

MERCANTILE BANKSHARES CORP  
Form 10-Q  
November 12, 2002

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

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**FORM 10-Q**

(MARK ONE)

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

For the Quarterly Period Ended September 30, 2002

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 0-5127

**MERCANTILE BANKSHARES CORPORATION**

(Exact name of registrant as specified in its charter)

Maryland

(State or other jurisdiction of  
incorporation or organization)

2 Hopkins Plaza, Baltimore, Maryland

(Address of principal executive offices)

52-0898572

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

21201

(Zip code)

(410) 237-5900

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

**APPLICABLE ONLY TO CORPORATE ISSUERS:**

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practical date. As of October 31, 2002, registrant had outstanding 68,839,527 shares of Common Stock.

**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements (Unaudited)****MERCANTILE BANKSHARES CORPORATION  
CONSOLIDATED BALANCE SHEETS**

| <i>(Dollars in thousands, except per share data)</i>   | <b>September 30,<br/>2002</b> | December 31,<br>2001 | September 30,<br>2001 |
|--|-------------------------------|----------------------|-----------------------|
| <b>ASSETS</b>  |                               |                      |                       |
| Cash and due from banks  | \$ 333,824                    | \$ 290,177           | \$ 275,485            |
| Interest-bearing deposits in other banks   | 358                           | 357                  | 356                   |
| Federal funds sold   | 272,134                       | 23,813               | 122,216               |
|  | <u>606,316</u>                | <u>314,347</u>       | <u>398,057</u>        |
| Total cash and cash equivalents  |                               |                      |                       |
| Investment securities available-for-sale (Note 3)  | 2,411,941                     | 2,288,694            | 1,872,726             |
| Investment securities held-to-maturity (Note 3)  | 52,454                        | 52,269               | 52,558                |
| Loans held-for-sale  | 94                            | 137,950              | 30,273                |
| Loans:   |                               |                      |                       |
| Commercial   | 4,213,108                     | 4,048,018            | 3,996,177             |
| Construction   | 790,318                       | 652,486              | 676,050               |
| Residential real estate  | 1,067,868                     | 1,060,519            | 1,060,857             |
| Consumer   | 1,009,040                     | 991,341              | 1,010,712             |
| Lease financing  | 120,456                       | 153,882              | 156,343               |
|  | <u>7,200,790</u>              | <u>6,906,246</u>     | <u>6,900,139</u>      |
| Total loans  |                               |                      |                       |
| Less: allowance for loan losses  | (136,587)                     | (141,463)            | (141,003)             |
|  | <u>7,064,203</u>              | <u>6,764,783</u>     | <u>6,759,136</u>      |
| Loans, net   |                               |                      |                       |
| Bank premises and equipment, less accumulated depreciation of \$116,687 (2002), \$113,806 (December 2001) and \$110,961 (September 2001) | 102,223                       | 101,295              | 101,762               |
| Other real estate owned, net   | 123                           | 181                  | 195                   |
| Goodwill, net  | 102,705                       | 102,705              | 104,838               |
| Other intangible assets, net   | 7,999                         | 9,319                | 7,296                 |
| Other assets   | 234,816                       | 157,243              | 141,163               |
|  | <u>10,582,874</u>             | <u>9,928,786</u>     | <u>9,468,004</u>      |
| Total assets   |                               |                      |                       |
| <b>LIABILITIES</b>   |                               |                      |                       |
| Deposits:  |                               |                      |                       |
| Noninterest-bearing deposits   | \$ 2,040,521                  | \$ 1,883,878         | \$ 1,789,489          |
| Interest-bearing deposits  | 6,004,976                     | 5,563,494            | 5,458,235             |
|  | <u>8,045,497</u>              | <u>7,447,372</u>     | <u>7,247,724</u>      |
| Total deposits   |                               |                      |                       |
| Short-term borrowings  | 811,840                       | 853,278              | 773,260               |
| Accrued expenses and other liabilities   | 105,803                       | 128,493              | 138,676               |
| Long-term debt   | 289,313                       | 269,437              | 84,200                |
|  | <u>9,252,453</u>              | <u>8,698,580</u>     | <u>8,243,860</u>      |
| Total liabilities  |                               |                      |                       |

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**SHAREHOLDERS EQUITY**

|  |  |  |              |
|--|--|--|--------------|
| Preferred stock, no par value; authorized 2,000,000 shares; issued and outstanding | None   |  |              |
| Common stock, \$2 par value; authorized 130,000,000 shares; issued shares          | 69,612,217 (2002), 69,775,710 (December 2001) and 69,816,937 (September 2001); restricted shares | 67,215 (2002) and None (December and September 2001) |              |
| Capital surplus  | <b>139,224</b>   | 139,551  | 139,634      |
| Retained earnings  | <b>150,592</b>   | 159,947  | 161,820      |
| Accumulated other comprehensive income (loss)                                      | <b>982,408</b>   | 904,479  | 879,802      |
|  | <b>58,197</b>  | 26,229   | 42,888       |
| <b>Total shareholders equity</b>   | <b>1,330,421</b>   | 1,230,206  | 1,224,144    |
| <b>Total liabilities and shareholders equity</b>                                   | <b>\$ 10,582,874</b>   | \$ 9,928,786   | \$ 9,468,004 |

See notes to consolidated financial statements

Mercantile Bankshares Corporation

**MERCANTILE BANKSHARES CORPORATION**  
**STATEMENT OF CONSOLIDATED INCOME**

| <i>(Dollars in thousands, except per share data)</i>       | <i>For the 9 Months Ended<br/>September 30,</i> |            | <i>For the 3 Months Ended<br/>September 30,</i> |            |
|--|---|------------|---|------------|
|  | <b>2002</b>                                     | 2001       | <b>2002</b>                                     | 2001       |
| <b>INTEREST INCOME</b>                                     |   |            |   |            |
| Interest and fees on loans                                 | <b>\$ 352,220</b>                               | \$ 418,998 | <b>\$ 118,398</b>                               | \$ 134,835 |
| Interest and dividends on investment securities:           |   |            |   |            |
| Taxable interest income                                    | <b>73,902</b>                                   | 68,890     | <b>24,695</b>                                   | 22,986     |
| Tax-exempt interest income                                 | <b>1,429</b>                                    | 1,506      | <b>470</b>                                      | 504        |
| Dividends  | <b>800</b>                                      | 984        | <b>258</b>                                      | 304        |
| Other investment income                                    | <b>8,732</b>                                    | 2,494      | <b>2,844</b>                                    | 804        |
|  | <b>84,863</b>                                   | 73,874     | <b>28,267</b>                                   | 24,598     |
| Other interest income                                      | <b>4,039</b>                                    | 5,087      | <b>1,372</b>                                    | 1,611      |
| Total interest income                                      | <b>441,122</b>                                  | 497,959    | <b>148,037</b>                                  | 161,044    |
| <b>INTEREST EXPENSE</b>                                    |   |            |   |            |
| Interest on deposits                                       | <b>94,268</b>                                   | 158,241    | <b>30,659</b>                                   | 49,303     |
| Interest on short-term borrowings                          | <b>9,074</b>                                    | 21,816     | <b>2,834</b>                                    | 5,762      |
| Interest on long-term debt                                 | <b>8,253</b>                                    | 4,425      | <b>2,630</b>                                    | 1,380      |
| Total interest expense                                     | <b>111,595</b>                                  | 184,482    | <b>36,123</b>                                   | 56,445     |
| <b>NET INTEREST INCOME</b>                                 | <b>329,527</b>                                  | 313,477    | <b>111,914</b>                                  | 104,599    |
| Provision for loan losses                                  | <b>11,443</b>                                   | 9,230      | <b>3,244</b>                                    | 3,101      |
| <b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b> | <b>318,084</b>                                  | 304,247    | <b>108,670</b>                                  | 101,498    |
| <b>NONINTEREST INCOME</b>                                  |   |            |   |            |
| Investment and wealth management                           | <b>51,521</b>                                   | 51,888     | <b>17,166</b>                                   | 17,229     |
| Service charges on deposit accounts                        | <b>23,161</b>                                   | 20,457     | <b>7,972</b>                                    | 7,157      |
| Mortgage banking related fees                              | <b>7,395</b>                                    | 7,967      | <b>2,306</b>                                    | 3,106      |
| Investment securities gains and (losses)                   | <b>846</b>                                      | 3,135      | <b>(203)</b>                                    | 1,596      |
| Other income   | <b>24,107</b>                                   | 23,763     | <b>8,145</b>                                    | 8,649      |
| Total noninterest income                                   | <b>107,030</b>                                  | 107,210    | <b>35,386</b>                                   | 37,737     |
| <b>NONINTEREST EXPENSES</b>                                |   |            |   |            |
| Salaries   | <b>97,283</b>                                   | 91,391     | <b>32,278</b>                                   | 31,101     |
| Employee benefits  | <b>25,076</b>                                   | 22,293     | <b>8,476</b>                                    | 7,157      |
| Stock-based compensation expense                           | <b>997</b>                                      | (353)      | <b>177</b>                                      | 185        |
| Net occupancy expense of bank premises                     | <b>12,214</b>                                   | 10,497     | <b>4,245</b>                                    | 3,726      |
| Furniture and equipment expenses                           | <b>18,062</b>                                   | 17,500     | <b>6,003</b>                                    | 5,752      |
| Communications and supplies                                | <b>10,014</b>                                   | 9,852      | <b>3,351</b>                                    | 3,279      |
| Goodwill amortization                                      |   | 6,939      |   | 2,134      |
| Other expenses   | <b>39,112</b>                                   | 36,538     | <b>14,107</b>                                   | 13,253     |

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|   |                   |            |                  |           |
|---|-------------------|------------|------------------|-----------|
| Total noninterest expenses                            | <b>202,758</b>    | 194,657    | <b>68,637</b>    | 66,587    |
| Income before income taxes                            | <b>222,356</b>    | 216,800    | <b>75,419</b>    | 72,648    |
| Applicable income taxes                               | <b>80,621</b>     | 79,739     | <b>26,804</b>    | 26,569    |
| <b>NET INCOME</b>                                     | <b>\$ 141,735</b> | \$ 137,061 | <b>\$ 48,615</b> | \$ 46,079 |
| <b>NET INCOME PER SHARE OF COMMON STOCK (Note 2):</b> |                   |            |                  |           |
| Basic   | <b>\$ 2.03</b>    | \$ 1.93    | <b>\$ .70</b>    | \$ .66    |
| Diluted   | <b>\$ 2.02</b>    | \$ 1.92    | <b>\$ .69</b>    | \$ .65    |

See notes to consolidated financial statements

Mercantile Bankshares Corporation

**MERCANTILE BANKSHARES CORPORATION**  
**STATEMENT OF CONSOLIDATED CASH FLOWS**

| <i>Increase (decrease) in cash and cash equivalents</i><br><i>(Dollars in thousands)</i> | <i>For the 9 Months Ended</i><br><i>September 30,</i> |                  |
|--|---|------------------|
|  | <b>2002</b>   | <b>2001</b>      |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>   |   |                  |
| Net income   | \$ 141,735  | \$ 137,061       |
| Adjustments to reconcile net income to net cash provided by operating activities:        |   |                  |
| Provision for loan losses  | 11,443  | 9,230            |
| Depreciation and amortization  | 9,679   | 9,267            |
| Amortization of goodwill   |   | 6,939            |
| Amortization of other intangible assets  | 1,561   | 1,265            |
| Investment securities (gains) and losses   | (846)   | (3,135)          |
| Write-downs of investments in private equity funds                                       | 2,494   | 619              |
| Write-downs of other real estate owned   | 2   | 36               |
| Gains on sales of other real estate owned  | (51)  | (267)            |
| Gains on sales of buildings  | (456)   | (510)            |
| Net (increase) decrease in assets:   |   |                  |
| Interest receivable  | (2,170)   | 2,337            |
| Other receivables  | (2,999)   | (69)             |
| Other assets   | (16,397)  | (527)            |
| Loans held-for-sale  | 137,856   | (23,678)         |
| Net increase (decrease) in liabilities:  |   |                  |
| Interest payable   | (3,520)   | 290              |
| Accrued expenses   | (5,262)   | (608)            |
| Taxes payable  | (588)   | 45,522           |
| Net cash provided by operating activities  | <u>272,481</u>  | <u>183,772</u>   |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>   |   |                  |
| Proceeds from maturities of investment securities held-to-maturity                       | 2,667   | 3,181            |
| Proceeds from maturities of investment securities available-for-sale                     | 419,357   | 447,892          |
| Proceeds from sales of investment securities available-for-sale                          | 79,253  | 3,135            |
| Purchases of investment securities held-to-maturity                                      | (2,852)   | (4,986)          |
| Purchases of investment securities available-for-sale                                    | (570,227)   | (599,974)        |
| Net increase in customer loans   | (310,983)   | (214,211)        |
| Proceeds from sales of other real estate owned   | 227   | 1,568            |
| Capital expenditures   | (11,126)  | (9,266)          |
| Proceeds from sales of buildings   | 975   | 916              |
| Acquisition of commercial mortgage company   |   | (7,000)          |
| Purchase of bank-owned life insurance  | (50,000)  |                  |
| Other investing activity   | (11,654)  | (2,083)          |
| Net cash used in investing activities  | <u>(454,363)</u>                                      | <u>(380,828)</u> |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>   |   |                  |
| Net increase in noninterest-bearing deposits   | 156,643   | 195,986          |
| Net increase in checking plus interest and savings accounts                              | 398,525   | 131,876          |
| Net increase in certificates of deposit  | 42,957  | 123,321          |
| Net decrease in short-term borrowings  | (41,438)  | (8,208)          |
| Repayment of long-term debt  | (8,300)   | (8,347)          |
| Proceeds from issuance of shares   | 6,566   | 5,733            |
| Repurchase of common shares  | (19,754)  | (61,953)         |
| Dividends paid   | (61,348)  | (58,040)         |

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|  |                   |                   |
|--|-------------------|-------------------|
| Net cash provided by financing activities            | <u>473,851</u>    | <u>320,368</u>    |
| Net increase (decrease) in cash and cash equivalents | <b>291,969</b>    | 123,312           |
| Cash and cash equivalents at beginning of period     | <b>314,347</b>    | 274,745           |
| Cash and cash equivalents at end of period           | <b>\$ 606,316</b> | <b>\$ 398,057</b> |

See notes to consolidated financial statements

Mercantile Bankshares Corporation

**MERCANTILE BANKSHARES CORPORATION**  
**STATEMENT OF CHANGES IN CONSOLIDATED SHAREHOLDERS EQUITY**

**FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2002 AND 2001**

| <i>(Dollars in thousands, except per share data)</i>   | Total                      | Common<br>Stock          | Capital<br>Surplus       | Retained<br>Earnings     | Accumulated Other<br>Comprehensive<br>Income (Loss) |
|--|----------------------------|--------------------------|--------------------------|--------------------------|---|
| BALANCE, DECEMBER 31, 2000   | \$ 1,173,301               | \$ 142,198               | \$ 214,454               | \$ 800,781               | \$ 15,868   |
| Net income   | 137,061                    |                          |                          | 137,061                  |   |
| Unrealized gains (losses) on securities available-for-sale,<br>net of reclassification adjustment, net of taxes          | 27,020                     |                          |                          |                          | 27,020  |
| Comprehensive income   | <u>164,081</u>             |                          |                          |                          |   |
| Cash dividends paid:   |                            |                          |                          |                          |   |
| Common stock (\$.82 per share)   | (58,040)                   |                          |                          | (58,040)                 |   |
| Issuance of 84,817 shares for dividend reinvestment and<br>stock purchase plan   | 3,128                      | 169                      | 2,959                    |                          |   |
| Issuance of 17,546 shares for employee stock purchase<br>dividend reinvestment plan                                      | 684                        | 35                       | 649                      |                          |   |
| Issuance of 115,824 shares for employee stock option<br>plan   | 1,921                      | 232                      | 1,689                    |                          |   |
| Purchase of 1,500,000 shares under stock repurchase<br>plan  | (61,953)                   | (3,000)                  | (58,953)                 |                          |   |
| Vested stock options   | 1,022                      |                          | 1,022                    |                          |   |
| BALANCE, SEPTEMBER 30, 2001  | <u>\$ 1,224,144</u>        | <u>\$ 139,634</u>        | <u>\$ 161,820</u>        | <u>\$ 879,802</u>        | <u>\$ 42,888</u>                                    |
| BALANCE, DECEMBER 31, 2001   | \$ 1,230,206               | \$ 139,551               | \$ 159,947               | \$ 904,479               | \$ 26,229   |
| Net income   | 141,735                    |                          |                          | 141,735                  |   |
| Unrealized gains (losses) on securities available-for-sale,<br>net of reclassification adjustment, net of taxes (Note 7) | 31,968                     |                          |                          |                          | 31,968  |
| Comprehensive income   | <u>173,703</u>             |                          |                          |                          |   |
| Cash dividends paid:   |                            |                          |                          |                          |   |
| Common stock (\$.88 per share)   | (61,348)                   |                          |                          | (61,348)                 |   |
| Issuance of 80,889 shares for dividend reinvestment and<br>stock purchase plan   | 2,889                      | 162                      | 2,727                    |                          |   |
| Issuance of 16,981 shares for employee stock purchase<br>dividend reinvestment plan                                      | 684                        | 34                       | 650                      |                          |   |
| Issuance of 175,922 shares for employee stock option<br>plan   | 2,993                      | 352                      | 2,641                    |                          |   |
| Issuance of 67,215 shares for restricted stock awards  | 3,019                      | 134                      | 2,885                    |                          |   |
| Deferred compensation restricted stock awards  | (2,458)                    |                          |                          | (2,458)                  |   |
| Purchase of 504,500 shares under stock repurchase plan   | (19,754)                   | (1,009)                  | (18,745)                 |                          |   |
| Vested stock options   | 487                        |                          | 487                      |                          |   |
| <b>BALANCE, SEPTEMBER 30, 2002</b>   | <u><b>\$ 1,330,421</b></u> | <u><b>\$ 139,224</b></u> | <u><b>\$ 150,592</b></u> | <u><b>\$ 982,408</b></u> | <u><b>\$ 58,197</b></u>                             |



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See notes to consolidated financial statements

Mercantile Bankshares Corporation

**MERCANTILE BANKSHARES CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. Basis of Presentation**

The consolidated financial statements, which include the accounts of Mercantile Bankshares Corporation (Bankshares) and all of its affiliates, are prepared in conformity with accounting principles generally accepted in the United States of America and follow general practice within the banking industry. In the opinion of management, the consolidated financial statements include all adjustments necessary for a fair presentation of the results for the interim period. These adjustments are of a normal recurring nature and include adjustments to eliminate all significant intercompany transactions. In view of the changing conditions in the national economy, the effect of actions taken by regulatory authorities and normal seasonal factors, the results for the interim period are not necessarily indicative of annual performance. For comparability, certain prior period amounts have been reclassified to conform with current period presentation.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and contingent assets and liabilities at the date of the financial statements, and the disclosure of revenues and expenses during the reporting period. These estimates and assumptions are based on information available as of the date of the financial statements and could differ from actual results.

**2. Earnings Per Share**

Basic earnings per share (EPS) is computed by dividing income available to common shareholders by weighted average common shares outstanding. Diluted EPS is computed using the same components as in basic EPS with the denominator adjusted for the dilutive effect of stock options and restricted stock awards. The following tables provide a reconciliation between the computation of basic EPS and diluted EPS for the nine months and quarters ended September 30, 2002 and 2001:

*For the 9 Months Ended September 30,*

|  | 2002       |                                |         | 2001       |                                |         |
|--|------------|--------------------------------|---------|------------|--------------------------------|---------|
|  | Net Income | Weighted Average Common Shares | EPS     | Net Income | Weighted Average Common Shares | EPS     |
| <i>(In thousands, except per share data)</i>                 |            |                                |         |            |                                |         |
| Basic EPS  | \$ 141,735 | 69,750                         | \$ 2.03 | \$ 137,061 | 70,844                         | \$ 1.93 |
| Dilutive effect of stock options and restricted stock awards |            | 530                            |         |            | 632                            |         |
| Diluted EPS  | \$ 141,735 | 70,280                         | \$ 2.02 | \$ 137,061 | 71,476                         | \$ 1.92 |

*For the 3 Months Ended September 30,*

|  | 2002       |                                |        | 2001       |                                |        |
|--|------------|--------------------------------|--------|------------|--------------------------------|--------|
|  | Net Income | Weighted Average Common Shares | EPS    | Net Income | Weighted Average Common Shares | EPS    |
| <i>(In thousands, except per share data)</i>                 |            |                                |        |            |                                |        |
| Basic EPS  | \$ 48,615  | 69,637                         | \$ .70 | \$ 46,079  | 70,237                         | \$ .66 |
| Dilutive effect of stock options and restricted stock awards |            | 474                            |        |            | 626                            |        |
| Diluted EPS  | \$ 48,615  | 70,111                         | \$ .69 | \$ 46,079  | 70,863                         | \$ .65 |

### 3. Investment Securities

The amortized cost and fair value of investment securities at September 30, 2002, December 31, 2001 and September 30, 2001, are shown below:

| <i>(Dollars in thousands)</i>         | September 30, 2002  |                     | December 31, 2001   |                     | September 30, 2001  |                     |
|---------------------------------------|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
|                                       | Amortized Cost      | Fair Value          | Amortized Cost      | Fair Value          | Amortized Cost      | Fair Value          |
| <b>Securities available-for-sale</b>  |                     |                     |                     |                     |                     |                     |
| U.S. Treasury and government agencies | \$ 2,115,091        | \$ 2,197,283        | \$ 2,029,682        | \$ 2,066,990        | \$ 1,758,252        | \$ 1,815,263        |
| States and political subdivisions     | 549                 | 579                 | 649                 | 667                 | 1,149               | 1,180               |
| Other investments                     | 202,700             | 214,079             | 215,545             | 221,037             | 43,771              | 56,283              |
| <b>Total</b>                          | <b>\$ 2,318,340</b> | <b>\$ 2,411,941</b> | <b>\$ 2,245,876</b> | <b>\$ 2,288,694</b> | <b>\$ 1,803,172</b> | <b>\$ 1,872,726</b> |
| <b>Securities held-to-maturity</b>    |                     |                     |                     |                     |                     |                     |
| States and political subdivisions     | \$ 36,993           | \$ 40,071           | \$ 38,815           | \$ 40,172           | \$ 39,104           | \$ 41,073           |
| Other investments                     | 15,461              | 15,461              | 13,454              | 13,454              | 13,454              | 13,454              |
| <b>Total</b>                          | <b>\$ 52,454</b>    | <b>\$ 55,532</b>    | <b>\$ 52,269</b>    | <b>\$ 53,626</b>    | <b>\$ 52,558</b>    | <b>\$ 54,527</b>    |

### 4. Impaired Loans

A loan is considered impaired, based on current information and events, if it is probable that Bankshares will not collect all principal and interest payments according to the contractual terms of the loan agreement. Generally, a loan is considered impaired once either principal or interest payments become 90 days past due at the end of a calendar quarter. A loan may be considered impaired sooner if, in management's judgment, such action is warranted. The impairment of a loan is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, or the fair value of the collateral if the repayment is expected to be provided predominantly by the underlying collateral. A majority of Bankshares' impaired loans are measured by reference to the fair value of the collateral. Accrued interest on impaired loans is reversed and is recognized on the cash basis. Information with respect to impaired loans and the related valuation allowance (if the measure of the impaired loan is less than the recorded investment) at September 30 and June 30, 2002 and at the end of December 2001, is shown below. See Form 10-K for more details.

| <i>(Dollars in thousands)</i>  | September 30, 2002 | June 30, 2002     | December 31, 2001 |
|--|--------------------|-------------------|-------------------|
| Impaired loans with a specific valuation allowance                           | \$ 14,678          | \$ 20,000         | \$ 47,963         |
| All other impaired loans   | 22,257             | 22,314            | 6,379             |
| <b>Total impaired loans</b>  | <b>\$ 36,935</b>   | <b>\$ 42,314</b>  | <b>\$ 54,342</b>  |
| Specific allowance for loan losses applicable to impaired loans              | \$ 6,494           | \$ 5,209          | \$ 10,484         |
| General allowance for loan losses  | 130,093            | 130,185           | 130,979           |
| <b>Total allowance for loan losses</b>                                       | <b>\$ 136,587</b>  | <b>\$ 135,394</b> | <b>\$ 141,463</b> |
| Year-to-date interest income on impaired loans recorded on the cash basis    | \$ 420             | \$ 274            | \$ 510            |
| Year-to-date average recorded investment in impaired loans during the period | \$ 56,948          | \$ 61,008         | \$ 33,095         |

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|   |    |                   |    |                   |    |                   |
|---|----|-------------------|----|-------------------|----|-------------------|
| Quarter-to-date interest income on impaired loans recorded on the cash basis    | \$ | 146               | \$ | 239               | \$ | 253               |
|   |    | <u>          </u> |    | <u>          </u> |    | <u>          </u> |
| Quarter-to-date average recorded investment in impaired loans during the period | \$ | 48,829            | \$ | 54,777            | \$ | 37,827            |
|   |    | <u>          </u> |    | <u>          </u> |    | <u>          </u> |

**Note:** Impaired loans do not include large groups of smaller balance homogeneous loans that are evaluated collectively for impairment (e.g., residential mortgages and consumer installment loans). The allowance for loan losses related to these loans is included in the allowance for loan losses applicable to other than impaired loans.

**5. Commitments**

Various commitments to extend credit (lines of credit) are made in the normal course of banking business. Total unused lines of credit approximated \$2,888,425,000, \$3,055,291,000 and \$2,803,080,000 at September 30, 2002, December 31, 2001 and

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September 30, 2001, respectively. In addition, letters of credit are issued for the benefit of customers by affiliated banks. Outstanding letters of credit were \$232,921,000 at September 30, 2002, \$197,546,000 at December 31, 2001 and \$194,510,000 at September 30, 2001.

## 6. Intangible Assets

The following table discloses the gross carrying amount and accumulated amortization of intangible assets subject to amortization at September 30, 2002 and December 31, 2001:

| <i>(Dollars in thousands)</i> | September 30, 2002    |                          |                 | December 31, 2001     |                          |                 |
|-------------------------------|-----------------------|--------------------------|-----------------|-----------------------|--------------------------|-----------------|
|                               | Gross Carrying Amount | Accumulated Amortization | Net Amount      | Gross Carrying Amount | Accumulated Amortization | Net Amount      |
| Deposit intangibles           | \$ 13,846             | \$ (6,215)               | \$ 7,631        | \$ 13,846             | \$ (4,899)               | \$ 8,947        |
| Mortgage servicing rights     | 1,600                 | (1,243)                  | 357             | 1,749                 | (1,406)                  | 343             |
| Other                         | 50                    | (39)                     | 11              | 50                    | (21)                     | 29              |
| <b>Total</b>                  | <b>\$ 15,496</b>      | <b>\$ (7,497)</b>        | <b>\$ 7,999</b> | <b>\$ 15,645</b>      | <b>\$ (6,326)</b>        | <b>\$ 9,319</b> |

The aggregate amortization expense was \$1,561,000 for the nine months ended September 30, 2002 and \$2,082,000 for the year ended December 31, 2001. The estimated aggregate amortization expense for each of the next five years is: 2003 \$1,716,000; 2004 \$1,463,000; 2005 \$1,463,000; 2006 \$1,463,000; 2007 \$1,261,000.

## 7. Comprehensive Income

The following table summarizes the related tax effect of unrealized gains (losses) on securities available-for-sale for the nine months ended September 30, 2002 and 2001. The net amount is included in accumulated other comprehensive income (loss) in the Statement of Changes in Consolidated Shareholders' Equity on Page 5.

| <i>(Dollars in thousands)</i>   | <i>For the 9 Months Ended September 30,</i> |                       |                  |                  |                       |                  |
|---|---|-----------------------|------------------|------------------|-----------------------|------------------|
|   | 2002  |                       |                  | 2001             |                       |                  |
|   | Pretax Amount                               | Tax (Expense) Benefit | Net Amount       | Pretax Amount    | Tax (Expense) Benefit | Net Amount       |
| Unrealized gains (losses) on securities available-for-sale:           |   |                       |                  |                  |                       |                  |
| Unrealized holding gains (losses) arising during the period           | \$ 51,629                                   | \$ (19,150)           | \$ 32,479        | \$ 47,224        | \$ (18,309)           | \$ 28,915        |
| Reclassification adjustment for (gains) losses included in net income | (846)                                       | 335                   | (511)            | (3,135)          | 1,240                 | (1,895)          |
| <b>Total</b>  | <b>\$ 50,783</b>                            | <b>\$ (18,815)</b>    | <b>\$ 31,968</b> | <b>\$ 44,089</b> | <b>\$ (17,069)</b>    | <b>\$ 27,020</b> |

## 8. Capital Adequacy

Bankshares and its bank affiliates are subject to various regulatory capital requirements administered by the federal and state banking agencies. These requirements include maintaining certain capital ratios above minimum levels. These capital ratios include Tier I capital and Total risk-based capital as percents of net risk-weighted assets and Tier I capital as a percent of adjusted average total assets (leverage ratio). The minimum ratios for capital adequacy purposes are 4.00%, 8.00% and 4.00%, for the Tier I capital, Total capital and leverage ratios, respectively.

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To be categorized as *well capitalized*, a bank must maintain minimum ratios of 6.00%, 10.00% and 5.00%, for its Tier I capital, Total capital and leverage ratios, respectively. Management believes that, as of September 30, 2002, Bankshares and its bank affiliates exceeded all capital adequacy requirements to which they are subject.

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Capital ratios and the amounts used to calculate them are presented in the following table for Bankshares and Mercantile Safe Deposit & Trust Company (MSD&T), the lead bank, as of September 30, 2002 and December 31, 2001.

| <i>(Dollars in thousands)</i> | September 30, 2002 |            | December 31, 2001 |            |
|-------------------------------|--------------------|------------|-------------------|------------|
|                               | Bankshares         | MSD&T      | Bankshares        | MSD&T      |
| Tier I capital                | \$ 1,161,179       | \$ 427,589 | \$ 1,092,262      | \$ 410,376 |
| Total risk-based capital      | 1,257,027          | 469,684    | 1,185,518         | 451,926    |
| Net risk-weighted assets      | 7,463,392          | 3,353,464  | 7,088,939         | 3,166,865  |
| Adjusted average total assets | 10,185,319         | 4,231,574  | 9,413,946         | 3,853,753  |
| Tier I capital ratio          | 15.56%             | 12.75%     | 15.41%            | 12.96%     |
| Total capital ratio           | 16.84%             | 14.01%     | 16.72%            | 14.27%     |
| Leverage ratio                | 11.40%             | 10.10%     | 11.60%            | 10.65%     |

## 9. Segment Reporting

Operating segments are defined as components of an enterprise about which separate financial information is available that management relies on for decision making and performance assessment. Bankshares has three reportable segments its nineteen Community Banks, the Banking Division of Mercantile Safe Deposit & Trust Company (MSD&T) and the Trust Division of MSD&T.

The following tables present selected segment information for the nine months ended September 30, 2002 and 2001. The components in the Other column consist of amounts for the nonbank affiliates and intercompany eliminations. Certain expense amounts such as operations overhead have been reclassified from internal financial reporting in order to provide for full cost absorption. These reclassifications are shown in the Adjustments line. The amounts reported reflect the merger of The Sparks State Bank into MSD&T.

### For the 9 Months Ended September 30, 2002

| <i>(Dollars in thousands)</i>     | MSD&T<br>Banking | MSD&T<br>Trust | Total<br>MSD&T | Community<br>Banks | Other        | Total         |
|-----------------------------------|------------------|----------------|----------------|--------------------|--------------|---------------|
| Net interest income               | \$ 109,942       | \$             | \$ 109,942     | \$ 221,296         | \$ (1,711)   | \$ 329,527    |
| Provision for loan losses         | (6,800)          |                | (6,800)        | (4,643)            |              | (11,443)      |
| Noninterest income                | 29,987           | 51,195         | 81,182         | 37,375             | (11,527)     | 107,030       |
| Noninterest expenses              | (68,215)         | (32,261)       | (100,476)      | (112,988)          | 10,706       | (202,758)     |
| Adjustments                       | 12,720           | (1,252)        | 11,468         | (6,376)            | (5,092)      |               |
| Income (loss) before income taxes | 77,634           | 17,682         | 95,316         | 134,664            | (7,624)      | 222,356       |
| Income tax (expense) benefit      | (28,045)         | (7,073)        | (35,118)       | (47,035)           | 1,532        | (80,621)      |
| Net income (loss)                 | \$ 49,589        | \$ 10,609      | \$ 60,198      | \$ 87,629          | \$ (6,092)   | \$ 141,735    |
| Average assets                    |                  |                | \$ 4,101,243   | \$ 6,157,184       | \$ (253,236) | \$ 10,005,191 |
| Average equity                    |                  |                | 435,080        | 774,514            | 42,913       | 1,252,507     |

### For the 9 Months Ended September 30, 2001

| <i>(Dollars in thousands)</i> | MSD&T<br>Banking | MSD&T<br>Trust | Total<br>MSD&T | Community<br>Banks | Other    | Total      |
|-------------------------------|------------------|----------------|----------------|--------------------|----------|------------|
| Net interest income           | \$ 107,481       | \$             | \$ 107,481     | \$ 206,368         | \$ (372) | \$ 313,477 |
| Provision for loan losses     | (4,853)          |                | (4,853)        | (4,377)            |          | (9,230)    |
| Noninterest income            | 27,851           | 51,703         | 79,554         | 34,442             | (6,786)  | 107,210    |

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|                                   |                   |                   |                   |                   |                   |                   |
|-----------------------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|
| Noninterest expenses              | (62,863)          | (29,983)          | (92,846)          | (105,961)         | 4,150             | (194,657)         |
| Adjustments                       | 8,849             | (1,381)           | 7,468             | (14,118)          | 6,650             |                   |
|                                   | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> |
| Income (loss) before income taxes | 76,465            | 20,339            | 96,804            | 116,354           | 3,642             | 216,800           |
| Income tax (expense) benefit      | (27,741)          | (8,136)           | (35,877)          | (43,048)          | (814)             | (79,739)          |
|                                   | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> |
| Net income (loss)                 | \$ 48,724         | \$ 12,203         | \$ 60,927         | \$ 73,306         | \$ 2,828          | \$ 137,061        |
|                                   | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> |
| Average assets                    |                   |                   | \$ 3,707,151      | \$ 5,586,602      | \$ (167,130)      | \$ 9,126,623      |
| Average equity                    |                   |                   | 407,806           | 669,512           | 118,132           | 1,195,450         |

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## 10. Derivative Instruments and Hedging Activities

Bankshares maintains an overall interest rate risk management strategy that incorporates the use of derivative instruments to minimize significant unplanned fluctuations in earnings that are caused by interest rate volatility. Derivative instruments that are used as part of the interest rate risk management strategy have been restricted to interest rate swaps. Interest rate swaps generally involve the exchange of fixed-rate and variable-rate interest payments between two parties, based on a common notional principal amount and maturity date. Bankshares has entered into interest rate swaps to convert fixed-rate loans made to borrowers to floating-rate loans and convert its nonprepayable fixed-rate debt to floating-rate debt.

The fair value of derivative instruments was \$13,563,000 at September 30, 2002, recorded in other assets, and \$14,625,000 at December 31, 2001, recorded in accrued expenses and other liabilities. For the nine months ended September 30, 2002, Bankshares recognized a net loss of \$12,000, included in interest and fees on loans, which represented the ineffective portion of the fair-value hedge of fixed-rate loans made to borrowers. For the year ended December 31, 2001, Bankshares recognized a net loss of \$28,000. The fair-value hedge of the nonprepayable fixed-rate debt was 100% effective for the reported periods.

## 11. Accounting Changes

In June 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard (SFAS) No. 141, Business Combinations and SFAS No. 142, Goodwill and Other Intangible Assets. SFAS No. 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. Additionally, it further clarifies the criteria for the initial recognition and measurement of intangible assets separate from goodwill. SFAS No. 142 is effective for fiscal years beginning after December 15, 2001 and prescribes the accounting for goodwill and intangible assets subsequent to initial recognition. The provisions of SFAS No. 142 discontinue the amortization of goodwill and intangible assets with indefinite lives. Instead, these assets will be subject to at least an annual impairment review, and more frequently if certain impairment indicators are in evidence. SFAS No. 142 also requires that reporting units be identified for the purpose of assessing potential future impairments of goodwill.

Mercantile Bankshares Corporation adopted SFAS No. 142 on January 1, 2002. In preparing for its adoption of SFAS No. 142, Bankshares determined its reporting units and the amounts of goodwill and intangible assets to be allocated to those reporting units. Bankshares is not anticipating any reclassifications between goodwill and intangible assets or any changes in the useful lives of intangible assets. Application of the nonamortization provisions of the Statement is expected to result in additional net income of \$8.4 million for the year ended December 31, 2002.

SFAS No. 142 requires that goodwill be tested annually for impairment using a two-step process. The first step, which Bankshares completed during the first half of 2002, is to identify a potential impairment. The second step, which Bankshares will complete by the end of 2002, measures the amount of the impairment loss, if any. Based on current information, Bankshares is not expecting impairment charges for goodwill to impact the 2002 financial statements.

The following table presents a reconciliation of reported net income and earnings per share to amounts adjusted to exclude goodwill amortization, net of tax:

|  | <i>For the 9 Months Ended<br/>September 30,</i> |            | <i>For the 3 Months Ended<br/>September 30,</i> |           |
|--|---|------------|---|-----------|
|  | <b>2002</b>                                     | 2001       | <b>2002</b>                                     | 2001      |
| <i>(Dollars in thousands, except per share data)</i> |   |            |   |           |
| <b>Net income</b>                                    |   |            |   |           |
| Reported   | \$ 141,735                                      | \$ 137,061 | \$ 48,615                                       | \$ 46,079 |
| Add: goodwill amortization                           |   | 6,834      |   | 2,089     |
| Adjusted   | <b>\$ 141,735</b>                               | \$ 143,895 | <b>\$ 48,615</b>                                | \$ 48,168 |
| Reported   | \$ 2.03   | \$ 1.93    | \$ .70  | \$ .66    |
| Add: goodwill amortization                           |   | .10        |   | .03       |
| Adjusted   | <b>\$ 2.03</b>                                  | \$ 2.03    | <b>\$ .70</b>                                   | \$ .69    |

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**Diluted earnings per share**

|                            |         |         |        |        |
|----------------------------|---------|---------|--------|--------|
| Reported                   | \$ 2.02 | \$ 1.92 | \$ .69 | \$ .65 |
| Add: goodwill amortization |         | .09     |        | .03    |
| Adjusted                   | \$ 2.02 | \$ 2.01 | \$ .69 | \$ .68 |

Mercantile Bankshares Corporation

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations****MERCANTILE BANKSHARES CORPORATION****Consolidated Financial Results**

Net income for the quarter ended September 30, 2002 was \$48,615,000, a 5.5% increase from net income of \$46,079,000 for the same period in 2001. For the quarter ended September 30, 2002, diluted net income per share was \$.69, an increase of 6.2% over the \$.65 reported for the third quarter last year. As a result of newly-adopted rules under Generally Accepted Accounting Principles, amortization of goodwill has been discontinued in 2002. Had the same rules been in effect in 2001, net income would have been \$.03 per share higher for the quarter ended September 30, 2001. The higher growth in earnings per share was also attributable to a decline in adjusted weighted average shares outstanding from 70,863,000 for the quarter ended September 30, 2001, to 70,111,000 for the quarter ended September 30, 2002. The decline in shares primarily resulted from activity under the share repurchase program, which had remaining repurchase authorization for 2.4 million shares at September 30, 2002.

For the first nine months of 2002, net income was \$141,735,000, an increase of 3.4% over the \$137,061,000 reported for the comparable period in 2001. Diluted net income per share for the first three quarters of 2002 was \$2.02, a 5.2% increase over the \$1.92 reported for the same period last year. Excluding goodwill amortization, net income would have been \$2.01 for the nine months ending September 30, 2001.

The return on average assets for the third quarter of 2002 was 1.87%, as compared with 2.06% for the third quarter of 2001. The return on average tangible equity was 16.45% and the ratio of average tangible equity to average tangible assets was 11.49% for the third quarter of 2002. For the third quarter 2001, the return on average tangible equity was 17.54% and the ratio of average tangible equity to average tangible assets was 11.88%.

**Net Interest Income and Net Interest Margin**

Net interest income for the quarter ended September 30, 2002 increased 7.0% to \$111,914,000 from \$104,599,000 for the third quarter last year. This represented the best quarterly performance over the prior year since the first quarter 2001, when the Federal Reserve began lowering short-term interest rates. The current quarter reflected a 1.3% growth over the \$110,425,000 reported for the prior quarter this year. The growth in net interest income was attributable to the growth in average earning assets, particularly investment securities. Average earning assets grew to \$9,789,103,000, a 10.8% increase over the previous year's \$8,837,624,000 quarterly average. The net interest margin at 4.60% for the third quarter 2002 was 17 basis points lower than the same quarter last year and 14 basis points lower than the prior quarter this year. The net interest margin was adversely affected by deposit growth that significantly exceeded loan demand. The excess was employed in lower yielding federal funds sold, which increased approximately \$160,000,000 from the prior quarter, accounting for 10 of the 14 basis point decline in the net interest margin.

Net interest income for the first nine months of 2002 increased to \$329,527,000 or 5.1% over the \$313,477,000 for the same period last year. The growth in net interest income was attributable to a 9.7% growth in average earning assets, partially offset by a 22 basis point decline in the net interest margin from 4.90% to 4.68%. See the Analysis of Interest Rates and Interest Differentials on pages 17 and 18 and Rate/Volume Analysis on page 19 for further details.

| <i>(Dollars in thousands)</i> | <i>For the 9 Months Ended September 30,<br/>2002 vs. 2001<br/>Due to variances in</i> |                |              | <i>For the 3 Months Ended September 30,<br/>2002 vs. 2001<br/>Due to variances in</i> |                |              |
|-------------------------------|---|----------------|--------------|---|----------------|--------------|
|                               | <i>Rates</i>  | <i>Volumes</i> | <i>Total</i> | <i>Rates</i>  | <i>Volumes</i> | <i>Total</i> |
| Total interest income         | \$ (97,452)   | \$ 40,339      | \$ (57,113)  | \$ (27,505)   | \$ 14,467      | \$ (13,038)  |
| Total interest expense        | (86,372)  | 13,485         | (72,887)     | (25,618)  | 5,296          | (20,322)     |
| Net interest earned           | \$ (11,080)   | \$ 26,854      | \$ 15,774    | \$ (1,887)  | \$ 9,171       | \$ 7,284     |

Interest income for the quarter decreased \$13,007,000 or 8.1% to \$148,037,000. For the first nine months of 2002, interest income decreased \$56,837,000 or 11.4% to \$441,122,000. On a tax-equivalent basis, interest income for the first nine months

of 2002 decreased \$57,113,000. This decline is attributable to the Federal Reserve's 475 basis point reduction in short-term interest rates last year. Reflective of the Federal Reserve's actions, the tax-equivalent yield on the loan portfolio declined 120 basis points from 7.83% last year to 6.63% in the current quarter and 153 basis points from 8.29% to 6.76% for the first three quarters of 2001 and 2002, respectively. Similarly, the tax-equivalent yield on the investment portfolio declined 75 basis points to 4.76% from 5.51% in the third quarter last year and 88 basis points from 5.78% to 4.90% for the first three quarters 2001 and 2002, respectively. The increase in interest income related to changes in volume is primarily attributable to the investment portfolio, which grew over the prior year by 32.8% and 35.1% for the quarter and nine months, respectively. In contrast, average loans grew by 3.9% and 3.3% for the three and nine months ended September 30, 2002 compared to the same periods last year.

Interest expense for the quarter ended September 30, 2002 decreased \$20,322,000 or 36.0% to \$36,123,000. For the first nine months of 2002, interest expense decreased \$72,887,000 or 39.5% to \$111,595,000. Although interest rates have generally stabilized since the fourth quarter 2001, the repricing upon maturity of longer duration certificates of deposit has continued to reduce interest expense. The average rate paid on time deposits \$100,000 and over during the third quarter 2002 was 3.10%, a decline of 222 basis points from the prior year. For the nine month period, the average rate paid declined 244 basis points to 3.31%. Other time deposits, primarily consumer certificates of deposit, declined 188 basis points and 193 basis points to an average rate paid of 3.39% and 3.65% for the three and nine months ended September 30, 2002, as compared to the same periods last year. Overall, the average rate paid on interest-bearing deposits declined 153 basis points and 171 basis points for the three and nine months ended September 30, 2002 when compared to the prior year. The average rate paid on short-term borrowings declined 168 basis points for the three months ended and 253 basis points for the nine months ended September 30, 2002, respectively. The increase in interest expense due to increased volume for both the quarter and nine months is attributable to the growth in long-term debt, short-term borrowings, savings and money market deposits. Average money market balances increased 32.6% compared to the third quarter 2001, and 30.8% for the nine month period. Comparing this quarter of 2002 with 2001, checking plus interest and savings account balances grew 13.8% and 15.2%, respectively, and the growth was 12.5% and 12.2% for the comparable nine month period.

#### Noninterest Income

| <i>Noninterest Income</i><br><i>(Dollars in thousands)</i> | <i>For the 9 Months Ended September 30,</i><br><i>2002 vs. 2001</i> |             | <i>For the 3 Months Ended September 30,</i><br><i>2002 vs. 2001</i> |              |
|--|---|-------------|---|--------------|
|  | Increase/(Decrease)   |             | Increase/(Decrease)   |              |
|  | Amount  | %           | Amount  | %            |
| Investment and wealth management                           | \$ (367)  | (.7)        | \$ (63)   | (.4)         |
| Service charges on deposit accounts                        | 2,704   | 13.2        | 815   | 11.4         |
| Mortgage banking related fees                              | (572)   | (7.2)       | (800)   | (25.8)       |
| Investments securities gains and (losses)                  | (2,289)   | (73.0)      | (1,799)   | (112.7)      |
| Other income   | 344   | 1.4         | (504)   | (5.8)        |
| <b>Total noninterest income</b>                            | <b>\$ (180)</b>   | <b>(.2)</b> | <b>\$ (2,351)</b>   | <b>(6.2)</b> |

Noninterest income decreased 6.2% to \$35,386,000 for the third quarter 2002 versus the comparable period in 2001. Included in noninterest income was a \$203,000 loss in third quarter 2002 and a \$1,596,000 gain in third quarter 2001 from the sale of investment securities. Excluding the securities gains and losses realized in the third quarter of 2002 and 2001, noninterest income declined 1.5%. Investment and wealth management revenues remained relatively unchanged for the quarter ended September 30, 2002. Mortgage banking revenues decreased 25.8% to \$2,306,000 due to lower volumes in commercial mortgage loan originations and outsourcing of the retail origination business. This quarter also reflects earnings of \$378,000 from the bank-owned life insurance program (BOLI) initiated through two \$25,000,000 investments in July and August. The other income component of noninterest income for the third quarter of 2002 reflects write-downs of investments in third-party private equity funds of \$1,456,000. See the Analysis of Financial Condition section for additional commentary. For the

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first nine months, excluding investment securities gains, noninterest income increased \$2,109,000, or 2.0%. Increased commercial checking and account analysis fees and the BOLI income account for the increase.

### Noninterest Expenses

| <i>Noninterest Expenses</i><br><i>(Dollars in thousands)</i> | <i>For the 9 Months Ended September 30,</i><br><i>2002 vs. 2001</i> |         | <i>For the 3 Months Ended September 30,</i><br><i>2002 vs. 2001</i> |         |
|--|---|---------|---|---------|
|  | Increase/(Decrease)<br>Amount                                       | %       | Increase/(Decrease)<br>Amount                                       | %       |
| Salaries   | \$ 5,892  | 6.4     | \$ 1,177  | 3.8     |
| Employee benefits  | 2,783   | 12.5    | 1,319   | 18.4    |
| Stock-based compensation expense                             | 1,350   | 382.4   | (8)   | (4.3)   |
| Net occupancy expense of bank premises                       | 1,717   | 16.4    | 519   | 13.9    |
| Furniture and equipment expenses                             | 562   | 3.2     | 251   | 4.4     |
| Communications and supplies                                  | 162   | 1.6     | 72  | 2.2     |
| Other expenses   | 2,574   | 7.0     | 854   | 6.4     |
| Noninterest expenses before goodwill amortization            | 15,040  | 8.0     | 4,184   | 6.5     |
| Goodwill amortization  | (6,939)   | (100.0) | (2,134)   | (100.0) |
| Total noninterest expenses                                   | \$ 8,101  | 4.2     | \$ 2,050  | 3.1     |

Noninterest expenses for the quarter ended September 30, 2002, increased 3.1% to \$68,637,000 from \$66,587,000 for the third quarter of 2001. Excluding goodwill amortization, noninterest expenses were \$64,453,000 for the third quarter of 2001. Excluding goodwill amortization, noninterest expenses for the third quarter 2002 increased by 6.5% over the third quarter 2001. Excluding \$1,700,000 in severance expenses related to investment and wealth management reorganization, recorded in the second quarter of 2002, noninterest expenses this quarter increased \$2,407,000 compared to the prior quarter. Other expenses provided the largest increase and included increases in professional fees, charitable contribution expense, and merchant card processing fees. Retiree medical insurance premiums also increased from last quarter. The principal contributor to the year over year increase in expenses was a \$1.3 million or 18.4% increase in employee benefits, primarily due to increases in pension expense and medical costs related to retiree insurance premiums. Net occupancy expense increased \$519,000 or 13.9% to \$4,245,000 for the current quarter from the quarter ending September 2001 due to growth in rent and utility costs. Other noninterest expense increases are a result of higher professional fees and a charitable contribution of appreciated equity securities with a cost of \$177,000. The gifting of these securities lowered the effective tax rate for the quarter.

Noninterest expenses for the first nine months of 2002 increased \$15,040,000, or 8.0%, after excluding the amortization of goodwill in 2001. The increase in expenses was attributable in part, to salaries and benefits related to severance expenses for the investment and wealth management reorganization, as discussed in the previous quarter. Also impacting this period was increased incentive compensation expenses and increased stock compensation related to stock options and restricted stock awards. The prior year's credit was due to directors' deferred compensation, which fluctuates based on the market price of Mercantile's stock. Additionally, the increase in occupancy expense is a function of increases in rental payments, repair and maintenance expenses associated with improvements at some branch locations and insurance costs. Mercantile continued to expand its internal use of its headquarters building causing a reduction in outside tenants in that building.

The efficiency ratio, a key measure of expense management, was 46.10% for year to date 2002 versus 44.49% for the comparable period in 2001.

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## Analysis of Financial Condition

At September 30, 2002, total assets increased 11.8% to \$10,582,874,000 compared to \$9,468,004,000 one year earlier. Compared to the year ended December 31, 2001 at \$9,928,786,000, total assets increased 6.6%. Investment securities increased 28.0% to \$2,464,395,000 compared to \$1,925,284,000 at September 30, 2001. Total loans increased 4.4% to \$7,200,790,000 at September 30, 2002, compared to \$6,900,139,000 at September 30, 2001. The mix of the loan portfolio is relatively consistent, except for the expected decline in leases in the portfolio from 2.3% of outstandings at September 2001 to 2.2% at December 2001 to 1.7% currently.

Included in other assets is the investment in third-party equity investments of \$5,205,000 at September 30, 2002. The total commitment to these investments is \$23,000,000, of which \$9,605,000 has been advanced. These investments are carried at the lower of cost or fair value. Also included in other assets this quarter is the BOLI at cash surrender value of \$50,378,000 funded in July and August of this quarter. The BOLI investment was made to partially fund increasing costs of employee benefits.

Total deposits at September 30, 2002, were \$8,045,497,000 an increase of 11.0% from \$7,247,724,000 at the end of the third quarter 2001, and an 8.0% increase from the end of last year. Interest-bearing deposits were \$6,004,976,000, an increase of 10.0% from September 30, 2001, and a 7.9% increase from the end of 2001. Interest-bearing deposits were 74.6% of total deposits at September 30, 2002, which represented a decrease from the 75.3% at September 30, 2001 and remained relatively unchanged from 74.7% at the end of last year. Noninterest-bearing deposits increased as a percentage of total deposits. Noninterest-bearing deposits were 24.7% of deposits at September 2001, 25.3% at the end of 2001 and 25.4% for the current quarter. Noninterest-bearing deposits increased 14.0% to \$2,040,521,000 as of September 30, 2002, compared to \$1,789,489,000 at September 30, 2001, and increased 8.3% compared to \$1,883,878,000 at December 31, 2001.

Shareholders' equity at September 30, 2002, was \$1,330,421,000, an increase of 8.7% from \$1,224,144,000 at September 30, 2001 and an increase of 8.1% from \$1,230,206,000 at December 31, 2001. The Corporation, having repurchased 504,500 shares year to date, still has prior authorizations enabling it to repurchase up to 2.4 million shares. For more details see the Statement of Changes in Consolidated Shareholders' Equity on page 5.

## Asset Quality

### *Nonperforming Assets*

Nonperforming assets consist of nonaccrual loans, renegotiated loans and other real estate owned (ie., real estate acquired in foreclosure or in lieu of foreclosure). With respect to nonaccrual loans, Bankshares' policy is that, regardless of the value of the underlying collateral and/or guarantees, no interest is accrued on the entire balance once either principal or interest payments on any loan become 90 days past due at the end of a calendar quarter. All accrued and uncollected interest on such loans is eliminated from the income statement and is recognized only as collected. A loan may be put on nonaccrual status sooner than this standard if, in management's judgement, such action is warranted.

During the three months ended September 30, 2002, nonperforming assets declined \$5,701,000 to \$39,640,000. Nonperforming loans, one of the components of nonperforming assets, decreased \$5,761,000 while other real estate owned, the other component increased \$60,000. The decrease in nonperforming loans is a result of successful efforts in collection and sale of collateral. Nonperforming assets as a percent of period-end loans and other real estate owned was .55% at September 30, 2002, .64% at June 30, 2002 and .50% at September 30, 2001, respectively. The current decline resulted from actions taken to address credit quality issues, particularly in the leasing business. The leasing company's portfolio accounted for \$8,114,000 or 20.5% of nonperforming loans at September 30, 2002, as compared to 2.3% of the outstanding portfolio of loans and leases. At June 30, 2002, nonperforming assets in the leasing portfolio were \$10,073,000 or 22.2% of nonperforming loans. As a result of credit quality concerns about the leasing portfolio, management previously announced it was narrowing the focus of the leasing business and discontinuing certain activities. These concerns are reflected in the increased allocation to leasing of the allowance for loan losses, reflected in the 2001 Form 10-K. Excluding the leasing portfolio, nonperforming loans are .44% of period-end loans.

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The level of monitored loans, or loans with characteristics suggesting that they could be classified as nonperforming in the near future, also improved during the quarter. At September 30, 2002, monitored loans were \$1,940,000 compared to \$7,885,000 at June 30, 2002. One monitored loan of \$3,861,000 at June 2002, was moved to nonaccrual/impaired status at September 30, 2002 and a valuation reserve of \$2,894,000 was established.

The level of impaired loans improved during the quarter. Impaired loans are also given nonaccrual or nonperforming status. Impaired loans at September 30, 2002 reflected a net decrease of \$17,407,000 to \$36,935,000, from \$54,342,000 at December 31, 2001. This is largely the result of gross charge-offs of \$18,673,000 this year. At December 31, 2001, 88.3% of the total impaired loans had a valuation allowance, while 47.3% did at June 30, 2002. At September 30, 2002 the percentage has declined to 39.7%. The decline in the ratio at December 31, 2001 to September 30, 2002 was also due to charge-offs. The decline in the portion of loans with a valuation allowance in this quarter is a result of a charge-off taken and a sale of collateral. The loan involved was previously shown as impaired with a valuation allowance and the current balance is now less than the collateral proceeds to be received. Therefore, while the remaining portion of this loan is still nonaccrual and included in impaired, there is no valuation allowance assigned.

The table below presents a comparison of nonperforming assets at September 30 and June 30, 2002 and at the end of December 2001.

| <i>Nonperforming Assets</i><br><i>(Dollars in thousands)</i>                             | <b>September 30,<br/>2002</b> | June 30,<br>2002 | December 31,<br>2001 |
|--|-------------------------------|------------------|----------------------|
| Nonaccrual loans (1)   |                               |                  |                      |
| Commercial   | \$ 30,420                     | \$ 35,764        | \$ 23,284            |
| Construction   | 2,015                         | 2,450            | 2,201                |
| Residential real estate  | 2,325                         | 2,648            | 2,251                |
| Consumer   | 257                           | 317              | 408                  |
| Lease financing  | 4,500                         | 4,099            | 4,775                |
| <b>Total nonaccrual loans</b>  | <b>39,517</b>                 | 45,278           | 32,919               |
| Renegotiated loans (1)   |                               |                  |                      |
| Loans contractually past due 90 days or more and still accruing interest                 |                               |                  |                      |
| <b>Total nonperforming loans</b>   | <b>39,517</b>                 | 45,278           | 32,919               |
| Other real estate owned  | 123                           | 63               | 181                  |
| <b>Total nonperforming assets</b>  | <b>\$ 39,640</b>              | \$ 45,341        | \$ 33,100            |
| <b>Nonperforming assets as a percent of period-end loans and other real estate owned</b> | <b>.55%</b>                   | .64%             | .48%                 |

(1) Aggregate gross interest income of \$2,681,000, \$2,285,000 and \$3,737,000 for the first nine months of 2002, the first six months of 2002 and the year 2001, respectively, on nonaccrual and renegotiated loans, would have been recorded if these loans had been accruing on their original terms throughout the period or since origination if held for part of the period. The amount of interest income on the nonaccrual and renegotiated loans that was recorded totalled \$536,000, \$458,000 and \$1,593,000 for the first nine months of 2002, the first six months of 2002 and the year 2001, respectively.

**Note:** The Corporation was monitoring loans estimated to aggregate \$1,940,000 at September 30, 2002, \$7,885,000 at June 30, 2002 and \$15,940,000 at December 31, 2001, not classified as nonaccrual or renegotiated loans. These loans had characteristics which indicated they might result in such classification in the future.

#### *Allowance and Provision for Loan Losses*

Each Bankshares affiliate is required to maintain an allowance for loan losses adequate to absorb losses inherent in the loan portfolio. Management at each affiliate, along with Bankshares management, maintains a regular overview to assure that adequacy. On a periodic basis, significant credit exposures, nonperforming loans, impaired loans, historical losses by loan type and various statistical measurements of asset quality are examined to assure the adequacy of the allowance for loan losses.

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The allowance for loan losses has been established through provisions for loan losses charged against income. The provision for loan losses for the third quarter of 2002 was \$3,244,000, a 4.6% increase over \$3,101,000 for the same period last year and 36.6% less than last quarter. The provision for the first nine months of 2002 was \$11,443,000, an increase of 24.0% over

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last year's provision of \$9,230,000. Loans deemed uncollectible are charged against the allowance for loan losses and any subsequent recoveries are credited to the allowance. Intensive collection efforts continue after charge-off in order to maximize recovery amounts. Charge-offs were lower in this quarter than the prior year and prior quarter. However, on a year to date basis, charge-offs increased over the prior year. There were no charge-offs related to the leasing business this quarter, but 43.5% of the charge-offs in 2002 were related to the leasing business. Net charge-offs were \$2,051,000 for the third quarter of 2002 compared to \$5,703,000 for the same period in 2001. Net charge-offs for the first three quarters of 2002 were \$16,319,000 compared to \$6,839,000 last year. The allowance for loan losses as a percent of period-end loans was 1.90% at September 30, 2002 and 2.04% at the end of the third quarter last year.

The following table presents a summary of the activity in the Allowance for Loan Losses for the nine months and quarters ended September 30, 2002 and 2001:

| <i>Allowance for Loan Losses</i><br><i>(Dollars in thousands)</i> | <i>For the 9 Months Ended</i><br><i>September 30,</i> |                | <i>For the 3 Months Ended</i><br><i>September 30,</i> |                |
|---|---|----------------|---|----------------|
|   | <b>2002</b>   | 2001           | <b>2002</b>   | 2001           |
| Allowance balance beginning                                       | \$ 141,463  | \$ 138,612     | \$ 135,394  | \$ 143,605     |
| Charge-offs:  |   |                |   |                |
| Commercial  | (11,522)  | (655)          | (2,136)   | (353)          |
| Construction  |   |                |   |                |
| Residential real estate   | (117)   | (71)           | (7)   | (1)            |
| Consumer  | (2,234)   | (2,432)        | (702)   | (907)          |
| Lease financing   | (4,800)   | (5,828)        |   | (5,175)        |
| <b>Total</b>  | <b>(18,673)</b>                                       | <b>(8,986)</b> | <b>(2,845)</b>  | <b>(6,436)</b> |
| Recoveries:   |   |                |   |                |
| Commercial  | 675   | 655            | 158   | 103            |
| Construction  | 148   | 66             | 11  | 37             |
| Residential real estate   | 77  | 85             | 19  | 30             |
| Consumer  | 1,244   | 1,341          | 396   | 563            |
| Lease financing   | 210   |                | 210   |                |
| <b>Total</b>  | <b>2,354</b>  | <b>2,147</b>   | <b>794</b>  | <b>733</b>     |
| Net charge-offs   | (16,319)  | (6,839)        | (2,051)   | (5,703)        |
| Provision for loan losses   | 11,443  | 9,230          | 3,244   | 3,101          |
| Allowance balance ending  | \$ 136,587  | \$ 141,003     | \$ 136,587  | \$ 141,003     |
| Average loans   | \$ 7,041,412  | \$ 6,816,978   | \$ 7,162,156  | \$ 6,890,076   |
| Net charge-offs (annualized) as a percent of average loans        | .31%  | .13%           | .11%  | .33%           |
| Period-end loans  | \$ 7,200,790  | \$ 6,900,139   |   |                |
| Allowance for loan losses as a percent of period-end loans        | 1.90%   | 2.04%          |   |                |

### Cautionary Statement

This report contains forward-looking statements within the meaning of and pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. A forward-looking statement encompasses any estimate, prediction, opinion or statement of belief contained in

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this report, and the underlying management assumptions. Such statements in this report include identification of trends, loan growth, comments on adequacy of the allowance for loan losses, credit quality, changes in leasing activities, impact of FASB pronouncements (including impairment testing of goodwill), effects of asset sensitivity and interest rate changes, and information concerning market risk referenced in Item 3. Forward-looking statements are based on current expectations and assessments of potential developments affecting market conditions, interest rates and other economic conditions, and results may ultimately vary from the statements made in this report.

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## MERCANTILE BANKSHARES CORPORATION

## ANALYSIS OF INTEREST RATES AND INTEREST DIFFERENTIALS

The following table presents the distribution of the average consolidated balance sheets, interest income/expense and annualized yields earned and rates paid through the first nine months of 2002 and 2001.

| <i>(Dollars in thousands)</i>              | <i>For the 9 Months Ended<br/>September 30, 2002</i> |                     |                 | <i>For the 9 Months Ended<br/>September 30, 2001</i> |                     |                 |
|--|--|---------------------|-----------------|--|---------------------|-----------------|
|  | Average<br>Balance                                   | Income*/<br>Expense | Yield*/<br>Rate | Average<br>Balance                                   | Income*/<br>Expense | Yield*/<br>Rate |
| <b>Earning assets</b>                      |  |                     |                 |  |                     |                 |
| Loans:                                     |  |                     |                 |  |                     |                 |
| Commercial                                 | \$ 4,256,364   | \$ 209,810          | 6.59%           | \$ 3,917,090   | \$ 243,750          | 8.32%           |
| Construction                               | 714,563  | 33,139              | 6.20            | 839,682  | 52,195              | 8.31            |
| Residential real estate                    | 1,074,334  | 59,239              | 7.37            | 1,061,458  | 63,665              | 8.02            |
| Consumer                                   | 996,151  | 53,603              | 7.19            | 998,748  | 63,155              | 8.45            |
| <b>Total loans</b>                         | <b>7,041,412</b>                                     | <b>355,791</b>      | <b>6.76</b>     | <b>6,816,978</b>                                     | <b>422,765</b>      | <b>8.29</b>     |
| Federal funds sold, et al                  | 152,041  | 4,028               | 3.54            | 141,591  | 5,073               | 4.79            |
| Securities:**                              |  |                     |                 |  |                     |                 |
| Taxable securities                         |  |                     |                 |  |                     |                 |
| U.S. Treasury securities                   | 1,494,734  | 52,100              | 4.66            | 1,331,986  | 55,096              | 5.53            |
| U.S. Agency securities                     | 583,895  | 21,802              | 4.99            | 300,149  | 13,794              | 6.14            |
| Other stocks and bonds                     | 224,559  | 9,633               | 5.74            | 60,906   | 3,608               | 7.92            |
| Tax-exempt securities                      |  |                     |                 |  |                     |                 |
| States and political subdivisions          | 38,888   | 2,364               | 8.13            | 40,603   | 2,492               | 8.21            |
| <b>Total securities</b>                    | <b>2,342,076</b>                                     | <b>85,899</b>       | <b>4.90</b>     | <b>1,733,644</b>                                     | <b>74,990</b>       | <b>5.78</b>     |
| Interest-bearing deposits in other banks   | 358  | 11                  | 4.21            | 368  | 14                  | 5.12            |
| <b>Total earning assets</b>                | <b>9,535,887</b>                                     | <b>445,729</b>      | <b>6.25</b>     | <b>8,692,581</b>                                     | <b>502,842</b>      | <b>7.73</b>     |
| Cash and due from banks                    | 224,488  |                     |                 | 213,652  |                     |                 |
| Bank premises and equipment, net           | 101,275  |                     |                 | 103,304  |                     |                 |
| Other assets                               | 285,367  |                     |                 | 259,555  |                     |                 |
| Less: allowance for loan losses            | (141,826)  |                     |                 | (142,469)  |                     |                 |
| <b>Total assets</b>                        | <b>\$ 10,005,191</b>                                 |                     |                 | <b>\$ 9,126,623</b>                                  |                     |                 |
| <b>Interest-bearing liabilities</b>        |  |                     |                 |  |                     |                 |
| Deposits:                                  |  |                     |                 |  |                     |                 |
| Savings                                    | \$ 951,952   | 6,630               | .93             | \$ 848,242   | 10,448              | 1.65            |
| Checking plus interest                     | 855,101  | 2,234               | .35             | 759,916  | 4,423               | .78             |
| Money market                               | 1,065,126  | 10,913              | 1.37            | 814,008  | 17,554              | 2.88            |
| Certificates of deposit \$100,000 and over | 1,057,250  | 26,147              | 3.31            | 1,153,200  | 49,631              | 5.75            |
| Other time deposits                        | 1,768,526  | 48,344              | 3.65            | 1,825,978  | 76,185              | 5.58            |
| <b>Total interest-bearing deposits</b>     | <b>5,697,955</b>                                     | <b>94,268</b>       | <b>2.21</b>     | <b>5,401,344</b>                                     | <b>158,241</b>      | <b>3.92</b>     |
| Short-term borrowings                      | 852,070  | 9,074               | 1.42            | 739,080  | 21,816              | 3.95            |
| Long-term debt                             | 280,752  | 8,253               | 3.93            | 89,669   | 4,425               | 6.60            |

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|  |                      |                   |              |              |                   |       |
|--|----------------------|-------------------|--------------|--------------|-------------------|-------|
| Total interest-bearing funds               | <b>6,830,777</b>     | <b>111,595</b>    | <b>2.18</b>  | 6,230,093    | 184,482           | 3.96  |
| Noninterest-bearing deposits               | <b>1,815,090</b>     |                   |              | 1,585,413    |                   |       |
| Other liabilities and accrued expenses     | <b>106,817</b>       |                   |              | 115,667      |                   |       |
| Total liabilities                          | <b>8,752,684</b>     |                   |              | 7,931,173    |                   |       |
| Shareholders' equity                       | <b>1,252,507</b>     |                   |              | 1,195,450    |                   |       |
| Total liabilities and shareholders' equity | <b>\$ 10,005,191</b> |                   |              | \$ 9,126,623 |                   |       |
| Net interest income                        |                      | <b>\$ 334,134</b> |              |              | <b>\$ 318,360</b> |       |
| Net interest rate spread                   |                      |                   | <b>4.07%</b> |              |                   | 3.77% |
| Effect of noninterest-bearing funds        |                      |                   | <b>.61</b>   |              |                   | 1.13  |
| Net interest margin on earning assets      |                      |                   | <b>4.68%</b> |              |                   | 4.90% |
| Taxable-equivalent adjustment included in: |                      |                   |              |              |                   |       |
| Loan income                                |                      | <b>\$ 3,571</b>   |              |              | <b>\$ 3,767</b>   |       |
| Investment securities income               |                      | <b>1,036</b>      |              |              | <b>1,116</b>      |       |
| Total                                      |                      | <b>\$ 4,607</b>   |              |              | <b>\$ 4,883</b>   |       |

\* Presented on a tax-equivalent basis using the statutory federal corporate income tax rate of 35%.

\*\* Balances reported at amortized cost; excludes pretax unrealized gains (losses) on securities available-for-sale.

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## MERCANTILE BANKSHARES CORPORATION

## ANALYSIS OF INTEREST RATES &amp; INTEREST DIFFERENTIALS

The following table presents the distribution of the average consolidated balance sheets, interest income/expense and annualized yields earned and rates paid for the third quarters of 2002 and 2001.

| (Dollars in thousands)                     | For the 3 Months Ended<br>September 30, 2002 |                     |                 | For the 3 Months Ended<br>September 30, 2001 |                     |                 |
|--|--|---------------------|-----------------|--|---------------------|-----------------|
|  | Average<br>Balance                           | Income*/<br>Expense | Yield*/<br>Rate | Average<br>Balance                           | Income*/<br>Expense | Yield*/<br>Rate |
| <b>Earning assets</b>                      |  |                     |                 |  |                     |                 |
| Loans:                                     |  |                     |                 |  |                     |                 |
| Commercial                                 | \$ 4,309,714                                 | \$ 70,450           | 6.49%           | \$ 3,985,579                                 | \$ 78,547           | 7.82%           |
| Construction                               | 769,238                                      | 11,702              | 6.04            | 849,489                                      | 16,162              | 7.55            |
| Residential real estate                    | 1,076,355                                    | 19,518              | 7.19            | 1,049,194                                    | 20,787              | 7.86            |
| Consumer                                   | 1,006,849                                    | 17,954              | 7.07            | 1,005,814                                    | 20,566              | 8.11            |
| <b>Total loans</b>                         | <b>7,162,156</b>                             | <b>119,624</b>      | <b>6.63</b>     | <b>6,890,076</b>                             | <b>136,062</b>      | <b>7.83</b>     |
| Federal funds sold, et al                  | 240,313                                      | 1,369               | 2.26            | 150,013                                      | 1,607               | 4.25            |
| Securities:**                              |  |                     |                 |  |                     |                 |
| Taxable securities                         |  |                     |                 |  |                     |                 |
| U.S. Treasury securities                   | 1,462,968                                    | 16,602              | 4.50            | 1,304,455                                    | 17,647              | 5.37            |
| U.S. Agency securities                     | 663,388                                      | 8,093               | 4.84            | 392,234                                      | 5,339               | 5.40            |
| Other stocks & bonds                       | 221,417                                      | 3,136               | 5.62            | 59,355                                       | 1,149               | 7.68            |
| Tax-exempt securities                      |  |                     |                 |  |                     |                 |
| States & political subdivisions            | 38,503                                       | 778                 | 8.02            | 41,135                                       | 835                 | 8.05            |
| <b>Total securities</b>                    | <b>2,386,276</b>                             | <b>28,609</b>       | <b>4.76</b>     | <b>1,797,179</b>                             | <b>24,970</b>       | <b>5.51</b>     |
| Interest-bearing deposits in other banks   | 358  | 3                   | 3.84            | 356  | 4                   | 4.72            |
| <b>Total earning assets</b>                | <b>9,789,103</b>                             | <b>149,605</b>      | <b>6.06</b>     | <b>8,837,624</b>                             | <b>162,643</b>      | <b>7.30</b>     |
| Cash and due from banks                    | 234,441                                      |                     |                 | 221,736                                      |                     |                 |
| Bank premises and equipment                | 101,131                                      |                     |                 | 102,849                                      |                     |                 |
| Other assets                               | 316,554                                      |                     |                 | 260,892                                      |                     |                 |
| Less: allowance for loan losses            | (137,249)                                    |                     |                 | (144,813)                                    |                     |                 |
| <b>Total assets</b>                        | <b>\$ 10,303,980</b>                         |                     |                 | <b>\$ 9,278,288</b>                          |                     |                 |
| <b>Interest-bearing liabilities</b>        |  |                     |                 |  |                     |                 |
| Deposits:                                  |  |                     |                 |  |                     |                 |
| Savings                                    | \$ 983,806                                   | 2,228               | .90             | \$ 854,026                                   | 3,040               | 1.41            |
| Checking plus interest                     | 872,322                                      | 754                 | .34             | 766,858                                      | 1,191               | .62             |
| Money market                               | 1,140,825                                    | 3,735               | 1.30            | 860,471                                      | 5,519               | 2.54            |
| Certificates of deposit \$100,000 and over | 1,138,356                                    | 8,881               | 3.10            | 1,153,042                                    | 15,455              | 5.32            |
| Other time deposits                        | 1,763,253                                    | 15,061              | 3.39            | 1,814,301                                    | 24,098              | 5.27            |
| <b>Total interest-bearing deposits</b>     | <b>5,898,562</b>                             | <b>30,659</b>       | <b>2.06</b>     | <b>5,448,698</b>                             | <b>49,303</b>       | <b>3.59</b>     |
| Short-term borrowings                      | 833,966                                      | 2,834               | 1.35            | 754,235                                      | 5,762               | 3.03            |
| Long-term debt                             | 275,677                                      | 2,630               | 3.78            | 84,200                                       | 1,380               | 6.50            |

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|  |                      |                   |              |                     |                   |              |
|--|----------------------|-------------------|--------------|---------------------|-------------------|--------------|
| Total interest-bearing funds               | <u>7,008,205</u>     | <u>36,123</u>     | <u>2.04</u>  | <u>6,287,133</u>    | <u>56,445</u>     | <u>3.56</u>  |
| Noninterest-bearing deposits               | <u>1,917,680</u>     |                   |              | <u>1,670,375</u>    |                   |              |
| Other liabilities and accrued expenses     | <u>103,074</u>       |                   |              | <u>125,362</u>      |                   |              |
| Total liabilities                          | <u>9,028,959</u>     |                   |              | <u>8,082,870</u>    |                   |              |
| Shareholders' equity                       | <u>1,275,021</u>     |                   |              | <u>1,195,418</u>    |                   |              |
| Total liabilities & shareholders' equity   | <u>\$ 10,303,980</u> |                   |              | <u>\$ 9,278,288</u> |                   |              |
| Net interest income                        |                      | <u>\$ 113,482</u> |              |                     | <u>\$ 106,198</u> |              |
| Net interest rate spread                   |                      |                   | <u>4.02%</u> |                     |                   | <u>3.74%</u> |
| Effect of noninterest-bearing funds        |                      |                   | <u>.58</u>   |                     |                   | <u>1.03</u>  |
| Net interest margin on earning assets      |                      |                   | <u>4.60%</u> |                     |                   | <u>4.77%</u> |
| Taxable-equivalent adjustment included in: |                      |                   |              |                     |                   |              |
| Loan income                                |                      | <u>\$ 1,226</u>   |              |                     | <u>\$ 1,227</u>   |              |
| Investment securities income               |                      | <u>342</u>        |              |                     | <u>372</u>        |              |
| Total                                      |                      | <u>\$ 1,568</u>   |              |                     | <u>\$ 1,599</u>   |              |

\* Presented on a tax-equivalent basis using the statutory federal corporate income tax rate of 35%.

\*\* Balances reported at amortized cost; excludes pretax unrealized gains (losses) on securities available-for-sale.

Mercantile Bankshares Corporation

## MERCANTILE BANKSHARES CORPORATION

## RATE/VOLUME ANALYSIS

A rate/volume analysis, which demonstrates changes in interest income and expense for significant assets and liabilities, appears below:

| <i>(Dollars in thousands)</i>              | <i>For the 9 Months<br/>Ended September 30,<br/>2002 vs. 2001<br/>Due to variances in</i> |           |             | <i>For the 3 Months<br/>Ended September 30,<br/>2002 vs. 2001<br/>Due to variances in</i> |          |            |
|--|---|-----------|-------------|---|----------|------------|
|  | Rates   | Volumes   | Total       | Rates   | Volumes  | Total      |
| Interest earned on:                        |   |           |             |   |          |            |
| Loans:                                     |   |           |             |   |          |            |
| Commercial (1)                             | \$ (55,052)   | \$ 21,112 | \$ (33,940) | \$ (14,485)   | \$ 6,388 | \$ (8,097) |
| Construction (2)                           | (11,279)  | (7,777)   | (19,056)    | (2,933)   | (1,527)  | (4,460)    |
| Residential real estate                    | (5,198)   | 772       | (4,426)     | (1,807)   | 538      | (1,269)    |
| Consumer                                   | (9,388)   | (164)     | (9,552)     | (2,633)   | 21       | (2,612)    |
| Total loans                                | (80,917)  | 13,943    | (66,974)    | (21,858)  | 5,420    | (16,438)   |
| Taxable securities (3)                     | (15,090)  | 26,127    | 11,037      | (4,437)   | 8,133    | 3,696      |
| Tax-exempt securities (3)                  | (23)  | (105)     | (128)       | (4)   | (53)     | (57)       |
| Federal funds sold, et al                  | (1,419)   | 374       | (1,045)     | (1,205)   | 967      | (238)      |
| Interest-bearing deposits in other banks   | (3)   |           | (3)         | (1)   |          | (1)        |
| Total interest income                      | (97,452)  | 40,339    | (57,113)    | (27,505)  | 14,467   | (13,038)   |
| Interest paid on:                          |   |           |             |   |          |            |
| Savings deposits                           | (5,095)   | 1,277     | (3,818)     | (1,274)   | 462      | (812)      |
| Checking plus interest deposits            | (2,743)   | 554       | (2,189)     | (601)   | 164      | (437)      |
| Money market accounts                      | (12,056)  | 5,415     | (6,641)     | (3,582)   | 1,798    | (1,784)    |
| Certificates of deposit \$100,000 and over | (19,355)  | (4,129)   | (23,484)    | (6,377)   | (197)    | (6,574)    |
| Other time deposits                        | (25,444)  | (2,397)   | (27,841)    | (8,359)   | (678)    | (9,037)    |
| Short-term borrowings                      | (16,077)  | 3,335     | (12,742)    | (3,537)   | 609      | (2,928)    |
| Long-term debt                             | (5,602)   | 9,430     | 3,828       | (1,888)   | 3,138    | 1,250      |
| Total interest expense                     | (86,372)  | 13,485    | (72,887)    | (25,618)  | 5,296    | (20,322)   |
| Net interest earned                        | \$ (11,080)   | \$ 26,854 | \$ 15,774   | \$ (1,887)  | \$ 9,171 | \$ 7,284   |

- (1) Year-to-date tax-equivalent adjustments of \$2,728,000 and \$3,134,000 for 2002 and 2001, respectively and quarter-to-date tax-equivalent adjustments of \$907,000 and \$998,000 for 2002 and 2001, respectively are included in the commercial loan rate variances.
- (2) Year-to-date tax-equivalent adjustments of \$843,000 and \$633,000 for 2002 and 2001, respectively and quarter-to-date tax-equivalent adjustments of \$319,000 and \$229,000 for 2002 and 2001, respectively are included in the construction loan rate variances.
- (3) Year-to-date tax-equivalent adjustments of \$1,036,000 and \$1,116,000 for 2002 and 2001, respectively and quarter-to-date tax-equivalent adjustments of \$342,000 and \$372,000 for 2002 and 2001, respectively are included in the investment securities rate variances.

## Item 3. Quantitative and Qualitative Disclosures About Market Risk

Information responsive to this Item as of December 31, 2001 appears under the captions "Asset/Liability and Liquidity Management", "Interest Rate Sensitivity Analysis" and "Earnings Simulation Model Projections" on pages 21-23 of the registrant's 2001 Annual Report to Shareholders, filed as Exhibit 13 to registrant's Annual Report on Form 10-K for the year ended December 31, 2001. There was no material change in such information as of September 30, 2002.

**Item 4. Controls and Procedures**

Within the ninety days prior to the filing of this report, the Company's management, under the supervision and with the participation of the Company's Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design

Mercantile Bankshares Corporation



and operation of the Company's disclosure controls and procedures. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective. There were no significant changes in the Company's internal controls or in other factors subsequent to the date of the evaluation that could significantly affect those controls.

**PART II. OTHER INFORMATION**

**Item 5. Other Information**

The 2003 Annual Meeting of Stockholders of the registrant is expected to be held on April 30, 2003.

**Item 6. Exhibits and Reports on Form 8-K**

(a) Exhibits

- 3 A (15). Certificate of Correction effective July 3, 2002, concerning Articles of Amendment effective May 8, 1986.
- 3 A (16). Certificate of Correction effective July 3, 2002, concerning Articles of Amendment effective April 26, 1990.
- 99.1 Certification of Chief Executive Officer
- 99.2 Certification of Chief Financial Officer

(b) Reports on Form 8-K

Form 8-K filed, dated July 19, 2002, Item 5.

Mercantile Bankshares Corporation

**SIGNATURES**

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

**MERCANTILE BANKSHARES CORPORATION**

November 8, 2002

Principal Executive Officer

/s/ Edward J. Kelly, III

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By: Edward J. Kelly, III  
President and  
Chief Executive Officer

November 8, 2002

Principal Financial Officer

/s/ Terry L. Troupe

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By: Terry L. Troupe  
Chief Financial Officer

November 8, 2002

Chief Accounting Officer

/s/ Diana E. Nelson

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By: Diana E. Nelson  
Controller and Chief Accounting Officer

Mercantile Bankshares Corporation

I, Edward J. Kelly, III, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Mercantile Bankshares Corporation:
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officer and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weakness.

/s/ EDWARD J. KELLY, III

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**Edward J. Kelly, III**  
**President and Chief Executive Officer**

Mercantile Bankshares Corporation

I, Terry L. Troupe, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Mercantile Bankshares Corporation:
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officer and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weakness.

/s/ TERRY L. TROUPE

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**Terry L. Troupe**  
**Chief Financial Officer and Treasurer**

Mercantile Bankshares Corporation