A Positive Outlook

2002 Annual Report

Hingham Institution for Savings

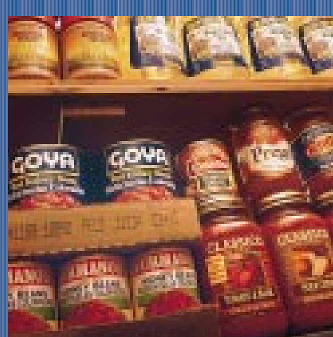
Community banking with a clear focus.

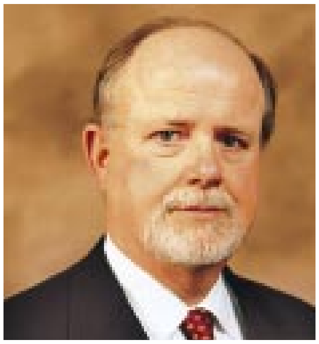
While Hingham Institution for Savings has grown significantly over the past 169 years, our focus on providing exceptional personal service has remained crystal clear. We take our role as a community bank very seriously. From our viewpoint, it's our responsibility to help individuals, families, businesses and worthwhile organizations thrive and succeed in the areas we serve.

Our energy and commitment is directed toward providing South Shore residents and businesses with exciting new opportunities so they may better realize their financial goals.

We remain constant in our effort to ensure that banking with Hingham Institution for Savings continues to be a very positive experience. We've seen a 50% increase in visits to our website and a very strong growth in the number of new PCBANK24 and BusinessOnline customers. We've added to our ATM network and are showing a steady increase in our overall ATM activity. In fact, the bank now operates a total of nine new or upgraded ATMs at our main office and five branches, as well as at convenient locations in Hingham. And yet, we've also observed that the number of customer visits to our branches continues to increase, a clear sign to us that there will never be a substitute for personal service. Efficiency and access to state-of-the-art technology remain balanced by our emphasis on old-fashioned courtesy and personal attention.

This past year has been very successful for us, with deposit and loan growth well beyond projections. While we are delighted to report this progress, our greatest joy on a daily basis is seeing customers both new and old pass through our doors to inquire about services, perform routine banking transactions, and meet and greet friends. Hingham Institution for Savings was founded on neighborly interaction. We plan to continue this friendly tradition for generations to come.





From the President

Dear Shareholder:

2002 was a year of dramatic increases in earnings, loans, dividends and stock value. Despite the gloomy outlook of a relatively weak economy, we have again achieved double-digit increases in all important financial indicators. Strong focus on the real needs of our individual retail and business customers provided us with opportunities for record levels of profitable expansion. Our accomplishments have received national recognition as well. Well-known analyst SNL Financial has ranked us the #1 Small Savings Institution in the country.

Earnings increased by 18% from $5,089,000 in 2001 to $5,980,000 in 2002. Total assets grew by 10% from $386,181,000 to $426,430,000. Loan originations grew by 51% from $105,000,000 in 2001 to $159,000,000 in 2002. Our Return on Equity grew to 16.58%. These accomplishments rewarded our stockholders with a 27% increase in the market value of their shares during 2002, while general market indexes went down.

Our company and its successes are a mirror of our customers, staff and management. It is their strong values, resilience and clearsighted leadership that reinforce our strength and stability, especially in uncertain times. This year gives every indication of being an extremely challenging one. Governmental budget shortfalls have prompted state officials to impose significant retroactive tax increases on certain financial institutions. Many of our local industries are wary of what the future holds for them.

Looking forward, we remain confident. Our credit quality remains high, and our management commitment remains strong. We are certain that our customers will continue to prefer a local institution to a national chain, especially when the local bank can offer useful products, a high level of competence, and individual attention to every person it serves. Each day brings new opportunities to expand customer relationships and improve our performance. With the help of a talented group of professionals and an active and involved Board of Directors, we indeed have a very positive outlook.

Thanking you for your support, I am
Very truly yours,

Robert H. Gaughen, Jr.
President


COHASSET
COHASSET
FIRE DEPT.
ENGINE 3

"Hingham Institution for Savings' customer service, accuracy and strength keep the town of Cohasset a loyal customer."

Joe DiVito
Cohasset Town Treasurer

Looking out for each other.

From the gleaming fire trucks to the tidy balance sheets at the town offices, residents of the small town of Cohasset clearly see the significance of community pride. And, although many residents commute daily to Boston, everyone takes a keen interest in ensuring that the town is a desirable place to live and raise a family. Joe DiVito, Cohasset Town Treasurer, has found that the fast, friendly customer service at the Cohasset Branch of Hingham Institution for Savings makes his banking transactions a pleasure. On those rare occasions when he needs it, the Bank provides Joe with one-on-one assistance for his deposit, payroll, and other banking needs. Quick response and personal attention keep the relationship between the Treasurer's Office and the Bank running smoothly. Our stability, strength, and integrity impressed the Town of Cohasset. May we say the feeling is reciprocated.

"I see Hingham Institution for Savings as family and take great pride in my relationship with the bank and my many friends who work there."

John Marrone
Owner, Elm Street Realty Trust

An entrepreneur's perspective.

In the 1960s, Hingham resident John Marrone believed he saw a real estate opportunity that others missed. With determination and solid business acumen, he pursued his dream, became his own boss, and soon began to grow his company. Now, as owner of the Elm Street Realty Trust and the John M. Marrone Construction Company, John is a very successful entrepreneur in real estate and property management throughout the South Shore. Hingham Institution for Savings has provided numerous real estate loans for John's enterprises. We recently provided John financing for the rehabilitation of an antique colonial home, as well as refinancing for a 46-unit apartment building. A long-time depositor and shareholder, he attributes his success to original thinking, good sense and strong values. We share these qualities and values. Perhaps that's why John considers himself our ambassador within the community. We are delighted that he is.

From a charitable viewpoint.

All too often we are so busy with our own lives we overlook others who need compassion and tangible assistance. At Wellspring, a unique community action and human services organization, the needs of others have always come first. Founded in 1985, Wellspring is now run by Jo Loughnane and serves the Hull, Cohasset and Hingham areas. Residents look to this "MultiService Center" for a host of vital services including a food pantry, adult learning, domestic violence assistance, job and crisis counseling, and clothing and household items for low-income families. In 2002, Hingham Institution for Savings donated $10,000 in support of Wellspring's programs and has pledged an ongoing commitment. In an age where many charities spend up to 70 cents of every dollar on administrative expenses, Wellspring spends less than 10 cents. We applaud their fiscal responsibility while enthusiastically endorsing their dedication, energy, and unflagging efforts.

"Our philosophy is that we offer a hand up, not a hand out, so we were very comfortable when Hingham Institution for Savings viewed their relationship with us in the same way."

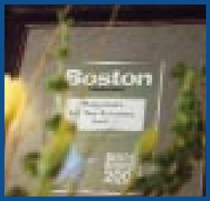
Jo Loughnane
Director, Wellspring

"We are delighted that Hingham Institution for Savings is our banking partner. With their help and continued encouragement, we look forward to being a South Shore favorite for years to come."

Joe and Susan LaSpada
Proprietors, Bridgeman's

A tasteful vision.

Joseph and Susan LaSpada had a fresh, positive outlook when they talked to us about financing their very first foray into restaurant ownership. Their enthusiasm and energy whetted our appetite, and soon a commercial mortgage loan from Hingham Institution for Savings saw the project underway. The results are inspirational. Located in Hull, the LaSpada's restaurant, Bridgeman's, has seating on two levels with additional seating for alfresco dining in the summer. Serving a blend of Central Italian and French cooking, it is now a favorite dining destination on the South Shore. In addition to the acquisition and construction financing, Joseph and Susan have their business operating accounts with the bank. Originally, family members referred them to us. We are delighted to have come so highly recommended, as the LaSpadas and the bank now enjoy a very palatable relationship.



The craftsman's keen eye.

When Curry Woodworking looked to expand their business, the Avon, MA company saw Hingham Institution for Savings as the natural choice. Established in 1915, Curry Woodworking designs, manufactures, and installs top-quality millwork for businesses, schools, hospitals, and homeowners. Curry Woodworking has a mortgage loan from us to finance a larger building for their growing operation. David Curry, Jr., who runs the family business, is a Cohasset resident, bank shareholder and depositor. Just as important, the family has always had a good relationship with us. David appreciates the Bank's responsiveness and his ready accessibility to senior management. Our personal service and flexibility ideally complement his business needs. David employs highly skilled craftsmen who create top-quality, one-of-a-kind designs. By its very nature, the work Curry Woodworking produces requires a high level of expertise and an eye for detail. The staff at Hingham Institution for Savings has similar attributes.

"I can count on prompt action, a tailored solution and superb customer service. I appreciate that nothing is ever overlooked."

David Curry, Jr.
President, Curry Woodworking

Senior Officers

Top row (left to right):

Peter R. Smollett, Vice President-Commercial Lending

Edward P. Zec, Vice President

Michael J. Sinclair, Vice President-Retail Lending

Shawn T. Sullivan, Vice President-Commercial Lending

Thomas I. Chew, Vice President-Branch Operations.

Front row (left to right):

Deborah J. Jackson, Senior Vice President and Treasurer

Robert H. Gaughen, Jr., President and Chief Executive Officer

William M. Donovan, Jr., Vice President-Administration

Board of Directors

Top row (left to right): Edward L. Sparda, Donald M. Tardiff, M.D., Kevin W. Gaughen, Esq., Howard M. Berger, Esq.

Second row (left to right): Julio R. Hernando, Esq., Joseph A. Ribaudo, CPA, Stacey M. Page, Ronald D. Falcione

Third row (left to right): Marion J. Fahey, Warren B. Noble, Robert A. Lane, Esq. James R. White

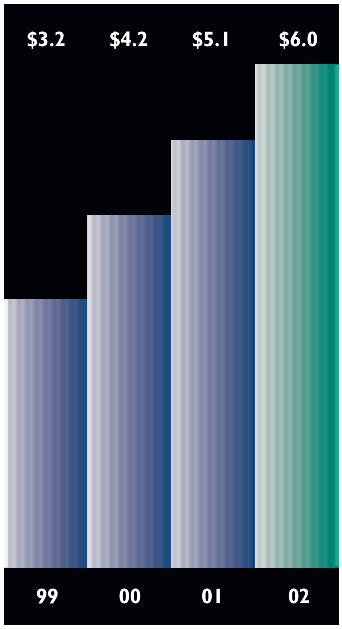
Front row (left to right): James V. Consentino, Robert H. Gaughen, Jr., Esq., Jacqueline M. Youngworth

Missing from photo: Geoffrey C. Wilkinson, Sr.

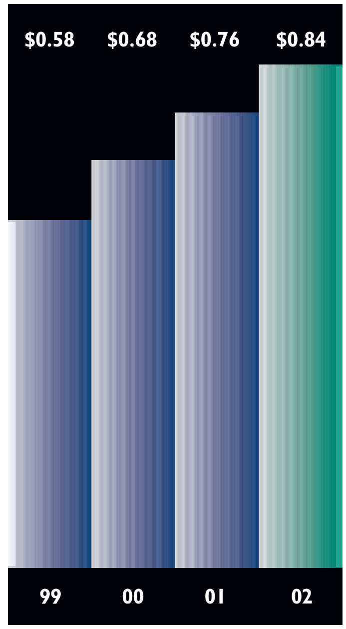
Financial Highlights

Net income rose 18% in 2002 due to a strong net yield on average earning assets of 3.94%. Also contributing to earnings growth was a gain on the termination of the Bank's pension plan.

Net Income
(in millions)

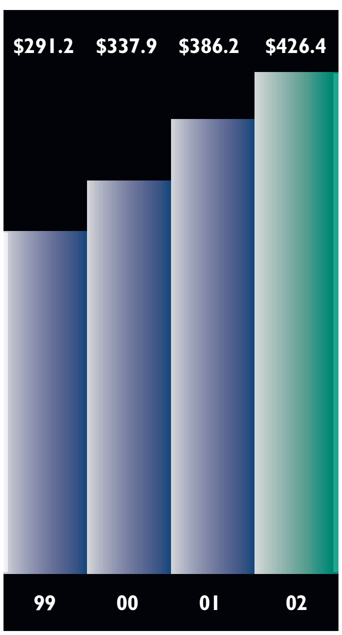


Dividends Declared
(per share)



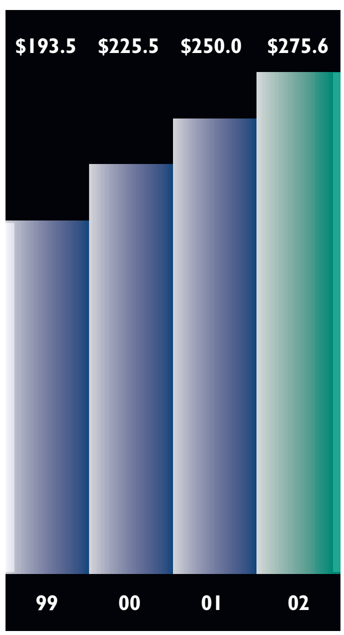
The Bank declared its eighth consecutive special dividend in 2002. Total dividends declared in 2002 exceeded 2001 by more than 10%.

Assets
(in millions)



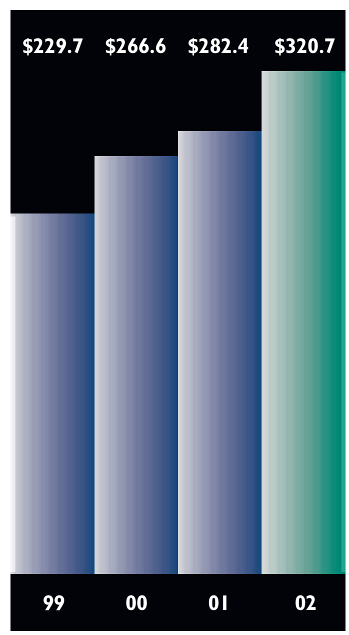
The Bank posted its eighth consecutive year of double-digit asset growth with 10% in 2002.

Deposits
(in millions)



Core deposits increased $19.5 million in 2002 and accounted for more than 75% of total deposit growth.

Loans
(in millions)



The Bank originated a record $158.7 million in loans in 2002, surpassing 2001 by more than 50%. Non-performing loans were a low 0.02% of total loans.

Selected Consolidated Financial Data

The following information does not purport to be complete and is qualified in its entirety by the more detailed information contained elsewhere herein.

	At December 31,				
	2002	2001	2000	1999	1998
			(In Thousands)		
Balance Sheet Data:					
Total assets	$ 426,430	$ 386,181	$ 337,881	$ 291,183	$ 260,076
Securities available for sale	49,333	49,619	39,440	35,532	28,235
Loans:					
Residential mortgage	153,293	130,723	124,175	108,999	95,629
Commercial mortgage	156,683	142,200	128,892	114,513	102,660
Construction, net	12,482	10,855	13,259	6,395	6,985
Other	765	894	2,285	1,592	1,219
Allowance for loan losses	2,810	2,510	2,272	1,976	1,729
Deposits	275,573	249,970	225,510	193,514	178,741
Federal Home Loan Bank advances	106,386	96,827	77,887	68,445	55,000
Other borrowed funds	394	134	204	248	56
Stockholders' equity	38,202	33,537	29,501	26,181	23,676

	Years Ended December 31,				
	2002	2001	2000	1999	1998
		(In Thousands, Except Per Share Amounts)			
Income Statement Data:					
Total interest and dividend income	$ 25,801	$ 26,041	$ 23,946	$ 20,259	$ 18,161
Total interest expense	10,422	12,571	12,105	9,968	9,223
Net interest income	15,379	13,470	11,841	10,291	8,938
Provision for loan losses	200	240	284	200	151
Other income	1,606	1,025	858	734	742
Operating expenses	7,715	6,567	6,068	5,540	4,716
Income before income taxes	9,070	7,688	6,347	5,285	4,813
Income tax provision	3,090	2,599	2,120	2,039	1,811
Net income	$ 5,980	$ 5,089	$ 4,227	$ 3,246	$ 3,002
Earnings per common share:					
Basic	$ 2.91	$ 2.49	$ 2.07	$ 1.65	$ 1.53
Diluted	$ 2.87	$ 2.46	$ 2.06	$ 1.62	$ 1.49
Financial Ratios:					
Return on average assets	1.48%	1.43%	1.35%	1.19%	1.26%
Return on average equity	16.58	15.95	15.17	13.07	13.18
Average equity to average assets	8.92	8.98	8.91	9.07	9.59
Interest rate spread	3.51	3.31	3.29	3.38	3.35
Net yield on average earning assets	3.94	3.90	3.90	3.88	3.88
Dividend payout ratio (basic)	28.87	30.52	32.85	35.15	32.03
Cash dividends declared per common share	$ 0.84	$ 0.76	$ 0.68	$ 0.58	$ 0.49

The following information should be read in conjunction with the Consolidated Financial Statements and Notes contained in this report.

For a discussion of recent developments which will materially impact earnings during 2003, refer to the "Income Taxes" section and Note 9 – "Tax Contingency".

COMPARISON OF THE YEARS 2002, 2001, and 2000

RESULTS OF OPERATIONS

For the year ended December 31, 2002, the Bank earned $6.0 million as compared to $5.1 million in 2001, an increase of 18%, and earned $4.2 million in 2000. On a per-share basis, the Bank earned $2.91 in 2002, $2.49 in 2001, and $2.07 in 2000. On a dilutive basis, which assumes that certain stock options have been exercised, earnings per share were $2.87 in 2002, $2.46 in 2001, and $2.06 in 2000.

Growth in earnings in each of the three periods was achieved primarily from growth in earning assets. In particular, loan originations were $158.7 million in 2002, as compared to $105.0 million in 2001 and $92.3 million in 2000, which resulted in net loan growth of $38.3 million, $15.8 million and $36.9 million for 2002, 2001 and 2000, respectively. Included in earnings in 2002 was the net gain on termination of the Bank's defined benefit pension plan which contributed $372,000 to net income, after tax effects. Contributing to the growth in earnings for 2001 over 2000 was a $134,000 gain on sale of securities.

Partially offsetting improvements in earnings were increases in expenses in each of the three periods, resulting primarily from increased salaries and employee benefits expenses, occupancy and equipment expenses, and legal expense. Despite increased expenses, the Bank's efficiency ratio, which measures the percent of net operating revenues consumed by operating expenses, amounted to a low 47.1% for 2002 as compared to 45.3% for 2001 and 47.8% for 2000.

Net Interest Income

In late 2002, the Federal Reserve Board lowered the federal funds rate by 50 basis points, bringing the rate down to 1.25%, its lowest in nearly forty years. During 2001, this rate had been cut by 475 basis points. The effect of these actions was evident in the declining yields on earning assets and interest-bearing liabilities reported by the Bank over the three periods.

The Bank reported $15.4 million in net interest income for 2002 as compared to $13.5 million in 2001 and $11.8 million in 2000. This positive trend was primarily the result of continued growth in loans. Outstanding loans averaged $307.4 million for 2002 as compared to $280.7 million for 2001 and $252.2 million for 2000. Other earning assets, consisting of securities, interest-bearing deposits and certificates of deposit, grew by $18.6 million in 2002 and by $12.7 million in 2001. Loans, however, were the most significant component of assets, accounting for approximately 80% of average total earning assets in each of the past three years.

The following table presents information regarding changes in interest and dividend income and interest expense of the Bank for the years indicated. For each category, information is provided with respect to changes attributable to changes in rate (change in rate multiplied by old volume) and changes in volume (change in volume multiplied by old rate). The change attributable to both volume and rate is allocated proportionately to the changes due to volume and rate.

	Years Ended December 31,					
	2002 Compared to 2001 Increase (Decrease)			2001 Compared to 2000 Increase (Decrease)		
	Due to			Due to		
	Volume	Rate	Total	Volume	Rate	Total
	(In Thousands)					
Interest and dividend income:						
Loans	$ 2,068	$ (1,870)	$ 198	$ 2,313	$ (246)	$ 2,067
Securities	437	(694)	(257)	133	(169)	(36)
Interest-bearing deposits and certificates of deposit	255	(436)	(181)	446	(382)	64
Total interest and dividend income	2,760	(3,000)	(240)	2,892	(797)	2,095
Interest expense:						
Deposits	392	(2,766)	(2,374)	821	(505)	316
Borrowed funds	974	(749)	225	671	(521)	150
Total interest expense	1,366	(3,515)	(2,149)	1,492	(1,026)	466
Net interest income	$ 1,394	$ 515	$ 1,909	$ 1,400	$ 229	$ 1,629

The following table details changes in net interest income and net yield on average earning assets.

	Years Ended December 31,								
	2002			2001			2000		
	Average Balance	Interest	Yield/ Rate	Average Balance	Interest	Yield/ Rate	Average Balance	Interest	Yield/ Rate
				(Dollars in Thousands)					
Assets:									
Loans:									
Real estate loans	$ 306,508	$ 22,916	7.48%	$ 278,655	$ 22,619	8.12%	$ 250,757	$ 20,595	8.21%
Commercial loans	154	16	10.39	253	25	9.88	333	34	10.21
Other loans	726	59	8.13	1,742	149	8.55	1,113	97	8.72
Total loans (1) (2)	307,388	22,991	7.48	280,650	22,793	8.12	252,203	20,726	8.22
Securities (3) (4)	52,196	2,306	4.42	43,826	2,563	5.85	41,634	2,599	6.24
Interest-bearing deposits and certificates of deposit	30,675	504	1.64	20,476	685	3.35	9,933	621	6.25
Total earning assets	390,259	25,801	6.61	344,952	26,041	7.55	303,770	23,946	7.88
Other assets	14,077			10,479			8,902		
Total assets	$ 404,336			$ 355,431			$ 312,672		
Liabilities and stockholders' equity:									
Interest-bearing deposits:									
NOW (5)	$ 18,436	52	0.28	$ 17,422	86	0.49	$ 15,933	79	0.50
Money market deposits	38,922	711	1.83	26,811	662	2.47	22,698	582	2.56
Regular	46,533	543	1.17	40,646	737	1.81	38,439	773	2.01
Term certificates	128,908	4,465	3.46	128,105	6,660	5.20	115,522	6,395	5.54
Total interest-bearing deposits	232,799	5,771	2.48	212,984	8,145	3.82	192,592	7,829	4.07
Borrowed funds	103,538	4,651	4.49	83,293	4,426	5.31	71,295	4,276	6.00
Total interest-bearing liabilities	336,337	10,422	3.10	296,277	12,571	4.24	263,887	12,105	4.59
Demand deposits	28,046			23,862			18,834		
Other liabilities	3,881			3,381			2,090		
Stockholders' equity	36,072			31,911			27,861		
Total liabilities and stockholders' equity	$ 404,336			$ 355,431			$ 312,672		
Net interest income		$ 15,379			$ 13,470			$ 11,841	
Weighted average rate spread			3.51%			3.31%			3.29%
Net yield on average earning assets (6)			3.94%			3.90%			3.90%

(1) Before allowance for loan losses.
(2) Includes average non-accrual loans.
(3) Excludes the impact of the average unrealized gain (loss) on securities available for sale.
(4) Includes Federal Home Loan Bank stock.
(5) Includes mortgagors' escrow accounts.
(6) Net interest income divided by average total earning assets.

Interest income is derived from residential and commercial mortgages, home equity, installment and commercial loans, the investment portfolio, and interest-bearing deposits. The Bank earned an average yield of 6.6% on these assets in 2002 as compared to 7.6% in 2001 and 7.9% in 2000. For 2002, 2001, and 2000, interest income totaled $25.8 million, $26.0 million, and $23.9 million, respectively. Average total earning assets increased $45.3 million, or 13%, in 2002 over 2001 and $41.2 million, or 14%, in 2001 over 2000. The Bank achieved this growth by continuing its focus on real estate lending.

In response to market conditions, the Bank lowered the rates it paid on each of its interest bearing deposit accounts in 2002. As a result, the average rate paid on certificates of deposit, NOW, savings, and money market deposit accounts decreased a total of 134 basis points. When comparing 2001 with 2000, the average rate paid on deposits decreased 25 basis points. Despite lower rates, the Bank continued to attract new deposits as evidenced by the 9% increase in average interest-bearing deposit balances in 2002 over 2001 and the 11% increase in 2001 over 2000.

Interest expense on borrowed funds increased in each of the past three years due to the increased volume of borrowed funds, partially offset by declines in market rates. During 2002, the Bank refinanced $40.1 million in Federal Home Loan Bank (FHLB) advances. When comparing 2002 with 2001, the average rate decreased 82 basis points and, when comparing 2001 with 2000, it decreased 69 basis points, resulting from lower market interest rates. The Bank continued its participation as a note option depository for treasury tax and loan deposits which allowed it to borrow short-term funds at a preferred interest rate.

Provision for Loan Losses

The provision for loan losses is based on management's assessment of the adequacy of the allowance for loan losses. Management considers the size of the loan portfolio, the risks associated with certain loan types, and the underlying collateral values of individual loans as well as other factors. Also considered are net recoveries on previously charged-off loans which increase the allowance for loan losses. In 2002, the Bank collected $100,000 in recoveries and recorded a $200,000 provision for loan losses. The provision for loan losses for 2001 was $240,000 as compared to $284,000 in 2000. As a percentage of the gross loan portfolio, the allowance for loan losses remained relatively constant at 0.87% for 2002, 0.88% for 2001 and 0.85% for 2000.

Other Income

The most significant component of other income in 2002 was a $605,000 gain on the termination of the Bank's defined benefit pension plan. Also contributing to the improvement in other income in 2002 over 2001 was the increase of $120,000 in the cash value of life insurance policies which the Bank purchased in August of 2002.

Fees earned on customer accounts were $698,000 for 2002, $704,000 for 2001 and $686,000 for 2000. Customer service fee income in each of the three years was derived primarily from deposit account transaction fees and ATM/debit card usage fees.

Other income is also comprised of net gains or losses on sales of investments and loans. Generally, the Bank holds investment securities and loans until their maturity. In 2001, the Bank reported a $134,000 gain on sales of securities. There were no such sales in 2002 or 2000.

Operating Expenses

As a percentage of average total assets, total operating expenses remained at or below 1.9% for each of the past three years.

Salaries and employee benefits were the largest component of operating expenses at $4.4 million for 2002, $3.7 million for 2001, and $3.4 million for 2000. Annual merit-based salary increases have been driving the increase in this category. In May 2002, the Bank terminated its defined benefit pension plan and simultaneously enhanced its 401(k) defined contribution plan retroactive to January 1, 2002. As part of the termination of the defined benefit pension plan, the Bank distributed approximately $301,000 in excess plan assets to the plan participants. For 2002, defined benefit and defined contribution plan expenses were $266,000 as compared to $136,000 for 2001. This increase reflects the rising costs of the defined benefit plan prior to its termination and the retroactive enhancement and increased participation in the defined contribution plan. The Bank believes that modifications to the pension plans will allow the Bank to exercise greater control over pension expenses in future periods. Also contributing to the increase in salaries and employee benefits expenses in 2002 over 2001 was the adoption of a Supplemental Employee Retirement Plan for certain Bank officers, effective September 2002, which accounted for $88,000 in expense for 2002.

Occupancy and equipment expenses increased over the three periods. In 2002, the Bank relocated its Main Office drive-up teller facility to 71 Main Street. This move provided enhanced customer convenience as well as the addition of much needed office space. During 2001, the Bank installed new computer hardware throughout the organization in order to provide greater functionality, improve processing speed and facilitate an upgrade to a Windows-based teller operating system.

Legal expenses increased by $103,000 when comparing 2002 to 2001. The increase in this category related to one-time expenditures associated with the modifications to the Bank's retirement plans and the ongoing assessment appeal to the Commonwealth of Massachusetts Department of Revenue which pertains to the tax treatment of dividends paid to the Bank by its real estate investment trust subsidiary as described under "Income Taxes."

All other operating expenses were $2.5 million for 2002, $2.1 million for 2001, and $2.0 million for 2000. The increase in 2002 over 2001 is primarily attributable to a check loss of approximately $75,000 and increased spending in auditing, reporting and training. The Bank is vigorously pursuing the collection of the check loss and is hopeful that the issue will be resolved in 2003.

Income Taxes

The Bank's effective tax rate for 2002 was 34.1% as compared to 33.8% and 33.4% for 2001 and 2000, respectively.

In June, October and December of 2002, the Bank received various notices from the Commonwealth of Massachusetts Department of Revenue

("DOR") which indicated that the Bank owed approximately $487,000 in additional taxes, plus interest, for the tax year ended October 31, 2001, related to the denial of the Bank's claim of a dividends received deduction for dividends received from the Bank's subsidiary, Hingham Capital Corporation, a real estate investment trust ("REIT").

The Bank believes that its tax treatment of the dividend was valid under existing Massachusetts law. The Bank filed a dispute of the DOR finding and is appealing the assessment. Accordingly, for 2002, the Bank estimated its tax provision under the assumption that it will claim the dividends received deduction.

In January 2003, legislation was proposed in Massachusetts which would prohibit the use of the 95 percent dividends received deduction from a REIT. This legislation would be effective for tax years beginning in 1999.

On March 5, 2003, the governor of Massachusetts signed the legislation. Accordingly, in March 2003, the Bank accrued a liability of approximately $1.4 million in state taxes, and related interest, net of federal tax benefits on such amounts, related to the fiscal years of 2000, 2001 and 2002. However, it is the Bank's intent to contest the retroactive feature of the legislation.

COMPARISON OF THE YEARS 2002 AND 2001

BALANCE SHEET ANALYSIS

The Bank had total assets of $426.4 million at December 31, 2002, an increase of $40.2 million, or 10%, from the $386.2 million level at year end 2001.

Loans

At December 31, 2002, the Bank reported net loans of $320.7 million, or 75% of total assets. Comparably at December 31, 2001, net loans were $282.4 million, or 73% of total assets. The decline in market rates during 2002 stimulated significant loan refinancing. The Bank originated $158.7 million in mortgage and other loan products which resulted in net loan growth of $38.3 million. The Bank experienced an overall principal repayment rate of approximately 28% in 2002 as compared to 25% for 2001. At December 31, 2002 and 2001, mortgage loans accounted for more than 99% of gross loans with residential mortgages and home equity loans representing approximately 48% and 46% of the mortgage portfolio in 2002 and 2001, respectively.

The Bank's lending strategy during 2002 and 2001 has continued to provide commercial property, single family, and multi-family loans at an initial fixed rate for three to seven years with an adjustable rate thereafter. Residential mortgages are generally underwritten to conform to Federal National Mortgage Association or Federal Home Loan Mortgage Corporation guidelines. The Bank also offers home equity loans indexed to the prime lending rate and construction loans.

The Bank's loan portfolio is reported net of the allowance for loan losses. At December 31, 2002 and 2001, the allowance had a balance of $2.8 million and $2.5 million, respectively. The allowance is maintained at a level adequate to absorb losses. The allowance is reviewed by senior management on at least a quarterly basis to determine its adequacy. Factors considered include loan-to-value ratios, underlying collateral values, payment history, and any other available information specific to a loan. Loan losses are charged against the allowance when the collectibility of loan principal becomes unlikely. Recoveries are recorded as additional reserves when received. For 2002, there were $100,000 in recoveries of previously charged-off loans and no loan charge-offs. There were $20,000 in recoveries and $22,000 in loan charge-offs in 2001.

The Bank reported $519,000 in non-accrual loans at December 31, 2002. There were no non-accrual loans at December 31, 2001.

Securities

The purpose of the Bank's securities portfolio is to supplement the Bank's lending activities by generating income, by providing liquidity and for use as collateral to obtain borrowed funds. At December 31, 2002, the portfolio was comprised of agency, mortgage-backed, trust preferred, and equity issues for a total of $49.3 million, or 12% of total assets, as compared to $49.6 million, or 13% of total assets, at year end 2001. At December 31, 2002 and 2001, the majority of the securities in the portfolio were issued or guaranteed by U.S. Government agencies or U.S. Government sponsored agencies.

At December 31, 2002, 88% of the portfolio consisted of agency bond issues. For the most part, these securities are offered at a fixed rate and term and at spreads above comparable U.S. Treasury issues. Approximately 5% of the portfolio was comprised of equity securities, all of which were government agency-issued preferred stock. Approximately 4% of the portfolio was comprised of bank-issued trust preferred stocks which are classified as debt securities.

The remaining 3%, or $1.5 million, was comprised of mortgage-backed securities, a decline of $400,000 from the $1.9 million held at December 31, 2001. These securities are subject to declines in principal balances due to principal repayments. Repayments tend to increase as market interest rates fall and the individual underlying mortgages are refinanced at lower rates. Conversely, repayments tend to decrease as market interest rates rise.

At year end 2002 and 2001, the entire investment portfolio was classified as available for sale and was carried at fair value with unrealized gains or losses reported in accumulated other comprehensive income, a separate component of stockholders' equity. The unrealized gain on the investment portfolio amounted to $774,000, net of tax effects, at December 31, 2002 as compared to $675,000 at year end 2001, reflecting an improvement in market conditions. The fair value of securities fluctuates with the movement of interest rates. Generally, during periods of falling interest rates, the fair values increase whereas the opposite may hold true during a rising interest rate environment.

Other Assets

In August 2002, the Bank purchased $7.3 million in Bank-Owned Life Insurance. The policies, which insure the lives of certain Bank officers, accrete at a variable rate of interest with minimum stated guaranteed rates.

Deposits

At December 31, 2002, the Bank held a total of $275.6 million in deposits, an increase of $25.6 million, or 10%, from the $250.0 million in deposits at year end 2001. Core deposits, comprised of savings, NOW, money market, and demand deposit accounts, were $141.9 million at December 31, 2002 as compared to $122.4 million at year end 2001, an increase of $19.5 million, or 16%. Certificates of deposit were $133.7 million, or 49% of total deposits, at December 31, 2002 as compared to $127.6 million, or 51% of total deposits, at year end 2001.

Primary competition for deposits are other banks and credit unions in the Bank's market area and mutual funds. The Bank's ability to attract and retain deposits depends upon satisfaction of depositors' requirements with respect to product, rate, and service. The Bank offers traditional deposit products, competitive rates, convenient branch locations, automated teller machines, debit cards, telephone banking and internet-based banking for consumers and commercial account holders. In 2001, the Bank introduced GOLD LINK, a premium rate money market deposit vehicle. By year end 2001, the product had attracted more than $7.0 million in deposits and grew to $15.3 million by year end 2002.

The Bank continues to attract deposits of all types as customers shift their funds from volatile equity markets to the safety of fully-insured bank deposits In addition, the Bank has continued to attract new deposits from customers displaced and inconvenienced by merger activity. Generally, these customers have become dissatisfied with post-merger service levels, product offerings, and fees and have sought out community-based institutions which can provide stability and quality customer service.

Deposits are insured in full through the combination of the Federal Deposit Insurance Corporation (FDIC) and the Deposit Insurance Fund of Massachusetts (DIF). Generally, separately insured deposit accounts are insured up to $100,000 by the FDIC and deposit balances in excess of $100,000 are insured by the DIF. Providing DIF insurance has become a competitive advantage for the Bank as the mid-sized to regional banks cannot offer this coverage.

Borrowings

The Bank had $106.4 million in FHLB advances at December 31, 2002 as compared to $96.8 million at year end 2001. Generally, the borrowings are drawn with a fixed rate and term; however, approximately $29.5 million, or 28%, can be called by the issuer after an initial specified term. The steep decline in interest rates over the course of 2002 and 2001 benefited the Bank by lowering interest expenses. The average rate paid on borrowings held at year end 2002 dropped to 4.32% from 4.63% at year end 2001. The Bank continues to borrow from the FHLB to fund growth in the Bank's loan portfolio.

The Bank is also a note option depository for treasury tax and loan deposits which provides the Bank with an additional source of short-term funding at a preferred interest rate. At December 31, 2002 and 2001, there were $394,000 and $134,000, respectively, in such borrowings.

Liquidity and Capital Resources

The Bank continually assesses its liquidity position by forecasting incoming and outgoing cash flows. In some cases, contractual maturity dates are used to anticipate cash flows. However, when an asset or liability is subject to early repayment or redemption at the discretion of the issuer or customer, cash flows can be difficult to predict. Generally, these prepayment rights are exercised when it is most financially favorable to the issuer or customer.

Approximately 88% of the Bank's investment portfolio is fixed with respect to rate and maturity date. Preferred stock and trust preferred issues, which represent 9% of the portfolio, can be called at the discretion of the issuer on or after pre-determined call dates. Mortgage-backed securities, which comprise 3% of the portfolio, are subject to repayment at the discretion of the underlying borrower. However, due to the negligible balances held in mortgage-backed issues, the Bank is not reliant on these cash flows to meet its liquidity targets.

Residential loans are susceptible to principal repayment at the discretion of the borrower. Commercial mortgages, while subject to significant penalties for early repayment in most cases, can also prepay at the borrower's discretion. During the significant decline in market interest rates in 2002 and 2001, the Bank experienced an overall prepayment rate on its loan portfolio of approximately 28% for 2002 as compared to approximately 25% for 2001.

The proceeds to the Bank under key executive life insurance polices are illiquid during the lives of the executives. Such policies total $7.7 million, or 2% of total assets, at December 31, 2002 as compared to $203,000 at December 31, 2001.

Core deposit balances can generally be withdrawn from the Bank at anytime. Certificates of deposit, with predefined maturity dates and subject to early redemption penalties, can also be withdrawn. The Bank estimates the volatility of its deposits in light of the general economic climate and recent actual experience. Over the past eight years, deposits have exceeded withdrawals resulting in net cash inflows from depositors.

Approximately 72% of the Bank's borrowings are fixed in terms of rate and maturity. The remaining 28%, or $29.5 million, can be called for earlier repayment at the discretion of the issuer. However, in the current economic environment, it is unlikely that these borrowings will be called in the near term.

The Bank also monitors its off-balance sheet items. At December 31, 2002, the Bank had approximately $69.1 million in commitments to extend credit as compared to $54.2 million at December 31, 2001.

The Bank takes each of these issues into consideration when measuring its liquidity position. Specific measurements include the Bank's cash flow position at both the 30 day and 90 day horizon, the level of volatile liabilities to earning assets and its loan-to-deposit ratio. At December 31, 2002 and 2001, each measurement was within predefined Bank guidelines.

To supplement its liquidity position, should the need arise, the Bank maintains its membership in the Federal Home Loan Bank of Boston where it is eligible to obtain both short and long-term credit advances. The Bank can borrow up to approximately $127.3 million to meet its borrowing needs, based on the Bank's available qualified collateral which consists primarily of 1-4 family residential mortgages and the qualifying portion of the Bank's investment in its real estate investment trust subsidiary. Upon specific approval from the FHLB, the Bank may also pledge other mortgages or its investment in its securities corporation subsidiary as collateral to secure as much as $108.7 million in additional borrowings. At December 31, 2002, the Bank had $106.4 million in advances outstanding.

At December 31, 2002, the Bank had capital of $38.2 million, or 9.0% of total assets, as compared to $33.5 million, or 8.7%, at December 31, 2001. Total capital is adjusted by the unrealized gains or losses in the Bank's available-for-sale securities portfolio and, as such, it is subject to fluctuations resulting from changes in the market values of its investment securities. At December 31, 2002, the Bank's entire securities portfolio was classified as available for sale which had the effect of increasing capital by $774,000. In comparison, at year end 2001, capital was increased by $675,000.

Massachusetts-chartered savings banks that are insured by the FDIC are subject to minimum capital maintenance requirements. Regulatory guidelines define the minimum amount of qualifying capital an institution must maintain as a percentage of risk-weighted assets and average total assets. The Bank's ratios exceeded these regulatory capital requirements in both 2002 and 2001.

During 2002, the Bank declared dividends of $0.84 per share which included an $0.18 per share special dividend which was declared in the fourth quarter. In comparison, in 2001, the Bank declared dividends of $0.76 per share which included a $0.16 per share special dividend. The Bank's dividend payout ratio, which is calculated by dividing dividends per share into earnings per share, was 28.9% for 2002 as compared to 30.5% for 2001.

IMPACT OF INFLATION AND CHANGING PRICES

The consolidated financial statements and related consolidated financial data presented herein have been prepared in accordance with accounting principles generally accepted in the United States of America which generally require the measurement of financial position and operating results in terms of historical dollars without considering the changes in the relative purchasing power of money over time due to inflation. The primary impact of inflation on operations of the Bank is reflected in increased operating costs. Unlike most industrial companies, virtually all the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates have a more significant impact on a financial institution's performance than the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the price of goods and services.

FORWARD-LOOKING STATEMENTS

This annual report may contain statements relating to future results of the Bank (including certain projections and business trends) that are considered "forward-looking statements" as defined in the Private Securities Litigation Reform Act of 1995. Actual results may differ materially from those projected as a result of certain risks and uncertainties, including but not limited to changes in political and economic conditions, interest rate fluctuations, competitive product and pricing pressures within the Bank's market, bond market fluctuations, personal and corporate customers' bankruptcies, and inflation, as well as other risks and uncertainties.

ASSET/LIABILITY MANAGEMENT

The earnings of most banking institutions are exposed to interest rate risk because their balance sheets, both assets and liabilities, are predominantly interest bearing. It is the Bank's objective to minimize, to the degree prudently possible, its exposure to interest rate risk, bearing in mind that the Bank, by its very nature, will always be in the business of taking on interest rate risk. Interest rate risk is monitored on a quarterly basis by the Asset Liability Committee (ALCO) of the Bank. The primary tool used by the Bank in managing interest rate risk is income simulation modeling. Income simulation modeling measures changes in net interest income by projecting the future composition of the Bank's balance sheet and applying different interest rate scenarios.

Management incorporates numerous assumptions into the simulation model, such as prepayment speeds, balance sheet growth, and deposit elasticity. Generally, rates are assumed to rise steadily over a twelve month period, then remain constant over the remaining period. The model assumes a 200 and 300 basis point increase in interest rates where the magnitude of the rate change varies with the term. For example, in the 200 basis point scenario, longer term rates are modeled to rise 168 basis points and short term rates are modeled to rise 200 basis points. The model estimates that, over a twenty-four month period, net interest income will decrease 4.84% if rates rise 200 basis points and will decrease 4.55% if rates rise 300 basis points.

The Bank's interest rate risk exposure is believed to be well managed and within pre-defined limits.

To a significantly lesser degree, the Bank also utilizes GAP analysis which involves comparing the difference between interest-rate sensitive assets and liabilities that mature or reprice during a given period of time. However, GAP analysis does not measure the financial impact of mismatched assets to liabilities, nor does it measure the velocity at which assets and liabilities reprice.

In 2002, the decline in market interest rates continued to prompt loan customers to obtain longer-term fixed-rate loans and adjustable loans with extended rate reset periods. Alternately, certificate of deposit customers showed a preference for savings or transaction-based products or certificates with shorter term maturities. In an effort to balance these consumer preferences and to take advantage of lower market interest rates, a portion of 2002 borrowings were taken in the longer term sectors. As a result, the Bank's one-year negative gap position at December 31, 2002 was approximately 1.25% of assets and well within pre-defined limits.

The following tables present interest-rate sensitive assets and liabilities categorized by expected maturity (or interest rate adjustment date, if earlier) and weighted average rates. Expected maturities are contractual maturities adjusted for amortization and prepayment of principal. Prepayment speeds range from 4% to 36% depending upon the particular asset category. Generally, adjustable rate loans are indexed to Prime or Treasury rates and can reprice as much as 200 basis points per year and 600 basis points over the life of the loan. Non-certificate deposits do not have contractual maturities. The tables reflect management's assumptions about the repricing characteristics of such deposits.

December 31, 2002

Maturing or repricing within:	One Year	1-2 Years	2-3 Years	3-4 Years	4-5 Years	Thereafter	Total
				(Dollars in Thousands)			
Interest-earning assets:							
Securities, at cost	$ 54,653	$ 20,406	$ 388	$ —	$ —	$ —	$ 75,447
	2.51%	3.22%	4.25%	—%	—%	—%	2.71%
Loans:							
Fixed rate	$ 25,722	$ 19,874	$ 16,531	$ 13,163	$ 10,373	$ 47,450	$ 133,113
	7.16%	7.12%	7.00%	6.89%	6.77%	6.40%	6.81%
Adjustable rate	$ 86,556	$ 29,391	$ 23,335	$ 20,978	$ 21,043	$ 8,807	$ 190,110
	6.96%	7.80%	7.64%	7.74%	7.11%	7.45%	7.30%
Interest-bearing liabilities:							
Deposits:							
Non-certificate accounts	$ 24,481	$ 24,489	$ 24,489	$ 10,167	$ 10,167	$ 18,615	$ 112,408
	1.25%	1.25%	1.25%	0.90%	0.90%	0.25%	1.02%
Term certificates	$ 109,508	$ 15,683	$ 5,036	$ 1,577	$ 1,915	$ —	$ 133,719
	2.98%	3.43%	3.87%	4.26%	3.95%	—%	3.09%
Borrowed funds	$ 36,394	$ 14,500	$ 18,500	$ 5,125	$ 6,000	$ 26,261	$ 106,780
	3.02%	4.72%	4.71%	4.41%	5.35%	5.33%	4.32%

December 31, 2001

Maturing or repricing within:	One Year	1-2 Years	2-3 Years	3-4 Years	4-5 Years	Thereafter	Total
				(Dollars in Thousands)			
Interest-earning assets:							
Securities, at cost	$ 50,648	$ 24,074	$ 5,584	$ —	$ —	$ —	$ 80,306
	3.11%	5.35%	5.26%	—%	—%	—%	3.93%
Loans:							
Fixed rate	$ 29,413	$ 21,103	$ 17,891	$ 15,160	$ 11,282	$ 28,425	$ 123,274
	7.76%	7.62%	7.62%	7.52%	7.36%	7.80%	7.66%
Adjustable rate	$ 72,585	$ 35,344	$ 21,650	$ 12,927	$ 15,620	$ 3,272	$ 161,398
	7.46%	8.46%	8.13%	8.32%	8.05%	8.58%	7.92%
Interest-bearing liabilities:							
Deposits:							
Non-certificate accounts	$ 19,787	$ 19,794	$ 19,794	$ 8,679	$ 8,679	$ 17,408	$ 94,141
	1.61%	1.61%	1.61%	1.25%	1.25%	0.41%	1.32%
Term certificates	$ 113,239	$ 9,650	$ 3,125	$ 935	$ 654	$ —	$ 127,603
	4.41%	4.58%	4.57%	4.98%	4.90%	—%	4.43%
Borrowed funds	$ 28,634	$ 14,500	$ 14,500	$ 9,500	$ 1,500	$ 28,327	$ 96,961
	3.73%	4.66%	4.72%	4.90%	4.91%	5.38%	4.63%

To the Board of Directors and Stockholders of
Hingham Institution for Savings

We have audited the consolidated balance sheets of Hingham Institution for Savings and subsidiaries as of December 31, 2002 and 2001, and the related consolidated statements of income, changes in stockholders' equity and cash flows for each of the years in the three-year period ended December 31, 2002. These consolidated financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Hingham Institution for Savings and subsidiaries as of December 31, 2002 and 2001, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2002 in conformity with accounting principles generally accepted in the United States of America.

Wolf & Company, P.C.

Boston, Massachusetts
January 17, 2003, except for Note 9 – "Tax Contingency"
as to which the date is March 5, 2003.

Consolidated Balance Sheets

ASSETS

	December 31, 2002	December 31, 2001
	(In Thousands)	
Cash and due from banks	$ 5,224	$ 7,417
Interest-bearing deposits	29,347	33,740
Cash and cash equivalents	34,571	41,157
Certificates of deposit	1,940	970
Securities available for sale, at fair value	49,333	49,619
Federal Home Loan Bank stock, at cost	5,469	4,841
Loans, net of allowance for loan losses of $2,810,000 in 2002 and $2,510,000 in 2001	320,692	282,386
Cash value of life insurance	7,429	—
Banking premises and equipment, net	3,785	3,801
Accrued interest receivable	1,991	1,978
Deferred income tax asset, net	564	793
Other assets	656	636
	$ 426,430	$ 386,181

LIABILITIES AND STOCKHOLDERS' EQUITY

	2002	2001
Deposits	$ 275,573	$ 249,970
Federal Home Loan Bank advances	106,386	96,827
Other borrowed funds	394	134
Mortgagors' escrow accounts	1,197	1,088
Accrued interest payable	426	404
Other liabilities	4,252	4,221
Total liabilities	388,228	352,644
Commitments and contingencies (Note 9)		
Stockholders' equity:		
Preferred stock, $1.00 par value, 2,500,000 shares authorized; none issued	—	—
Common stock, $1.00 par value, 5,000,000 shares authorized; 2,067,250 and 2,047,250 shares issued and outstanding at December 31, 2002 and 2001, respectively	2,067	2,047
Additional paid-in capital	9,188	8,891
Undivided profits	26,173	21,924
Accumulated other comprehensive income	774	675
Total stockholders' equity	38,202	33,537
	$ 426,430	$ 386,181

See accompanying notes to consolidated financial statements.

Consolidated Statements of Income

	Years Ended December 31,		
	2002	2001	2000
	(In Thousands, Except Per Share Data)		
Interest and dividend income:			
Loans	$ 22,991	$ 22,793	$ 20,726
Debt and trust preferred securities	1,977	2,184	2,237
Other equity securities	329	379	362
Interest-bearing deposits and certificates of deposit	504	685	621
Total interest and dividend income	25,801	26,041	23,946
Interest expense:			
Deposits	5,771	8,145	7,829
Borrowed funds	4,651	4,426	4,276
Total interest expense	10,422	12,571	12,105
Net interest income	15,379	13,470	11,841
Provision for loan losses	200	240	284
Net interest income, after provision for loan losses	15,179	13,230	11,557
Other income:			
Customer service fees on deposits	698	704	686
Gain on sales of securities available for sale	—	134	—
Gain on termination of pension plan	605	—	—
Other	303	187	172
Total other income	1,606	1,025	858
Operating expenses:			
Salaries and employee benefits	4,358	3,740	3,367
Data processing	626	551	501
Occupancy and equipment	787	721	711
Legal	117	14	31
Other	1,827	1,541	1,458
Total operating expenses	7,715	6,567	6,068
Income before income taxes	9,070	7,688	6,347
Income tax provision	3,090	2,599	2,120
Net income	$ 5,980	$ 5,089	$ 4,227
Earnings per common share:			
Basic	$ 2.91	$ 2.49	$ 2.07
Diluted	$ 2.87	$ 2.46	$ 2.06

See accompanying notes to consolidated financial statements.

Consolidated Statements of Changes in Stockholders' Equity

Years Ended December 31, 2002, 2001, and 2000

	Common Stock	Additional Paid-in Capital	Undivided Profits	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
			(In Thousands)		
Balance at December 31, 1999	$ 2,041	$ 8,809	$ 15,559	$ (228)	$ 26,181
Comprehensive income:					
Net income	—	—	4,227	—	4,227
Change in net unrealized gain (loss) on securities available for sale, net of tax effect	—	—	—	485	485
Total comprehensive income					4,712
Cash dividends declared-common($0.68 per share)	—	—	(1,392)	—	(1,392)
Balance at December 31, 2000	2,041	8,809	18,394	257	29,501
Comprehensive income:					
Net income	—	—	5,089	—	5,089
Change in net unrealized gain (loss) on securities available for sale, net of reclassification adjustment and tax effect	—	—	—	418	418
Total comprehensive income					5,507
Stock options exercised, after tax effect of $17,000	6	82	—	—	88
Cash dividends declared-common($0.76 per share)	—	—	(1,559)	—	(1,559)
Balance at December 31, 2001	2,047	8,891	21,924	675	33,537
Comprehensive income:					
Net income	—	—	5,980	—	5,980
Change in net unrealized gain (loss) on securities available for sale, net of tax effect	—	—	—	99	99
Total comprehensive income					6,079
Stock options exercised, after tax effect of $121,000	20	297	—	—	317
Cash dividends declared-common($0.84 per share)	—	—	(1,731)	—	(1,731)
Balance at December 31, 2002	$ 2,067	$ 9,188	$ 26,173	$ 774	$ 38,202

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows

	Years Ended December 31,		
	2002	2001	2000
		(In Thousands)	
Cash flows from operating activities:			
Net income	$ 5,980	$ 5,089	$ 4,227
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses	200	240	284
Amortization (accretion) of securities, net	378	39	(18)
Amortization of deferred loan origination costs, net	97	29	48
Depreciation	398	380	370
Increase in cash value of life insurance	(120)	—	—
Gain on sales of securities	—	(134)	—
Gain on sale of loans	—	(2)	—
Deferred tax (benefit) provision	178	(24)	(108)
Changes in operating assets and liabilities:			
Accrued interest receivable and other assets	(33)	(158)	(475)
Accrued interest payable and other liabilities	87	852	1,719
Net cash provided by operating activities	7,165	6,311	6,047
Cash flows from investing activities:			
Activity in available-for-sale securities:			
Sales	—	597	—
Maturities, prepayments and calls	13,429	15,784	10,146
Purchases	(13,371)	(25,828)	(13,259)
Purchase of certificates of deposit	(970)	(970)	—
Loans originated, net of payments received	(38,603)	(17,168)	(37,213)
Proceeds from sale of loans	—	1,083	—
Increase in Federal Home Loan Bank stock	(628)	(822)	(596)
Payments made for cash value of life insurance	(7,309)	—	—
Additions to banking premises and equipment	(382)	(1,003)	(151)
Net cash used in investing activities	(47,834)	(28,327)	(41,073)

(continued)

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows

(Concluded)

	Years Ended December 31,		
	2002	2001	2000
		(In Thousands)	
Cash flows from financing activities:			
Increase in deposits, net	$ 25,603	$ 24,460	$ 31,996
Increase in mortgagors' escrow accounts	109	36	182
Proceeds from stock options exercised	196	71	—
Cash dividends paid on common stock	(1,644)	(1,496)	(1,309)
Net proceeds (repayments) of borrowings with maturities of less than three months	260	(3,570)	3,456
Proceeds from Federal Home Loan Bank advances with maturities of three months or more	48,500	88,500	80,500
Repayment of Federal Home Loan Bank advances with maturities of three months or more	(38,941)	(66,060)	(74,558)
Net cash provided by financing activities	34,083	41,941	40,267
Net increase (decrease) in cash and cash equivalents	(6,586)	19,925	5,241
Cash and cash equivalents at beginning of year	41,157	21,232	15,991
Cash and cash equivalents at end of year	$ 34,571	$ 41,157	$ 21,232
Supplementary information:			
Interest paid on deposit accounts	$ 5,771	$ 8,144	$ 7,827
Interest paid on borrowed funds	4,629	4,437	4,223
Income taxes paid, net of refunds	2,427	1,649	742

See accompanying notes to consolidated financial statements.

Years Ended December 31, 2002, 2001, and 2000

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation and consolidation

The consolidated financial statements include the accounts of Hingham Institution for Savings ("Bank") and its majority-owned subsidiary, Hingham Capital Corporation, a real estate investment trust (“REIT”), formed during 2000 which holds title to certain loans,(see Note 9) and its wholly-owned subsidiaries, Hingham Securities Corporation and Hingham Securities Corporation II, which hold title to certain securities available for sale. Hingham Securities Corporation was dissolved during 2000. All intercompany accounts and transactions have been eliminated in consolidation. The minority interest of $46,000 pertaining to preferred stock issued by the REIT is included in other liabilities.

Use of estimates

In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the consolidated balance sheet and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are susceptible to significant change in the near term relate to the determination of the allowance for loan losses and provision for income taxes.

Business and operating segments

The Bank provides a variety of financial services to individuals and small businesses through its six offices in southeastern Massachusetts. Its primary deposit products are savings, checking, and term certificate accounts, and its primary lending products are residential and commercial mortgage loans.

Statement of Financial Accounting Standards (“SFAS”) No. 131, “Disclosures about Segments of an Enterprise and Related Information,” establishes standards for the way that public business enterprises report information about operating segments in annual and interim financial statements. It also establishes standards for related disclosures about products and services, geographic areas, and major customers. Generally, financial information is required to be reported on the basis that it is used internally for evaluating segment performance and deciding how to allocate resources to segments. Management evaluates the Bank’s performance and allocates resources based on a single segment concept. Accordingly, there are no separately identified operating segments for which discrete financial information is available. The Bank does not derive revenues from, or have assets located in foreign countries, nor does it derive revenues from any single customer that represents 10% or more of the Bank’s total revenues.

Reclassification

Certain amounts have been reclassified in the 2001 and 2000 consolidated financial statements to conform to the 2002 presentation.

Cash and cash equivalents

Cash and cash equivalents include amounts due from banks and interest-bearing deposits.

Interest-bearing deposits

Interest-bearing deposits mature within ninety days and are carried at cost, which approximates fair value.

Certificates of deposit

Certificates of deposit mature within three years and are carried at cost.

Securities available for sale

Securities are classified as available for sale and reflected at fair value, with unrealized gains and losses, after tax effects, excluded from earnings and reported in accumulated other comprehensive income (loss) as a separate component of stockholders’ equity.

Purchased premiums and discounts are amortized to earnings by a method which approximates the interest method over the terms of the securities. Declines in the value of securities that are deemed to be other than temporary are reflected in earnings when identified. Gains and losses on disposition of securities are recorded on the trade date and are determined using the specific identification method.

Loans

The Bank grants mortgage, commercial, and consumer loans to customers. A substantial portion of the loan portfolio is represented by mortgage loans in the southeastern Massachusetts area. The ability of the Bank's debtors to honor their contracts is dependent upon the real estate, construction, and general economic sectors.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off generally are reported at their outstanding unpaid principal balances adjusted for charge offs, the allowance for loan losses, and deferred fees or costs on originated loans. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield using the interest method.

The accrual of interest on mortgage and commercial loans is discontinued at the time the loan is 90 days past due unless the credit is well-secured and in process of collection. Personal loans are typically charged off no later than becoming 180 days past due. Past due status is based on contractual terms of the loan. In all cases, loans are placed on non-accrual or charged off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not collected for loans that are placed on non-accrual or charged off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual status. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

A loan is considered impaired when, based on current information and events, it is probable that a creditor will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Impaired loans are generally maintained on a non-accrual basis. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent. Substantially all of the Bank's loans which are identified as impaired are measured by the fair value of existing collateral.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Bank does not separately identify individual consumer loans for impairment disclosures.

Allowance for loan losses

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral, and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of allocated and general loss components. The allocated loss component relates to loans that are classified as either doubtful, substandard, or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flow (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on an estimated range of possible losses reflective of historical loss experience and qualitative factors.

Banking premises and equipment

Land is carried at cost. Buildings and equipment are carried at cost, less accumulated depreciation computed on the straight-line method over the estimated useful lives of the assets. It is general practice to charge the cost of maintenance and repairs to earnings when incurred; major expenditures for betterments are capitalized and depreciated.

Transfers of financial assets

Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Bank, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before maturity.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Income taxes

Deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted accordingly through the provision for income taxes. The Bank's base amount of its federal income tax reserve for loan losses is a permanent difference for which there is no recognition of a deferred tax liability. However, the loan loss allowance maintained for financial reporting purposes is a temporary difference with allowable recognition of a related deferred tax asset, if it is deemed realizable. The Bank and its subsidiaries, Hingham Securities Corporation and Hingham Securities Corporation II, file state and consolidated federal income tax returns based on an October 31 year-end. Its subsidiary, Hingham Capital Corporation files state and federal income tax returns based on a December 31 year-end. Effective December 31, 2002, all entities will file returns based on a December 31 year-end. See Note 9, "Other Contingencies."

Retirement plan

The compensation cost of an employee's pension benefit is recognized on the net periodic pension cost method over the employee's approximate service period. The aggregate cost method is utilized for funding purposes. See Note 12.

Stock compensation plans

SFAS No. 123, "Accounting for Stock-Based Compensation," encourages all entities to adopt a fair value based method of accounting for employee stock compensation plans, whereby compensation cost is measured at the grant date based on the value of the award and is recognized over the service period, which is usually the vesting period. However, it also allows an entity to continue to measure compensation cost for those plans using the intrinsic value based method of accounting prescribed by Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," whereby compensation cost is the excess, if any, of the quoted market price of the stock at the grant date (or other measurement date) over the amount an employee must pay to acquire the stock. Stock options issued under the Bank's stock option plans have no intrinsic value at the grant date and under Opinion No. 25 no compensation cost is recognized for them. The Bank has elected to continue with the accounting methodology in Opinion No. 25 and, as a result, has provided pro forma disclosures of net income and earnings per share and other disclosures, as if the fair value-based method of accounting had been applied. The pro forma disclosures include the effects of all awards granted on or after January 1, 1995.

At December 31, 2002, the Bank has two fixed stock option plans as described in Note 11. The Bank applies APB Opinion 25 and related Interpretations in accounting for the plans. Accordingly, no compensation cost has been recognized for the plans as all options granted under the plans had an exercise price equal to the market value of the underlying common stock on the date of grant. Had compensation cost for the plans been determined based on the fair value at the grant dates for awards under the plans consistent with the method prescribed by SFAS No. 123, "Accounting for Stock-Based Compensation," the Bank's net income and earnings per share would have been reduced to the pro forma amounts indicated below:

	Years Ended December 31,		
	2002	2001	2000
Net income:	(In Thousands, Except Per Share Amounts)		
As reported	$ 5,980	$5,089	$4,227
Less total stock-based employee compensation expense determined under fair value based method for all awards, net of tax effects	6	—	—
Pro forma	$ 5,974	$5,089	$4,227
Earnings per common share:			
As reported	$ 2.91	$ 2.49	$ 2.07
Pro forma	2.90	2.49	2.07
Earnings per common share-assuming dilution for stock options:			
As reported	$ 2.87	$ 2.46	$ 2.06
Pro forma	2.87	2.46	2.06

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (concluded)

Advertising costs

Advertising costs are expensed as incurred.

Earnings per common share

Basic earnings per common share represent income available to common stockholders divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. Potential common shares that may be issued by the Bank relate solely to outstanding stock options and are determined using the treasury stock method.

For the years ended December 31, 2002, 2001, and 2000, options applicable to 1,500 shares, 1,500 shares, and 23,500 shares, respectively, were anti-dilutive and excluded from the diluted earnings per share computations.

Earnings per common share have been computed based on the following:

	Years Ended December 31,		
	2002	2001 (In Thousands)	2000
Average number of common shares outstanding	2,058	2,045	2,041
Effect of dilutive options	27	26	14
Average number of common shares outstanding used to calculate diluted earnings per common share	2,085	2,071	2,055

Comprehensive income

Accounting principles generally require that recognized revenue, expenses, gains, and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the equity section of the consolidated balance sheet, such items, along with net income, are components of comprehensive income.

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

	Years Ended December 31,		
	2002	2001 (In Thousands)	2000
Net unrealized holding gains on available-for-sale securities	$ 150	$ 771	$ 777
Reclassification adjustment for gains realized in income	—	(134)	—
Net unrealized gains	150	637	777
Tax effect	(51)	(219)	(292)
Net-of-tax amount	$ 99	$ 418	$ 485

Accounting change

In December, 2001, the American Institute of Certified Public Accountants ("AICPA") issue Statement of Position 01-6, "Accounting by Certain Entities (Including Entities with Trade Receivables) That Lend to or Finance the Activities of Others", to reconcile and conform the accounting and financial reporting provisions established by various AICPA industry audit guides. This Statement is effective for annual and interim financial statements issued for fiscal years beginning after December 15, 2001, and did not have a material impact on the Bank's consolidated financial statements.

Subsequent accounting change

In June, 2002, the Financial Accounting Standards Board ("FASB") issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities", which requires recognition of a liability, when incurred, for a cost associated with an exit or disposal activity. The liability shall be recognized at fair value. The provisions of this Statement are effective for exit or disposal activities initiated after December 31, 2002. Management does not anticipate that the adoption of this Statement will have a material impact on the consolidated financial statements.

2. RESTRICTIONS ON CASH AND AMOUNTS DUE FROM BANKS

The Bank is required to maintain average balances on hand or with the Federal Reserve Bank. At December 31, 2002 and 2001, cash and due from banks included $200,000 to satisfy such reserve requirements.

3. SECURITIES AVAILABLE FOR SALE

The amortized cost and estimated fair value of securities available for sale, with gross unrealized gains and losses, follows:

	December 31, 2002			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In Thousands)			
Debt securities:				
U.S. Government and federal agency obligations	$ 42,685	$ 777	$ —	$ 43,462
Mortgage-backed - FHLMC	722	7	(1)	728
Mortgage-backed - FNMA	753	8	—	761
Trust preferred	1,750	123	—	1,873
Total debt securities	45,910	915	(1)	46,824
Equity securities	2,250	259	—	2,509
Total securities available for sale	$ 48,160	$1,174	$ (1)	$ 49,333

	December 31, 2001			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In Thousands)			
Debt securities:				
U.S. Government and federal agency obligations	$ 43,684	$ 843	$ (74)	$ 44,453
Mortgage-backed - FHLMC	1,014	—	(6)	1,008
Mortgage-backed - FNMA	898	7	—	905
Trust preferred	750	77	—	827
Total debt securities	46,346	927	(80)	47,193
Equity securities	2,250	178	(2)	2,426
Total securities available for sale	$ 48,596	$1,105	$ (82)	$ 49,619

At December 31, 2002 and 2001, the Bank had pledged U.S. Government obligations with a fair value of $1,125,000 and $1,149,000, respectively, as collateral against its treasury tax and loan account.

SECURITIES AVAILABLE FOR SALE (concluded)

The amortized cost and estimated fair value of debt securities by contractual maturity at December 31, 2002 are shown below. Expected maturities will differ from contractual maturities because of prepayments and scheduled payments on mortgage-backed securities. Further, certain obligors have the right to call bonds and obligations without prepayment penalties.

	Amortized Cost	Fair Value
	(In Thousands)	
Bonds and obligations:		
Within 1 year	$ 23,346	$ 23,668
Over 1 year to 5 years	19,339	19,794
Over 10 years	1,750	1,873
	44,435	45,335
Mortgage-backed securities:		
Over 1 year to 5 years	72	76
Over 10 years	1,403	1,413
	1,475	1,489
Total debt securities	$ 45,910	$ 46,824

For the year ended December 31, 2001 proceeds from the sale of securities available for sale amounted to $597,000 resulting in gross realized gains of $134,000 and no gross realized losses. There were no sales of securities during 2002 or 2000.

4. LOANS

A summary of the balances of loans follows:

	December 31, 2002	December 31, 2001
	(In Thousands)	
Mortgage loans:		
Residential	$ 138,152	$ 118,663
Commercial	155,720	140,958
Construction	12,482	10,855
Equity lines of credit	15,141	12,060
Second mortgages	963	1,242
Total mortgage loans	322,458	283,778
Other loans:		
Personal installment	522	593
Commercial	116	176
Revolving credit	127	125
Total other loans	765	894
Total loans	323,223	284,672
Allowance for loan losses	(2,810)	(2,510)
Net deferred loan origination costs	279	224
Loans, net	$ 320,692	$ 282,386

The Bank has sold mortgage loans in the secondary mortgage market and has retained the servicing responsibility and receives fees for the services provided. Loans sold and serviced for others amounted to $2,198,000, $4,217,000, and $4,041,000 at December 31, 2002, 2001, and 2000, respectively. All loans serviced for others were sold without recourse provisions and are not included in the accompanying consolidated balance sheets.

LOANS (concluded)

An analysis of the allowance for loan losses follows:

	Years Ended December 31,		
	2002	2001	2000
		(In Thousands)	
Balance at beginning of year	$ 2,510	$ 2,272	$ 1,976
Provision for loan losses	200	240	284
Loans charged off	—	(22)	(3)
Recoveries on loans previously charged off	100	20	15
Balance at end of year	$ 2,810	$ 2,510	$ 2,272

The following is a summary of information pertaining to impaired and non-accrual loans:

	December 31,	
	2002	2001
	(In Thousands)	
Impaired loans without a valuation allowance	$ 139	$ —
Non-accrual loans	$ 519	$ —
Loans past due 90 days or more and still accruing	$ —	$ —

	Years Ended December 31,		
	2002	2001	2000
		(In Thousands)	
Average investment in impaired loans	$ 93	$ 155	$ 211
Interest income recognized on impaired loans	$ —	$ —	$ 50
Interest income recognized on a cash basis on impaired loans	$ —	$ —	$ 50

There were no additional funds committed to be advanced in connection with impaired loans.

5. BANKING PREMISES AND EQUIPMENT

A summary of the cost and accumulated depreciation of banking premises and equipment follows:

	December 31, 2002	December 31, 2001
	(In Thousands)	
Banking premises:		
Land	$ 873	$ 873
Buildings	3,721	3,549
Equipment	2,762	2,583
	7,356	7,005
Less accumulated depreciation	(3,571)	(3,204)
	$ 3,785	$ 3,801

Depreciation expense for the years ended December 31, 2002, 2001, and 2000 amounted to $398,000, $380,000, and $370,000, respectively.

6. DEPOSITS

A summary of deposit balances, by type, is as follows:

	December 31, 2002	December 31, 2001
	(In Thousands)	
Regular	$ 51,354	$ 43,611
Money market deposits	42,439	33,122
NOW	18,615	17,408
Demand	29,446	28,226
Total non-certificate accounts	141,854	122,367
Term certificates less than $100,000	88,970	88,371
Term certificates of $100,000 or more	44,749	39,232
Total certificate accounts	133,719	127,603
Total deposits	$ 275,573	$ 249,970

DEPOSITS (concluded)

The maturity distribution of term certificates is as follows:

	December 31,			
	2002		2001	
	Amount	Weighted Average Rate	Amount	Weighted Average Rate
	(Dollars in Thousands)			
Within 1 year	$ 109,508	2.98%	$ 113,239	4.41%
Over 1 year to 2 years	15,683	3.43	9,650	4.58
Over 2 years to 3 years	5,036	3.87	3,125	4.57
Over 3 years to 5 years	3,492	4.09	1,589	4.95
	$ 133,719	3.09%	$ 127,603	4.43%

A summary of interest expense on deposits is as follows:

	Years Ended December 31,		
	2002	2001	2000
	(In Thousands)		
Regular	$ 543	$ 737	$ 773
Money market deposits	711	662	582
NOW	52	86	79
Term certificates	4,465	6,660	6,395
	$ 5,771	$ 8,145	$ 7,829

7. FEDERAL HOME LOAN BANK ADVANCES

A summary of advances from the Federal Home Loan Bank of Boston follows:

	December 31,			
	2002		2001	
Maturing During the Year Ending December 31,	Amount	Weighted Average Rate	Amount	Weighted Average Rate
	(Dollars in Thousands)			
2002	$ —	—%	$ 28,500	3.73%
2003	36,000	3.02	14,500	4.66
2004	14,500	4.72	14,500	4.72
2005	18,500	4.71	7,500	5.32
2006	5,125	4.41	3,500	4.00
2007	6,000	5.35	2,000	5.95
Thereafter	26,261	5.33	26,327	5.33
	$ 106,386	4.32%	$ 96,827	4.63%

All borrowings from the Federal Home Loan Bank of Boston are fixed rate and are secured by a blanket lien on “qualified collateral” defined principally as 75% of the carrying value of first mortgage loans on certain owner-occupied residential property. Expected maturities may differ from contractual maturities because certain borrowings, aggregating $29.5 million at December 31, 2002, can be called by the FHLB after an initial specified term.

The Bank also has an available line of credit with the Federal Home Loan Bank of Boston at an interest rate that adjusts daily. Borrowings under this line are limited to $4,633,000 at December 31, 2002.

8. INCOME TAXES

Allocation of federal and state income taxes between current and deferred portions is as follows:

	Years Ended December 31, 2002	2001	2000
		(In Thousands)	
Current tax provision (benefit):			
Federal	$ 2,902	$ 2,617	$ 2,257
State	10	6	(29)
	2,912	2,623	2,228
Deferred tax provision (benefit):			
Federal	152	(18)	(80)
State	26	(6)	(28)
	178	(24)	(108)
	$ 3,090	$ 2,599	$ 2,120

The reasons for the differences between the statutory federal income tax rate and the effective tax rates are summarized as follows:

	Years Ended December 31, 2002	2001	2000
Statutory rate	34.0%	34.0%	34.0%
Increase (decrease) resulting from:			
State taxes, net of federal tax benefit	0.3	—	(0.6)
Other, net	(0.2)	(0.2)	—
Effective tax rate	34.1%	33.8%	33.4%

INCOME TAXES (continued)

The components of the net deferred tax asset are as follows:

	December 31, 2002	December 31, 2001
	(In Thousands)	
Deferred tax assets:		
Federal	$ 972	$ 998
State	335	344
	1,307	1,342
Deferred tax liabilities:		
Federal	(669)	(502)
State	(74)	(47)
	(743)	(549)
Net deferred tax asset	$ 564	$ 793

The tax effects of each type of income and expense item that give rise to deferred taxes are as follows:

	December 31, 2002	December 31, 2001
	(In Thousands)	
Allowance for loan losses	$ 1,077	$ 991
Employee benefits	—	162
Other accrued expenses	79	97
Fees on loans	(175)	(146)
Net unrealized gain on securities available for sale	(399)	(348)
Other	(18)	37
Net deferred tax asset	$ 564	$ 793

A summary of the change in the net deferred tax asset is as follows:

	Years Ended December 31, 2002	2001	2000
	(In Thousands)		
Balance at beginning of year	$ 793	$ 988	$ 1,172
Deferred tax benefit (provision)	(178)	24	108
Deferred tax effects of net unrealized gain on securities available for sale	(51)	(219)	(292)
Balance at end of year	$ 564	$ 793	$ 988

INCOME TAXES (concluded)

Tax reserve for loan losses

The federal income tax reserve for loan losses at the Bank's base year was $3,780,000. If any portion of the reserve is used for purposes other than to absorb loan losses, approximately 150% of the amount actually used, limited to the amount of the reserve, will be subject to taxation in the fiscal year in which used. As the Bank intends to use the reserve only to absorb loan losses, a deferred tax liability of approximately $1,550,000 has not been provided.

9. COMMITMENTS AND CONTINGENCIES

In the normal course of business, there are outstanding commitments and contingencies which are not reflected in the consolidated financial statements.

Loan commitments

The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include unused lines of credit, commitments to originate loans, and standby letters of credit. The instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets.

The Bank's exposure to credit loss in the event of non-performance by the other party to its financial instruments is represented by the contractual amount of these commitments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

At December 31, 2002 and 2001, the following financial instruments were outstanding for which contract amounts represent credit risk:

	December 31,	
	2002	2001
	(In Thousands)	
Unused lines of credit	$ 26,677	$ 18,093
Commitments to originate loans:		
Commercial mortgages	19,054	15,598
Residential mortgages	14,028	13,386
Unadvanced funds on construction loans	9,266	6,872
Standby letters of credit	38	225

Commitments to extend credit are agreements to lend to a customer provided there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the borrower. The commitments to originate loans, unadvanced construction funds, and the majority of unused lines of credit are secured by real estate.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers.

COMMITMENTS AND CONTINGENCIES (concluded)

Employment agreements

The Bank has entered into employment agreements with certain senior executives. The original terms of the agreements are for three or two years and can generally be extended for one year periods. The agreements generally provide for certain lump sum severance payments under certain circumstances, within a one-year period following a "change in control," as defined in the agreements.

Tax contingency

In June 2002, the Bank received a "Notice of Intent to Assess" from the Commonwealth of Massachusetts Department of Revenue ("DOR") and subsequently, in October 2002, received a "Notice of Assessment." The notices indicate that the Bank owes approximately $ 487,000 in additional state taxes, plus interest, for the tax year ended October 31, 2001, related to the denial by the DOR of the Bank's claim of a dividends received deduction for dividends received from the Bank's real estate investment trust subsidiary. The possible assessments relating to all periods, including subsequent periods ending December 31, 2002, are estimated at approximately $1.4 million, after federal tax benefits related to these amounts.

The DOR contends that dividend distributions by the Bank's subsidiary, Hingham Capital Corporation (the "Subsidiary") to the Bank are fully taxable in Massachusetts. The Bank believes that the Massachusetts statute that provides for a dividends received deduction equal to 95% of certain dividend distributions applies to the distributions made by Subsidiary to the Bank. Accordingly, no provision has been made in the Bank's consolidated financial statements as of December 31, 2002 for the amounts assessed or additional amounts that might be assessed in the future. The Bank has appealed the assessment and will pursue all available means to defend its position. Assessed amounts ultimately paid, if any, would be deductible expenses for federal income tax purposes.

In January 2003, retroactive legislation was proposed in Massachusetts which would prohibit the use of the 95 percent dividends received deduction when the dividends are received from a REIT, effective for tax years beginning in 1999.

On March 5, 2003, the governor of Massachusetts signed the legislation. As a result, the Bank has ceased recording the tax benefits associated with the dividends received deduction effective for the 2003 tax year and in March 2003 accrued the aggregate liability of $1.4 million described above. The Bank intends to challenge the retroactive nature of the provision on constitutional and other grounds.

Other legal claims

Other legal claims arise from time to time in the normal course of business, which, in the opinion of management, will have no material effect on the Bank's consolidated financial position.

10. MINIMUM REGULATORY CAPITAL REQUIREMENTS

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Bank's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of its assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined) and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of December 31, 2002 and 2001, that the Bank meets all capital adequacy requirements to which it is subject.

MINIMUM REGULATORY CAPITAL REQUIREMENTS (concluded)

As of December 31, 2002, the most recent notification from the Federal Deposit Insurance Corporation categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the following table. There are no conditions or events since the notification that management believes have changed the Bank's category. The Bank's actual capital amounts and ratios as of December 31, 2002 and 2001 are also presented in the table.

	Actual		Minimum Capital Requirement		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
			(Dollars in Thousands)			
December 31, 2002						
Total Capital to Risk-Weighted Assets	$ 40,238	15.55%	$ 20,698	8.0%	$ 25,872	10.0%
Tier 1 Capital to Risk-Weighted Assets	37,428	14.47	10,349	4.0	15,523	6.0
Tier 1 Capital to Average Assets	37,428	8.89	16,832	4.0	21,040	5.0
December 31, 2001						
Total Capital to Risk-Weighted Assets	$ 35,372	16.16%	$ 17,508	8.0%	$ 21,884	10.0%
Tier 1 Capital to Risk-Weighted Assets	32,862	15.02	8,754	4.0	13,131	6.0
Tier 1 Capital to Average Assets	32,862	8.81	14,926	4.0	18,657	5.0

11. STOCK OPTION PLANS

Under the Bank's 1988 and 1996 stock option plans, options may be granted to officers, other employees, and certain directors as the Stock Option Committee of the Board may determine. A total of 125,000 shares of common stock were reserved for issuance pursuant to options granted under the 1988 plan and a total of 60,000 shares of common stock were reserved for issuance pursuant to options granted under the 1996 plan. Both "incentive options" and "non-qualified options" may be granted under the plans. All options under both plans will have an exercise price per share equal to, or in excess of, the fair market value of a share of common stock at the date the option is granted and will have a maximum option term of 10 years.

Stock option activity is as follows:

	Years Ended December 31,					
	2002		2001		2000	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Shares under option:						
Outstanding at beginning of year	77,000	$ 10.90	83,500	$ 10.90	83,500	$ 10.90
Granted	1,500	29.54	—	—	—	—
Exercised	(20,000)	9.79	(6,500)	10.96	—	—
Outstanding at end of year	58,500	$ 11.75	77,000	$ 10.90	83,500	$ 10.90
Options exercisable at end of year	58,500	$ 11.75	77,000	$ 10.90	83,500	$ 10.90
Weighted average fair value of options granted during the year		$ 6.45		$ —		$ —

The fair value of each option grant is estimated on the date of the grant using the Black-Scholes option pricing model with the following assumptions:

	Years Ended December 31,		
	2002	2001	2000
Dividend yield	2.71%	—	—
Expected life	10 years	—	—
Expected volatility	13.87%	—	—
Risk-free interest rate	5.21%	—	—

Options outstanding consist of the following:

	December 31,			
	2002		2001	
Option price	Shares	Weighted Average Remaining Contractual Life in Years	Shares	Weighted Average Remaining Contractual Life In Years
$29.540	1,500	9	—	—
23.500	1,500	6	1,500	7
16.000	3,000	7	3,000	8
15.000	12,500	7	17,000	8
12.250	4,500	5	4,500	6
9.167	23,500	4	30,000	5
8.500	12,000	3	18,000	4
5.916	—	—	3,000	2
	58,500		77,000	

12. EMPLOYEE BENEFIT PLANS

Pension Plan

The Bank terminated its defined benefit pension plan effective May 31, 2002. During the second quarter of 2002, the Bank recorded a gain of $130,000 from the curtailment of its defined benefit pension plan. The final plan settlement was approved by the IRS in the fourth quarter of 2002, upon which the Bank recorded a settlement gain of $475,000.

The Bank had provided pension benefits for all of its eligible officers and employees through membership in a defined benefit plan of the Savings Banks Employees Retirement Association ("SBERA"). Each employee reaching the age of 21 and having completed at least one year of continuous service and 1,000 hours of service during each twelve-month period beginning with such employee's date of employment became a participant of the Plan. All participants became fully vested after three years of service or age 62 if earlier. Under the Plan, retirement benefits were based on years of credited service, the highest average compensation (as defined), and the primary social security benefit. In addition, employees could make optional, voluntary contributions to the Plan under several methods. The optional contributions provided retirement benefits to the employee in addition to those otherwise available under the Bank's Plan. Annual contributions by the Bank, if required, were based on assessments from SBERA.

Information pertaining to the activity in the plan is as follows:

	Fourteen Months Ended December 31, 2002	Plan Year Ended October 31, 2001
	(In Thousands)	
Change in plan assets:		
Fair value of plan assets at beginning of period	$ 2,861	$ 3,036
Actual return (loss) on plan assets	174	(340)
Employer contribution	—	194
Benefits paid	(2,891)	(29)
Amounts recovered by the Bank	(136)	—
Other	(8)	—
Fair value of plan assets at end of period	—	2,861
Change in benefit obligation:		
Benefit obligation at beginning of period	2,697	2,213
Service cost	136	226
Interest cost	147	171
Amendments	(145)	—
Actuarial loss	56	116
Benefits paid	(2,891)	(29)
Benefit obligation at end of period	—	2,697
Funded status	—	164
Unrecognized net actuarial gain	—	(564)
Unrecognized prior service cost	—	16
Accrued pension cost	$ —	$ (384)

EMPLOYEE BENEFIT PLANS (concluded)

Net periodic pension cost is as follows:

	Fourteen Months Ended December 31, 2002	Plan Years Ended October 31, 2001	2000
		(In Thousands)	
Service cost - benefits earned during year	$ 136	$ 226	$ 205
Interest cost on projected benefits	147	171	147
Expected return on plan assets	(154)	(243)	(204)
Net amortization and deferral	1	3	3
Amortization of net gain	(44)	(84)	(71)
Net periodic pension cost	$ 86	$ 73	$ 80

For the plan years ended October 31, 2002, 2001, and 2000, actuarial assumptions include an assumed discount rate on benefit obligations of 7.00% for 2002, and 7.75% for 2001 and 2000, and an annual salary increase of 5.50% and an expected long-term rate of return on plan assets of 8.00% for all years.

401(k) Plan

The Bank has a 401(k) Plan whereby each employee reaching the age of 21 and having completed at least three months of continuous service and 1,000 hours of service in a twelve-month period, beginning with date of employment, becomes a participant in the Plan. Employees may contribute a percentage of their compensation subject to certain limits based on federal tax laws. Effective January 1, 2000, the Bank matched contributions up to 1% of an employee's compensation. Effective January 1, 2001, the Bank matched contributions up to 2% of an employee's compensation. Effective January 1, 2002 the Bank contributed 3% of an employee's compensation, regardless of the employee's contribution. At May 1, 2002, the Bank matched contributions up to 6% of an employee's compensation, at a rate of 50%. For the years ended December 31, 2002, 2001 and 2000, expense attributable to the Plan amounted to $162,000, $46,000 and $21,000, respectively.

Supplemental Employee Benefit Plans

During 2002, the Bank established supplemental employee retirement plans for the benefit of certain senior executives. Benefits commence at age sixty two, or in the case of one executive, at such earlier time as he may retire, and are to be paid monthly over twenty years. In connection with these plans, the Bank purchased life insurance policies amounting to $7,309,000 and contributed them to a Rabbi Trust. The value of these policies is $7,429,000 at December 31, 2002 and is included in cash value of life insurance on the consolidated balance sheet. In accordance with the agreements, a secular trust was established for each executive into which the Bank makes annual contributions which become the property of the executive. Expense related to these plans amounted to $88,000 for the year ended December 31, 2002. In addition the Bank provides the President of the Bank with a split dollar life insurance policy, for which the Bank pays the annual premium. The total premiums paid will be reimbursed to the Bank at death. For the years ended December 31, 2002, 2001, and 2000, the (income) expense related to this policy amounted to ($7,000), ($1,000), and $3,000 respectively.

13. RELATED PARTY TRANSACTIONS

In the ordinary course of business, the Bank had granted loans to principal officers and directors and their affiliates amounting to $13,000 at December 31, 2002 and $15,000 at December 31, 2001. In 1993, the Bank established a policy whereby new loans (excluding passbook loans) cannot be granted to employees, officers, or directors.

14. FAIR VALUE OF FINANCIAL INSTRUMENTS

SFAS No. 107, "Disclosures about Fair Value of Financial Instruments," requires disclosure of estimated fair values of all financial instruments where it is practicable to estimate such values. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows.

Accordingly, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of the instrument. Statement No. 107 excludes certain financial instruments and all non-financial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Bank.

FAIR VALUE OF FINANCIAL INSTRUMENTS (concluded)

The following methods and assumptions were used by the Bank in estimating fair value disclosures for financial instruments:

Cash and cash equivalents: The carrying amounts of cash, due from banks, and interest-bearing deposits approximate fair values

Certificates of deposit: Fair values for certificates of deposit are based upon quoted market prices.

Securities available for sale: Fair values for securities available for sale are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments.

Federal Home Loan Bank stock: The carrying value of Federal Home Loan Bank stock is deemed to approximate fair value based on the redemption provisions of the Federal Home Loan Bank of Boston.

Loans: For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. Fair values for other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Fair values for non-performing loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

Deposits: The fair values of non-certificate accounts are, by definition, equal to the amount payable on demand at the reporting date which is their carrying amount. Fair values for certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.

Federal Home Loan Bank advances: The fair values of the advances are estimated using discounted cash flow analyses based on the Bank's current incremental borrowing rates for similar types of borrowing arrangements.

Other borrowed funds and mortgagors' escrow accounts: The carrying amounts of other borrowed funds and mortgagors' escrow accounts approximate fair value.

Accrued interest: The carrying amounts of accrued interest approximate fair value.

Off-balance-sheet instruments: Fair values for off-balance-sheet lending commitments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. At December 31, 2002 and 2001, the fair value of commitments outstanding is not significant since fees charged are not material.

The carrying amounts and estimated fair values of the Bank's financial instruments are as follows:

	December 31,			
	2002		2001	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(In Thousands)			
Financial assets:				
Cash and cash equivalents	$ 34,571	$ 34,571	$ 41,157	$ 41,157
Certificates of deposit	1,940	1,991	970	970
Securities available for sale	49,333	49,333	49,619	49,619
Federal Home Loan Bank stock	5,469	5,469	4,841	4,841
Loans, net	320,692	325,235	282,386	286,613
Accrued interest receivable	1,991	1,991	1,978	1,978
Financial liabilities:				
Deposits	275,573	276,565	249,970	251,498
Federal Home Loan Bank advances	106,386	108,990	96,827	96,174
Other borrowed funds	394	394	134	134
Mortgagors' escrow accounts	1,197	1,197	1,088	1,088
Accrued interest payable	426	426	404	404

15. QUARTERLY FINANCIAL DATA (UNAUDITED)

Quarterly results of operations for the years ended December 31, 2002 and 2001 are as follows:

	Years Ended December 31,							
	2002				2001			
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
	(In Thousands, Except Per Share Data)							
Interest and dividend income	$ 6,511	$ 6,452	$ 6,485	$ 6,353	$ 6,422	$ 6,585	$ 6,545	$ 6,489
Interest expense	2,541	2,642	2,594	2,645	2,912	3,146	3,201	3,312
Net interest income	3,970	3,810	3,891	3,708	3,510	3,439	3,344	3,177
Provision for loan losses	(25)	75	75	75	60	60	60	60
Net interest income, after provision for loan losses	3,995	3,735	3,816	3,633	3,450	3,379	3,284	3,117
Other income	815(1)	243	339	209	244	207	217	357
Operating expenses	2,094	1,976	1,903	1,742	1,681	1,649	1,641	1,596
Income before income taxes	2,716	2,002	2,252	2,100	2,013	1,937	1,860	1,878
Income tax provision	946	676	759	709	678	655	631	635
Net income	$ 1,770	$ 1,326	$ 1,493	$ 1,391	$ 1,335	$ 1,282	$ 1,229	$ 1,243
Earnings per common share:								
Basic	$ 0.86	$ 0.64	$ 0.73	$ 0.68	$ 0.65	$ 0.63	$ 0.60	$ 0.61
Diluted	$ 0.85	$ 0.64	$ 0.72	$ 0.67	$ 0.64	$ 0.62	$ 0.59	$ 0.60
Cash dividends declared per common share	$ 0.35(2)	$ 0.17	$ 0.16	$ 0.16	$ 0.31(3)	$ 0.15	$ 0.15	$ 0.15

(1) Includes $475,000 gain on termination of pension plan.

(2) Includes a special dividend of $0.18 per common share declared on November 21, 2002.

(3) Includes a special dividend of $0.16 per common share declared on November 20, 2001.

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Form 10-K
A copy of the Bank's Annual Report on Form 10-K for the fiscal year ended December 31, 2002, as filed with the Federal Deposit Insurance Corporation, may be obtained without charge by any stockholder of the Bank upon written request addressed to the Investor Relations Department.

STOCK DATA

Hingham Institution for Savings' common shares are listed and traded on The Nasdaq Stock Market under the symbol HIFS.

As of December 31, 2002, there were approximately 473 stockholders of record, holding 1,043,521 outstanding shares of common stock. These shares do not include the number of persons who hold their shares in nominee or street name through various brokerage firms.

The following table presents the quarterly high and low bid prices for the Bank's common stock reported by Nasdaq.

	High	Low
2001		
First Quarter	$ 19.00	$ 16.50
Second Quarter	21.90	18.50
Third Quarter	27.00	21.55
Fourth Quarter	24.25	22.25
2002		
First Quarter	26.60	23.60
Second Quarter	31.27	26.50
Third Quarter	29.99	28.35
Fourth Quarter	30.77	28.75

The closing sale price of the Bank's common stock at December 31, 2002 was $29.99 per share.

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South Hingham
37 Whiting Street
Hingham, MA 02043

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