

CENTURY BANCORP INC

Form 10-Q

May 10, 2006

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q**

(Mark One)

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

For the quarterly period ended March 31, 2006.

or

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

For the transition period from _____.

Commission file number 0-15752.

CENTURY BANCORP, INC.

(Exact name of registrant as specified in its charter)

COMMONWEALTH OF MASSACHUSETTS

04-2498617

(State or other jurisdiction of incorporation or organization)

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

400 MYSTIC AVENUE, MEDFORD, MA

02155

(Address of principal executive offices)

(Zip Code)

(781) 391-4000

(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 and 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

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

Large accelerated filer Accelerated filer Non-accelerated filer

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

Yes No

As of April 30, 2006, the Registrant had outstanding:

| | |
|---|-------------------------|
| Class A Common Stock, \$1.00 par value | 3,483,638 Shares |
| Class B Common Stock, \$1.00 par value | 2,057,450 Shares |

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PART I Item 1

Century Bancorp, Inc. Consolidated Balance Sheets (unaudited)

(000 s, except share data)

| | March 31, 2006 | December 31, 2005 |
|---|-------------------|----------------------|
| <u>Assets</u> | | |
| Cash and due from banks | \$ 46,920 | \$ 47,626 |
| Federal funds sold and interest-bearing deposits in other banks | 52,002 | 105,053 |
| Total cash and cash equivalents | 98,922 | 152,679 |
| Securities available-for-sale, amortized cost \$532,527 and \$546,524, respectively | 517,613 | 532,982 |
| Securities held-to-maturity, market value \$270,573 and \$277,769, respectively | 281,071 | 286,578 |
| Loans, net: | | |
| Commercial & industrial | 101,803 | 94,139 |
| Construction & land development | 71,505 | 58,846 |
| Commercial real estate | 305,766 | 302,279 |
| Residential real estate | 153,987 | 146,355 |
| Consumer & other | 10,566 | 11,316 |
| Home equity | 74,360 | 76,710 |
| Total loans, net | 717,987 | 689,645 |
| Less: allowance for loan losses | 9,427 | 9,340 |
| Net loans | 708,560 | 680,305 |
| Bank premises and equipment | 24,631 | 25,228 |
| Accrued interest receivable | 7,357 | 7,127 |
| Goodwill | 2,714 | 2,714 |
| Core deposit intangible | 2,350 | 2,447 |
| Other assets | 40,926 | 38,709 |
| Total assets | \$ 1,684,144 | \$ 1,728,769 |
| <u>Liabilities</u> | | |
| Deposits: | | |
| Demand deposits | \$ 283,800 | \$ 296,696 |
| Savings and NOW deposits | 261,620 | 239,326 |
| Money market accounts | 307,801 | 279,245 |
| Time deposits | 314,747 | 401,773 |
| Total deposits | 1,167,968 | 1,217,040 |

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| | | |
|--|---------------------|---------------------|
| Securities sold under agreements to repurchase | 54,020 | 50,010 |
| Federal Home Loan Bank (FHLB) borrowings and other borrowed funds | 303,775 | 304,722 |
| Other liabilities | 18,954 | 17,713 |
| Subordinated debentures | 36,083 | 36,083 |
| Total liabilities | 1,580,800 | 1,625,568 |
| <u>Stockholders equity</u> | | |
| Class A common stock, \$1.00 par value per share; authorized 10,000,000 shares; issued 3,479,788 shares and 3,453,202 shares, respectively | 3,480 | 3,453 |
| Class B common stock, \$1.00 par value per share; authorized 5,000,000 shares; issued 2,061,300 shares and 2,082,240 shares, respectively | 2,061 | 2,082 |
| Additional paid-in capital | 11,504 | 11,416 |
| Retained earnings | 98,226 | 97,338 |
| | 115,271 | 114,289 |
| Unrealized losses on securities available-for-sale, net of taxes | (9,109) | (8,270) |
| Additional minimum pension liability, net of taxes | (2,818) | (2,818) |
| Total accumulated other comprehensive loss, net of taxes | (11,927) | (11,088) |
| Total stockholders equity | 103,344 | 103,201 |
| Total liabilities and stockholders equity | \$ 1,684,144 | \$ 1,728,769 |

See accompanying Notes to unaudited Consolidated Financial Statements.

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Century Bancorp, Inc. Consolidated Statements of Income (unaudited)

(000 s except share data)

| | Three months ended March 31, | |
|---|------------------------------|----------|
| | 2006 | 2005 |
| Interest income | | |
| Loans | \$ 11,935 | \$ 9,198 |
| Securities held-to-maturity | 2,613 | 3,196 |
| Securities available-for-sale | 4,609 | 4,935 |
| Federal funds sold and interest-bearing deposits in other banks | 30 | 323 |
| Total interest income | 19,187 | 17,652 |
| Interest expense | | |
| Savings and NOW deposits | 923 | 715 |
| Money market accounts | 1,778 | 1,711 |
| Time deposits | 3,181 | 2,057 |
| Securities sold under agreements to repurchase | 415 | 100 |
| Other borrowed funds and subordinated debentures | 3,563 | 2,520 |
| Total interest expense | 9,860 | 7,103 |
| Net interest income | 9,327 | 10,549 |
| Provision for loan losses | 150 | 150 |
| Net interest income after provision for loan losses | 9,177 | 10,399 |
| Other operating income | | |
| Service charges on deposit accounts | 1,516 | 1,428 |
| Lockbox fees | 675 | 709 |
| Brokerage commissions | 48 | 153 |
| Other income | 888 | 375 |
| Total other operating income | 3,127 | 2,665 |
| Operating expenses | | |
| Salaries and employee benefits | 6,248 | 6,103 |
| Occupancy | 1,045 | 986 |
| Equipment | 735 | 782 |
| Other | 2,137 | 2,164 |

| | | |
|--|-----------|-----------|
| Total operating expenses | 10,165 | 10,035 |
| Income before income taxes | 2,139 | 3,029 |
| Provision for income taxes | 709 | 988 |
| Net income | \$ 1,430 | \$ 2,041 |
| Share data: | | |
| Weighted average number of shares outstanding, basic | 5,540,523 | 5,534,651 |
| Weighted average number of shares outstanding, diluted | 5,546,470 | 5,543,783 |
| Net income per share, basic | \$ 0.26 | \$ 0.37 |
| Net income per share, diluted | \$ 0.26 | \$ 0.37 |
| Cash dividends paid: | | |
| Class A common stock | \$ 0.12 | \$ 0.12 |
| Class B common stock | \$ 0.06 | \$ 0.06 |

See accompanying Notes to unaudited Consolidated Financial Statements.

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Century Bancorp, Inc. Consolidated Statements of Changes in Stockholders' Equity (unaudited)

| | Class A Common Stock | Class B Common Stock | Additional Paid-In Capital | Retained Earnings (000's) | Accumulated Other Comprehensive Income (Loss) | Total Stockholders' Equity |
|---|-------------------------------|----------------------------|----------------------------------|---------------------------------|---|----------------------------------|
| <u>2005</u> | | | | | | |
| Balance at December 31, 2004 | \$ 3,434 | \$ 2,099 | \$ 11,395 | \$ 92,611 | (\$4,766) | \$ 104,773 |
| Net income | | | | 2,041 | | 2,041 |
| Other comprehensive income, net of tax: Unrealized holding losses arising during period net of \$2,907 in taxes less: reclassification adjustment for gains included in net income | | | | | (4,557) | (4,557) |
| Minimum pension liability adjustment | | | | | | 0 |
| Comprehensive income | | | | | | (2,516) |
| Stock Options Exercised, 1,229 shares | 2 | | 18 | | | 20 |
| Cash dividends paid, Class A common stock, \$.12 per share | | | | (411) | | (411) |
| Cash dividends paid, Class B common stock, \$.06 per share | | | | (127) | | (127) |
| Balance at March 31, 2005 | \$ 3,436 | \$ 2,099 | \$ 11,413 | \$ 94,114 | (\$9,323) | \$ 101,739 |
| <u>2006</u> | | | | | | |
| Balance at December 31, 2005 | \$ 3,453 | \$ 2,082 | \$ 11,416 | \$ 97,338 | (\$11,088) | \$ 103,201 |

| | | | | | | |
|---|----------|----------|-----------|-----------|------------|------------|
| Net income | | | | 1,430 | | 1,430 |
| Other comprehensive income, net of tax: | | | | | | |
| Unrealized holding losses arising during period net of \$533 in taxes | | | | | (839) | (839) |
| less: reclassification adjustment for gains included in net income | | | | | | 0 |
| Minimum pension liability adjustment | | | | | | 0 |
| Comprehensive income | | | | | | 591 |
| Conversion of Class B Common Stock to Class A Common Stock | 21 | (21) | | | | 0 |
| Stock Options Exercised, 5,646 shares | 6 | | 88 | | | 94 |
| Cash dividends paid, Class A common stock, \$.12 per share | | | | | (418) | (418) |
| Cash dividends paid, Class B common stock, \$.06 per share | | | | | (124) | (124) |
| Balance at March 31, 2006 | \$ 3,480 | \$ 2,061 | \$ 11,504 | \$ 98,226 | (\$11,927) | \$ 103,344 |

See accompanying Notes to unaudited Consolidated Financial Statements.

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Century Bancorp, Inc. Consolidated Statements of Cash Flows (unaudited)

| | Three months ended March 31, | |
|---|---------------------------------|-----------|
| | 2006 | 2005 |
| | (000's) | |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income | \$ 1,430 | \$ 2,041 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Provision for loan losses | 150 | 150 |
| Deferred income taxes | (184) | 172 |
| Net depreciation and amortization | 899 | 668 |
| Increase in accrued interest receivable | (230) | (654) |
| Increase in other assets | (1,518) | (2,221) |
| Increase in other liabilities | 1,253 | 1,092 |
| Net cash provided by operating activities | 1,800 | 1,248 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Proceeds from maturities of securities available-for-sale | 13,912 | 128,931 |
| Purchase of securities available-for-sale | | (107,848) |
| Proceeds from maturities of securities held-to-maturity | 5,535 | 15,265 |
| Purchase of securities held-to-maturity | | (2,022) |
| Net increase in loans | (28,405) | (28,534) |
| Capital expenditures | (142) | (1,009) |
| Net cash (used in) provided by investing activities | (9,100) | 4,783 |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Net decrease in time deposits | (87,026) | (127,933) |
| Net increase (decrease) in demand, savings, money market and NOW deposits | 37,954 | (73,115) |
| Net proceeds from the exercise of stock options | 94 | 20 |
| Cash dividends | (542) | (538) |
| Net increase (decrease) in securities sold under agreements to repurchase | 4,010 | (560) |
| Net (decrease) increase in FHLB borrowings and other borrowed funds | (947) | 30,020 |
| Decrease in subordinated debentures | | (29,639) |
| Net cash used in financing activities | (46,457) | (201,745) |
| Net decrease in cash and cash equivalents | (53,757) | (195,714) |
| Cash and cash equivalents at beginning of period | 152,679 | 238,235 |
| Cash and cash equivalents at end of period | \$ 98,922 | \$ 42,521 |

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:

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Cash paid during the period for:

| | | |
|---|-----------|-----------|
| Interest | \$ 10,065 | \$ 6,449 |
| Income taxes | 86 | 111 |
| Change in unrealized gains on securities available-for-sale, net of taxes | (\$839) | (\$4,557) |

See accompanying Notes to unaudited Consolidated Financial Statements.

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Century Bancorp, Inc.

Notes to Consolidated Financial Statements (unaudited)

Basis of Financial Statement Presentation

The consolidated financial statements include the accounts of Century Bancorp, Inc. (the Company) and its wholly-owned subsidiary, Century Bank and Trust Company (the Bank). The consolidated financial statements also include the accounts of the Bank 's wholly-owned subsidiaries, Century Subsidiary Investments, Inc. (CSII), Century Subsidiary Investments, Inc. II (CSII II), Century Subsidiary Investments, Inc. III (CSII III). CSII, CSII II, CSII III are engaged in buying, selling and holding investment securities. The Company also owns 100% of Century Bancorp Capital Trust II (CBCT II). The entity is an unconsolidated subsidiary of the Company.

All significant intercompany accounts and transactions have been eliminated in consolidation. The Company provides a full range of banking services to individual, business and municipal customers in Massachusetts. As a bank holding company, the Company is subject to the regulation and supervision of the Federal Reserve Board. The Bank, a state chartered financial institution, is subject to supervision and regulation by applicable state and federal banking agencies, including the Federal Reserve Board, the Federal Deposit Insurance Corporation (the FDIC) and the Commonwealth of Massachusetts Commissioner of Banks. The Bank is also subject to various requirements and restrictions under federal and state law, including requirements to maintain reserves against deposits, restrictions on the types and amounts of loans that may be granted and the interest that may be charged thereon, and limitations on the types of investments that may be made and the types of services that may be offered. Various consumer laws and regulations also affect the operations of the Bank. In addition to the impact of regulation, commercial banks are affected significantly by the actions of the Federal Reserve Board as it attempts to control the money supply and credit availability in order to influence the economy. All aspects of the Company 's business are highly competitive. The Company faces aggressive competition from other lending institutions and from numerous other providers of financial services. The Company has one reportable operating segment.

The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and to general practices within the banking industry. In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenues and expenses for the period. Actual results could differ from those estimates.

Material estimates that are susceptible to change in the near-term relate to the allowance for loan losses. Management believes that the allowance for loan losses is adequate based on independent appraisals and review of other factors associated with the loans. While management uses available information to recognize loan losses, future additions to the allowance for loan losses may be necessary based on changes in economic conditions. In addition, regulatory agencies periodically review the Company 's allowance for loan losses. Such agencies may require the Company to recognize additions to the allowance for loan losses based on their judgments about information available to them at the time of their examination.

Whenever necessary prior year amounts were reclassified to conform with the current year presentation.

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Summary of Critical Accounting Policies

Accounting policies involving significant judgments and assumptions by management, which have, or could have, a material impact on the carrying value of certain assets and impact income, are considered critical accounting policies. The Company considers the following to be its critical accounting policies: allowance for loan losses and impairment of investment securities. There have been no significant changes since December 31, 2005 in these methods or assumptions used in the accounting policies that require material estimates and assumptions.

Allowance for Loan Losses

Arriving at an appropriate level of allowance for loan losses necessarily involves a high degree of judgment. Management maintains an allowance for loan losses to absorb losses inherent in the loan portfolio. The allowance is based on assessments of the probable estimated losses inherent in the loan portfolio. Management's methodology for assessing the appropriateness of the allowance consists of several key elements, which include the formula allowance, specific allowances for identified problem loans and the unallocated allowance. The formula allowance evaluates groups of loans to determine the allocation appropriate within each portfolio segment. Individual loans within the commercial and industrial, commercial real estate and real estate construction loan portfolio segments are assigned internal risk ratings to group them with other loans possessing similar risk characteristics. Changes in risk grades affect the amount of the formula allowance. Risk grades are determined by reviewing current collateral value, financial information, cash flow, payment history and other relevant facts surrounding the particular credit. Provisions for losses on the remaining commercial and commercial real estate loans are based on pools of similar loans using a combination of historical loss experience and qualitative adjustments. For the residential real estate and consumer loan portfolios, the reserves are calculated by applying historical charge-off and recovery experience and qualitative adjustments to the current outstanding balance in each loan category. Loss factors are based on the Company's historical loss experience, as well as regulatory guidelines.

Specific allowances for loan losses entails the assignment of allowance amounts to individual loans on the basis of loan impairment. Certain loans are evaluated individually and are judged to be impaired when management believes it is probable that the Company will not collect all the contractual interest and principle payments as scheduled in the loan agreement. Under this method, loans are selected for evaluation based upon a change in internal risk rating, occurrence of delinquency, loan classification or non-accrual status. A specific allowance amount is allocated to an individual loan when such loan has been deemed impaired and when the amount of a probable loss is able to be estimated on the basis of: (a.) fair value of collateral, (b.) present value of anticipated future cash flows or (c.) the loan's observable fair market price.

The unallocated allowance recognizes the model and estimation risk associated with the formula allowance and specific allowances, as well as management's evaluation of various conditions, including business and economic conditions, delinquency trends, charge-off experience and other quality factors, the effects of which are not directly measured in the determination of the formula and specific allowances. The evaluation of the inherent loss with respect to these conditions is subject to a higher degree of uncertainty because they are not identified with specific problem credits.

Management has identified certain risk factors, which could impact the degree of loss sustained within the portfolio. These include: (a.) market risk factors, such as the effects of economic variability on the entire portfolio, and (b.) unique portfolio risk factors that are inherent characteristics of the Company's loan portfolio. Market risk factors may consist of changes to general economic and business conditions that may impact the Company's loan portfolio customer base in terms of ability to repay and that may result in changes in value of underlying collateral. Unique portfolio risk factors may include industry concentrations and geographic concentrations or trends that may exacerbate losses resulting from economic

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events which the Company may not be able to fully diversify out its portfolio. Management believes that the allowance for loan losses is adequate. In addition, various regulatory agencies, as part of the examination process, periodically review the Company's allowance for loan losses. Such agencies may require the Company to recognize additions to the allowance based on their judgments about information available to them at the time of their examination.

Impaired Investment Securities

If a material decline in fair value below the amortized cost basis of an investment security is judged to be "other-than-temporary," the cost basis of the investment is written down to fair value. The amount of the write down is included as a charge to earnings. An "other-than-temporary" impairment exists for debt securities if it is probable that the Company will be unable to collect all amounts due according to contractual terms of the security. Some factors considered for "other than temporary" impairment related to a debt security include an analysis of yield which results in a decrease in expected cash flows, whether an unrealized loss is issuer specific, whether the issuer has defaulted on scheduled interest and principal payments, whether the issuer's current financial condition hinders its ability to make future scheduled interest and principal payments on a timely basis or whether there was a downgrade in ratings by rating agencies. The Company has the ability and intent to hold these investments until recovery of fair value, which may be maturity.

Stock Option Accounting

During 2000 and 2004, common stockholders of the Company approved stock option plans (the "Option Plans") that provides for granting of options for not more than 150,000 shares of Class A common stock per plan. Under the Option Plans, all officers and key employees of the Company are eligible to receive non-qualified and incentive stock options to purchase shares of Class A common stock. The Option Plans are administered by the Compensation Committee of the Board of Directors, whose members are ineligible to participate in the Option Plans. Based on management's recommendations, the Committee submits its recommendations to the Board of Directors as to persons to whom options are to be granted, the number of shares granted to each, the option price (which may not be less than 85% of the fair market value for non-qualified stock options, or the fair market value for incentive stock options, of the shares on the date of grant) and the time period over which the options are exercisable (not more than ten years from the date of grant). There were 123,487 options exercisable at March 31, 2006.

On December 30, 2005 a Board vote approved the acceleration and immediate vesting of all unvested options with an exercise price of \$31.60 and \$31.83 or greater per share. As a consequence of the Board vote, options to purchase 23,950 shares of Century Bancorp Class A common stock became exercisable immediately. The average of the high and low price at which the Company's common stock traded on December 30, 2005, the date of the Board vote, was \$29.28 per share. The Company estimates that, as a result of this accelerated vesting, approximately \$190,000 of 2006 non-cash compensation expense was eliminated that would otherwise have been recognized in the Company's earnings.

In December 2004, the FASB issued a revised Statement No. 123, (revised 2004) (SFAS 123R), "Share-Based Payment". This Statement replaces SFAS No. 123, *Accounting for Stock-Based Compensation*, and supercedes APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and its related implementation guidance. This Statement establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services. This Statement requires a public entity to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award (with limited exceptions). That cost will be recognized over the period during which an employee is required to provide service in exchange for the award-the requisite service period (usually the vesting period). This Statement is effective as of the beginning of

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the first annual reporting period that begins after June 15, 2005. The Company voted to accelerate the vesting of certain unvested out-of-the-money stock options awarded to Century Bank employees pursuant to the Century Bancorp, Inc. 2000 and 2004 Employee Stock Option Plans so that they immediately vested as of December 30, 2005. The Board also voted a technical amendment to each of the Plans to eliminate the possibility that the terms of any outstanding or future stock option would require a cash settlement on the occurrence of any circumstance outside the control of the Company. These amendments avoid classification of the Company's stock options as liabilities under SFAS 123R. On January 1, 2006 the Company adopted SFAS 123R for all share based payments.

The Company decided to accelerate the vesting of certain stock options primarily to reduce the non-cash compensation expense that would otherwise be expected to be recorded in conjunction with the Company's required adoption of SFAS 123R in 2006. There was no earnings impact for the first quarter of 2006 due to the Company's adoption of SFAS 123R.

Had compensation cost for the Company's stock option plans been determined based on the fair value at the grant date, the Company's net income and earnings per share would have been reduced to the pro forma amounts indicated below:

| | Three Months Ended March 31, 2005 (Dollars in Thousands) |
|---|---|
| Net income | |
| As reported | \$ 2,041 |
| Less: Pro forma stock based Compensation (net of tax) | 40 |
| Pro forma net income | 2,001 |
| Basic income per share | |
| As reported | 0.37 |
| Pro forma | 0.36 |
| Diluted income per share | |
| As reported | 0.37 |
| Pro forma | 0.36 |

In determining the pro forma amounts, the fair value of each option grant was estimated as of the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

| | |
|-------------------------|---------|
| Dividend yield | 1.59% |
| Expected life | 9 years |
| Expected volatility | 28% |
| Risk-free interest rate | 3.95% |

Stock option activity under the plan is as follows:

| | Amount | March 31, 2006 Weighted Average Exercise Price |
|----------------------------------|---------|--|
| Shares under option: | | |
| Outstanding at beginning of year | 130,133 | \$ 26.74 |
| Granted | | |

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| | | | |
|--|---------|----|-------|
| Cancelled | (1,000) | | 27.29 |
| Exercised | (5,646) | | 16.57 |
| Outstanding at end of period | 123,487 | \$ | 27.20 |
| Exercisable at end of period | 123,487 | \$ | 27.20 |
| Available to be granted at end of period | 150,775 | | |
| Weighted average fair value of options granted during the year | | | NA |

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At March 31, 2006, the 123,487 options outstanding have exercise prices between \$15.063 and \$35.010, with a weighted average exercise price at \$27.20 and a weighted average remaining contractual life of 6 years. The intrinsic value of options exercised for the quarter ended March 31, 2006 was \$12.45 with an aggregate of \$70,293. The intrinsic value of options exercisable at March 31, 2006 was \$1.83 with an aggregate of \$225,981.

The Company uses the fair value method to account for stock options. All of the Company's stock options are vested and there were no options granted during the first quarter of 2006.

Employee Benefits

The Company has a qualified Defined Benefit Pension Plan (the Plan) which is offered to all employees reaching minimum age and service requirements. The Company also has a Supplemental Insurance/Retirement Plan (the Supplemental Plan), which is limited to certain officers and employees of the Company.

Components of Net Periodic Benefit Cost for the Three Month Period Ending March 31.

| | Pension Benefits | | Supplemental Insurance/ Retirement Plan | |
|---------------------------------|-------------------------|--------|---|--------|
| | 2006 | 2005 | 2006 | 2005 |
| | (Dollars in Thousands) | | | |
| Service Cost | \$ 221 | \$ 190 | \$ 27 | \$ 32 |
| Interest | 249 | 229 | 191 | 186 |
| Expected Return on Plan Assets | (254) | (214) | 0 | 0 |
| Recognized Prior Service Cost | (29) | (5) | 16 | 16 |
| Recognized Net Actuarial Losses | 93 | 64 | 27 | 13 |
| Net Periodic Benefit Cost | \$ 280 | \$ 264 | \$ 261 | \$ 247 |

Contributions

The Company previously disclosed in its financial statements for the year ended December 31, 2005 that it expected to contribute \$1,480,000 to its pension plan in 2006. As of March 31, 2006, \$370,000 of the contribution had been made.

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Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations.

Forward Looking Statements

Except for the historical information contained herein, this Quarterly Report on Form 10-Q may contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Investors are cautioned that forward-looking statements are inherently uncertain. Actual performance and results of operations may differ materially from those projected or suggested in the forward-looking statements due to certain risks and uncertainties, including, without limitation, (i) the fact that the Company's success is dependent to a significant extent upon general economic conditions in New England, (ii) the fact that the Company's earnings depend to a great extent upon the level of net interest income (the difference between interest income earned on loans and investments and the interest expense paid on deposits and other borrowings) generated by the Bank and thus the Bank's results of operations may be adversely affected by increases or decreases in interest rates, (iii) the fact that the banking business is highly competitive and the profitability of the Company depends upon the Bank's ability to attract loans and deposits within its market area, where the Bank competes with a variety of traditional banking and other institutions such as credit unions and finance companies, and (iv) the fact that a significant portion of the Company's loan portfolio is comprised of commercial loans, exposing the Company to the risks inherent in loans based upon analyses of credit risk, the value of underlying collateral, including real estate, and other more intangible factors, which are considered in making commercial loans. Accordingly, the Company's profitability may be negatively impacted by errors in risk analyses, by loan defaults, and the ability of certain borrowers to repay such loans may be adversely affected by any downturn in general economic conditions. These factors, as well as general economic and market conditions, may materially and adversely affect the market price of shares of the Company's common stock. Because of these and other factors, past financial performance should not be considered an indicator of future performance. The forward-looking statements contained herein represent the Company's judgment as of the date of this Form 10-Q, and the Company cautions readers not to place undue reliance on such statements.

Executive Overview

Century Bancorp, Inc. (together with its bank subsidiary, unless the context otherwise requires, the Company), is a Massachusetts state chartered bank holding company headquartered in Medford, Massachusetts. The Company is a Massachusetts corporation formed in 1972 and has one banking subsidiary (the Bank): Century Bank and Trust Company formed in 1969. The Company had total assets of approximately \$1.7 billion as of March 31, 2006. The Company presently operates 23 banking offices in 16 cities and towns in Massachusetts ranging from Braintree in the south to Beverly in the north. The Bank's customers consist primarily of small and medium-sized businesses and retail customers in these communities and surrounding areas, as well as local governments and institutions throughout Massachusetts.

The Company's results of operations are largely dependent on net interest income, which is the difference between the interest earned on loans and securities and interest paid on deposits and borrowings. The results of operations are also affected by the level of income/fees from loans, deposits, as well as operating expenses, the provision for loan losses, the impact of federal and state income taxes and the relative levels of interest rates and economic activity.

The Company offers a wide range of services to commercial enterprises, state and local governments and agencies, non-profit organizations and individuals. It emphasizes service to small and medium-sized businesses and retail customers in its market area. The Company makes commercial loans, real estate and construction loans, consumer

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Management's Discussion and Analysis of Financial Condition and Results of Operation (con t.)

loans, and accepts savings, time, and demand deposits. In addition, the Company offers to its corporate and institutional customers automated lock box collection services, cash management services and account reconciliation services, and actively promotes the marketing of these services to the municipal market. Also, the Company provides full service securities brokerage services through its division, Investment Services at Century Bank in conjunction with Independent Financial Marketing Group, a full service securities brokerage business. The Company is also a provider of financial services including cash management, transaction processing and short term financing to municipalities in Massachusetts and Rhode Island. The Company has deposit relationships with approximately 30% of the 351 cities and towns in Massachusetts.

During the fourth quarter of 2004, the Company announced that it entered into an Investment Management Agreement with BlackRock Financial Management, Inc. for the Company's Available-For-Sale securities portfolio. During 2005 the Company began experiencing strong loan growth, and believes that reinvesting the investment cash flows in loans will help to achieve improvements in its yield. The expense related to this contract ended on June 30, 2005 and the contract terminated January 31, 2006.

Earnings for the first quarter ended March 31, 2006 were \$1.4 million, a decrease of \$0.6 million when compared with the first quarter 2005 earnings of \$2.0 million. Diluted earnings per share for the first quarter 2006 were \$0.26 versus \$0.37 for the first quarter of 2005. Earnings were negatively impacted by a decrease in net interest income. Included in other income for 2006 is a pre-tax gain of \$600 thousand from the sale of the Company's rights to future royalty payments for a portion of its Merchant Credit Card customer base.

Financial Condition

Loans

On March 31, 2006, total loans outstanding, net of unearned discount, were \$718.0 million, an increase of 4.1% from the total on December 31, 2005. At March 31, 2006, commercial real estate loans accounted for 42.6% and residential real estate loans, including home equity credit lines, accounted for 31.8% of total loans. Commercial and industrial loans increased to \$101.8 million from \$94.1 million on December 31, 2005. Construction loans increased to \$71.5 million at March 31, 2006 from \$58.8 million on December 31, 2005.

The primary reason for the increase in loans across all of the business lines is due, in large part, to the hiring of additional officers as well as an emphasis on small business loans.

Allowance for Loan Losses

The allowance for loan losses was 1.31% of total loans on March 31, 2006 compared with 1.35% on December 31, 2005. The ratio decreased due to growth in the loan portfolio and the change in the mix of loans. Net charge-offs for the three-month period ended March 31, 2006 were \$63 thousand compared with net recoveries of \$3 thousand for the same period in 2005. Provisions to the allowance have been made due to growth in the loan portfolio. At the current time, management believes that the allowance for loan losses is adequate.

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Management's Discussion and Analysis of Financial Condition and Results of Operation (continued.)

Nonperforming Assets

| | March 31, 2006 | December 31, 2005 |
|---|------------------------|----------------------|
| | (Dollars in Thousands) | |
| Nonaccruing loans | \$ 239 | \$ 949 |
| Nonperforming assets | \$ 239 | \$ 949 |
| Loans past due 90 days or more and still accruing | \$ | \$ |
| Nonaccruing loans as a percentage of total loans | .03% | .14% |

Cash and Cash Equivalents

Cash and cash equivalents decreased mainly as a result of decreases in cyclical time deposits. Time deposits decreased mainly because of a decreased reliance on time deposits greater than \$100 thousand.

Investments Management continually evaluates its investment alternatives in order to properly manage the overall balance sheet mix. The timing of purchases, sales and reinvestments, if any, will be based on various factors including expectation of movements in market interest rates, deposit flows and loan demand. Notwithstanding these events, it is the intent of management to grow the earning asset base through loan originations, loan purchases or investment acquisitions while funding this growth through a mix of retail deposits, FHLB advances, and retail repurchase agreements.

| | March 31, 2006 | December 31, 2005 |
|---|------------------------|----------------------|
| | (Dollars in Thousands) | |
| <u>Securities Available-for-Sale</u> | | |
| U.S. Government and Agencies | \$ 288,936 | \$ 294,132 |
| Other Bonds and Equity Securities | 20,077 | 20,298 |
| Mortgage-backed Securities | 208,600 | 218,552 |
| | | |
| Total Securities Available-for-Sale | \$ 517,613 | \$ 532,982 |

Securities Held-to-Maturity

| | | |
|-----------------------------------|------------|------------|
| U.S. Government and Agencies | \$ 159,955 | \$ 159,952 |
| Mortgage-backed Securities | 121,116 | 126,626 |
| | | |
| Total Securities Held-to-Maturity | \$ 281,071 | \$ 286,578 |

Securities Available-for-Sale

The securities available-for-sale portfolio totaled \$517.6 million at March 31, 2006, a decrease of 2.9% from December 31, 2005. The portfolio decreased mainly because of contraction in the balance sheet. The contraction is explained within the Deposits and Borrowed Funds section of Management's Discussion and Analysis of Financial Condition and Results of Operation. The portfolio is concentrated in United States Government and Agency securities and has an estimated weighted average remaining life of 2.1 years.

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Management's Discussion and Analysis of Financial Condition and Results of Operation (cont.)

Securities Held-to-Maturity

The securities held-to-maturity portfolio totaled \$281.1 million on March 31, 2006, a decrease of 1.9% from the total on December 31, 2005. The portfolio decreased mainly because of a contraction in the balance sheet. The contraction is explained within the Deposits and Borrowed Funds section of Management's Discussion and Analysis of Financial Condition and Results of Operation. The portfolio is concentrated in United States Government Agency Collateralized Mortgage Obligations and has an estimated weighted average remaining life of 2.9 years.

Other Assets

Other Assets increased by \$2.2 million or 5.7%. Other Assets increased mainly because of an increase in the cash surrender value of life insurance policies and deferred tax assets associated with the increase in unrealized available-for-sale losses.

Deposits and Borrowed Funds

On March 31, 2006, deposits totaled \$1.2 billion, representing a 4.0% decrease in total deposits from December 31, 2005. Total deposits decreased primarily as a result of decreases in time deposits. Time deposits decreased mainly because the Company competed less aggressively for these types of deposits during the quarter. Borrowed funds totaled \$357.8 million compared to \$354.7 million at December 31, 2005. Borrowed funds remained relatively stable.

Results of Operations

Net Interest Income

For the three-month period ended March 31, 2006, net interest income totaled \$9.3 million, a decrease of 11.6% from the comparable period in 2005. The decrease in net interest income for the three-month period is mainly due to a 22 basis point decrease in the net interest margin as well as a \$59.1 million or 3.7% decrease in average earning assets. The net yield on average earning assets on a fully taxable equivalent basis decreased to 2.44% for the first three months of 2006 from 2.66% during the same period in 2005 but remained stable from the fourth quarter of 2005. The Company believes that the net interest margin will continue to be challenged as rates rise. This is mainly the result of deposit and borrowing pricing that has the potential to increase at a faster rate than corresponding asset categories. The following table sets forth the distribution of the Company's average assets, liabilities and stockholders' equity, and average rates earned or paid on a fully taxable equivalent basis for each of the three-month periods indicated.

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Management's Discussion and Analysis of Financial Condition and Results of Operation (con t.)

| | March 31, 2006 | | Three Months Ended | | March 31, 2005 | |
|--|--------------------|-----------------------------------|-------------------------|--------------------|-----------------------------------|-------------------------|
| | Average Balance | Interest Income/ Expense(1) | Rate Earned/ Paid | Average Balance | Interest Income/ Expense(1) | Rate Earned/ Paid |
| <u>Assets</u> | | | | | | |
| Interest-earning assets: | | | | | | |
| Loans (2) | \$ 702,327 | \$ 11,935 | 6.88% | \$ 591,377 | \$ 9,198 | 6.29% |
| Securities available-for-sale | | | | | | |
| Taxable | 537,092 | 4,604 | 3.43% | 595,341 | 4,931 | 3.31% |
| Tax-exempt | 582 | 5 | 3.44% | 674 | 4 | 2.37% |
| Securities held-to-maturity | | | | | | |
| Taxable | 283,949 | 2,613 | 3.68% | 338,893 | 3,196 | 3.77% |
| Temporary funds | 3,014 | 30 | 3.96% | 59,797 | 323 | 2.16% |
| Interest bearing deposits in other banks | 51 | | 4.74% | | | 0.00% |
| Total interest earning assets | \$ 1,527,015 | \$ 19,187 | 5.06% | \$ 1,586,082 | \$ 17,652 | 4.48% |
| Non interest-earning assets | 121,034 | | | 118,655 | | |
| Allowance for loan losses | (9,395) | | | (9,098) | | |
| Total assets | \$ 1,638,654 | | | \$ 1,695,639 | | |
| <u>Liabilities and Stockholders' Equity</u> | | | | | | |
| Interest bearing deposits: | | | | | | |
| NOW account | \$ 204,563 | \$ 856 | 1.70% | \$ 248,971 | \$ 645 | 1.05% |
| Savings accounts | 71,935 | 67 | 0.38% | 76,393 | 70 | 0.37% |
| Money market accounts | 302,250 | 1,778 | 2.39% | 426,312 | 1,711 | 1.63% |
| Time deposits | 323,222 | 3,181 | 3.99% | 285,522 | 2,057 | 2.92% |
| Total interest-bearing deposits | 901,970 | 5,882 | 2.64% | 1,037,198 | 4,483 | 1.75% |
| Securities sold under | | | | | | |
| Agreements to repurchase | 52,256 | 415 | 3.22% | 38,560 | 100 | 1.05% |
| Other borrowed funds and Subordinated debentures | 279,024 | 3,563 | 5.18% | 213,377 | 2,520 | 4.79% |
| Total interest-bearing liabilities | 1,233,250 | 9,860 | 3.24% | 1,289,135 | 7,103 | 2.23% |
| Non interest-bearing Liabilities | | | | | | |
| Demand deposits | 282,872 | | | 286,497 | | |

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| | | | |
|---|--------------|----------|--------------|
| Other liabilities | 18,662 | | 16,309 |
| Total liabilities | 1,534,784 | | 1,591,941 |
| Stockholders equity | 103,870 | | 103,698 |
| Total liabilities & stockholders equity | \$ 1,638,654 | | \$ 1,695,639 |
| Net interest income | | \$ 9,327 | \$ 10,549 |
| Net interest spread | | 1.82% | 2.25% |
| Net interest margin | | 2.44% | 2.66% |

(1) On a fully taxable equivalent basis calculated using a tax rate of 41.825%.

(2) Nonaccrual loans are included in average amounts outstanding.

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Management's Discussion and Analysis of Financial Condition and Results of Operation (continued)

| | Three Months Ended March 31, 2006 Compared with Three Months Ended March 31, 2005 Increase/(Decrease) Due to Change in | | |
|--|--|----------------|----------------------------------|
| | Volume | Rate | Income Increase (Decrease) |
| | (dollars in thousands) | | |
| Interest Income: | | | |
| Loans | \$ 1,833 | \$ 904 | 2,737 |
| Securities available-for-sale | | | |
| Taxable | (495) | 168 | (327) |
| Tax-exempt | (1) | 2 | 1 |
| Securities held-to-maturity | | | |
| Taxable | (507) | (76) | (583) |
| Tax-exempt | (0) | (0) | (0) |
| Temporary funds | (443) | 150 | (293) |
| Interest bearing deposits | | | |
| In other banks | 0 | 0 | 0 |
| Total interest income | 387 | 1,148 | 1,535 |
| Interest expense: | | | |
| Deposits: | | | |
| NOW accounts | (131) | 342 | 211 |
| Savings accounts | (4) | 1 | (3) |
| Money market accounts | (587) | 654 | 67 |
| Time deposits | 298 | 826 | 1,124 |
| Total interest-bearing deposits | (424) | 1,823 | 1,399 |
| Securities sold under agreements to repurchase | 46 | 269 | 315 |
| Other borrowed funds and long term debt | 825 | 218 | 1,043 |
| Total interest expense | 447 | 2,310 | 2,757 |
| Change in net interest income | (60) | (1,162) | (1,222) |

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Management's Discussion and Analysis of Financial Condition and Results of Operation (con t.)

Provision for Loan Losses

For the three-month period ended March 31, 2006, the loan loss provision was \$150 thousand compared to a provision of \$150 thousand for the same period last year. The Company's loan loss allowance as a percentage of total loans outstanding has decreased from 1.35% at December 31, 2005 to 1.31% at March 31, 2006. The coverage ratio decreased mainly as a result of continued low levels of problem assets.

Non-Interest Income and Expense

Other operating income for the quarter ended March 31, 2006 was \$3.1 million compared to \$2.7 million for the first quarter of 2005. The increase was mainly attributable to a pre-tax gain of \$600 thousand from the sale of rights to future royalty payments for a portion of the Company's Merchant Credit Card customer base. Also, service charges on deposit accounts increased by \$88 thousand, increases in cash surrender values decreased by \$133 thousand, brokerage commissions decreased by \$105 thousand and lockbox fees decreased by \$34 thousand. Service charges on deposit accounts increased mainly because of an increase in overdraft fees. The decrease in increased cash surrender values was mainly attributable to lower returns on life insurance policies. The decrease in lockbox fees was mainly attributable to competitive pricing pressures. The decrease in brokerage commissions was primarily the result of decreased transaction volume.

During the quarter ended March 31, 2006, operating expenses increased by \$130 thousand or 1.3% to \$10.2 million, from the same period last year. The increase in operating expenses was mainly attributable to an increase of \$145 thousand in salaries and employee benefits, \$59 thousand in occupancy expense, a \$47 thousand decrease in equipment expense and \$27 thousand decrease in other expense. Salaries and employee benefits increased mainly as a result of increases in salaries expense, pension expense and health insurance costs. Occupancy expense increased mainly because of increased utility costs. Equipment expense decreased mainly as a result of decreased depreciation and service contract costs. Other expenses decreased mainly as a result of decreases in personnel recruitment and consulting, offset by increases in marketing and audit and exam fees.

Income Taxes

For the first quarter of 2006, the Company's income tax expense totaled \$0.7 million on pretax income of \$2.1 million for an effective tax rate of 33.2%. For last year's corresponding quarter, the Company's income tax expense totaled \$1.0 million on pretax income of \$3.0 million for an effective tax rate of 32.6%. The income tax rate increased for the current quarter mainly as a result of a decrease in non-taxable income (insurance gains) compared to last year.

Table of Contents**Item 3****Quantitative and Qualitative Disclosure about Market Risk**

Market risk is the risk of loss from adverse changes in market prices and rates. The Company's market risk arises primarily from interest rate risk inherent in its lending and deposit taking activities. To that end, management actively monitors and manages its interest rate risk exposure. The Company's profitability is affected by fluctuations in interest rates. A sudden and substantial increase or decrease in interest rates may adversely impact the Company's earnings to the extent that the interest rates tied to specific assets and liabilities do not change at the same speed, to the same extent, or on the same basis. The Company monitors the impact of changes in interest rates on its net interest income using several tools. The Company's primary objective in managing interest rate risk is to minimize the adverse impact of changes in interest rates on the Company's net interest income and capital, while structuring the Company's asset-liability structure to obtain the maximum yield-cost spread on that structure. Management believes that there have been no material changes in the interest rate risk reported in the Company's 2005 Annual Report on Form 10-K. The information is contained in the form 10-K within the Market Risk and Asset Liability Management section of Management's Discussion and Analysis of Results of Operations and Financial Condition.

Item 4**Controls and Procedures**

The principal executive officers with participation of its principal financial officer have evaluated its disclosure controls and procedures as of the end of the period covered by the quarterly report. Based on this evaluation, the Company's principal executive officers with participation of its principal financial officer have concluded that the disclosure controls and procedures effectively ensure that information required to be disclosed in the Company's filings and submissions with the Securities and Exchange Commission under the Exchange Act is accumulated and reported to Company management (including the principal executive officers and the principal financial officer) and is recorded, processed, summarized and reported within the time periods specified by the Securities and Exchange Commission. In addition, the Company has evaluated its internal controls over financial reporting and there has been no change in its internal controls over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Part II Other Information

Item 1 Legal proceedings At the present time, the Company is not engaged in any legal proceedings which, if adversely determined to the Company, would have a material adverse impact on the Company's financial condition or results of operations. From time to time, the Company is party to routine legal proceedings within the normal course of business. Such routine legal proceedings, in the aggregate, are believed by management to be immaterial to the Company's financial condition and results of operation.

Item 1A Risk Factors No material changes from risk factors as previously disclosed in the registrant's Annual Report on 2005 Form 10-K.

Item 2 Unregistered Sales of Equity Securities and Use of Proceeds None

Item 3 Defaults Upon Senior Securities None

Item 4 Submission of Matters to a Vote of Security Holders None

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Item 5 Other Information None

Item 6 Exhibits

31.1 Certification of Co-President and Co-Chief Executive Officer of the Company Pursuant to Securities Exchange Act Rules 13a-14 and 15d-14.

31.2 Certification of Co-President and Co-Chief Executive Officer of the Company Pursuant to Securities Exchange Act Rules 13a-14 and 15d-14.

31.3 Certification of Chief Financial Officer of the Company Pursuant to Securities Exchange Act Rules 13a-14 and 15d-14.

32.1 Certification of Co-President and Co-Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification of Co-President and Co-Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.3 Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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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.

Date: May 9, 2006

Century Bancorp, Inc

/s/ Barry R. Sloane

/s/ Jonathan G. Sloane

Barry R. Sloane
Co-President & Co-Chief Executive Officer

Jonathan G. Sloane
Co-President & Co-Chief Executive Officer

/s/ Paul V. Cusick, Jr.

Paul V. Cusick, Jr.
Vice President and Treasurer
(Principal Accounting Officer)