



Management's Analysis of Financial Condition and Review of Operations

P.15

The Bank of N. T. Butterfield & Son Limited reported record Group earnings of \$82.3 million for the year ended 30 June 2002. This represents an increase of 35.5% over the \$60.7 million (after losses from discontinued operations) achieved in fiscal 2001 and was our fourth consecutive year of record earnings.

Of the \$21.5 million increase, \$17.0 million arose from the gain on disposal of an 80% controlling interest in our Hong Kong subsidiaries during June 2002 to Dexia Banque Internationale à Luxembourg (Dexia BIL). Excluding this disposal, therefore, underlying net income was up \$4.5 million, or 7.5%, which is extremely pleasing given the underlying economic environment during the year under review.

The global uncertainty and stock market downturn after 11 September 2001, and recent corporate accounting events in the US and Europe, affected businesses worldwide. In particular, financial services companies were impacted by substantial interest rate cuts made by the United States Federal Reserve Board and the Bank of England, which brought short-term US and UK interest rates to their lowest levels in 40 years.

These cuts resulted in a decrease in net interest income across the Bank's businesses. However, in the circumstances, a reduction of only 3.0% in net interest income after provisions for credit losses was not unsatisfactory.

Despite the economic background, we achieved financial success in many of the activities of our core businesses. We experienced an increase of \$2.4 million, or 9.1%, in the profitability of our Community Banking business in Bermuda reflecting increased loan growth and fee income. In Cayman, the impact of US interest rate cuts on interest margins was more severe and was a major factor in the decrease in its net income by 20.5%, or \$4.6 million, to \$17.9 million. Our Guernsey operations continue to produce substantial business growth with significant fee income resulting from the acquisition of the Canadian Imperial Bank of Commerce's (CIBC) businesses. As a result net income was up a pleasing \$0.6 million or 14.7%. The United Kingdom operation provides a valuable presence in a strategically important market, and we expect its contribution to grow steadily in the future.

The solid performance reflects our strategy of concentrating on core businesses and existing strengths. We continue to apply our expertise and knowledge to businesses and markets which offer the greatest opportunity. At the same time, we maintain a focus on efficiency in our operations. The result is that we move from strength to strength as we actively and selectively market our services. The diversity of

business streams and geographical areas also contributed to our strong performance.

Our asset quality remains strong. While non-performing loans have increased from \$9.5 million a year ago to \$24.8 million, they still only represent 1.4% of total loans. The reason for the increase is related to the Bermuda and Cayman tourism market, and three hotel loans in particular. Given our conservative lending criteria and strength of security taken, we anticipate substantial recovery of both principal and interest on these loans, which collectively total \$13.0 million. As at June 2002 the general provision for loan losses of \$20.6 million was equivalent to 1.2% of total loans. In addition, there are specific provisions of \$3.9 million held for possible shortfalls in the security held for non-performing loans. In total, therefore, loan provisions were \$24.5 million, or 1.4% of the loan portfolio.

Approximately one third of our assets are held in investments, predominantly high quality investment grade securities, the purpose of which is to enhance both the Bank's liquidity position and the yield over that available in the inter-bank deposit market. The Bank has engaged Standard & Poor's, the world renowned credit rating agency, to monitor and rate the Bank's own securities portfolios, which constitute some 91.5% of total investments. All of these portfolios have received investment grade ratings.

(See table on page 42.)



Management's Analysis of Financial Condition and Review of Operations

P16



Performance Indicators

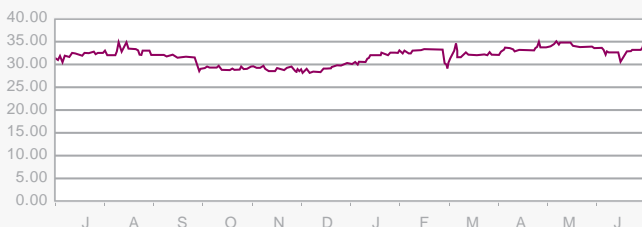
Certain key measures indicate the Bank's overall strength and performance. Our return on equity (ROE) for the year was 27.1%, up from 22.7% in 2001. Earnings per share (EPS) was \$4.27, up 36.0% compared to \$3.14 last year when restated for the 1 for 10 stock dividend in August last year. Return on assets (ROA) improved from 1.2% in 2001 to 1.5% in 2002. The Bank's net book value per share increased by 17.2% to \$17.41.

The loan portfolio growth reflects our ability to meet new demand for lending products, particularly in Community Banking in Bermuda, where we produced loan growth of 18.5%, and in the Cayman Islands, where growth was 12.7%.

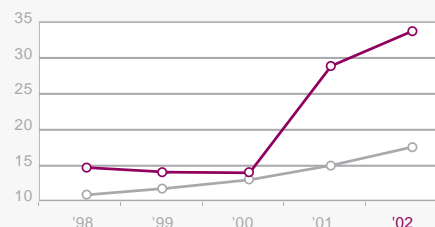
An important productivity indicator is the efficiency ratio – operating expenses (excluding corporation tax and amortisation of intangible assets) expressed as a percentage of operating income (excluding credit provisions). In 2002 Bank of Butterfield achieved an efficiency ratio of 61.9% compared to 61.8% a year ago. However, excluding income from the sale of Hong Kong, the efficiency ratio declined to 67.0%, reflecting a reduction in net interest income due to the sustained low interest rate environment. We continue to adopt a judicious approach to revenue growth and expense management to improve this ratio as a key financial objective.

We believe our careful attention to improving efficiency will reduce our cost of doing business going forward.

During the year 287,521 shares were repurchased and cancelled, at an average cost of \$31.75. The Board approved a 1 for 10 stock dividend effective 14 August 2001. In addition, the Board increased the quarterly dividend in the fourth quarter by 9.4% to \$0.35 per share. The total dividend for the year was \$1.28 per share when adjusted for the impact of the stock dividend issue, an increase of 21.9% over 2001. This represents a 30.0% payout on 2002 net income.



Market Price per Share 1 July 2001 to 30 June 2002 (\$) Not adjusted for 1 for 10 Stock Dividend



Market Value & Net Book Value per Share (\$) 1998-2001 Values Restated for Stock Dividend

○ Market Value
14.55 13.91 13.82 28.64 33.00
○ Book Value
10.76 11.69 12.85 14.85 17.41



Outlook

We are optimistic that our core markets will see improved economic conditions and that management will continue to find opportunities to maintain and grow the businesses.

In Bermuda and the Cayman Islands we are confident that the results of our ongoing business development, operational improvements and the enhancement of our products and services to meet customers' financial needs will be beneficial.

Our presence in Guernsey, significantly strengthened by the acquisition of the Guernsey operations of CIBC in July 2001, is positioned for continued

success. Bank of Butterfield (UK) Limited maintains a positive reputation in the United Kingdom and is important to our expansion aspirations.

We have retained a strategic interest in Hong Kong through a 20% equity interest in Dexia BIL's Trust and Corporate Services operations in that jurisdiction. This will enable the Bank to continue to participate in the highly competitive Hong Kong market through an alliance with a major global provider of administration services to the investment and pension fund industries. It will also provide continuity of service to our customers based in the region who use the services of our other offices, particularly Bermuda.

Pictured Left to Right:

Graham C. Brooks Executive Vice President, International & Trust
C. Wendell Emery Executive Vice President, Operations
Richard J. Ferrett Executive Vice President & Chief Financial Officer

Karla Lacey-Minors Senior Vice President, Human Resources & Corporate Communications
Michael A. McWatt Senior Vice President, Credit Risk Management

Janet M. Nearon Senior Vice President, Customer Relations
Peter J. M. Rodger Senior Vice President, Group Legal Adviser

Ronald E. Simmons Senior Vice President & Chief Accountant

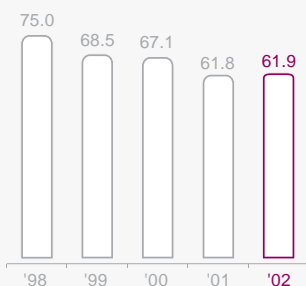
Fred H. Tesch Senior Vice President & Head of Group Internal Audit

Lloyd O. Wiggan Senior Vice President, Banking
Bob W. Wilson Senior Vice President, Credit

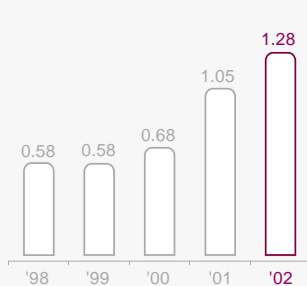
Sheila Brown Vice President, Head of Investment Services

Andrew R. Collins Vice President & Managing Director, Butterfield Corporate Services Limited

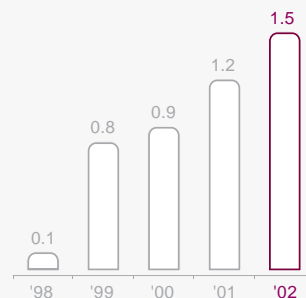
Ian Coulman Vice President & Managing Director, Butterfield Asset Management Limited



Efficiency Ratio (%)



Annual Dividend (\$)



Return on Assets (%)