less allowance for loan losses (Note 4)	(3,061)	(2,998)
	<hr/>	<hr/>
Net loans	201,222	203,257
	<hr/>	<hr/>
Premises and equipment	5,803	5,710
Other assets	11,254	10,810
	<hr/>	<hr/>
Total assets	\$ 439,120	\$ 439,921
	<hr/>	<hr/>
LIABILITIES		
Noninterest-bearing deposits	\$ 51,424	\$ 53,229
Interest-bearing deposits (Note 6)	282,463	284,432
	<hr/>	<hr/>
Total deposits	333,887	337,661
	<hr/>	<hr/>
Federal Home Loan Bank advances and other borrowings	49,321	49,362
Other liabilities	5,498	2,374
	<hr/>	<hr/>
Total liabilities	388,706	389,397
	<hr/>	<hr/>
Commitments and contingent liabilities (Notes 8 & 16)		
SHAREHOLDERS' EQUITY		
Common stock — \$5.00 stated value — authorized 20,000,000 shares; issued 4,003,702 shares in 2002 and 4,003,702 in 2001 (Note 1)	20,020	20,020
Additional paid-in capital (Note 1)	10,980	10,945
Retained earnings	19,754	19,172
Accumulated other comprehensive income (loss) (Note 1)	1,275	1,834
Treasury stock, at cost, 85,579 shares in 2002 and 81,626 shares in 2001	(1,615)	(1,447)
	<hr/>	<hr/>
Total shareholders' equity (Notes 15 and 17)	50,414	50,524
	<hr/>	<hr/>
Total liabilities and shareholders' equity	\$ 439,120	\$ 439,921
	<hr/>	<hr/>

See accompanying notes to consolidated financial statements
of Cortland Bancorp and Subsidiaries

CORTLAND BANCORP AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

(Amounts in thousands, except per share data)

	THREE MONTHS ENDED MARCH 31,	
	2002	2001
INTEREST INCOME		
Interest and fees on loans	\$4,005	\$4,434
Interest and dividends on investment securities:		
Taxable interest income	767	1,188
Nontaxable interest income	601	442
Dividends	40	72
Interest on mortgage-backed securities	1,411	1,346
Other interest income	46	76
	<hr/>	<hr/>
Total interest income	6,870	7,558
	<hr/>	<hr/>
INTEREST EXPENSE		
Deposits	2,028	3,022
Borrowed funds	621	682
	<hr/>	<hr/>
Total interest expense	2,649	3,704
	<hr/>	<hr/>
Net interest income	4,221	3,854
Provision for loan losses	115	75
	<hr/>	<hr/>
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	4,106	3,779
	<hr/>	<hr/>
OTHER INCOME		
Fees for other customer services	314	367
Investment securities gains — net	111	126
Gain on sale of loans — net	50	10
Other non-interest income	138	143
	<hr/>	<hr/>
Total other income	613	646
	<hr/>	<hr/>
OTHER EXPENSES		
Salaries and employee benefits	1,611	1,536
Net occupancy expense	218	212
Equipment expense	299	305
State and local taxes	130	155
Office supplies	109	127
Marketing expense	44	20
Other operating expenses	443	391
	<hr/>	<hr/>
Total other expenses	2,854	2,746
	<hr/>	<hr/>
INCOME BEFORE FEDERAL INCOME TAXES	1,865	1,679
Federal income taxes	423	406
	<hr/>	<hr/>
NET INCOME	\$1,442	\$1,273
	<hr/>	<hr/>
BASIC EARNINGS PER COMMON SHARE (NOTE 6)	\$ 0.37	\$ 0.32
	<hr/>	<hr/>
DILUTED EARNINGS PER COMMON SHARE (NOTE 6)	\$ 0.37	\$ 0.32
	<hr/>	<hr/>
CASH DIVIDENDS DECLARED PER SHARE	\$ 0.22	\$ 0.22
	<hr/>	<hr/>

See accompanying notes to consolidated financial statements
of Cortland Bancorp and Subsidiaries

CORTLAND BANCORP AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY (UNAUDITED)

(Amounts in thousands)

	COMMON STOCK	ADDITIONAL PAID-IN CAPITAL	RETAINED EARNINGS	ACCUMULATED OTHER COMPREHENSIVE INCOME	TREASURY STOCK	TOTAL SHARE- HOLDERS' EQUITY
BALANCE AT JANUARY 1, 2002	\$20,020	\$10,945	\$19,172	\$ 1,834	(\$1,447)	\$50,524
Comprehensive income:						
Net income			1,442			1,442
Other comprehensive income, net of tax:						
Unrealized gains or (losses) on available- for-sale securities, net of reclassification adjustment				(559)		(559)
Total comprehensive income						883
Common stock transactions:						
Shares sold						
Treasury shares reissued		35			381	416
Treasury shares purchased					(549)	(549)
Cash dividends declared			(860)			(860)
BALANCE AT MARCH 31, 2002	\$20,020	\$10,980	\$19,754	\$ 1,275	(\$1,615)	\$50,414
DISCLOSURE OF RECLASSIFICATION FOR AVAILABLE FOR SALE SECURITY GAINS AND LOSSES:						
Net unrealized holding gains or (losses) on available- for-sale securities arising during the period, net of tax				(\$486)		
Less: Reclassification adjustment for net gains realized in net income, net of tax				73		
Net unrealized gains on available- for-sale securities, net of tax				(\$559)		

See accompanying notes to consolidated financial statements
of Cortland Bancorp and Subsidiaries

CORTLAND BANCORP AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(Amounts in thousands)

	FOR THE THREE MONTHS ENDED MARCH 31,	
	2002	2001
NET CASH FLOWS FROM OPERATING ACTIVITIES	\$ 4,507	\$ 3,367
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of securities held to maturity	(20,023)	(8,716)
Purchases of securities available for sale	(9,254)	(4,268)
Proceeds from call, maturity and principal payments on securities	18,813	17,750
Net decrease (increase) in loans made to customers	1,920	(277)
Proceeds from disposition of other real estate	167	
Proceeds from sale of fixed assets	0	9
Purchase of premises and equipment	(306)	(234)
Net cash flows from investing activities	(8,683)	4,264
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase (decrease) in deposit accounts	(3,774)	(618)
Net increase (decrease) in borrowings	(41)	(556)
Dividends paid	(860)	(840)
Purchases of treasury stock	(549)	(365)
Treasury shares reissued	416	505
Net cash flows from financing activities	(4,808)	(1,874)
NET CHANGE IN CASH AND CASH EQUIVALENTS	(8,984)	5,757
CASH AND CASH EQUIVALENTS		
Beginning of period	26,720	14,887
End of period	<u>\$ 17,736</u>	<u>\$ 20,644</u>
SUPPLEMENTAL DISCLOSURES		
Interest paid	\$ 2,726	\$ 3,720
Income taxes paid	\$ 0	\$ 0

See accompanying notes to consolidated financial statements
of Cortland Bancorp and Subsidiaries

CORTLAND BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

(Dollars in thousands)

1.) Management Representation:

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring items) considered necessary for a fair presentation have been included. Operating results for the three months ended March 31, 2002 are not necessarily indicative of the results that may be expected for the year ending December 31, 2002. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's annual report on Form 10-K for the year ended December 31, 2001.

2.) Reclassifications:

Certain items contained in the 2001 financial statements have been reclassified to conform with the presentation for 2002. Such reclassifications had no effect on the net results of operations.

3.) Investment Securities:

Securities classified as held to maturity are those that management has the positive intent and ability to hold to maturity. Securities held to maturity are stated at cost, adjusted for amortization of premiums and accretion of discounts, with such amortization or accretion included in interest income.

Securities classified as available for sale are those that could be sold for liquidity, investment management, or similar reasons even though management has no present intentions to do so. Securities available for sale are carried at fair value using the specific identification method. Changes in the unrealized gains and losses on available for sale securities are recorded net of tax effect as a component of comprehensive income.

Trading securities are principally held with the intention of selling in the near term. Trading securities are carried at fair value with changes in fair value reported in the Consolidated Statements of Income.

CORTLAND BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

(Dollars in thousands)

Realized gains or losses on dispositions are based on net proceeds and the adjusted carrying amount of securities sold, using the specific identification method. The table below sets forth the proceeds, gains and losses realized on securities sold or called for the period ended:

	THREE MONTHS March 31, 2002	THREE MONTHS March 31, 2001
Proceeds on securities sold	\$ 0	\$ 0
Gross realized gains		
Gross realized losses		
Proceeds on securities called	\$ 5,060	\$ 4,745
Gross realized gains	111	126
Gross realized losses		

Securities available for sale, carried at fair value, totalled \$121,370 at March 31, 2002 and \$121,430 at December 31, 2001 representing 59.8% and 62.8%, respectively, of all investment securities. These levels provide an adequate level of liquidity in management’s opinion.

Investment securities with a carrying value of approximately \$40,135 at March 31, 2002 and \$41,739 at December 31, 2001 were pledged to secure deposits and for other purposes.

CORTLAND BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

(Dollars in thousands)

The amortized cost and estimated market value of debt securities at March 31, 2002, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because borrowers have the right to call or prepay certain obligations with or without call or prepayment penalties.

Investment securities available for sale	AMORTIZED COST	ESTIMATED FAIR VALUE
Due in one year or less	\$ 5,434	\$ 5,494
Due after one year through five years	5,295	5,409
Due after five years through ten years	10,102	10,449
Due after ten years	22,870	22,987
	43,701	44,339
Mortgage-backed securities	72,118	73,398
	\$ 115,819	\$ 117,737

Investment securities held to maturity	AMORTIZED COST	ESTIMATED FAIR VALUE
Due in one year or less	\$ 3,091	\$ 3,112
Due after one year through five years	272	274
Due after five years through ten years	21,621	21,545
Due after ten years	34,029	33,625
	59,013	58,556
Mortgage-backed securities	22,722	22,605
	\$ 81,735	\$ 81,161

CORTLAND BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

(Dollars in thousands)

The amortized cost and estimated fair value of investment securities available for sale and investment securities held to maturity as of March 31, 2002, are as follows:

Securities available for sale	AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	ESTIMATED FAIR VALUE
U.S. Treasury Securities	\$ 5,767	\$ 308	\$	\$ 6,075
U.S. Government agencies and corporations	16,014	435	14	16,435
Obligations of states and political subdivisions	21,920	193	284	21,829
Mortgage-backed and related securities	72,118	1,368	88	73,398
Total	115,819	2,304	386	117,737
Marketable equity securities	714	130	122	722
Other securities	2,911			2,911
Total available for sale	\$119,444	\$2,434	\$ 508	\$121,370

Securities held to maturity	AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	ESTIMATED FAIR VALUE
U.S. Government agencies and corporations	\$30,504	\$179	\$ 288	\$30,395
Obligations of states and political subdivisions	28,509	195	543	28,161
Mortgage-backed and related securities	22,722	115	232	22,605
Total held to maturity	\$81,735	\$489	\$1,063	\$81,161

CORTLAND BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

(Dollars in thousands)

The following provides a summary of the amortized cost and estimated fair value of investment securities available for sale and investment securities held to maturity as of December 31, 2001:

Securities available for sale	AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	ESTIMATED FAIR VALUE
U.S. Treasury Securities	\$ 5,790	\$ 445	\$	\$ 6,235
U.S. Government agencies and corporations	13,107	722	3	13,826
Obligations of states and political subdivisions	21,791	228	290	21,729
Mortgage-backed and related securities	74,376	1,676	14	76,038
Total	115,064	3,071	307	117,828
Marketable equity securities	714	116	109	721
Other securities	2,881			2,881
Total available for sale	\$118,659	\$3,187	\$ 416	\$121,430

Securities held to maturity	AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	ESTIMATED FAIR VALUE
U.S. Government agencies and corporations	\$25,204	\$489	\$ 41	\$25,652
Obligations of states and political subdivisions	26,222	189	466	25,945
Mortgage-backed and related securities	20,568	127	137	20,558
Total held to maturity	\$71,994	\$805	\$ 644	\$72,155

CORTLAND BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

(Dollars in thousands)

4.) Concentration of Credit Risk and Off Balance Sheet Risk:

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, standby letters of credit, and financial guarantees. Such instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized on the balance sheet. The contract or notional amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments.

In the event of nonperformance by the other party, the Company’s exposure to credit loss on these financial instruments is represented by the contract or notional amount of the instrument. The Company uses the same credit policies in making commitments and conditional obligations as it does for instruments recorded on the balance sheet. The amount and nature of collateral obtained, if any, is based on management’s credit evaluation.

	CONTRACT OR NOTIONAL AMOUNT	
	March 31, 2002	December 31, 2001
Financial instruments whose contract amount represents credit risk:		
Commitments to extend credit:		
Fixed rate	\$ 3,188	\$ 2,321
Variable	30,819	35,242
Standby letters of credit	605	485

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Generally these financial arrangements have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of these commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

CORTLAND BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

(Dollars in thousands)

The Company, through its subsidiary bank, grants residential, consumer and commercial loans, and also offers a variety of saving plans to customers located primarily in Northeast Ohio and Western Pennsylvania. The following represents the composition of the loan portfolio:

	March 31, 2002	December 31, 2001
1-4 family residential mortgages	36.8%	37.6%
Commercial mortgages	41.0%	40.6%
Consumer loans	6.6%	7.2%
Commercial loans	11.8%	10.8%
Home equity loans	3.8%	3.8%

There are no mortgage loans held for sale included in 1-4 family residential mortgages as of March 31, 2002, or at December 31, 2001.

The following table sets forth the aggregate balance of underperforming loans for each of the following categories at March 31, 2002 and December 31, 2001:

	March 31, 2002	December 31, 2001
Loans accounted for on a nonaccrual basis	\$ 1,088	\$ 829
Loans contractually past due 90 days or more as to interest or principal payments (not included in nonaccrual loans above)	None	None
Loans considered troubled debt restructurings (not included in nonaccrual loans or loans contractually past due above)	134	134

CORTLAND BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

(Dollars in thousands)

The following shows the amounts of contractual interest income and interest income actually reflected in income on loans accounted for on a nonaccrual basis and loans considered troubled debt restructuring as of March 31, 2002.

	March 31, 2002	March 31, 2001
Gross interest income that would have been recorded if the loans had been current in accordance with their original terms	\$ 37	\$ 68
Interest income actually included in income on the loan	22	32

A loan is placed on a nonaccrual basis whenever sufficient information is received to question the collectibility of the loan or any time legal proceedings are initiated involving a loan. When a loan is placed on nonaccrual status, any interest that has been accrued and not collected on the loan is charged against earnings. Cash payments received while a loan is classified as nonaccrual are recorded as a reduction to principal or reported as interest income according to management’s judgement as to collectibility of principal.

Impaired loans are generally included in nonaccrual loans. Management does not individually evaluate certain smaller balance loans for impairment as such loans are evaluated on an aggregate basis. These loans include 1 — 4 family , consumer and home equity loans. Impaired loans were evaluated using the fair value of collateral as the measurement method. At March 31, 2002, there were no loans considered impaired.

As of March 31, 2002, there were \$1,661 in loans not included in the above categories and not considered impaired, but which can be considered potential problem loans.

Any loans classified for regulatory purposes as loss, doubtful, substandard, or special mention that have not been disclosed above do not (i) represent or result from trends or uncertainties which management reasonably expects will materially impact future operating results, liquidity, or capital resources, or (ii) represent material credits about which management is aware of any information which causes management to have serious doubts as to the ability of such borrowers to comply with the loan repayment terms.

CORTLAND BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

(Dollars in thousands)

The following is an analysis of the allowance for loan losses for the three month periods ended March 31, 2002 and March 31, 2001:

	2002	2001
Balance at beginning of period	\$ 2,998	\$ 2,974
Loan charge-offs:		
1-4 family residential mortgages	—	—
Commercial mortgages	—	—
Consumer loans	59	50
Commercial loans	16	—
Home equity loans	—	3
	75	53
Recoveries on previous loan losses:		
1-4 family residential mortgages	—	—
Commercial mortgages	—	—
Consumer loans	20	24
Commercial loans	3	1
Home equity loans	—	—
	23	25
Net charge-offs	(52)	(28)
Provision charged to operations	115	75
Balance at end of period	\$ 3,061	\$ 3,021
Ratio of annualized net charge-offs to average net loans outstanding	0.10%	0.05%

For each of the periods presented above, the provision for loan losses charged to operations is based on management’s judgment after taking into consideration all known factors connected with the collectibility of the existing portfolio. Management evaluates the portfolio in light of economic conditions, changes in the nature and volume of the portfolio, industry standards and other relevant factors. Specific factors considered by management in determining the amounts charged to operations include previous loan loss experience, the status of past due interest and principal payments, the quality of financial information supplied by customers and the general economic conditions present in the lending area of the Company’s bank subsidiary.

5.) Legal Proceedings:

The Company’s subsidiary bank was a defendant in federal district court in a class action lawsuit Frank Slentz, et al. v. Cortland Savings and Banking Company, involving purchased interests in two campgrounds. On October 20, 1997 the judge presiding over this case filed a judgment entry dismissing all claims against the Bank without prejudice. The judgment was appealed by the plaintiffs. On March 2, 1999, the United States Court of Appeals for the Sixth Circuit affirmed the decision of the district court to grant summary judgment in favor of the defendant Bank. Plaintiffs have refiled a similar suit in the Common Pleas Court of Trumbull County seeking damages of approximately \$4.3 million. Based on the decision of the United States Court of Appeals and the facts of the case, management believes that a reasonable probability exists that the Bank can prevail in Common Pleas Court. While it is not feasible to predict the ultimate resolution of this case, an outcome unfavorable to the Company’s bank subsidiary could have a material effect on the Company’s quarterly and annual operating results for that period.

CORTLAND BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

(Dollars in thousands except per share data)

The Bank is also involved in other legal actions arising in the ordinary course of business. In the opinion of management, the outcome of these matters is not expected to have any material effect on the Company.

6.) Earnings Per Share and Capital Transactions:

The following table sets forth the computation of basic earnings per common share and diluted earnings per common share.

	THREE MONTHS ENDED MARCH 31,	
	2002	2001
Net Income	\$ 1,442	\$ 1,273
Weighted average common shares outstanding *	3,932,412	3,929,927
Basic earnings per share *	\$ 0.37	\$ 0.32
Diluted earnings per share *	\$ 0.37	\$ 0.32

* Average shares outstanding and resultant per share amounts have been restated to give retroactive effect to the 3% stock dividend of January 1, 2002.

CORTLAND BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

(Dollars in thousands except per share data)

7.) Stock Repurchase Program

On January 23, 2001 the Company's Board of Directors approved a Stock Repurchase Program (the "2001 Program") which allowed the Company to repurchase up to 187,000 shares (or approximately 4.9% of the 3,815,125 shares outstanding as of January 31, 2001) of the Company's outstanding common stock. The program expired February 6, 2002. On January 22, 2002, the Company's Board of Directors approved a new program (the "2002 Program") which allows the Company to repurchase up to 193,000 shares (or approximately 4.9% of the 3,943,151 shares outstanding as of January 31, 2002) of the Company's outstanding common stock. This program will expire not later than February 6, 2003, with results depending on market conditions. Repurchased shares are designated as treasury shares, available for general corporate purposes, including possible use in connection with the Company's dividend reinvestment program, employee benefit plans, acquisitions or other distributions.

Repurchase amounts are effected through open market transactions or in privately negotiated agreements in accordance with applicable regulations of the Securities and Exchange Commission. Under the 2001 program based on the value of the Company's stock on January 31, 2001, the commitment to repurchase the stock over the next year was approximately \$3,179. The Company repurchased 5,587 shares between January 1 and February 6, 2002, bringing the total repurchased shares to 51,321 under the 2001 Program. The Company also reissued 21,484 shares to existing shareholders under its dividend reinvestment program in January 2002.

Under the 2002 program, based on the value of the Company's stock on January 31, 2002, the commitment to repurchase the stock over the next year was \$4,053. At March 31, 2002, the remaining commitment to repurchase the stock was approximately \$3,766. As of March 31, 2002 the Company had repurchased 19,851 shares under the 2002 Program.

CORTLAND BANCORP AND SUBSIDIARIES

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

(Dollars in thousands)

The following is management's discussion and analysis of the financial condition and results of operations of Cortland Bancorp (the "Company"). The discussion should be read in conjunction with the Consolidated Financial Statements and related notes included elsewhere in this report.

Note Regarding Forward-looking Statements

In addition to historical information contained herein, the following discussion may contain forward-looking statements that involve risks and uncertainties. Economic circumstances, the Company's operations and actual results could differ significantly from those discussed in any forward-looking statements. Some of the factors that could cause or contribute to such differences are changes in the economy and interest rates either nationally or in the Company's market area; increased competitive pressures or changes in either the nature or composition of competitors; changes in the legal and regulatory environment; changes in factors influencing liquidity such as expectations regarding the rate of inflation or deflation, currency exchange rates, and other factors influencing market volatility; unforeseen risks associated with other global economic and financial factors.

Liquidity

The central role of the Company's liquidity management is to (1) ensure sufficient liquid funds to meet the normal transaction requirements of its customers, (2) take advantage of market opportunities requiring flexibility and speed, and (3) provide a cushion against unforeseen liquidity needs.

Principal sources of liquidity for the Company include assets considered relatively liquid, such as interest-bearing deposits in other banks, federal funds sold, cash and due from banks, as well as cash flows from maturities and repayments of loans, investment securities and mortgage-backed securities.

CORTLAND BANCORP AND SUBSIDIARIES

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

(Dollars in thousands)

Along with its liquid assets, the Company has other sources of liquidity available to it which help to ensure that adequate funds are available as needed. These other sources include, but are not limited to, the ability to obtain deposits through the adjustment of interest rates, the purchasing of federal funds, borrowings from the Federal Home Loan Bank of Cincinnati and access to the Federal Reserve Discount Window.

Cash and cash equivalents decreased compared to year end 2001. Operating activities provided cash of \$4,507 and \$3,367 during the three months ended March 31, 2002 and 2001, respectively. Refer to the Consolidated Statements of Cash Flows for a summary of the sources and uses of cash for March 31, 2002 and 2001.

Capital Resources

The capital management function is a continuous process which consists of providing capital for both the current financial position and the anticipated future growth of the Company. Central to this process is internal equity generation, particularly through earnings retention. Internal capital generation is measured as the annualized rate of return on equity, exclusive of any appreciation or depreciation relating to available for sale securities, multiplied by the percentage of earnings retained. Internally generated capital retained by the Company measured 4.7% for the three months ended March 31, 2002, as compared to 3.6% for the like period during 2001. Overall capital (a figure which reflects earnings, dividends paid, common stock issued, treasury shares purchased, treasury shares reissued and the net change in the estimated fair value of available for sale securities) contracted at an annual rate of (0.9)%, reflecting a decline in the estimated fair value of available for sale securities and an increase in the amount and cost of Treasury stock held.

Risk-based standards for measuring capital adequacy require banks and bank holding companies to maintain capital based on "risk-adjusted" assets. Categories of assets with potentially higher credit risk require more capital than assets with lower risk. In addition, banks and bank holding companies are required to maintain capital to support, on a risk-adjusted basis, certain off-balance sheet activities such as standby letters of credit and interest rate swaps.

CORTLAND BANCORP AND SUBSIDIARIES

ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

(Dollars in thousands)

These standards also classify capital into two tiers, referred to as Tier 1 and Tier 2. The Company’s Tier 1 capital consists of common shareholders’ equity (excluding any gain or loss on available for sale debt securities) less intangible assets and the net unrealized loss on equity securities with readily determinable fair values. Tier 2 capital is the allowance for loan and lease losses reduced for certain regulatory limitations. Risk based capital standards require a minimum ratio of 8% of qualifying total capital to risk-adjusted total assets with at least 4% constituting Tier 1 capital. Capital qualifying as Tier 2 capital is limited to 100% of Tier 1 capital. All banks and bank holding companies are also required to maintain a minimum leverage capital ratio (Tier 1 capital to total average assets) in the range of 3% to 4%, subject to regulatory guidelines.

The Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) required banking regulatory agencies to revise risk-based capital standards to ensure that they adequately account for the following additional risks: interest rate, concentration of credit, and nontraditional activities. Accordingly, regulators will subjectively consider an institution’s exposure to declines in the economic value of its capital due to changes in interest rates in evaluating capital adequacy. The table below illustrates the Company’s risk weighted capital ratios at March 31, 2002 and December 31, 2001.

	March 31, 2002	December 31, 2001
Tier 1 Capital	\$ 48,830	\$ 48,372
Tier 2 Capital	2,824	2,853
TOTAL QUALIFYING CAPITAL	\$ 51,654	\$ 51,225
Risk Adjusted Total Assets (*)	\$ 225,372	\$ 227,829
Tier 1 Risk-Based Capital Ratio	21.67%	21.23%
Total Risk-Based Capital Ratio	22.92%	22.48%
Tier 1 Risk-Based Capital to Average Assets (Leverage Capital Ratio)	11.27%	11.18%

(*) Includes off-balance sheet exposures.

CORTLAND BANCORP AND SUBSIDIARIES

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

(Dollars in thousands)

Assets, less intangibles and the net unrealized market value adjustment of investment securities available for sale, averaged \$433,099 for the three months ended March 31, 2002 and \$432,696 for the year ended December 31, 2001.

First Three Months of 2002 as Compared to First Three Months of 2001

During the first three months of 2002, net interest income after provision for loan losses increased by \$327 compared to the first three months of 2001. Total interest income decreased by \$688, or 9.1%, from the level recorded in 2001. This was accompanied by a decrease in interest expense of \$1,055 or 28.5%, and a \$40 increase in the provision for loan losses.

The average rate paid on interest sensitive liabilities decreased by 131 basis points year-over-year. The average balance of interest sensitive liabilities increased by \$1,438 or 0.4%. Compared to the first quarter of last year, average borrowings, primarily with the Federal Home Loan Bank, decreased by \$1,039 while the average rate paid on borrowings decreased by 38 basis points, from 5.54% to 5.16%. Average interest bearing demand deposits increased by \$2,680, while savings and money market accounts increased by \$6,867 and \$3,572 respectively. The average rate paid on these products decreased by 121 basis points in the aggregate. The average balance on time deposit products decreased by \$10,642, as the average rate paid decreased by 149 basis points, from 6.01% to 4.52%.

Interest and dividend income on securities registered a decrease of \$229, or 7.5%, during the first three months of 2002 when compared to 2001, while on a fully tax equivalent basis income on securities decreased by \$143 or 4.4%. The average invested balances increased by 1.6%, increasing by \$ 2,983 over the levels of a year ago. The increase in the average balance of investment securities was accompanied by a 40 basis point decrease in the tax equivalent yield of the portfolio.

Interest and fees on loans decreased by \$429 for the first three months of 2002 compared to 2001. A \$330 increase in the average balance of the loan portfolio, or 0.2%, was accompanied by an 87 basis point decrease in the portfolio's tax equivalent yield.

Other interest income decreased by \$30 from the same period a year ago. The average balance of Federal Funds sold and other money market funds increased by \$5,330. The yield on federal funds decreased by 381 basis points reflecting the change in Federal Reserve policy initiated early in 2001. The yield on Federal Funds sold is anticipated to rise late in 2002 as the Federal Reserve is expected to begin to raise the targeted Federal Funds rate by increments of 25 to 50 basis points starting in the fall.

CORTLAND BANCORP AND SUBSIDIARIES

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

(Dollars in thousands)

The tax equivalent yield on earning assets decreased by 76 basis points from the same quarter a year ago. The tax equivalent yield of the investment portfolio measured 6.41%, a 40 basis point decrease from the same quarter a year ago, while the loan portfolio yielded 7.84%, down 87 basis points from last year's rate. Meanwhile, the rate paid on interest-bearing liabilities decreased 112 basis points compared to a year ago. The net effect of these changes was that the tax equivalent net interest margin increased to 4.38%, an increase of 36 basis points from that achieved during last year's first quarter.

Other income from all sources decreased by \$33 from the same period a year ago. Gains on 1-4 residential mortgage loans in the secondary mortgage market increased by \$40 from the same period a year ago. Gains on securities called and gains on the sale of available for sale investment securities decreased by \$15 from year ago levels. Fees for other customer services decreased by \$53, due mainly to a reduction in deposit account service charge income caused by a restructuring of product offerings to better serve our customers. Other sources of non-recurring non-interest income decreased by \$5 from the same period a year ago.

Loans net of the allowance for losses decreased by \$2,035 during the period. Gross loans as a percentage of earning assets stood at 49.3% as of March 31, 2002 as compared to 50.4% on March 31, 2001. The loan to deposit ratio at the end of the first three months of 2002 was 61.2% compared to 62.3% at the end of the same period a year ago. The investment portfolio represented 60.8% of each deposit dollar, up from 58.4% a year ago.

Loan charge-offs during the first three months were \$75 in 2002 and \$53 in 2001, while the recovery of previously charged-off loans amounted to \$23 in 2002 compared to \$25 in 2001. A provision for loan loss of \$115 was charged to operations in 2002, compared to \$75 charged in 2001. At March 31, 2002, the loan loss allowance of \$3,061 represented 1.5 % of outstanding loans. Non accrual loans at March 31, 2002 represented 0.5% of the loan portfolio compared to 0.4% at December 31, 2001 and 0.9% a year ago.

Total other expenses in the first three months were \$2,854 in 2002 compared to \$2,746 in 2001, an increase of \$108 or 3.9%. Full time equivalent employment during the first three months averaged 167 employees in 2002, a 1.8% increase from the 164 employed in the same quarter of 2001, as the Company expanded its branch network by one office. Salaries and benefits increased by \$75 or 4.9% compared to the similar period a year ago, primarily due to the increased cost of benefits, and the opening of the aforementioned new branch in the first quarter of 2002.

CORTLAND BANCORP AND SUBSIDIARIES

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

(Dollars in thousands)

For the first three months of 2002, state and local taxes decreased by \$25 or 16.1%. Occupancy and equipment expense remained stable. All other expense categories increased by 10.8% or \$58 as a group, with the Company's new office representing 21% of the increase and certain other non-recurring items accounting for an additional 50% of the total increase.

Income before income tax expense amounted to \$1,865 for the first three months of 2002 compared to \$1,679 for the similar period of 2001. The effective tax rate for the first three months was 22.7% in 2002 compared to 24.2% in 2001, resulting in income tax expense of \$423 and \$406 respectively. Net income for the first three months registered \$1,442 in 2002 compared to \$1,273 in 2001, representing per share amounts of \$0.37 in 2002 and \$0.32 in 2001.

Regulatory Matters

On March 13, 2000, the Board of Governors of the Federal Reserve System approved the Company's application to become a financial holding company. As a financial holding company, the Company may engage in activities that are financial in nature or incidental to a financial activity, as authorized by the Gramm-Leach-Bliley Act of 1999 (The Financial Services Reform Act). Under the Financial Services Reform Act, the Company may continue to claim the benefits of financial holding company status as long as each depository institution that it controls remains well capitalized and well managed. The Company is required to provide notice to the Board of Governors of the Federal Reserve System when it becomes aware that any depository institution controlled by the Company ceases to be well capitalized or well managed. Furthermore, current regulation specifies that prior to initiating or engaging in any new activities that are authorized for financial holding companies, the Company's insured depository institutions must be rated "satisfactory" or better under the Community Reinvestment Act (CRA). As of March 31, 2002, the Company's bank subsidiary was rated "satisfactory" for CRA purposes, and remained well capitalized and well managed, in management's opinion.

CORTLAND BANCORP AND SUBSIDIARIES

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

(Dollars in thousands)

Management considers interest rate risk to be the Company's principal source of market risk. Since December 31, 2001, short term interest rates as measured by U. S. Treasury securities with maturities of one year or less, have increased by 10 to 58 basis points, reflecting the markets concern over possible future increases by the Federal Reserve. Intermediate interest rates, as measured by U.S. Treasury securities with maturities of two to five years, have increased by approximately 54 to 79 basis points. Long term interest rates, as measured by U.S. Treasury securities with maturities of ten to twenty years have increased less dramatically, increasing by approximately 29 to 34 basis points as they are more influenced by federal spending plans, taxation policies and expectations of growth and inflation over a much longer and uncertain planning horizon.

Over the past twelve months, the Federal Reserve has decreased its target rate for overnight federal funds by 325 basis points. During the quarter ended March 31, 2002, the yield curve steepened as the difference between the yield on the ten year Treasury and the three month Treasury increased to 363 basis points from the 333 basis points at December 31, 2001, with interest rates peaking in the long-end of the Treasury curve.

The net effect of these changes in the level of interest rates and the shape of the yield curve have had minimal effect on the Company's risk position. When these changes are incorporated into the Company's risk analysis, simulated results for an unchanged rate environment indicate a \$345 increase in net interest income for the twelve month horizon subsequent to March 31, 2002 compared to the simulated results for a similar twelve month horizon subsequent to December 31, 2001. The increase in the Company's net interest income primarily reflects an approximate \$10 million increase in the investment portfolio, with an attendant reduction of similar magnitude in cash and cash equivalents, such as overnight federal funds sold.

CORTLAND BANCORP AND SUBSIDIARIES

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

(CONTINUED)

(Dollars in thousands)

The following table indicates the Company’s current estimate of interest rate sensitivity based on the composition of the balance sheet at March 31, 2002 and December 31, 2001. For purposes of this analysis, short term interest rates as measured by the federal funds rate and the prime lending rate are assumed to increase (decrease) gradually over the subsequent twelve month period, reaching a level 300 basis points higher (lower) than the rates in effect at March 31, 2002 and December 31, 2001. Under both the rising rate scenario and the falling rate scenario, the yield curve is assumed to exhibit a parallel shift. The analysis assumes no growth in assets and liabilities and no change in asset or liability mix over the subsequent twelve month period.

Changes in Interest Rates	Simulated Net Interest Income (NII) Scenarios For the Twelve Months Ending					
	Net Interest Income		\$ Change in NII		% Change in NII	
	March 31, 2003	Dec. 31, 2002	March 31, 2003	Dec. 31, 2002	March 31, 2003	Dec. 31, 2002
Graduated increase of +300 basis points	17,171	16,848	(846)	(824)	(4.7)%	(4.7)%
Short term rates unchanged	18,017	17,672				
Graduated decrease of -300 basis points	17,468	17,266	(549)	(406)	(3.0)%	(2.3)%

The Company’s sensitivity to both an increasing and a decreasing rate environment increased marginally, reflecting a slightly larger decline in the Company’s expected net interest income in both cases.

The level of interest rate risk indicated remains within limits that management considers acceptable. However, given that interest rate movements can be sudden and unanticipated, and are increasingly influenced by global events and circumstances beyond the purview of the Federal Reserve, no assurance can be made that interest rate movements will not impact key assumptions and relationships in a manner not presently anticipated.

CORTLAND BANCORP AND SUBSIDIARIES

PART II — OTHER INFORMATION

Item 1. Legal Proceedings

See Note (5) of the financial statements.

Item 2. Changes in Securities

Not applicable

Item 3. Defaults upon Senior Securities

Not applicable

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

None

Item 5. Other Information

Not applicable

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

- 2. Not applicable
- 4. Not applicable
- 10. Not applicable
- 11. See Note (6) of the Financial Statements
- 15. Not applicable
- 18. Not applicable
- 19. Not applicable
- 22. Not applicable
- 23. Not applicable
- 24. Not applicable
- 99. Not applicable

CORTLAND BANCORP AND SUBSIDIARIES

PART II — OTHER INFORMATION

(b) Reports on Form 8-K

Form 8-K was filed with the United States Securities and Exchange Commission, dated February 1, 2002. The 8-K applied to Item 5 — Other Events, per the 8-K instructions, and announced that the Board of Directors had approved a stock repurchase program authorizing the acquisition of up to 4.9% of Cortland Bancorp's outstanding common stock. No financial statements were filed with this report.

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.

Cortland Bancorp
(Registrant)

DATED: May 7, 2002

Lawrence A. Fantauzzi
Secretary/Treasurer
(Chief Financial Officer)

DATED: May 7, 2002

Rodger W. Platt
Chairman and President
(Duly Authorized Officer)