

Washington, D.C. 20549

**FORM 10-Q**

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

For quarterly period ended  
**September 30, 2001**

OR

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

Commission File No. 0-16455

**NEWMIL BANCORP, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction  
of incorporation or organization)

**06-1186389**

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

**19 Main St., P.O. Box 600, New Milford, Conn.**

(Address of principal executive offices)

**06776**

(Zip Code)

**(860) 355-7600**

(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

The number of shares of Common Stock outstanding as of September 30, 2001 is 4,411,060.

**NEWMIL BANCORP, INC. and SUBSIDIARY**

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**NewMil Bancorp, Inc. and Subsidiary**  
CONSOLIDATED BALANCE SHEETS  
(dollars in thousands)  
(unaudited)

	September 30, 2001 (unaudited)	December 31, 2000
<b>ASSETS</b>		
Cash and due from banks	\$ 20,704	\$ 21,784
Federal funds sold	<u>-</u>	<u>6,029</u>
Total cash and cash equivalents	20,704	27,813
Securities:		
Available-for-sale at market	180,204	103,221
Held-to-maturity at amortized cost (market value: \$33,726 and \$36,853)	32,915	37,177
Loans (net of allowance for loan losses: \$5,496 and \$5,518)	344,590	332,544
Other real estate owned	92	150
Bank premises and equipment, net	6,100	6,491
Accrued income	3,853	3,499
Intangible assets (net of accumulated amortization: \$571 and \$82)	9,114	9,459
Deferred tax asset, net	-	1,135
Other assets	<u>2,625</u>	<u>2,089</u>
<b>Total Assets</b>	<b><u>\$600,197</u></b>	<b><u>\$523,578</u></b>
<b>LIABILITIES and SHAREHOLDERS' EQUITY</b>		
Deposits		
Demand (non-interest bearing)	\$ 39,655	\$ 37,325
NOW accounts	59,919	54,785
Money market	116,185	107,131
Savings and other	67,272	65,657
Certificates of deposit	<u>184,759</u>	<u>172,895</u>
Total deposits	467,790	437,793
Federal Home Loan Bank advances	68,000	27,500
Repurchase Agreements	6,982	4,591
Accrued interest and other liabilities	<u>6,233</u>	<u>6,177</u>
<b>Total Liabilities</b>	<b><u>549,005</u></b>	<b><u>476,061</u></b>
Commitments and contingencies	-	-
Shareholders' Equity		
Common stock - \$.50 per share par value		
Authorized - 20,000,000 shares		
Issued - 5,990,138 shares	2,995	2,995
Paid-in capital	42,568	42,755
Retained earnings	17,213	14,447
Accumulated other comprehensive income	4,041	755
Treasury stock, at cost - 1,499,378 and 1,398,963 shares	<u>(15,625)</u>	<u>(13,435)</u>
<b>Total Shareholders' Equity</b>	<b><u>51,192</u></b>	<b><u>47,517</u></b>
<b>Total Liabilities and Shareholders' Equity</b>	<b><u>\$600,197</u></b>	<b><u>\$523,578</u></b>

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

**NewMil Bancorp, Inc. and Subsidiary**  
CONSOLIDATED STATEMENT OF INCOME  
(in thousands except per share amounts)  
(unaudited)

	Three months ended September 30		Nine months ended September 30	
	2001	2000	2001	2000
<b>INTEREST AND DIVIDEND INCOME</b>				
Interest and fees on loans	\$6,661	\$4,707	\$20,321	\$13,466
Interest and dividends on securities	2,723	2,399	7,652	6,750
Interest on federal funds sold	<u>44</u>	<u>43</u>	<u>164</u>	<u>102</u>
Total interest and dividend income	<u>9,428</u>	<u>7,149</u>	<u>28,137</u>	<u>20,318</u>
<b>INTEREST EXPENSE</b>				
Deposits	3,633	3,044	11,605	8,136
Borrowed funds	<u>479</u>	<u>497</u>	<u>1,265</u>	<u>1,372</u>
Total interest expense	<u>4,112</u>	<u>3,541</u>	<u>12,870</u>	<u>9,508</u>
Net interest and dividend income	5,316	3,608	15,267	10,810
PROVISION FOR LOAN LOSSES	<u>-</u>	<u>-</u>	<u>-</u>	<u>25</u>
Net interest and dividend income after provision for loan losses	<u>5,316</u>	<u>3,608</u>	<u>15,267</u>	<u>10,785</u>
<b>NON-INTEREST INCOME</b>				
Service charges on deposit accounts	535	369	1,534	1,026
Gains on sale of mortgage loans, net	116	48	306	111
Gains on sale of OREO property	-	39	-	62
Loan servicing fees	30	15	109	46
Other	<u>127</u>	<u>92</u>	<u>332</u>	<u>269</u>
Total non-interest income	<u>808</u>	<u>563</u>	<u>2,281</u>	<u>1,514</u>
<b>NON-INTEREST EXPENSE</b>				
Compensation	1,917	1,429	5,425	3,977
Occupancy	320	245	964	759
Equipment	317	241	978	740
Professional, collections & OREO	175	78	502	287
Marketing	102	90	293	276
Amortization of intangible assets	163	-	489	-
Other	<u>832</u>	<u>530</u>	<u>2,270</u>	<u>1,475</u>
Total non-interest expense	<u>3,826</u>	<u>2,613</u>	<u>10,921</u>	<u>7,514</u>
Income before income taxes	2,298	1,558	6,627	4,785
Provision for income taxes	<u>822</u>	<u>518</u>	<u>2,378</u>	<u>1,634</u>
NET INCOME	<u>\$1,476</u>	<u>\$1,040</u>	<u>\$ 4,249</u>	<u>\$ 3,151</u>
<b>Per common share</b>				
Diluted earnings	\$0.32	\$0.28	\$0.91	\$0.84
Basic earnings	0.33	0.29	0.95	0.87
Cash dividends	0.11	0.10	0.33	0.30

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

**NewMil Bancorp, Inc. and Subsidiary**

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(dollars in thousands)

	<u>Common Stock</u>		<u>Paid-in</u>	<u>Retained</u>	<u>Trea-</u>	<u>Accumulated</u>	<u>Total</u>
	<u>Shares</u>	<u>Amount</u>	<u>capital</u>	<u>earnings</u>	<u>sury</u>	<u>other comp-</u>	<u>share-</u>
					<u>stock</u>	<u>rehensive</u>	<u>holders'</u>
						<u>income</u>	<u>equity</u>
<b>Balances at</b>							
<b>December 31, 1999</b>	5,990,138	\$2,995	\$43,348	\$11,811	\$(23,415)	\$(1,602)	\$33,137
Net income	-	-	-	3,151	-	-	3,151
Net unrealized gains on securities, net of taxes	-	-	-	-	-	1,093	<u>1,093</u>
Total comprehensive income							<u>4,244</u>
Cash dividends paid	-	-	-	(1,084)	-	-	(1,084)
Proceeds from exercise of stock options	-	-	(122)	-	215	-	93
Tax benefit of exercise of non-qualifying options	-	-	113	-	-	-	113
Common stock repurchased	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(626)</u>	<u>-</u>	<u>(626)</u>
<b>Balances at</b>							
<b>September 30, 2000</b>	<u>5,990,138</u>	<u>\$2,995</u>	<u>\$43,339</u>	<u>\$13,878</u>	<u>\$(23,826)</u>	<u>\$(509)</u>	<u>\$35,877</u>
<b>Balances at</b>							
<b>December 31, 2000</b>	5,990,138	\$2,995	\$42,755	\$14,447	\$(13,435)	\$755	\$47,517
Net income	-	-	-	4,249	-	-	4,249
Net unrealized gains on securities, net of taxes	-	-	-	-	-	3,286	<u>3,286</u>
Total comprehensive income							<u>7,535</u>
Cash dividends paid	-	-	-	(1,483)	-	-	(1,483)
Proceeds from exercise of stock options	-	-	(146)	-	280	-	134
Common stock issued	-	-	(61)	-	850	-	789
Tax benefit of exercise of non-qualifying options	-	-	20	-	-	-	20
Common stock repurchased	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(3,320)</u>	<u>-</u>	<u>(3,320)</u>
<b>Balances at</b>							
<b>September 30, 2001</b>	<u>5,990,138</u>	<u>\$2,995</u>	<u>\$42,568</u>	<u>\$17,213</u>	<u>\$(15,625)</u>	<u>\$4,041</u>	<u>\$51,192</u>

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

**NewMil Bancorp, Inc. and Subsidiary**  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(in thousands) (unaudited)

	Nine months ended September 30,	
	<u>2001</u>	<u>2000</u>
<b>Operating Activities</b>		
Net income	\$ 4,249	\$ 3,151
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	-	25
Provision for depreciation and amortization	722	594
Amortization of intangible assets	489	-
Amortization and accretion of securities premiums and discounts, net	(25)	(29)
Gains on sales of loans, net	(306)	(110)
Gain on sale of OREO	-	(62)
Loans originated for sale	(17,777)	(5,633)
Proceeds from sales of loans originated for sale	18,083	5,743
Deferred income tax (benefit) provision	125	(25)
Increase in accrued interest income	(384)	(605)
(Decrease) increase in accrued interest expense and other liabilities	(587)	1,357
Increase in other assets, net	<u>(690)</u>	<u>(1,130)</u>
Net cash provided by operating activities	<u>3,899</u>	<u>3,276</u>
<b>Investing Activities</b>		
Purchases of securities available-for-sale	(30,100)	(23,682)
Purchases of mortgage backed securities available-for-sale	(54,279)	(19,506)
Proceeds from maturities and principal repayments of securities	1,816	10,245
Principal collected on mortgage backed securities	14,846	1,659
Loan advances, net	(11,988)	(15,100)
Payments to improve OREO	-	(3)
Proceeds from sales of OREO	-	463
Purchases of Bank premises and equipment, net	<u>(331)</u>	<u>(588)</u>
Net cash used by investing activities	<u>(80,036)</u>	<u>(46,512)</u>
<b>Financing Activities</b>		
Net increase in deposits	29,998	31,876
Net increase in repurchase agreements	2,390	3,258
FHLB advances, net	40,500	25,745
Common Stock repurchased	(3,320)	(626)
Proceeds from Common Stock reissued	789	-
Cash dividends paid	(1,483)	(1,084)
Tax benefit from exercise of stock options	20	113
Proceeds from exercise of stock options	<u>134</u>	<u>93</u>
Net cash provided by financing activities	<u>69,028</u>	<u>59,375</u>
(Decrease) increase in cash and cash equivalents	(7,109)	16,139
Cash and federal funds sold, beginning of period	<u>27,813</u>	<u>7,925</u>
Cash and federal funds sold, end of period	<u>\$20,704</u>	<u>\$24,064</u>
<b>Cash paid during period</b>		
Interest to depositors	\$11,681	\$ 8,009
Interest on borrowings	1,297	1,328
Income taxes	1,890	1,356
<b>Non-cash transfers</b>		
From Loans to OREO	-	336
From OREO to Loans	59	-
Financed Portion of OREO sale	-	218

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

**NEWMIL BANCORP, INC. and SUBSIDIARY**  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(unaudited)

**NOTE 1 - BASIS OF PRESENTATION**

The interim consolidated financial statements of NewMil Bancorp, Inc. ("NewMil") include those of NewMil and its wholly-owned subsidiary, NewMil Bank (the "Bank"). Certain prior period amounts in the statement of income and balance sheets have been reclassified to conform with the current financial presentation. In the opinion of management, the interim unaudited consolidated financial statements include all adjustments (consisting of normal recurring adjustments) necessary to present fairly the financial position of NewMil and the statements of income and shareholders' equity and cash flows for the interim periods presented.

The financial statements have been prepared in accordance with generally accepted accounting principles. In preparing the financial statements, management is required to make extensive use of estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet, and revenues and expenses for the period. Actual results could differ significantly 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 the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans. In connection with the determination of the allowance for loan losses and valuation of real estate, management obtains independent appraisals for significant properties.

Certain financial information which is normally included in financial statements prepared in accordance with generally accepted accounting principles, but which is not required for interim reporting purposes, has been condensed or omitted. Operating results for the nine month period ended September 30, 2001 are not necessarily indicative of the results that may be expected for the year ending December 31, 2001. The accompanying condensed financial statements should be read in conjunction with the financial statements and notes thereto included in NewMil's Annual Report for the period ended December 31, 2000.

**New Accounting Pronouncements**

In June 2001 the Financial Accounting Standards Board approved Statements of Financial Accounting Standards No. 141 "Business Combinations" ("SFAS 141") and No. 142 "Goodwill and Other Intangible Assets" (SFAS 142") which are effective July 1, 2001 and January 1, 2002, respectively for NewMil. SFAS 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. Under SFAS 142, amortization of goodwill, including goodwill recorded in past business combinations, will be discontinued upon adoption of this standard. In addition, goodwill recorded as a result of business combinations completed during the six-month period ending December 31, 2001 will not be amortized. All goodwill and intangible assets will be tested for impairment in accordance with the provisions of the Statement. Upon adoption of SFAS 141 and 142, NewMil has determined that it will not have to amortize approximately \$82,000 each quarter for goodwill and does not anticipate having to record any impairment charges.

**NOTE 2 - SECURITIES**

Securities classified available-for-sale (carried at fair value) were as follows:

(dollars in thousands)	Estimated fair value	Gross unrealized		Amortized
		gains	losses	cost
<b>September 30, 2001</b>				
US Government Agency notes				
After 1 but within 5 years	\$ 10,475	\$ 630	\$ -	\$ 9,845
Corporate bonds				
After 1 but within 5 years	39,086	2,287	-	36,799
Mortgage backed securities	110,796	2,964	-	107,832
Collateralized mortgage obligations	<u>16,098</u>	<u>336</u>	<u>-</u>	<u>15,762</u>
Total debt securities	176,455	6,217	-	170,238
Federal Home Loan Bank stock and other equity securities	<u>3,749</u>	<u>1</u>	<u>-</u>	<u>3,748</u>
Total securities available-for-sale	<u>\$180,204</u>	<u>\$6,218</u>	<u>\$ -</u>	<u>\$173,986</u>
<b>December 31, 2000</b>				
US Government Agency notes				
After 1 but within 5 years	\$ 10,294	\$ 481	\$ -	\$ 9,813
Corporate bonds				
After 1 but within 5 years	22,718	488	-	22,230
Mortgage backed securities	65,525	927	489	65,087
Collateralized mortgage obligations	<u>1,157</u>	<u>-</u>	<u>160</u>	<u>1,317</u>
Total debt securities	99,694	1,896	649	98,447
Federal Home Loan Bank stock and other equity securities	<u>3,527</u>	<u>-</u>	<u>-</u>	<u>3,527</u>
Total securities available-for-sale	<u>\$103,221</u>	<u>\$1,896</u>	<u>\$ 649</u>	<u>\$101,974</u>

Securities classified held-to-maturity (carried at amortized cost) were as follows:

(dollars in thousands)	Amortized cost(a)	Gross unrealized		Estimated fair value
		gains	losses	
<b>September 30, 2001</b>				
Municipal Bonds				
After 1 but within 5 years	\$ 500	\$ -	\$ 2	\$ 498
After 10 years	10,539	49	127	10,461
Mortgage backed securities	15,998	795	-	16,793
Collateralized mortgage obligations	<u>5,878</u>	<u>96</u>	<u>-</u>	<u>5,974</u>
Total securities held-to-maturity	<u>\$32,915</u>	<u>\$ 940</u>	<u>\$ 129</u>	<u>\$33,726</u>
<b>December 31, 2000</b>				
Municipal Bonds				
After 1 but within 5 years	\$ 250	\$ -	\$ 2	\$ 248
After 10 years	10,545	-	398	10,147
Mortgage backed securities	19,307	296	-	19,603
Collateralized mortgage obligations	<u>7,075</u>	<u>2</u>	<u>222</u>	<u>6,855</u>
Total securities held-to-maturity	<u>\$37,177</u>	<u>\$ 298</u>	<u>\$ 622</u>	<u>\$36,853</u>

- (a) Securities transferred from available-for-sale are carried at estimated fair value as of the transfer date and adjusted for subsequent amortization.

At September 30, 2001 securities with a carrying value and market value of \$1,491,000 and \$1,511,000, respectively, were pledged as collateral against public funds, and securities with a carrying value and market value of \$19,006,000 and \$19,692,000, respectively, were pledged as collateral against repurchase agreements. Also, securities with a carrying value and market value of \$10,170,000 and \$10,044,000, respectively, were pledged as collateral for Treasury, tax and loan payments as well as possible Federal Reserve discount window borrowings.

### NOTE 3 - LOANS

Major classifications of loans are as follows:

(in thousands)	September 30, 2001	December 31, 2000
Real estate mortgages:		
One-four family residential	\$186,525	\$187,755
Five or more family residential	16,078	19,759
Commercial	80,407	63,089
Land	3,097	3,423
Commercial and industrial	32,687	36,390
Home equity lines of credit	28,237	24,121
Installment and other	<u>3,401</u>	<u>3,868</u>
Total loans, gross	350,432	338,405
Deferred loan origination fees and purchase premium, net	(346)	(343)
Allowance for loan losses	<u>(5,496)</u>	<u>(5,518)</u>
Total loans, net	<u>\$344,590</u>	<u>\$332,544</u>
Impaired loans		
With valuation allowance	\$ 97	\$500
With no valuation allowance	<u>428</u>	<u>224</u>
Total impaired loans	<u>\$525</u>	<u>\$724</u>
Valuation allowance	\$ 4	\$238

NewMil's loans consist primarily of residential and commercial real estate loans located principally in western Connecticut, NewMil's service area. NewMil offers a broad range of loans and credit facilities to borrowers in its service area, including residential mortgage loans, commercial real estate loans, construction loans, working capital loans and a variety of consumer loans, including home equity lines of credit, installment and collateral loans. All residential and commercial mortgage loans are collateralized by first or second mortgages on real estate. The ability and willingness of borrowers to satisfy their loan obligations is dependent in large part upon the status of the regional economy and regional real estate market. Accordingly, the ultimate collectability of a substantial portion of NewMil's loan portfolio and the recovery of a substantial portion of OREO is susceptible to changes in market conditions.

Changes in the allowance for loan losses during the nine month periods ended September 30, are as follows:

(in thousands)	2001	2000
Balance, beginning of period	\$5,518	\$5,029
Provision for losses	-	25
Charge-offs	(71)	(155)
Recoveries	<u>49</u>	<u>83</u>
Balance, end of period	<u>\$5,496</u>	<u>\$4,982</u>

**NOTE 4 - NON-PERFORMING ASSETS**

The components of non-performing assets are as follows:

(in thousands)	Sept 30, <u>2001</u>	December 31, <u>2000</u>
Non-accrual loans	\$1,332	\$1,240
Accruing loans past due 90 days or more	386	351
Accruing troubled debt restructured loans	<u>-</u>	<u>-</u>
Total non-performing loans	1,718	1,591
Other real estate owned	<u>92</u>	<u>150</u>
Total non-performing assets	<u>\$1,810</u>	<u>\$1,741</u>

Other real estate owned (OREO) includes collateral acquired through foreclosure, forgiveness of debt or otherwise in lieu of debt.

**NOTE 5 - EARNINGS PER SHARE**

Basic earnings per share is computed using the weighted-average number of common shares outstanding during the year. The computation of diluted earnings per share is similar to the computation of basic earnings per share except the denominator is increased to include the number of additional common shares that would have been outstanding if dilutive potential common shares had been issued. Shares used in the computations are as follows:

(in thousands)	Three months ended September 30,		Nine months ended September 30,	
	<u>2001</u>	<u>2000</u>	<u>2001</u>	<u>2000</u>
Basic	4,460	3,611	4,490	3,613
Effect of dilutive stock options	<u>185</u>	<u>150</u>	<u>164</u>	<u>149</u>
Diluted	<u>4,645</u>	<u>3,761</u>	<u>4,654</u>	<u>3,762</u>

**NOTE 6 - COMPREHENSIVE INCOME**

The components of comprehensive income are as follows:

(in thousands)	Three months ended September 30,		Nine months ended September 30,	
	<u>2001</u>	<u>2000</u>	<u>2001</u>	<u>2000</u>
Comprehensive income				
Net income	\$1,476	\$1,040	\$4,249	\$3,151
Net unrealized gains on securities during period	<u>2,673</u>	<u>853</u>	<u>3,286</u>	<u>1,093</u>
Comprehensive income	<u>\$4,149</u>	<u>\$1,893</u>	<u>\$7,535</u>	<u>\$4,244</u>

The components of other comprehensive income, and related tax effects are as follows:

(in thousands)	Before tax <u>amount</u>	Tax (expense) <u>benefit</u>	Net of tax <u>amount</u>
<b>Three months ended September 30, 2001</b>			
Net unrealized gains on securities available-for-sale arising during the period	\$4,046	\$(1,377)	\$2,669
Accretion of unrealized loss on securities transferred from available-for-sale to held-to-maturity	<u>5</u>	<u>(1)</u>	<u>4</u>
Net unrealized gains on securities during period	<u>\$4,051</u>	<u>\$(1,378)</u>	<u>\$2,673</u>
<b>Three months ended September 30, 2000</b>			
Net unrealized losses on securities available-for-sale arising during the period	\$1,289	\$(439)	\$ 850
Accretion of unrealized loss on securities transferred from available-for-sale to held-to-maturity	<u>5</u>	<u>(2)</u>	<u>3</u>
Net unrealized losses on securities during period	<u>\$1,294</u>	<u>\$(441)</u>	<u>\$ 853</u>
<b>Nine months ended September 30, 2001</b>			
Net unrealized gains on securities available-for-sale arising during the period	\$4,972	\$(1,691)	\$3,281
Accretion of unrealized loss on securities transferred from available-for-sale to held-to-maturity	<u>8</u>	<u>(3)</u>	<u>5</u>
Net unrealized gains on securities during period	<u>\$4,980</u>	<u>\$(1,694)</u>	<u>\$3,286</u>
<b>Nine months ended September 30, 2000</b>			
Net unrealized losses on securities available-for-sale arising during the period	\$1,640	\$(559)	\$1,081
Accretion of unrealized loss on securities transferred from available-for-sale to held-to-maturity	<u>19</u>	<u>(7)</u>	<u>12</u>
Net unrealized losses on securities during period	<u>\$1,659</u>	<u>\$(566)</u>	<u>\$1,093</u>

#### **NOTE 7 - SHAREHOLDERS' EQUITY**

##### Capital Requirements

NewMil and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. The Bank was classified at its most recent notification as "well capitalized". NewMil and the Bank's regulatory capital ratios at September 30, 2001 are as follows:

	<u>NewMil</u>	<u>Bank</u>
Leverage ratio	6.95%	6.94%
Tier I risk-based ratio	11.01%	11.02%
Total risk-based ratio	12.26%	12.27%

##### Restrictions on Subsidiary's Dividends and Payments

NewMil's ability to pay dividends is dependent on the Bank's ability to pay dividends to NewMil. There are certain restrictions on the payment of dividends and other payments by the Bank to NewMil. Under Connecticut law the Bank is prohibited from declaring a cash dividend on its common stock except from its net earnings for the current year and retained net profits for the preceding two years. In some instances, further restrictions on dividends may be imposed on NewMil by the Federal Reserve Bank.

## **NewMil Bancorp, Inc. and Subsidiary**

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

Management's discussion and analysis of financial condition and results of operations of NewMil and its subsidiary should be read in conjunction with NewMil's Annual Report on Form 10-K for the period ended December 31, 2000.

#### **BUSINESS**

NewMil Bancorp, Inc. ("NewMil"), a Delaware corporation, is a bank holding company for NewMil Bank ("Bank"), a Connecticut-chartered and Federal Deposit Insurance Corporation (the "FDIC") insured savings bank headquartered in New Milford, Connecticut. NewMil's principal business consists of the business of the Bank. The Bank is engaged in customary banking activities, including general deposit taking and lending activities to both retail and commercial markets, and conducts its business from eighteen full-service offices in Litchfield, Fairfield and New Haven Counties and one special needs office in New Haven County. NewMil and the Bank were formed in 1987 and 1858, respectively.

On November 9, 2000, NewMil acquired Nutmeg Federal Savings and Loan Association ("Nutmeg") for a total purchase price of \$20.3 million, in consideration for which, NewMil paid \$10.3 million in cash and issued 1.0 million shares of common stock. Based on the terms of the agreement, Nutmeg shareholders received \$8.38 per common share and \$14.67 per preferred share, including a net gain (after expenses and taxes payable) on Nutmeg's sale of certain loan servicing rights. Nutmeg was a federally chartered savings and loan association headquartered in Danbury, Connecticut, with \$109.1 million in assets and \$84.7 million in deposits with four branch locations, including two in Danbury, one in Bethel and one in Ridgefield, Connecticut.

#### **RESULTS OF OPERATIONS**

**For the three month periods ended September 30, 2001 and 2000**

##### Overview

NewMil earned net income of \$1,476,000, or 32 cents per share (diluted), for the quarter ended September 30, 2001 as compared with \$1,040,000, or 28 cents per share (diluted), for the quarter ended September 30, 2000.

##### Analysis of net interest and dividend income

Net interest and dividend income increased \$1,708,000, or 47.4%, for the quarter ended September 30, 2001 as compared with the prior year period. This increase resulted from a \$148.2 million increase in average earning assets, as well as a 22 basis point increase in the net interest margin. The increase in earning assets is due to both the Nutmeg acquisition and internal growth. The increase in the net interest margin, to 4.04% from 3.82%, is due mostly to the effects of lower market interest rates and their impact on asset/liability repricing during 2001 as compared with 2000 and to changes in deposit pricing and balance sheet mix. NewMil was able to reprice quickly its deposit base to offset the effects of lower market interest rates by reducing rates on deposits during the period. The following table sets forth the components of NewMil's net interest income and yields on average interest-earning assets and interest-bearing funds.

<b>Three months ended September 30, 2001</b> (dollars in thousands)	Average <u>balance</u>	Income/ <u>expense</u>	Average <u>yield/rate</u>
Loans(a)	\$350,032	\$6,661	7.61%
Mortgage backed securities(b)	88,026	1,459	6.63
Other securities(b)(c)	<u>88,280</u>	<u>1,308</u>	5.93
Total earning assets	526,338	<u>9,428</u>	7.17
Other assets	<u>39,972</u>		
Total assets	<u>\$566,310</u>		
NOW accounts	\$ 60,236	171	1.14
Money market accounts	116,271	836	2.88
Savings & other	66,864	369	2.21
Certificates of deposit	<u>181,451</u>	<u>2,257</u>	4.98
Total interest-bearing deposits	424,822	3,633	3.42
Borrowings	<u>46,130</u>	<u>479</u>	4.15
Total interest-bearing funds	470,952	<u>4,112</u>	3.49
Demand deposits	40,682		
Other liabilities	5,639		
Shareholders' equity	<u>49,037</u>		
Total liabilities and shareholders' equity	<u>\$566,310</u>		
Net interest income		<u>\$5,316</u>	
Spread on interest-bearing funds			3.68
Net interest margin (d)			4.04

<b>Three months ended September 30, 2000</b> (dollars in thousands)	Average <u>balance</u>	Income/ <u>expense</u>	Average <u>yield/rate</u>
Loans (a)	\$230,827	\$4,707	8.16%
Mortgage backed securities (b)	89,982	1,509	6.71
Other securities (b)(c)	<u>57,323</u>	<u>933</u>	6.51
Total earning assets	378,132	<u>7,149</u>	7.56
Other assets	<u>14,644</u>		
Total assets	<u>\$392,776</u>		
NOW accounts	\$ 40,723	116	1.14
Money market accounts	84,454	824	3.90
Savings & other	46,893	286	2.44
Certificates of deposit	<u>131,836</u>	<u>1,818</u>	5.52
Total interest-bearing deposits	303,906	3,044	4.01
Borrowings	<u>30,707</u>	<u>497</u>	6.47
Total interest-bearing funds	334,613	<u>3,541</u>	4.23
Demand deposits	20,984		
Other liabilities	2,427		
Shareholders' equity	<u>34,752</u>		
Total liabilities and shareholders' equity	<u>\$392,776</u>		
Net interest income		<u>\$3,608</u>	
Spread on interest-bearing funds			3.33
Net interest margin (d)			3.82

(a) Includes non-accrual loans.

(b) Average balances of investments are based upon historical cost.

(c) Includes interest-bearing deposits in other banks and federal funds sold.

(d) Net interest income divided by average interest-earning assets.

The following table sets forth the changes in interest due to volume and rate.

Three months ended September 30, (dollars in thousands)	2001 versus 2000			
		Change in interest due to		
	<u>Volume</u>	<u>Rate</u>	<u>Vol/rate</u>	<u>Net</u>
Interest-earning assets:				
Loans	\$2,431	\$ (314)	\$ (163)	\$1,954
Mortgage backed securities	(33)	(18)	-	(51)
Other securities	<u>504</u>	<u>(83)</u>	<u>(45)</u>	<u>376</u>
Total	<u>2,902</u>	<u>(415)</u>	<u>(208)</u>	<u>2,279</u>
Interest-bearing liabilities:				
Deposits	1,211	(445)	(177)	589
Borrowings	<u>250</u>	<u>(178)</u>	<u>(90)</u>	<u>(18)</u>
Total	<u>1,461</u>	<u>(623)</u>	<u>(267)</u>	<u>571</u>
Net change to interest income	<u>\$1,441</u>	<u>\$ 208</u>	<u>\$ 59</u>	<u>\$1,708</u>

#### Interest income

Total interest and dividend income increased \$2,279,000, or 31.9%, for the quarter ended September 30, 2001 as compared with the same period a year ago. Loan income increased \$1,954,000, or 41.5%, as a result of higher average loan balances offset slightly by a lower average yield. Average loans increased \$119.2 million, or 51.6%, due to internal growth and the Nutmeg acquisition. The decrease in the average loan yield, down 55 basis points, was due to lower market interest rates throughout 2001, and to changes in portfolio mix. Investment income increased \$325,000, or 13.3%, as a result of higher average volume offset somewhat by lower average yields. Average securities increased \$29.0 million, or 19.7%. The decrease in average investment yield, down 35 basis points, was due to lower rates on new securities added during 2001, and to changes in portfolio mix.

#### Interest expense

Interest expense for the quarter ended September 30, 2001 increased \$571,000, or 16.1%, as compared with the same period a year ago as a result of the Nutmeg acquisition, internal deposit growth and higher average borrowings. Deposit expense increased \$589,000, or 19.4%, as a result higher deposit volume and deposit mix. Average interest-bearing deposits increased \$120.9 million, or 39.8%. The average cost of interest-bearing deposits declined when compared to the prior period, decreasing 59 basis points to 3.42%. The decline in interest costs was attributable to the lower deposit rates paid during the 2001 period. Interest expense on borrowings decreased \$18,000, or 3.6%, as a result of a lower borrowing cost during the period, down 232 basis points, offset by an increase of \$15.4 million in average borrowings.

#### Provision and Allowance for loan losses

NewMil made no provision for loan losses during the quarter ending September 30, 2001. Also, no provision was made during the prior year quarter. During the past year the allowance for loan losses has benefited from continued low levels of non-performing loans and low charge-offs, offset in-part by modest loan portfolio growth. These factors have enabled the Bank to reduce its provision for loan losses while maintaining reserve adequacy. The following table sets forth key ratios for the periods presented.

	Sept. 30, <u>2001</u>	December 31, <u>2000</u>	Sept. 30, <u>2000</u>
Ratio of allowance for loan losses:			
to non-performing loans	319.9%	346.8%	640.4%
to total gross loans	1.57	1.63	2.13
Ratio of non-performing loans			
to total loans	0.5	0.5	0.3

Since December 2000, non-performing loans increased \$127,000 or 8.0%, while gross loans increased \$12.0 million, or 3.6%. NewMil remains adequately reserved both against total loans and non-performing loans. For a discussion on loan quality see "Non-

## Performing Assets".

The Bank determines its allowance and provisions for loan losses based upon a detailed evaluation of the loan portfolio through a process which considers numerous factors, including estimated credit losses based upon internal and external portfolio reviews, delinquency levels and trends, estimates of the current value of underlying collateral, concentrations, portfolio volume and mix, changes in lending policy, historical loan loss experience, current economic conditions and examinations performed by regulatory authorities. Determining the level of the allowance at any given period is difficult, particularly during deteriorating or uncertain economic periods. Management must make estimates using assumptions and information, which is often subjective and changing rapidly. The review of the loan portfolio is a continuing event in the light of a changing economy and the dynamics of the banking and regulatory environment. In management's judgment, the allowance for loan losses at September 30, 2001 is adequate. Should the economic climate deteriorate, borrowers could experience difficulty and the level of non-performing loans, charge-offs and delinquencies could rise and require increased provisions. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance for loan losses. Such agencies could require the Bank to recognize additions to the allowance based on their judgments of information available to them at the time of their examination. The Bank was last examined by its banking regulators in February 2001 and no additions to the allowance were requested as a result of this examination.

The allowance for loan losses is reviewed and approved by the Bank's Board of Directors on a quarterly basis. The allowance for loan losses is computed by taking the portfolio and segregating it into various risk rating categories. Some loans have been further segregated and carry specific reserve amounts. All other loans that do not have specific reserves assigned are reserved based on a loss percentage assigned to the outstanding balance. The percentage applied to the outstanding balance varies depending on the risk rating.

### Non-interest income

The following table details the principal categories of non-interest income.

(in thousands)	<u>2001</u>	<u>2000</u>	<u>Change</u>	
Service charges on deposit accounts	\$ 535	\$ 369	\$ 166	45.0%
Gains on sales of mortgage loans, net	116	48	68	141.7
Gain on sale of OREO	-	39	(39)	(100.0)
Loan servicing	30	15	15	100.0
Other	<u>127</u>	<u>92</u>	<u>35</u>	38.0
Total non-interest income	<u>\$ 808</u>	<u>\$ 563</u>	<u>\$ 245</u>	43.5

The increase in non-interest income results primarily from increased customer service fee income, due to the increase in the number of deposit accounts during the 2001 period as compared with the 2000 period, due to both the Nutmeg acquisition and internal deposit growth during the period. The increase in gains on sales of residential mortgage loans resulted from higher loan sales volume, \$7.1 million in 2001 compared to \$2.9 million in 2000. Secondary market loan sales are generally pre-arranged on a loan-by-loan basis prior to origination and loans are sold with servicing rights released. The increase in loan servicing fees resulted from the addition of a loan-servicing portfolio with the Nutmeg acquisition.

### Operating expenses

The following table details the principal categories of operating expenses.

(in thousands)	<u>2001</u>	<u>2000</u>	<u>Change</u>	
Compensation	\$1,917	\$1,429	\$ 488	34.2%
Occupancy	320	245	75	30.6
Equipment	317	241	76	31.5
Professional	175	78	97	124.4
Marketing	102	90	12	13.3
Amortization of intangible assets	163	-	163	100.0
Other	<u>832</u>	<u>530</u>	<u>302</u>	57.0
Total operating expenses	<u>\$3,826</u>	<u>\$2,613</u>	<u>\$1,213</u>	46.4

The increase in compensation expense for the quarter ended September 30, 2001 as compared with the prior year period was due primarily to additional staffing, including the Nutmeg acquisition, and year-over-year salary increases of approximately 4.5%. The increase in occupancy and equipment expense results from the additional Nutmeg branch locations, related increases in equipment maintenance and depreciation expense and the implementation of the Bank's internet banking product in May 2000. Professional fees increased during the 2001 period due to consultants engaged for expense control and salary analysis, higher legal collection costs, offset by OREO property sale gains during the 2000 period. Marketing expense increased primarily as a result of increased advertising costs as a result of the new market areas acquired in the Nutmeg acquisition. The amortization of intangible assets relates to the Nutmeg acquisition, accounted for as a purchase transaction. Changes in other operating expense also reflect the Nutmeg acquisition and other internal asset growth.

### Income taxes

Net income for the quarter included an income tax provision of \$822,000, representing a 35.8% effective rate, as compared with a provision of \$518,000 a year ago, representing a 33.2% effective rate. The primary difference between NewMil's effective tax rate and the Federal corporate tax rate of 34% is attributable to the amortization of goodwill and core deposit intangible during the 2001 period, which is not deductible for tax purposes.

## **RESULTS OF OPERATIONS**

**For the nine month periods ended September 30, 2001 and 2000**

### Overview

NewMil earned net income of \$4,249,000, or 91 cents per share (diluted), for the year ended September 30, 2001 as compared with \$3,151,000, or 84 cents per share (diluted), for the year ended September 30, 2000.

### Analysis of net interest and dividend income

Net interest and dividend income increased \$7,820,000, or 38.5%, for the nine months ending September 30, 2001 as compared with the prior year period. This increase resulted from a \$142.8 million increase in average earning assets and by a 5 basis point increase in the net interest margin. The increase in earning assets is due to both the Nutmeg acquisition and internal growth. The increase in the net interest margin, to 4.01% from 3.96%, is due mostly to the effects of lower market interest rates and their impact on asset/liability re-pricing during 2001 as compared with 2000 and to changes in deposit pricing and balance sheet mix. The following table sets forth the components of NewMil's net interest income and yields on average interest-earning assets and interest-bearing funds.

<b>Nine months ended September 30, 2001</b> (dollars in thousands)	Average <u>balance</u>	Income/ <u>expense</u>	Average <u>yield/rate</u>
Loans(a)	\$343,616	\$20,321	7.89%
Mortgage backed securities(b)	85,246	4,250	6.65
Other securities(b)(c)	<u>78,165</u>	<u>3,566</u>	6.08
Total earning assets	507,027	<u>28,137</u>	7.40
Other assets	<u>37,338</u>		
Total assets	<u>\$544,364</u>		
NOW accounts	\$ 56,722	480	1.13
Money market accounts	116,156	2,880	3.31
Savings & other	65,594	1,161	2.36
Certificates of deposit	<u>178,079</u>	<u>7,084</u>	5.30
Total interest-bearing deposits	416,551	11,605	3.72
Borrowings	<u>36,402</u>	<u>1,265</u>	4.63
Total interest-bearing funds	452,953	<u>12,870</u>	3.79
Demand deposits	37,635		
Other liabilities	5,371		
Shareholders' equity	<u>48,405</u>		
Total liabilities and shareholders' equity	<u>\$544,364</u>		
Net interest income		<u>\$15,267</u>	
Spread on interest-bearing funds			3.61
Net interest margin (d)			4.01

<b>Nine months ended September 30, 2000</b> (dollars in thousands)	Average <u>balance</u>	Income/ <u>expense</u>	Average <u>yield/rate</u>
Loans (a)	\$224,495	\$13,466	8.00%
Mortgage backed securities (b)	89,318	4,466	6.67
Other securities (b)(c)	<u>50,365</u>	<u>2,386</u>	6.32
Total earning assets	364,178	<u>20,318</u>	7.44
Other assets	<u>12,739</u>		
Total assets	<u>\$376,917</u>		
NOW accounts	\$ 40,157	341	1.13
Money market accounts	75,275	1,948	3.45
Savings & other	48,318	875	2.42
Certificates of deposit	<u>128,125</u>	<u>4,972</u>	5.17
Total interest-bearing deposits	291,875	8,136	3.72
Borrowings	<u>29,248</u>	<u>1,372</u>	6.26
Total interest-bearing funds	321,123	<u>9,508</u>	3.95
Demand deposits	19,909		
Other liabilities	2,215		
Shareholders' equity	<u>33,670</u>		
Total liabilities and shareholders' equity	<u>\$376,917</u>		
Net interest income		<u>\$10,810</u>	
Spread on interest-bearing funds			3.49
Net interest margin (d)			3.96

(a) Includes non-accrual loans.

(b) Average balances of investments are based upon historical cost.

(c) Includes interest-bearing deposits in other banks and federal funds sold.

(d) Net interest income divided by average interest-earning assets.

The following table sets forth the changes in interest due to volume and rate.

Nine months ended September 30, (dollars in thousands)	2001 versus 2000			
		Change in interest due to		
	<u>Volume</u>	<u>Rate</u>	<u>Vol/rate</u>	<u>Net</u>
Interest-earning assets:				
Loans	\$7,145	\$ (190)	\$ (100)	\$6,855
Mortgage backed securities	(204)	(13)	-	(217)
Other securities	<u>1,317</u>	<u>(88)</u>	<u>(48)</u>	<u>1,181</u>
Total	<u>8,258</u>	<u>(291)</u>	<u>(148)</u>	<u>7,819</u>
Interest-bearing liabilities:				
Deposits	3,475	(4)	(2)	3,469
Borrowings	<u>336</u>	<u>(356)</u>	<u>(87)</u>	<u>(107)</u>
Total	<u>3,811</u>	<u>(360)</u>	<u>(89)</u>	<u>3,362</u>
Net change to interest income	<u>\$4,447</u>	<u>\$ 69</u>	<u>\$ (59)</u>	<u>\$4,457</u>

#### Interest income

Total net interest income increased \$4,457,000, or 41.2%, for the year ended September 30, 2001 as compared with the same period a year ago. Loan income increased \$6,855,000, or 50.9%, as a result of higher average loan balances offset by a lower average yield. Average loans increased \$119.1 million, or 53.1%, due to internal growth and the Nutmeg acquisition. The decrease in the average loan yield, down 11 basis points, was due to lower market interest rates throughout 2001, and to changes in portfolio mix. Investment income increased \$964,000, or 14.1%, as a result of higher average volume offset somewhat by lower average yields. Average securities increased \$23.7 million, or 17.0%. The decrease in average investment yield, down 16 basis points, was due to lower rates on new securities added during 2001, and to changes in portfolio mix.

#### Interest expense

Interest expense for the nine months ended September 30, 2001 increased \$3,362,000, or 35.4, as compared with the same period a year ago as a result of the Nutmeg acquisition and internal deposit growth, higher average borrowings, and higher interest rates on CD's. Deposit expense increased \$3,469,000, or 42.6%, as a result higher deposit volume and changes in deposit mix. Average interest-bearing deposits increased \$124.7 million, or 42.7%. The average cost of interest-bearing deposits remained stable at 3.72%, while certificate of deposit costs increased 13 basis points offset by lower costing money market, savings rates and to a lesser degree NOW accounts. Interest expense on borrowings decreased \$107,000, or 7.8%, as a result of lower borrowing rates, down 163 basis points, offset by an increase of \$7.2 million in average borrowings.

#### Provision and Allowance for loan losses

NewMil made no provision for loan losses during the year ending September 30, 2001 and a \$25,000 provision in the prior year period. During the past year the allowance for loan losses has benefited from an improvement in loan quality, offset in-part by modest loan portfolio growth. These factors have enabled the Bank to reduce its provision for loan losses while maintaining reserve adequacy. For a detailed discussion of the Bank's allowance for loan losses refer to "Results of Operations - For the three month periods ended September 30, 2001 and 2000" above.

### Non-interest income

The following table details the principal categories of non-interest income for the nine month periods.

(in thousands)	<u>2001</u>	<u>2000</u>	<u>Change</u>	
Service charges on deposit accounts	\$1,534	\$1,026	\$ 508	49.5%
Gains on sales of mortgage loans, net	306	111	195	175.7
Gain on sale of OREO	-	62	(62)	(100.0)
Loan servicing	109	46	63	137.0
Other	<u>332</u>	<u>269</u>	<u>63</u>	23.4
Total non-interest income	<u>\$2,281</u>	<u>\$1,514</u>	<u>\$ 767</u>	50.7

The increase in non-interest income results primarily from increased customer service fee income due to the increase in the number of deposit accounts during the 2001 period as compared with the 2000 period, as a result of both the Nutmeg acquisition and internal deposit growth during the period. The increase in gains on sales of residential mortgage loans resulted from higher loan sales volume, \$17.8 million in 2001 compared to \$5.7 million in 2000. Secondary market loan sales are generally pre-arranged on a loan by loan basis prior to origination and loans are sold with servicing rights released. The increase in loan servicing fees resulted from the addition of a loan servicing portfolio with the Nutmeg acquisition.

### Operating expenses

The following table details the principal categories of operating expenses for the nine-month period.

(in thousands)	<u>2001</u>	<u>2000</u>	<u>Change</u>	
Compensation	\$ 5,425	\$3,977	\$1,448	36.4%
Occupancy	964	759	205	27.0
Equipment	978	740	238	32.2
Professional	502	287	215	74.9
Marketing	293	276	17	6.2
Amortization of intangible assets	489	-	489	100.0
Other	<u>2,270</u>	<u>1,475</u>	<u>795</u>	53.9
Total operating expenses	<u>\$10,921</u>	<u>\$7,514</u>	<u>\$3,407</u>	44.8

The increase in compensation expense for the nine months ended September 30, 2001 as compared with the prior year period was due primarily to additional staffing, including the Nutmeg acquisition, and year-over-year salary increases of approximately 4.5%. The increase in occupancy and equipment expense results from the additional Nutmeg branch locations, related increases in equipment maintenance and depreciation expense and the implementation of the Bank's internet banking product in May 2000. Professional fees increased during the 2001 period primarily due to higher legal collection costs, consultants engaged for expense control, offset by OREO property sale gains during the 2000 period. The increase in marketing expenses is primarily due to the additional market areas now serviced as a result of the Nutmeg acquisition. The amortization of intangible assets relates to the Nutmeg acquisition, accounted for as a purchase transaction. Changes in other operating expense also reflect the Nutmeg acquisition and other internal asset growth.

### Income taxes

Net income for the nine-month period included an income tax provision of \$2,378,000, representing a 35.9% effective rate, as compared with a provision of \$1,634,000 a year ago, representing a 34.1% effective rate. The primary difference between NewMil's effective tax rate and the Federal corporate tax rate of 34% is attributable to the amortization of goodwill and core deposit intangible during the 2001 period, which is not deductible for tax purposes.

## FINANCIAL CONDITION

During the nine-month period ended September 30, 2001 total assets increased \$76.6 million, or 14.6%, to \$600.2 million. The increase in assets was due to deposit growth of \$30.0 million, or 6.9%, as well as an increase in FHLB borrowings of \$40.5 million or 147.3%. During the nine-month period securities increased \$72.7 million, or 51.8%, while net loans increased \$12.0 million, or 3.6%. Non-performing assets increased slightly to \$1,810,000, or 0.30% of total assets at September 30, 2001.

### Securities

For the nine-month period securities increased \$72.7 million, or 51.8%, to \$213.1 million at September 30, 2001. During the period NewMil purchased \$54.3 million of fixed rate mortgage backed securities, \$15.1 million of fixed rate CMO's, \$14.5 million of corporate bonds and \$470,000 of other securities.

NewMil's securities portfolio consists of US Government Agency notes, mortgage backed securities (MBS), corporate bonds, bank qualified municipal bonds, collateralized mortgage obligations (CMOs), and Federal Home Loan Bank stock. At September 30, 2001, the portfolio had a projected weighted average duration and life of 3.8 years and 5.2 years, respectively, based on median projected prepayment speeds at current interest rates. At September 30, 2001, securities totaling \$180.2 million, or 84.6%, were classified as available-for-sale and securities totaling \$32.9 million, or 15.4%, were classified as held-to-maturity.

### Loans

During the nine month period ended September 30, 2001 net loans grew \$12.0 million, or 3.6%. Loan originations and advances totaled \$104.6 million, while loan repayments and loans sold in the secondary market were \$92.7 million and \$17.8 million, respectively. Major classifications of loans are as follows:

(in thousands)	Sept. 30, <u>2001</u>	December 31, <u>2000</u>
Real estate mortgages:		
One-four family residential	\$186,525	\$187,755
Five or more family residential	16,078	19,759
Commercial	80,407	63,089
Land	3,097	3,423
Commercial and industrial	32,687	36,390
Home equity lines of credit	28,237	24,121
Installment and other	<u>3,401</u>	<u>3,868</u>
Total loans, gross	350,432	338,405
Deferred loan origination fees and purchase premium, net	(346)	(343)
Allowance for loan losses	<u>(5,496)</u>	<u>(5,518)</u>
Total loans, net	<u>\$344,590</u>	<u>\$332,544</u>

The Commercial Lending department specializes in lending to small and mid-size companies and professional practices and provides short-term and long-term financing, construction loans, commercial mortgages and property improvement loans. The department also works with several government-assisted lending programs. The Residential Mortgage Department, in addition to traditional portfolio lending, originates loans for sale to the secondary market on a service-released basis, which enables the Bank to offer a very comprehensive mortgage product line. The department also offers home equity loans and lines of credit and consumer installment loans.

### Non-performing assets

The following table details the composition of non-performing assets as of September 30, 2001.

Non-Performing Assets (dollars in thousands)	Non- accrual loans	Accruing loans past due 90 or more days	OREO	Total non- perform- ing assets
<b>September 30, 2001</b>				
Real estate:				
Residential	\$ 192	\$ 259	\$ -	\$ 451
Commercial	873	127	92	1,092
Land and land development	267	-	-	267
Collateral and installment loans	-	-	-	-
Totals	<u>\$1,332</u>	<u>\$ 386</u>	<u>\$ 92</u>	<u>\$1,810</u>

In addition to non-performing assets, at September 30, 2001 NewMil had \$2,829,000 of performing classified loans that are considered potential problem loans. Although not impaired, performing classified loans, in the opinion of management, exhibit a higher than normal degree of risk and warrant monitoring due to various considerations, including (i) the degree of documentation supporting the borrower's current financial position, (ii) potential weaknesses in the borrowers' ability to service the loan, (iii) possible collateral value deficiency, and (iv) other risk factors such as geographic location, industry focus and negatively trending financial results. These deficiencies create some uncertainty, but not serious doubt, as to the borrowers' ability to comply with the loan repayment terms in the future. Management believes that reserves for these loans are adequate.

NewMil pursues the resolution of all non-performing assets through restructurings, credit enhancements or collections. When collection procedures do not bring a loan into performing or restructured status, NewMil generally initiates action to foreclose the property or to acquire it by deed in lieu of foreclosure. NewMil actively markets all OREO property.

### **LIQUIDITY**

NewMil manages its liquidity position to ensure that there is sufficient funding availability at all times to meet both anticipated and unanticipated deposit withdrawals, loan originations and advances, securities purchases and other operating cash outflows. NewMil's primary sources of liquidity are principal payments and maturities of securities and loans, short-term borrowings through repurchase agreements and Federal Home Loan Bank advances, net deposit growth and funds provided by operations. Liquidity can also be provided through sales of loans and available-for-sale securities.

Operating activities for the nine month period ended September 30, 2001 provided net cash of \$3,899,000. Investing activities used net cash of \$80,036,000, principally as a result of securities purchases and net loans advances offset, in part, by securities repayments and maturities. Financing activities provided net cash of \$69,028,000, principally from increases in deposits, FHLB borrowings and repurchase agreements, and offset in part by cash dividends paid and treasury stock purchases.

At September 30, 2001, NewMil's liquidity ratio, as represented by cash, short term available-for-sale securities, marketable assets and the ability to borrow against held-to-maturity securities and loans through unused FHLB and other short term borrowing capacity, of approximately \$197.5 million, to net deposits and short term

unsecured liabilities, was 55.3%, well in excess of NewMil's minimum guideline of 15%. At September 30, 2001, NewMil had outstanding commitments to fund new loan originations of \$19.2 million, construction mortgage commitments of \$8.2 million and unused lines of credit of \$36.8 million. These commitments will be met in the normal course of business. NewMil believes that its liquidity sources will continue to provide funding sufficient to support operating activities, loan originations and commitments, and deposit withdrawals.

## **CAPITAL RESOURCES**

During the nine month period ended September 30, 2001 shareholders' equity increased \$3.7 million, to \$51,192,000, while book value per share increased \$1.24 to \$11.59. The increase in shareholders' equity resulted from net income of \$4.2 million, or \$0.91 per share (diluted), net unrealized gains on securities available-for-sale of \$3.3 million, net of taxes, common stock issued of \$789,000 and stock option exercise proceeds of \$134,000, offset by treasury stock purchases of \$3.3 million and dividend payments of \$1.4 million.

### Capital requirements

NewMil and the Bank are subject to minimum capital requirements established, respectively, by the Federal Reserve Board (the "FRB") and the FDIC. At September 30, 2001 NewMil's tier 1 leverage capital ratio was 6.95% and its tier 1 and total risk-based capital ratios were 11.01% and 12.26%, respectively. At September 30, 2001 the Bank's tier 1 leverage capital ratio was 6.94% and its tier 1 and total risk-based capital ratios were 11.02% and 12.27%, respectively. NewMil and the Bank are categorized as "well capitalized". A well capitalized institution, which is the highest capital category for an institution as defined by the Prompt Corrective regulations issued by the FDIC and the FRB, is one which maintains a total risk-based ratio of 10% or above, a Tier I risk-based ratio of 6% or above and a leverage ratio of 5% or above, and is not subject to any written order, written agreement, capital directive, or prompt corrective action directive to meet and maintain a specific capital level.

### Dividends

NewMil's ability to pay dividends is dependent on the Bank's ability to pay dividends to NewMil. There are certain restrictions on the payment of dividends and other payments by the Bank to NewMil. Under Connecticut law the Bank is prohibited from declaring a cash dividend on its common stock except from its net earnings for the current calendar year and retained net profits for the preceding two years. In some instances, further restrictions on dividends may be imposed on NewMil by the Federal Reserve Bank.

NewMil believes that the payment of cash dividends to its shareholders is appropriate, provided that such payment considers NewMil's capital needs, asset quality, and overall financial condition and does not adversely affect the financial stability of NewMil or the Bank. The continued payment of cash dividends by NewMil will be dependent on NewMil's future core earnings, financial condition and capital needs, regulatory restrictions, and other factors deemed relevant by the Board of Directors of NewMil.

Item 3. QUANTITATIVE and QUALITATIVE DISCLOSURE of MARKET RISK

NewMil manages interest rate risk through an Asset Liability Committee comprised of representatives from senior management and the Board of Directors. The committee monitors exposure to interest rate risk on a quarterly basis using both a traditional gap analysis and an earnings simulation analysis. Traditional gap analysis identifies short and long term interest rate positions or exposure. Income simulation analysis measures the amount of short-term earnings at risk under both rising and falling rate scenarios. NewMil's interest rate risk has not significantly changed from the prior year.

PART II. **OTHER INFORMATION**

Item 1. **LEGAL PROCEEDINGS**

There are no material legal proceedings pending against NewMil or the Bank or any of their properties, other than ordinary routine litigation incidental to NewMil's business.

Item 4. **SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

None

Item 5. **OTHER INFORMATION**

None

Item 6. **EXHIBITS AND REPORTS ON FORM 8-K**

(a) Exhibits

11. Computation of earnings per share.

(b) Report on Form 8-K.

None

**SIGNATURES**

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

**NEWMIL BANCORP, INC.**

November 12, 2001                   By        /s/ Francis J. Wiatr  
Francis J. Wiatr,  
Chairman, President and CEO

November 12, 2001                   By        /s/ B. Ian McMahon  
B. Ian McMahon,  
Chief Financial Officer

Exhibit 11.1

NEWMIL BANCORP, INC.  
 COMPUTATION OF NET INCOME PER COMMON SHARE  
 (in thousands except per share amounts)

	Three month period ended September 30,		Nine month period ended September 30,	
	2001	2000	2001	2000
<u>Net income</u>				
Net income - basic and diluted	<u>\$1,476</u>	<u>\$1,040</u>	<u>\$4,249</u>	<u>\$3,151</u>
<u>Weighted Average Common and Common Equivalent Stock</u>				
Weighted average common stock outstanding	4,460	3,611	4,490	3,613
Assumed conversion as of the beginning of each period or upon issuance during a period of stock options outstanding at the end of each period	457	303	417	326
Assumed purchase of treasury stock during each period with proceeds from conversion of stock options outstanding at the end of each period	<u>(272)</u>	<u>(153)</u>	<u>(253)</u>	<u>(177)</u>
Weighted average common and common equivalent stock outstanding - diluted	<u>4,645</u>	<u>3,761</u>	<u>4,654</u>	<u>3,762</u>
<u>Earnings Per Common and Common Equivalent Share</u>				
Basic	<u>\$0.33</u>	<u>\$0.29</u>	<u>\$0.95</u>	<u>\$0.87</u>
Diluted	<u>\$0.32</u>	<u>\$0.28</u>	<u>\$0.91</u>	<u>\$0.84</u>

**Exhibit 27**

**NEWMIL BANCORP, INC.  
FINANCIAL DATA SCHEDULE**

This schedule contains summary financial information extracted from the registrant's June 30, 2001 unaudited balance sheet, income statement and cash flow statement, and notes thereto, and is qualified in its entirety by reference to such financial statements.

<u>Item</u> <u>Number</u>	<u>Item</u> <u>Description</u>	
9-03(1)	Cash and due from banks	\$20,605,000
9-03(2)	Interest bearing deposits	99,000
9-03(3)	Federal funds sold	-0-
9-03(4)	Trading account assets	-0-
9-03(6)	Investment and mortgage backed securities available for sale	180,204,000
9-03(6)	Investment and mortgage backed securities held to maturity - carrying value	32,915,000
9-03(6)	Investment and mortgage backed securities held to maturity - market value	33,726,000
9-03(7)	Loans	344,590,000
9-03(7)(2)	Allowance for losses	5,496,000
9-03(11)	Total assets	600,197,000
9-03(12)	Deposits	467,790,000
9-03(13)	Short term borrowings	74,982,000
9-03(15)	Other liabilities	6,233,000
9-03(16)	Long term debt	-0-
9-03(19)	Preferred stock - mandatory redemption	-0-
9-03(20)	Preferred stock - no mandatory redemption	-0-
9-03(21)	Common stock	2,995,000
9-03(22)	Other shareholders' equity	48,197,000
9-03(23)	Total liabilities and shareholders' equity	600,197,000
9-04(1)	Interest and fees on loans	20,321,000
9-04(2)	Interest and dividends on investments	7,652,000
9-04(4)	Other interest income	164,000
9-04(5)	Total interest income	28,137,000
9-04(6)	Interest on deposits	11,605,000
9-04(9)	Total interest expense	12,870,000
9-04(10)	Net interest income	15,267,000
9-04(11)	Provision for loan losses	-0-
9-04(13)(h)	Securities gains (losses)	-0-
9-04(14)	Other expenses	10,921,000
9-04(15)	Income before income tax	6,627,000
9-04(17)	Income before extraordinary items	6,627,000
9-04(18)	Extraordinary items, less tax	-0-
9-04(19)	Cumulative change in accounting principals	-0-
9-04(20)	Net income	4,249,000
9-04(21)	Earnings per share - basic	0.95
9-04(21)	Earnings per share - diluted	0.91

Guide Number	Item Description	
I.B.5	Net yield-interest earning assets-actual	4.01%
III.C.1(a)	Loans on non accrual	\$1,332,000
III.C.1(b)	Accruing loans past due 90 days or more	386,000
III.C.1(c)	Troubled debt restructuring	-0-
III.C.2	Potential problem loans	2,829,000
IV.A.1	Allowance for loan loss- beginning of period	5,518,000
IV.A.2	Total chargeoffs	71,000
IV.A.3	Total recoveries	49,000
IV.A.4	Allowance for loan loss-end of period	5,496,000
IV.B.1	Loan loss allowance allocated to domestic loans	5,496,000
IV.B.2	Loan loss allowance allocated to foreign loans	-0-
IV.B.3	Loan loss allowance-unallocated	481,000