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Butterfield Bank

QUARTERLY REPORT

2008 | Q2

REPORT TO SHAREHOLDERS & FINANCIAL RESULTS FOR THE SIX MONTHS ENDED 30 JUNE 2008

Consolidated Balance Sheet

(In $ thousands - unaudited except where stated)

	As at		
	30 June 2008	31 December 2007*	30 June 2007
Assets			
Cash and demand deposits with banks	243,911	267,261	223,654
Term deposits with banks	2,072,297	2,249,751	2,424,613
Total cash and deposits with banks	2,316,208	2,517,012	2,648,267
Investments			
Trading	209,124	58,534	58,223
Available for sale	1,221,655	932,238	1,121,510
Held to maturity	3,664,973	3,754,217	3,783,790
Total investments	5,095,752	4,744,989	4,963,523
Loans, net of allowance for credit losses	4,314,029	4,124,764	3,928,338
Premises, equipment and computer software	228,566	215,379	191,120
Accrued interest	55,467	68,597	78,367
Goodwill	25,540	25,260	25,466
Other intangible assets	77,514	81,230	67,578
Other assets	137,579	133,689	100,412
Total assets	12,250,655	11,910,920	12,003,071
Liabilities			
Deposits			
Non-interest bearing	1,685,758	1,042,062	1,151,428
Interest bearing			
Customers	9,015,665	9,399,517	9,425,146
Banks	373,464	306,392	326,057
Total deposits	11,074,887	10,747,971	10,902,631
Employee future benefits	96,840	98,063	111,469
Accrued interest	29,902	34,774	38,851
Dividend payable	15,314	14,081	14,148
Other liabilities	143,124	102,510	83,737
Total other liabilities	285,180	249,428	248,205
Subordinated capital	284,944	284,191	280,301
Total liabilities	11,645,011	11,281,590	11,431,137
Shareholders' equity			
Common share capital ($1.00 par: Authorised shares 260,000,000 (31 December 2007 and 30 June 2007: 100,000,000))	98,400	89,456	29,819
Additional paid in capital	606,403	455,114	513,202
Retained Earnings	(2,044)	167,607	120,179
Less: treasury common stock	(83,952)	(71,576)	(58,147)
Accumulated other comprehensive loss	(13,163)	(11,271)	(33,119)
Total shareholders' equity	605,644	629,330	571,934
Total liabilities and shareholders' equity	12,250,655	11,910,920	12,003,071

* Audited

Consolidated Statement of Income

(In $ thousands, except per share data - unaudited)

	For the three month period ended			For the six month period ended	
	30 June 2008	31 March 2008	30 June 2007	30 June 2008	30 June 2007
Non-interest income					
Investment and pension fund administration	13,506	13,458	12,576	26,964	24,371
Banking	10,756	10,357	11,061	21,113	21,198
Foreign exchange revenue	11,135	11,234	9,361	22,369	18,458
Asset management	11,024	10,765	9,042	21,789	18,093
Trust and custody	10,614	9,725	9,020	20,339	18,001
Other non-interest income	2,510	3,316	2,474	5,826	3,964
Total non-interest income	59,545	58,855	53,534	118,400	104,085
Interest income					
Loans	66,386	69,631	69,855	136,017	137,257
Investments	48,790	58,798	61,301	107,588	112,704
Deposits with banks	22,470	28,049	32,454	50,519	68,195
Total interest income	137,646	156,478	163,610	294,124	318,156
Interest expense					
Deposits	72,068	85,667	98,028	157,735	189,323
Subordinated capital	3,126	3,272	3,736	6,398	7,451
Total interest expense	75,194	88,939	101,764	164,133	196,774
Net interest income before provision for credit losses	62,452	67,539	61,846	129,991	121,382
Provision for credit losses	(1,243)	(229)	(197)	(1,472)	(475)
Net interest income after provision for credit losses	61,209	67,310	61,649	128,519	120,907
Realised / unrealised gains (losses) on trading securities	1,113	(1,090)	683	23	1,508
Realised (losses) on held to maturity investments	(23,032)	-	-	(23,032)	-
Gain on sale of affiliate	-	-	170	-	170
Other (losses) gains	(20,913)	2,007	13	(18,906)	224
Total revenue	77,922	127,082	116,049	205,004	226,894
Non-interest expense					
Salaries and other employee benefits	51,995	49,552	46,494	101,547	90,186
Property	8,419	7,804	7,583	16,223	14,321
Technology and communications	9,483	9,497	7,491	18,980	14,172
Professional and outside services	8,485	8,712	5,400	17,197	9,779
Non-income taxes	3,945	3,845	3,428	7,790	6,922
Marketing	2,429	1,507	1,422	3,936	2,938
Amortisation of intangible assets	1,958	1,962	1,672	3,920	3,326
Other expenses	6,184	6,406	5,031	12,590	10,447
Total non-interest expense	92,898	89,285	78,521	182,183	152,091
Net (loss) income before income taxes	(14,976)	37,797	37,528	22,821	74,803
Income taxes	(1,522)	(1,471)	(1,619)	(2,993)	(3,210)
Net (loss) income	(16,498)	36,326	35,909	19,828	71,593
Earnings per share					
Basic	(0.18)	0.39	0.38	0.21	0.77
Diluted	(0.18)	0.38	0.37	0.21	0.75
Return on shareholders' equity (%)	(10.4)	22.9	25.1	6.3	25.5

Earnings per share comparative figures have been restated for the one for ten stock dividend in February 2008 and the three for one stock split in August 2007.

Consolidated Statement of Changes in Retained Earnings and Comprehensive Income

(In $ thousands - unaudited)

	For the three month period ended		For the six month period ended	
	30 June 2008	30 June 2007	30 June 2008	30 June 2007
Retained earnings				
Balance at beginning of period	29,149	97,732	167,607	76,881
Effect of changing employee future benefit plans' measurement date	-	-	(1,068)	-
Net (loss) income for the period	(16,498)	35,909	19,828	71,593
Cash dividends declared	(14,695)	(13,462)	(29,498)	(28,295)
Stock dividend	-	-	(158,913)	-
Balance at end of period	(2,044)	120,179	(2,044)	120,179
Accumulated other comprehensive loss				
Balance at beginning of period	(11,706)	(34,164)	(11,271)	(35,031)
Net change in unrealised gains and losses on translation of net investment in foreign operations	(1,468)	978	(2,022)	1,000
Net change in unrealised gains and losses on available for sale securities	(293)	(733)	(632)	(726)
Net change in unrealised gains and losses on cash flow hedges	-	-	-	38
Net change in employee future benefits	304	800	762	1,600
Balance at end of period	(13,163)	(33,119)	(13,163)	(33,119)

Consolidated Statement of Cash Flows

(In $ thousands - unaudited)

	For the three month period ended		For the six month period ended	
	30 June 2008	30 June 2007	30 June 2008	30 June 2007
Cash flows from operating activities				
Net (loss) income	(16,498)	35,909	19,828	71,593
Adjustments to reconcile net (loss) income to cash provided by operating activities				
Depreciation and amortisation	6,012	6,365	12,127	11,823
Increase in carrying value of investments in affiliates	(1,239)	(872)	(2,196)	(1,181)
Share-based compensation	1,035	1,648	4,385	3,919
Gain on sale of affiliate	-	(170)	-	(170)
Gain on sale of premises and equipment	(69)	-	(68)	-
Realised and unrealised gains on private equity investments	(6,903)	-	(24,796)	-
Loss on credit derivative instruments	27,725	-	43,460	-
Impairment charge on held to maturity security	23,032	-	23,032	-
Provision for credit losses	1,243	197	1,472	475
Decrease (increase) in accrued interest receivable	989	(10,222)	13,232	(13,324)
(Increase) decrease in other assets	(811)	6,705	11,506	5,049
(Decrease) increase in accrued interest payable	(2,294)	3,359	(4,916)	4,979
(Decrease) increase in other liabilities	(26,206)	10,680	(6,223)	(19,617)
	6,016	53,599	90,843	63,546
Net change in trading account securities	(234)	(391)	(914)	(1,299)
Cash provided by operating activities	5,782	53,208	89,929	62,247
Cash flows from investing activities				
Net decrease in term deposits with banks	447,339	578,409	181,216	408,807
Net additions to premises, equipment and computer software	(9,419)	(14,100)	(21,899)	(27,383)
Net increase in loans	(66,201)	(79,645)	(187,487)	(141,612)
Held to maturity securities: proceeds from maturities	577,988	323,520	1,049,940	789,824
Held to maturity securities: purchases	(595,451)	(1,050,680)	(981,034)	(1,800,948)
Available for sale securities: proceeds from sale and maturities	1,716,168	571,307	3,330,492	1,529,758
Available for sale securities: purchases	(1,786,143)	(827,768)	(3,765,652)	(1,655,652)
Proceeds on sale of private equity investment	2,819	-	12,872	-
Cash provided by (used in) investing activities	287,100	(498,957)	(381,552)	(897,206)
Cash flows from financing activities				
Net (decrease) increase in demand and term deposit liabilities	(559,585)	569,043	311,101	770,913
Proceeds from dividend re-investment plan	2,904	2,687	5,632	6,993
Common shares repurchased	(10,149)	(32,294)	(24,560)	(35,639)
Treasury stock	1,289	914	3,488	1,897
Cash dividends paid	(14,757)	(13,693)	(28,265)	(27,325)
Cash (used in) provided by financing activities	(580,298)	526,657	267,396	716,839
Effect of exchange rates on cash and demand deposits with banks	671	174	877	192
Net (decrease) increase in cash and demand deposits with banks	(286,745)	81,082	(23,350)	(117,928)
Cash and demand deposits with banks: beginning of period	530,656	142,572	267,261	341,582
Cash and demand deposits with banks: end of period	243,911	223,654	243,911	223,654
Supplemental disclosure of cash flow information				
Cash interest paid	73,490	98,779	160,290	192,564
Cash income tax paid	59	886	118	2,880

Segmented Information

(In $ thousands - unaudited)

	For the three month period ended						For the six month period ended			
	30 June 2008		31 March 2008		30 June 2007		30 June 2008		30 June 2007	
	Total revenue	Net income (loss)	Total revenue	Net income (loss)	Total revenue	Net income (loss)	Total revenue	Net income (loss)	Total revenue	Net income (loss)
Bermuda										
Community Banking	(355)	(37,005)	45,675	9,529	40,712	9,801	45,320	(27,476)	78,443	18,650
Wealth Management & Fiduciary Services and Investment & Pension Fund Administration	20,784	7,277	21,199	7,982	20,015	9,059	41,983	15,259	39,964	18,575
Real Estate	303	(2,298)	255	(2,176)	278	(2,329)	558	(4,474)	561	(4,423)
Sub-total Bermuda	20,732	(32,026)	67,129	15,335	61,005	16,531	87,861	(16,691)	118,968	32,802
Overseas businesses										
Barbados	3,638	679	5,102	2,192	3,359	525	8,740	2,871	6,176	573
Cayman	25,634	7,954	27,878	11,617	28,066	14,202	53,512	19,571	55,549	28,837
Guernsey	16,494	5,130	16,924	5,346	15,347	3,519	33,418	10,476	29,707	6,997
Switzerland	56	(1,416)	91	(752)	51	(147)	147	(2,168)	51	(408)
The Bahamas	3,126	685	3,122	741	2,844	473	6,248	1,426	5,548	1,050
United Kingdom	10,792	1,955	9,873	1,565	8,115	588	20,665	3,520	15,729	1,160
Malta	610	170	240	130	-	-	850	300	-	-
Hong Kong	1,225	371	717	152	218	218	1,942	523	582	582
Sub-total overseas	61,575	15,528	63,947	20,991	58,000	19,378	125,522	36,519	113,342	38,791
Less: inter-segment eliminations (principally rent and management fees)	(4,385)	-	(3,994)	-	(2,956)	-	(8,379)	-	(5,416)	-
Total	77,922	(16,498)	127,082	36,326	116,049	35,909	205,004	19,828	226,894	71,593

Total assets

As at	30 June 2008	31 December 2007*	30 June 2007
Bermuda	5,715,934	5,555,496	5,337,406
Barbados	286,687	277,297	266,791
Cayman	3,044,174	2,729,334	3,048,963
Guernsey	2,289,998	2,368,565	2,025,790
Switzerland	964	537	422
The Bahamas	177,039	181,671	173,272
United Kingdom	2,099,736	1,999,093	2,169,597
Malta	4,926	-	-
Hong Kong	6,077	4,271	3,680
	13,625,535	13,116,264	13,025,921
Less: inter-segment eliminations	(1,374,880)	(1,205,344)	(1,022,850)
Total	12,250,655	11,910,920	12,003,071

* Audited

Notes to Interim Unaudited Consolidated Financial Statements

(In $ thousands, except per share data)

1. Accounting Policies

These interim consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America and should be read in conjunction with the consolidated financial statements for the year ended 31 December 2007, as set out in the Annual Report. The accounting policies used in the preparation of these interim consolidated financial statements are consistent with the accounting policies used in the Bank's year end audited financial statements for 2007.

2. Employee Future Benefits

The Bank maintains trusteed pension plans including non-contributory defined benefit plans and a number of defined contribution plans, and provides post-retirement medical benefits to its qualifying retirees. The defined benefit provisions under the pension plans are generally based upon years of service and average salary during the final years of employment. The defined benefit plans are non-contributory and the funding required is provided by the Bank, based upon the advice of an independent actuary.

The following table summarises the components of the Bank’s defined benefit and post-retirement medical benefit plans’ net expense recognised in the consolidated statement of income:

	For the three month period ended			For the six month period ended	
	30 June 2008	31 March 2008	30 June 2007	30 June 2008	30 June 2007
Defined benefit pension expense					
Service cost	749	748	874	1,497	1,739
Interest cost	1,871	1,870	1,654	3,741	3,297
Expected return on plan assets	(2,223)	(2,223)	(2,042)	(4,446)	(4,071)
Amortisation of past service cost	10	10	10	20	20
Amortisation of net actuarial (gain) loss	(4)	(4)	(12)	(8)	(24)
Total defined benefit pension expense	403	401	484	804	961
Post-retirement medical benefit expense					
Service cost	792	791	653	1,583	1,306
Interest cost	1,768	1,769	1,548	3,537	3,096
Amortisation of net actuarial loss	322	322	800	644	1,600
Total post-retirement medical benefit expense	2,882	2,882	3,001	5,764	6,002

Estimated Bank contributions to the defined benefit pension and medical benefit plans for the 2008 financial year are $3,300 and $3,510 respectively.

3. Stock Option Plan

At the Annual General Meeting of Shareholders held on 29 October 1997, the Directors were granted authority to implement a Stock Option Plan for executive officers and employees. As at 30 June 2008 the total number of options which can be exercised until 2018 was 9,550,021 with a weighted average exercise price of $13.90. The total compensation cost that has been charged against net income for this plan for the quarter ended 30 June 2008 was $0.6 million (30 June 2007: $0.7 million).

The following table presents the details of stock options granted to directors and executive officers:

	For the six month period ended 30 June 2008	
	Number of Stock Options	Weighted Average Exercise Price ($)
Executive Officers' Stock Option Plan		
Outstanding at beginning of period	1,399,048	12.91
Granted (prior to 2008 stock dividend)	280,000	17.40
Stock dividend granted	167,908	12.42
Outstanding at end of period	**1,846,956**	**12.42**

Pursuant to Regulation 6.9(2)(x)(a) and (b) of Section IIA of the Bermuda Stock Exchange Listing Regulations, the total interests of all directors and executive officers of the Bank in the shares of the Bank as at 30 June 2008 were 1,237,539 shares.

(In $ thousands, except per share data)

4. Fair value measurements

The following table presents the financial assets and liabilities that are measured at fair value on a recurring basis and classifies such fair value based on the type of input used in the related valuations:

	Fair value measurement using			
30 June 2008	Quoted prices in active markets for identical assets	Significant other observable inputs	Significant unobservable inputs	Total fair value
Assets				
Investments				
Trading	195,484	13,640	-	209,124
Available for sale	1,221,655	-	-	1,221,655
Liabilities				
Derivatives	-	(55,268)	-	(55,268)

	Fair value measurement using			
30 June 2007	Quoted prices in active markets for identical assets	Significant other observable inputs	Significant unobservable inputs	Total fair value
Assets				
Investments				
Trading	50,406	7,817	-	58,223
Available for sale	1,121,510	-	-	1,121,510
Derivatives	-	3,232	-	3,232
Liabilities				
Derivatives	-	(10,632)	-	(10,632)

5. Share Buy-Back Plan

During the three month period ended 30 June 2008 nil common shares were purchased and cancelled at a cost of nil (30 June 2007: 68,683 shares at a cost of $4.1 million) and 564,625 common shares were purchased to be held as treasury stock at a cost of $9.3 million (30 June 2007: 470,000 shares at a cost of $28.2 million).

During the three month period ended 30 June 2008, the Bank's Stock Option Trust bought nil common shares at a cost of nil million (30 June 2007: 54,647 common shares at a cost of $3.3 million).

6. Large Shareholders

The following professional nominees at 30 June 2008 were registered holders of 5% or more of the issued common share capital: Harcourt & Co. (16.93%), Palmar Limited (6.18%), Wilson & Co. (5.31%) and Murdoch & Co. (5.01%). Known beneficial holding of 5% or more of issued common share capital at that date was Bermuda Life Insurance Limited (7.13%).

7. Credit Support Agreements

On 30 April 2008 the Bank extended the first of its two credit enhancement arrangements with Butterfield Money Market Fund Ltd. (BMMFL), on a month-by-month basis for a maximum of three months. Under this extended credit enhancement agreement (the Agreement), the Bank is committed to compensate BMMFL subject to a maximum of $41.0 million should specific identified investment holdings in BMMFL have a fair value less than their carrying value and BMMFL is required to draw down on the obligation in order to retain its credit rating from the ratings agency or should, under a restructuring, BMMFL receive money market ineligible securities. The decision by the ratings agency with regards to the rating requirements is outside the control of the Bank. In consideration, the Bank is entitled to receive a fee of $0.5 million over the three month period covered by the Agreement ending 31 July 2008. The Agreement may be terminated without being drawn down before its term expires in certain circumstances, including if the underlying asset backed commercial paper is sold or restructured into securities at a price equal to or more than its then amortised cost.

The Bank’s quarterly mark to market loss on the second of its two credit support agreements (signed 15 January 2008) is $25.1 million and is reported in the line item ‘Other (losses) gains’ in the 30 June 2008 quarterly income statement. See also note 9(a) Subsequent Events.

8. Future Accounting Developments

(a) Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities

In June 2008, the Financial Accounting Standards Board (FASB) issued the FASB Staff Position (FSP) No. EITF 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities (FSP No. EITF 03-6-1), which specifies that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents are "participating securities" and therefore should be included in computing earnings per share. FSP No. EITF 03-6-1 will be effective for fiscal years beginning after 15 December 2008 and therefore effective from the Bank's first quarter in 2009. There will be no effect on adoption as the Bank is already in compliance.

(b) Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlements)

In May 2008, the Financial Accounting Standards Board (FASB) issued the FASB Staff Position (FSP) No. APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial cash Settlements) (FSP No. APB 14-1), which specifies that issuers of this type of convertible debt account for the liability and equity components separately. The initial measurement of the liability component is to be consistent with similar non-convertible debt as of the issuance date. The convertible debt proceeds less the fair value of the liability component is recorded as additional paid-in capital. FSP No. APB 14-1 will be effective for fiscal years beginning after 15 December 2008 and therefore effective from the Bank's first quarter in 2009. Currently, the bank is not an issuer of debt instruments considered by this FSP, therefore management does not expect any effect of adoption.

(c) Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133

In March 2008, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 161, Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133 (SFAS 161), which addresses how companies should disclose information about derivative instruments and hedging activities. SFAS 161 is designed to improve the relevance, comparability, and transparency of financial information relating to derivative instruments and hedging activities. SFAS 161 will be effective for fiscal years beginning after 15 December 2008 and therefore effective from the Bank's first quarter in 2009. Management is currently evaluating the effect of adoption.

(d) Non-controlling Interests in Consolidated Financial Statements

In December 2007, the FASB issued SFAS No. 160, Non-controlling Interest in Consolidated Financial Statements (SFAS 160), which addresses how companies should measure and present non-controlling interests. SFAS 160 is designed to improve the relevance, comparability, and transparency of financial information relating to non-controlling interests. SFAS 160 will be effective for fiscal years beginning after 15 December 2008 and therefore effective from the Bank's first quarter in 2009. Management is currently evaluating the effect of adoption.

(e) Business Combinations

In December 2007, the FASB issued SFAS No. 141 (Revised), Business Combinations (SFAS 141R), which addresses how companies should recognise and measure assets and liabilities acquired through business combinations. SFAS 141R is designed to improve the relevance and comparability of financial information relating to business combinations. SFAS 141R will be effective for fiscal years beginning after 15 December 2008 and therefore effective from the Bank's first quarter in 2009. Management is currently evaluating the effect of adoption.

9. Subsequent Events

a) Credit Support Agreement Extension

On 15 July 2008 the Bank extended the second of its two credit enhancement arrangement with BMMFL for six months. Under the credit enhancement agreement (the Agreement), the Bank is committed to compensate BMMFL subject to a maximum of $51.0 million should specific identified investment holdings in BMMFL have a fair value less than their carrying value and BMMFL is required to draw down on the obligation in order to retain its credit rating from the ratings agency. The decision by the ratings agency with regard to the rating requirements is outside the control of the Bank. In consideration, the Bank is entitled to receive a fee of $4.5 million over the six month period covered by the Agreement ending 15 January 2009. The Agreement may be terminated without being drawn down before its term expires in certain circumstances, including if the underlying asset backed commercial paper is sold or restructured into securities at a price equal to or more than its then amortised cost.

(b) Credit Support Agreement Trigger

On 17 July BMMFL triggered the first of its two credit support agreements with the Bank. The Bank paid to BMMFL $18.625 million which was equal to its mark to market unrealised loss on the contract to date. Of this amount, $2.625 million was recognised in 'Other (losses) gains' in the 30 June 2008 quarterly income statement, the remainder having already been recognised in Q4 2007 and Q1 2008. Subsequent to the above noted triggering event, the Bank purchased from BMMFL the underlying securities at their fair value of $63.1 million, and placed these securities into the available for sale portfolio.

(c) Disposal of Asset Group

The Bank has entered into an agreement, subject to regulatory approvals, to sell all outstanding shares of its Butterfield Fund Services businesses in Bermuda, Canada, Cayman, Guernsey, and The Bahamas to the Fulcrum Group, a Bermuda based hedge fund administrator with offices in New York, San Francisco, London, Bermuda, Ireland, Canada, the Cayman Islands, and India in exchange for cash and a 40% equity interest in the combined businesses. The Bank expects to record a material gain upon completion, which is anticipated to occur prior to the end of this financial year.