

PATRIOT NATIONAL BANCORP INC
Form 10-Q
November 14, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the Quarter Ended September 30, 2006

Commission file number 000-29599

PATRIOT NATIONAL BANCORP, INC.
(Exact name of registrant as specified in its charter)

Connecticut
(State of incorporation)

06-1559137
(I.R.S. Employer Identification Number)

900 Bedford Street, Stamford, Connecticut 06901
(Address of principal executive offices)

(203) 324-7500
(Registrant's telephone number)

Check whether the registrant (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days:

Yes No

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

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer:

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer

State the number of shares outstanding of each of the registrant's classes of common equity, as of the latest practicable date.

Common stock, \$2.00 par value per share, 4,739,494 shares issued and outstanding as of the close of business October 31, 2006.

Transitional Disclosure Format (check one): Yes No

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PART I - FINANCIAL INFORMATION**Item 1. Consolidated Financial Statements****PATRIOT NATIONAL BANCORP, INC.
CONSOLIDATED BALANCE SHEETS
(Unaudited)**

| | September 30, 2006 | December 31, 2005 |
|---|-----------------------|-----------------------|
| ASSETS | | |
| Cash and due from banks | \$ 6,494,390 | \$ 7,220,577 |
| Federal funds sold | 38,500,000 | 6,500,000 |
| Short term investments | 30,249,645 | 2,247,028 |
| Cash and cash equivalents | 75,244,035 | 15,967,605 |
| Available for sale securities (at fair value) | 68,740,162 | 78,672,068 |
| Federal Reserve Bank stock | 1,022,950 | 1,022,300 |
| Federal Home Loan Bank stock | 2,727,200 | 1,296,700 |
| Loans receivable (net of allowance for loan losses: 2006 \$5,630,432; 2005 \$4,588,335) | 455,001,231 | 364,243,777 |
| Accrued interest receivable | 3,202,246 | 2,445,417 |
| Premises and equipment | 2,670,878 | 2,474,153 |
| Deferred tax asset, net | 2,522,801 | 2,675,595 |
| Goodwill | 930,091 | 930,091 |
| Other assets | 1,763,811 | 913,456 |
| Total assets | \$ 613,825,405 | \$ 470,641,162 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Liabilities | | |
| Deposits: | | |
| Noninterest bearing deposits | \$ 50,928,672 | \$ 48,797,389 |
| Interest bearing deposits | 453,575,146 | 370,277,899 |
| Total deposits | 504,503,818 | 419,075,288 |
| Federal Home Loan Bank borrowings | 34,000,000 | 9,000,000 |
| Junior subordinated debt owed to unconsolidated trust | 8,248,000 | 8,248,000 |
| Accrued expenses and other liabilities | 3,743,998 | 2,943,259 |
| Total liabilities | 550,495,816 | 439,266,547 |
| Shareholders' equity | | |
| Preferred stock: 1,000,000 shares authorized; no shares issued | | |
| Common stock, \$2 par value: 60,000,000 shares authorized; shares issued and outstanding: 2006 - 4,739,494; 2005 - 3,230,649 | 9,478,988 | 6,461,298 |
| Additional paid in capital | 49,307,949 | 21,709,224 |
| Retained earnings | 5,397,507 | 4,308,242 |
| Accumulated other comprehensive income - net unrealized loss on available for sale securities, net of taxes | (854,855) | (1,104,149) |
| Total shareholders' equity | 63,329,589 | 31,374,615 |
| Total liabilities and shareholders' equity | \$ 613,825,405 | \$ 470,641,162 |

See accompanying notes to consolidated financial statements.

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PATRIOT NATIONAL BANCORP, INC.
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|------------------|------------------------------------|-------------------|
| | 2006 | 2005 | 2006 | 2005 |
| Interest and Dividend Income | | | | |
| Interest and fees on loans | \$ 8,962,195 | \$ 5,536,477 | \$ 24,472,546 | \$ 15,128,669 |
| Interest and dividends | | | | |
| on investment securities | 743,068 | 814,647 | 2,290,737 | 2,483,631 |
| Interest on federal funds sold | 151,591 | 88,134 | 286,255 | 230,460 |
| Total interest and dividend income | 9,856,854 | 6,439,258 | 27,049,538 | 17,842,760 |
| Interest Expense | | | | |
| Interest on deposits | 4,152,620 | 2,514,851 | 10,834,245 | 6,543,197 |
| Interest on Federal Home Loan Bank borrowings | 491,319 | 80,024 | 1,099,124 | 303,485 |
| Interest on subordinated debt | 177,013 | 136,924 | 497,680 | 380,267 |
| Interest on other borrowings | 648 | 1,312 | 4,798 | 1,312 |
| Total interest expense | 4,821,600 | 2,733,111 | 12,435,847 | 7,228,261 |
| Net interest income | 5,035,254 | 3,706,147 | 14,613,691 | 10,614,499 |
| Provision for Loan Losses | 116,500 | 350,000 | 1,040,000 | 710,000 |
| Net interest income after provision for loan losses | 4,918,754 | 3,356,147 | 13,573,691 | 9,904,499 |
| Noninterest Income | | | | |
| Mortgage brokerage referral fees | 373,299 | 673,029 | 1,052,937 | 1,648,487 |
| Loan processing fees | 64,862 | 125,635 | 218,712 | 308,978 |
| Fees and service charges | 166,749 | 143,793 | 455,159 | 428,195 |
| Other income | 27,653 | 43,125 | 117,349 | 131,818 |
| Total noninterest income | 632,563 | 985,582 | 1,844,157 | 2,517,478 |
| Noninterest Expenses | | | | |
| Salaries and benefits | 2,795,341 | 2,393,739 | 7,709,120 | 6,652,635 |
| Occupancy and equipment expense, net | 694,925 | 538,645 | 2,030,499 | 1,523,961 |
| Data processing and other outside services | 293,358 | 333,024 | 1,100,622 | 817,291 |
| Professional services | 125,269 | 120,170 | 373,227 | 383,461 |
| Advertising and promotional expenses | 152,906 | 112,459 | 448,772 | 336,206 |
| Loan administration and processing expenses | 46,286 | 47,839 | 126,759 | 153,511 |
| Other noninterest expenses | 382,594 | 324,142 | 1,135,477 | 1,010,924 |
| Total noninterest expenses | 4,490,679 | 3,870,018 | 12,924,476 | 10,877,989 |

| | | | | |
|-----------------------------------|-------------------|-------------------|---------------------|-------------------|
| Income before income taxes | 1,060,638 | 471,711 | 2,493,372 | 1,543,988 |
| Provision for Income Taxes | 390,000 | 191,000 | 916,000 | 625,000 |
| Net income | \$ 670,638 | \$ 280,711 | \$ 1,577,372 | \$ 918,988 |
| Basic income Per Share | \$ 0.20 | \$ 0.11 | \$ 0.49 | \$ 0.37 |
| Diluted income Per Share | \$ 0.20 | \$ 0.11 | \$ 0.48 | \$ 0.36 |
| Dividends per share | \$ 0.045 | \$ 0.040 | \$ 0.130 | \$ 0.115 |

See accompanying notes to consolidated financial statements.

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PATRIOT NATIONAL BANCORP, INC
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(Unaudited)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|-------------------|------------------------------------|-------------------|
| | 2006 | 2005 | 2006 | 2005 |
| Net income | \$ 670,638 | \$ 280,711 | \$ 1,577,372 | \$ 918,988 |
| Unrealized holding gains (losses) on securities: | | | | |
| Unrealized holding gains (losses) arising during the period, net of taxes | 520,829 | (284,657) | 249,294 | (461,446) |
| Comprehensive income (loss) | \$ 1,191,467 | \$ (3,946) | \$ 1,826,666 | \$ 457,542 |

See accompanying notes to consolidated financial statements.

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PATRIOT NATIONAL BANCORP, INC.
CONSOLIDATED STATEMENTS OF SHAREHOLDER'S EQUITY
(Unaudited)

| | Number of Shares | Common Stock | Additional Paid-In Capital | Retained Earnings | Accumulated Other Comprehensive Loss | Total |
|---|---------------------|-----------------|----------------------------------|----------------------|---|---------------|
| Nine months ended September 30, 2005 | | | | | | |
| Balance at December 31, 2004 | 2,486,391 | \$ 4,972,782 | \$ 11,830,173 | \$ 3,346,718 | \$ (393,239) | \$ 19,756,434 |
| Comprehensive income | | | | | | |
| Net income | | | | 918,988 | | 918,988 |
| Unrealized holding loss on available for sale securities, net of taxes | | | | | (461,446) | (461,446) |
| Total comprehensive income | | | | | | 457,542 |
| Dividends | | | | (315,876) | | (315,876) |
| Issuance of capital stock | 742,883 | 1,485,766 | 9,859,905 | | | 11,345,671 |
| Balance, September 30, 2005 | 3,229,274 | \$ 6,458,548 | \$ 21,690,078 | \$ 3,949,830 | \$ (854,685) | \$ 31,243,771 |
| Nine months ended September 30, 2006 | | | | | | |
| Balance at December 31, 2005 | 3,230,649 | \$ 6,461,298 | \$ 21,709,224 | \$ 4,308,242 | \$ (1,104,149) | \$ 31,374,615 |
| Comprehensive income | | | | | | |
| Net income | | | | 1,577,372 | | 1,577,372 |
| Unrealized holding gain on available for sale securities, net of taxes | | | | | 249,294 | 249,294 |
| Total comprehensive income | | | | | | 1,826,666 |
| Dividends | | | | (488,107) | | (488,107) |
| Issuance of capital stock | 1,508,845 | 3,017,690 | 27,598,725 | | | 30,616,415 |
| Balance, September 30, 2006 | 4,739,494 | \$ 9,478,988 | \$ 49,307,949 | \$ 5,397,507 | \$ (854,855) | \$ 63,329,589 |

See accompanying notes to consolidated financial statements.

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PATRIOT NATIONAL BANCORP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

| | Nine Months Ended September 30, | |
|---|------------------------------------|---------------------|
| | 2006 | 2005 |
| Cash Flows from Operating Activities | | |
| Net income | \$ 1,577,372 | \$ 918,988 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Amortization and accretion of investment premiums and discounts, net | 181,110 | 298,196 |
| Provision for loan losses | 1,040,000 | 710,000 |
| Depreciation and amortization | 461,119 | 441,315 |
| Directors fees paid by issuance of common stock | 24,928 | - |
| Changes in assets and liabilities: | | |
| Increase (decrease) in deferred loan fees | 348,296 | (86,946) |
| Increase in accrued interest receivable | (756,829) | (483,283) |
| Increase in other assets | (16,015) | (51,068) |
| Increase in accrued expenses and other liabilities | 716,689 | 257,407 |
| Net cash provided by operating activities | 3,576,670 | 2,004,609 |
| Cash Flows from Investing Activities | | |
| Purchases of available for sale securities | - | (28,208,360) |
| Principal repayments on available for sale securities | 10,152,884 | 16,282,227 |
| Proceeds from maturities of available for sale securities | - | 2,000,000 |
| Purchase of Federal Reserve Bank Stock | (650) | (600) |
| Purchase of Federal Home Loan Bank Stock | (1,430,500) | - |
| Net increase in loans | (92,980,090) | (77,737,980) |
| Purchases of bank premises and equipment | (657,844) | (748,767) |
| Net cash used in investing activities | (84,916,200) | (88,413,480) |
| Cash Flows from Financing Activities | | |
| Net decrease in demand, savings and money market deposits | (5,181,818) | (5,742,167) |
| Net increase in time certificates of deposits | 90,610,348 | 48,505,111 |
| Proceeds from FHLB borrowings | 93,718,000 | 36,001,000 |
| Principal repayments of FHLB borrowings | (68,718,000) | (40,001,000) |
| Proceeds from issuance of common stock | 30,591,487 | 11,345,671 |
| Dividends paid on common stock | (404,057) | (273,729) |
| Net cash provided by financing activities | 140,615,960 | 49,834,886 |
| Net increase (decrease) in cash and cash equivalents | 59,276,430 | (36,573,985) |
| Cash and cash equivalents | | |
| Beginning | 15,967,605 | 55,630,466 |
| Ending | \$ 75,244,035 | \$ 19,056,481 |

PATRIOT NATIONAL BANCORP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS, Continued
(Unaudited)

| | Nine Months Ended September 30, | |
|---|------------------------------------|--------------|
| | 2006 | 2005 |
| Supplemental Disclosures of Cash Flow Information | | |
| Cash paid for: | | |
| Interest | \$ 12,355,752 | \$ 7,241,149 |
| Income taxes | \$ 1,319,020 | \$ 780,921 |
| Supplemental disclosures of noncash investing and financing activities: | | |
| Transfer of held to maturity securities to available for sale securities | \$ - | \$ - |
| Transfer of loans to other real estate owned | \$ 834,341 | \$ - |
| Unrealized holding gain (loss) on available for sale securities arising during the period | \$ 402,088 | \$ (744,270) |
| Dividends declared on common stock | \$ 213,277 | \$ 129,171 |

See accompanying notes to consolidated financial statements.

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PATRIOT NATIONAL BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Note 1. Basis of Financial Statement Presentation

The Consolidated Balance Sheet at December 31, 2005 has been derived from the audited financial statements of Patriot National Bancorp, Inc. ("Bancorp") at that date, but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements.

The accompanying unaudited financial statements and related notes have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted. The accompanying consolidated financial statements and related notes should be read in conjunction with the audited financial statements of Bancorp and notes thereto for the year ended December 31, 2005.

The information furnished reflects, in the opinion of management, all normal recurring adjustments necessary for a fair presentation of the results for the interim periods presented. The results of operations for the three and nine months ended September 30, 2006 are not necessarily indicative of the results of operations that may be expected for the remainder of 2006.

Certain 2005 amounts have been reclassified to conform to the 2006 presentation. Such reclassifications had no effect on net income.

Note 2. Investments

The following table is a summary of Bancorp's available for sale securities portfolio, at fair value, at the dates shown:

| | September 30, 2006 | December 31, 2005 |
|---|-----------------------|----------------------|
| U.S. Government Agency and sponsored agency obligations | \$ 16,539,324 | \$ 16,476,684 |
| Mortgage-backed securities | 46,200,838 | 56,195,384 |
| Money market preferred equity securities | 6,000,000 | 6,000,000 |
| Total Available For Sale Securities | \$ 68,740,162 | \$ 78,672,068 |

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The amortized cost, gross unrealized gains, gross unrealized losses and fair values of available for sale securities at September 30, 2006 are as follows:

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|-------------------|------------------------------|-------------------------------|---------------|
| U. S. Government Agency and sponsored agency obligations | \$ 16,999,725 | \$ - | \$ (460,401) | \$ 16,539,324 |
| Mortgage-backed securities | 47,119,234 | 7,435 | (925,831) | 46,200,838 |
| Money market preferred equity securities | 6,000,000 | - | - | 6,000,000 |
| Total Available For Sale Securities | \$ 70,118,959 | \$ 7,435 | \$ (1,386,232) | \$ 68,740,162 |

At September 30, 2006, gross unrealized holding gains and gross unrealized holding losses on available for sale securities totaled \$7,435 and \$1.4 million respectively. Of the securities with unrealized losses, there are nine U. S. Government agency or sponsored agency obligations and 29 mortgage-backed securities that have unrealized losses for a period in excess of twelve months with a combined current unrealized loss of \$1.4 million. Management does not believe that any of the unrealized losses are other than temporary since they are the result of changes in the interest rate environment and they relate to debt and mortgage-backed securities issued by U. S. Government and U.S. Government sponsored agencies. Bancorp has the ability to hold these securities to maturity if necessary and expects to receive all contractual principal and interest related to these investments.

Note 3. Loans

The following table is a summary of Bancorp's loan portfolio at the dates shown:

| | September 30, 2006 | December 31, 2005 |
|-----------------------------|-----------------------|----------------------|
| Real Estate | | |
| Commercial | \$ 153,846,478 | \$ 129,178,889 |
| Residential | 91,985,593 | 77,391,833 |
| Construction | 171,200,552 | 107,232,587 |
| Commercial | 16,597,015 | 15,591,818 |
| Consumer installment | 1,237,842 | 1,106,648 |
| Consumer home equity | 26,936,900 | 39,097,450 |
| Total Loans | 461,804,380 | 369,599,225 |
| Premiums on purchased loans | 310,183 | 367,491 |
| Net deferred fees | (1,482,900) | (1,134,604) |
| Allowance for loan losses | (5,630,432) | (4,588,335) |
| Loans receivable, net | \$ 455,001,231 | \$ 364,243,777 |

Analysis of Allowance for Loan Losses

The changes in the allowance for loan losses for the periods shown are as follows:

| <i>(Thousands of dollars)</i> | Three months ending September 30, | | Nine months ending September 30, | |
|---|--------------------------------------|----------|-------------------------------------|----------|
| | 2006 | 2005 | 2006 | 2005 |
| Balance at beginning of period | \$ 5,510 | \$ 3,842 | \$ 4,588 | \$ 3,482 |
| Charge-offs | - | - | (1) | - |
| Recoveries | 3 | - | 3 | - |
| Net recoveries | 3 | - | 2 | - |
| Provision charged to operations | 117 | 350 | 1,040 | 710 |
| Balance at end of period | \$ 5,630 | \$ 4,192 | \$ 5,630 | \$ 4,192 |
| Ratio of net recoveries during the period to average loans outstanding during the period. | 0.00% | 0.00% | 0.00% | 0.00% |

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Note 4. Deposits

The following table is a summary of Bancorp's deposits at the dates shown:

| | September 30, 2006 | December 31, 2005 |
|--|-----------------------|----------------------|
| Noninterest bearing | \$ 50,928,672 | \$ 48,797,389 |
| Interest bearing | | |
| NOW | 33,370,486 | 25,383,234 |
| Savings | 23,804,913 | 20,089,889 |
| Money market | 38,783,395 | 57,798,772 |
| Time certificates, less than \$100,000 | 223,831,363 | 168,565,756 |
| Time certificates, \$100,000 or more | 133,784,989 | 98,440,248 |
| Total interest bearing | 453,575,146 | 370,277,899 |
| Total Deposits | \$ 504,503,818 | \$ 419,075,288 |

Note 5. Borrowings

In addition to the outstanding borrowings disclosed in the consolidated balance sheet, the Bank has the ability to borrow approximately \$78.6 million in additional advances from the Federal Home Loan Bank of Boston which includes a \$2.0 million overnight line of credit. The Bank also has arranged a \$3.0 million overnight line of credit from a correspondent bank and \$10.0 million under a repurchase agreement; no amounts were outstanding under these two arrangements at September 30, 2006.

Note 6. Income per share

Bancorp is required to present basic income per share and diluted income per share in its income statements. Basic income per share amounts are computed by dividing net income by the weighted average number of common shares outstanding. Diluted income per share reflects additional common shares that would have been outstanding if potential dilutive common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. Potential common shares that may be issued by Bancorp relate to outstanding stock options and are determined using the treasury stock method. Bancorp is also required to provide a reconciliation of the numerator and denominator used in the computation of both basic and diluted income per share. The following is information about the computation of income per share for the three and nine months ended September 30, 2006 and 2005.

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Quarter ended September 30, 2006

| | Net Income | Shares | Amount |
|--|------------|-----------|---------|
| Basic Income Per Share | | | |
| Income available to common shareholders | \$ 670,638 | 3,271,472 | \$ 0.20 |
| Effect of Dilutive Securities | | | |
| Warrants/Stock Options outstanding | - | 25,188 | - |
| Diluted Income Per Share | | | |
| Income available to common shareholders plus assumed conversions | \$ 670,638 | 3,296,660 | \$ 0.20 |

Quarter ended September 30, 2005

| | Net Income | Shares | Amount |
|--|------------|-----------|---------|
| Basic Income Per Share | | | |
| Income available to common shareholders | \$ 280,711 | 2,573,139 | \$ 0.11 |
| Effect of Dilutive Securities | | | |
| Warrants/Stock Options outstanding | - | 34,033 | - |
| Diluted Income Per Share | | | |
| Income available to common shareholders plus assumed conversions | \$ 280,711 | 2,607,172 | \$ 0.11 |

Nine months ended September 30, 2006

| | Net Income | Shares | Amount |
|--|--------------|-----------|---------|
| Basic Income Per Share | | | |
| Income available to common shareholders | \$ 1,577,372 | 3,244,162 | \$ 0.49 |
| Effect of Dilutive Securities | | | |
| Warrants/Stock Options outstanding | - | 39,294 | (0.01) |
| Diluted Income Per Share | | | |
| Income available to common shareholders plus assumed conversions | \$ 1,577,372 | 3,283,456 | \$ 0.48 |

Nine months ended September 30, 2005

| | Net Income | Shares | Amount |
|--|------------|-----------|---------|
| Basic Income Per Share | | | |
| Income available to common shareholders | \$ 918,988 | 2,516,856 | \$ 0.37 |
| Effect of Dilutive Securities | | | |
| Warrants/Stock Options outstanding | - | 43,935 | (0.01) |
| Diluted Income Per Share | | | |
| Income available to common shareholders plus assumed conversions | \$ 918,988 | 2,560,791 | \$ 0.36 |

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Note 7. Other Comprehensive Income

Other comprehensive income, which is comprised solely of the change in unrealized gains and losses on available for sale securities, is as follows:

| | Three Months Ended September 30, 2006 | | | Nine Months Ended September 30, 2006 | | |
|--|--|---------------|-------------------------|---|---------------|-------------------------|
| | Before Tax Amount | Tax Effect | Net of Tax Amount | Before Tax Amount | Tax Effect | Net of Tax Amount |
| Unrealized holding gain arising during the period | \$ 840,046 | \$ (319,217) | \$ 520,829 | \$ 402,088 | \$ (152,794) | \$ 249,294 |
| Reclassification adjustment for gains recognized in income | - | - | - | - | - | - |
| Unrealized holding gain on available for sale securities, net of taxes | \$ 840,046 | \$ (319,217) | \$ 520,829 | \$ 402,088 | \$ (152,794) | \$ 249,294 |
| | Three Months Ended September 30, 2005 | | | Nine Months Ended September 30, 2005 | | |
| | Before Tax Amount | Tax Effect | Net of Tax Amount | Before Tax Amount | Tax Effect | Net of Tax Amount |
| Unrealized holding loss arising during the period | \$ (459,125) | \$ 174,468 | \$ (284,657) | \$ (744,270) | \$ 282,824 | \$ (461,446) |
| Reclassification adjustment for gains recognized in income | - | - | - | - | - | - |
| Unrealized holding loss on available for sale securities, net of taxes | \$ (459,125) | \$ 174,468 | \$ (284,657) | \$ (744,270) | \$ 282,824 | \$ (461,446) |

Note 8. Financial Instruments with Off-Balance Sheet Risk

In the normal course of business, Bancorp is a party to financial instruments with off-balance-sheet risk to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit and involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the balance sheets. The contractual amounts of these instruments reflect the extent of involvement Bancorp has in particular classes of financial instruments. The contractual amounts of commitments to extend credit and standby letters of credit represent the amounts of potential accounting loss should: the contract be fully drawn

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upon, the customer defaults and the value of any existing collateral becomes worthless. Bancorp uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments and evaluates each customer's creditworthiness on a case-by-case basis. Management believes that Bancorp controls the credit risk of these financial instruments through credit approvals, credit limits, monitoring procedures and the receipt of collateral as deemed necessary.

Financial instruments whose contractual amounts represent credit risk are as follows at September 30, 2006:

| | |
|-------------------------------------|----------------|
| Commitments to extend credit: | |
| Future loan commitments | \$ 55,104,198 |
| Unused lines of credit | 43,197,027 |
| Undisbursed construction loans | 79,926,186 |
| Financial standby letters of credit | 264,483 |
| | \$ 178,491,894 |

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments to extend credit generally have fixed expiration dates or other termination clauses and may require payment of a fee by the borrower. Since these commitments could expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if deemed necessary by Bancorp upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies but may include residential and commercial property, deposits and securities.

Standby letters of credit are written commitments issued by Bancorp to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Newly issued or modified guarantees that are not derivative contracts are recorded on Bancorp's consolidated balance sheet at the fair value at inception. No liability related to guarantees was required to be recorded at September 30, 2006.

Note 9. Stock Based Compensation

In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 123R, "Share-Based Payment" (SFAS 123R). Under SFAS 123R, companies are no longer permitted to account for share-based compensation transactions using the intrinsic value method in accordance with APB Opinion No. 25 whereby compensation cost charged to expense, if any, was the excess of the quoted market price of the stock at the grant date (or other measurement date) over the amount an employee would pay to acquire the stock. Instead, under SFAS 123R

companies are required to account for such transactions using a fair-value method and recognize the expense in the consolidated statements of income. This statement applies to all awards granted, modified, repurchased or cancelled after the required effective date.

The Company adopted SFAS 123R, effective January 1, 2006, using the modified prospective transition method; this may impact the amount of compensation expense recorded in future financial statements if the Company grants share-based compensation to employees or directors in the future.

Stock Options

On August 17, 1999, the Bank adopted a stock option plan (the "Plan") for employees and directors, under which both incentive and non-qualified stock options were granted, and subsequently the Company assumed all obligations related to such options. The Plan provided for the grant of 110,000 non-qualified and incentive stock options in 1999 to certain directors of the Company, with an exercise price equal to the market value of the Company's stock on the date of the grant. Such options were immediately exercisable and expire, if unexercised, ten years after the date of the grant. The Company has reserved 65,000 shares of common stock remaining for issuance under the Plan. No additional options may be granted under the Plan.

A summary of the status of the stock options at September 30, 2006 and 2005 is as follows:

| | Number of Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Life (in years) |
|-----------------------------------|---------------------|--|--|
| September 30, 2006 | | | |
| Outstanding, January 1, 2006 | 73,000 | \$ 10.13 | 3.7 |
| Exercised | 8,000 | 10.11 | |
| Outstanding, September 30, 2006 | 65,000 | 10.13 | 2.9 |
| Exercisable at September 30, 2006 | 65,000 | 10.13 | 2.9 |
| September 30, 2005 | | | |
| Outstanding, January 1, 2005 | 110,000 | \$ 10.13 | 4.7 |
| Exercised | 37,000 | 10.15 | |
| Outstanding, September 30, 2005 | 73,000 | 10.13 | 3.9 |
| Exercisable at September 30, 2005 | 73,000 | 10.13 | 3.9 |

The intrinsic value of options outstanding and exercisable at September 30, 2006 and 2005 was \$1,144,260 and \$645,466, respectively. The intrinsic value of options exercised during the nine months ended September 30, 2006 and 2005 were \$149,275 and \$316,037, respectively. There are no pro forma disclosures required for the nine months ended September 30, 2006 and 2005, because there was no compensation expense attributed to these periods as no awards were granted or vested under this Plan during these periods.

The provisions of SFAS 123R have had no impact on existing plans under the employment agreements discussed below:

President's Agreement

Under the terms of a previous employment agreement, which expired on October 23, 2003 (the "Agreement") between the Company and the President, was a provision that the Company grants shares of the Company's common stock to the President on December 31, 2000, and annually thereafter through December 31, 2003. The number of shares was based on 30% of the President's base salary for the preceding annual employment period. Compensation costs for grants through 2002 were recognized over the period ending with the expiration date of the Agreement and compensation cost for the 2003 grant is being recognized over the term of the current employment agreement. This stock grant has been settled in cash in each year from 2001 through 2005 and is anticipated to settle in cash until fully settled. The expense charged to operations related to this component of the Agreement was \$11,798 and \$6,813, respectively, for the three months ended September 30, 2006 and 2005, and \$41,174 and \$20,439, respectively, for the nine months ended September 30, 2006 and 2005.

The Agreement also provided for the grant of options to purchase a minimum of 10,000 shares of the Company's common stock on December 31, 2000, and annually thereafter through December 31, 2003. In the event that the Company did not have stock options available to grant at any of these dates, which was the case at December 31, 2000, 2001, 2002 and 2003, the President was able to elect, on a future determination date, to be chosen by the President, to receive cash compensation in the future equal to the difference between the value of the Company's stock at the time the options would have been granted, and the value of the Company's stock on the determination date. The expense charged to operations for the option component of the Agreement was \$32,208 and \$18,885, respectively, for the three months ended September 30, 2006 and 2005, and \$103,833 and \$56,655, respectively, for the nine months ended September 30, 2006 and 2005.

Stock Appreciation Rights Plan

During 2001, the Company adopted the Patriot National Bancorp, Inc. 2001 Stock Appreciation Rights Plan (the "SAR Plan"), providing for the grant by the Company of stock appreciation rights to officers of the Company. Stock appreciation rights entitle the

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officers to receive, in cash or Company common stock, the appreciation in value of the Company's common stock from the date of the grant. Each award vests at the rate of 20% per year from the date of the grant. Any unexercised rights will expire ten years from the date of grant. During 2001, the Company granted 18,000 stock appreciation rights to three officers. The expense charged to operations under the SAR Plan was \$21,832 and \$14,535, respectively, for the three months ended September 30, 2006 and 2005, and \$88,816 and \$43,605, respectively, for the nine months ended September 30, 2006 and 2005.

Note 10. Segment Reporting

Bancorp provides its commercial customers with products such as commercial mortgage and construction loans, working capital loans, equipment loans and other business financing arrangements, and provides its consumer customers with residential mortgage loans, home equity loans and other consumer installment loans. Bancorp also attracts deposits from both consumer and commercial customers, and invests such deposits in loans, investments and working capital. Revenues are generated primarily from net interest income from lending, investment and deposit activities. Additional revenues are derived from loan brokerage and application processing fees through the solicitation and processing of conventional mortgage loans, deposit account transaction based fees and service charges and other loan origination and processing fees.

Bancorp's loan and deposit customers are primarily residents and businesses located in the Connecticut communities in which Bancorp has branches, as well as in bordering communities. Its lending customers extend beyond these areas and also include other nonadjacent towns in Fairfield County, Connecticut and towns in Westchester County, New York. Bancorp also makes loans from its Melville (Long Island) and New York City, New York loan production offices.

Bancorp's customer base is diversified. There is not a concentration of either loans or deposits from a single person or groups of individuals or within a single industry or groups of industries. Bancorp is not dependent on one or a few significant customers for either its loan or deposit activities, the loss of any one of which would have a material adverse impact on its business.

Prior to April 1, 2006, Bancorp had two reportable segments: commercial banking and mortgage brokerage activities. The operations of the mortgage broker have been fully integrated into the operations of the commercial bank. The activities of the former mortgage broker segment have expanded to include the products and services of the former commercial banking segment and developed such that they are indistinguishable from the lending activities of the commercial bank. Any such separate financial disclosures would be consistent with those presented in the financial statements.

Note 11. Other real estate owned

Other real estate owned of \$834,000 is included in other assets and is comprised of one property obtained through loan foreclosure proceedings completed at the end of the third quarter of 2006.

Note 12. Commitments

Bancorp has received regulatory approval to purchase a New York City branch office and the related deposits from another financial institution. The transaction is expected to close during the fourth quarter; after which, it is anticipated that Bancorp will record intangible assets of approximately \$560,000 related to this acquisition.

Note 13. Recent Accounting Pronouncements

In July 2006, the FASB issued Interpretation No. 48 ("FIN 48"), *Accounting for Uncertainty in Income Taxes*. FIN 48 applies to all tax positions related to income taxes subject to SFAS No. 109, *Accounting for Income Taxes*. This includes tax positions considered to be "routine" as well as those with a high degree of uncertainty. FIN 48 utilizes a two-step approach for evaluating tax positions. Recognition (step one) occurs when an enterprise concludes that a tax position, based solely on its technical merits, is more-likely-than-not to be sustained upon examination. Measurement (step two) is only addressed if step one has been satisfied (i.e., the position is more-likely-than-not to be sustained). FIN 48 clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position must meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition.

FIN 48 is effective for fiscal years beginning after December 15, 2006. Earlier adoption is permitted as of the beginning of an enterprise's fiscal year, provided the enterprise has not yet issued financial statements, including financial statements for any interim period, for that fiscal year. Management elected not to early adopt FIN 48 and does not believe that the adoption of FIN 48 will have a material impact on the Company's consolidated financial statements.

"SAFE HARBOR" STATEMENT UNDER PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

Certain statements contained in Bancorp's public reports, including this report, and in particular in "Management's Discussion and Analysis of Financial Condition and Results of Operation," may be forward looking and subject to a variety of risks and uncertainties. These factors include, but are not limited to, (1) changes in prevailing interest rates which would affect the interest earned on Bancorp's interest earning assets and the interest paid on its interest bearing liabilities, (2) the timing of repricing of Bancorp's interest earning assets and interest bearing liabilities, (3) the effect of changes in governmental monetary policy, (4) the effect of changes in regulations applicable to Bancorp and the conduct of its business, (5) changes in competition among financial services companies, including possible further encroachment of non-banks on services traditionally provided by banks, (6) the ability of competitors that are larger than Bancorp to provide products and services that are impracticable for Bancorp to provide, (7) the effects of Bancorp's opening of branches, including a new branch in New York State, (8) the effect of any decision by Bancorp to engage in any new business activities and (9) the ability of Bancorp to timely and successfully deploy the capital raised in the 2006 offering and any future offerings. Other such factors may be described in Bancorp's future filings with the SEC.

CRITICAL ACCOUNTING POLICIES

The preparation of the consolidated financial statements in accordance 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, liabilities, revenues and expenses and the disclosure of contingent assets and liabilities. A material estimate that is particularly susceptible to significant near-term change relates to the determination of the allowance for loan losses. Actual results could differ significantly from those estimates under different assumptions and conditions. The Company believes the following discussion addresses Bancorp's only critical accounting policy, which is the policy that is most important to the presentation of Bancorp's financial results. This policy requires management's most difficult, subjective and complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain.

Allowance for Loan Losses

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

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may

affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are considered impaired. A risk rating system is utilized to measure the adequacy of the general component of the allowance for loan losses. Under this system, each loan is assigned a risk rating between one and nine, which has a corresponding loan loss factor assigned, with a rating of "one" being the least risk and a rating of "nine" reflecting the most risk or a complete loss. Risk ratings are assigned based upon the recommendations of the credit analyst and originating loan officer and confirmed by the loan committee at the initiation of the transactions and are reviewed and changed, when necessary, during the life of the loan. Loan loss reserve factors are applied to the balances in each risk rating category to arrive at the appropriate level of the allowance for loan losses. Loans assigned a risk rating of "six" or above are monitored more closely by the credit administration officers. The unallocated portion of the allowance reflects management's estimate of probable but undetected losses inherent in the portfolio; such estimates are influenced by uncertainties in economic conditions, delays in obtaining information, including unfavorable information about a borrower's financial condition, difficulty in identifying triggering events that correlate perfectly to subsequent loss rates, and risk factors that have not yet manifested themselves in loss allocation factors. Loan quality control is continually monitored by management subject to oversight by the board of directors through its members who serve on the loan committee. It is also reviewed by the full board of directors on a monthly basis. The methodology for determining the adequacy of the allowance for loan losses is consistently applied; however, revisions may be made to the methodology and assumptions based on historical information related to charge-off and recovery experience and management's evaluation of the current loan portfolio.

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

SUMMARY

Bancorp completed a stock offering of 1.5 million shares during September 2006 resulting in an increase in common stock and additional paid in capital of \$30.5 million, net of offering fees and expenses.

Bancorp's net income of \$671,000 (\$0.20 basic and diluted income per share) for the quarter ended September 30, 2006 represents an increase of \$390,000, or 139%, as compared to net income of \$281,000 (\$0.11 basic and diluted income per share) for the quarter ended September 30, 2005. For the nine-month period ended September 30, 2006, net income of \$1,577,000 (\$0.49 basic income per share and \$0.48 diluted income per share) represents an increase of \$658,000, or 72%, as compared to net income of \$919,000 (\$0.37 basic income per share and \$0.36 diluted income per share) for the nine months ended September 30, 2005.

Total assets increased \$143.2 million from \$470.6 million at December 31, 2005 to \$613.8 million at September 30, 2006. Cash and cash equivalents increased \$59.2 million to \$75.2 million at September 30, 2006 as compared to \$16.0 million at December 31, 2005. The available for sale securities portfolio decreased \$9.9 million to \$68.7 million at September 30, 2006 from \$78.7 million at December 31, 2005. The net loan portfolio increased \$90.8 million from \$364.2 million at December 31, 2005 to \$455.0 million at September 30, 2006. Deposits increased \$85.4 million to \$504.5 million at September 30, 2006 from \$419.1 million at December 31, 2005. Borrowings increased \$25.0 million from \$17.2 million at December 31, 2005 to \$42.2 million at September 30, 2006. Total shareholders' equity increased \$31.9 million from \$31.4 million at December 31, 2005 to \$63.3 million at September 30, 2006.

FINANCIAL CONDITION

Assets

Bancorp's total assets increased \$143.2 million, or 30%, from \$470.6 million at December 31, 2005 to \$613.8 million at September 30, 2006. The growth in the balance sheet was funded by an increase in deposits and borrowings and through a stock offering as discussed below. Cash and cash equivalents increased \$59.2 million to \$75.2 million at September 30, 2006 as compared to \$16.0 million at December 31, 2005. Cash and due from banks decreased \$0.7 million. Federal funds sold and short term investments increased \$32.0 million and \$28.0 million, respectively; these increases are the result of investing funds from the receipt of the stock offering proceeds which closed on the last business day of the quarter as well as to a large inflow of certificates of deposit and attorney escrow account deposits late in the month.

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Investments

Available for sale securities decreased \$9.9 million, or 13%, from \$78.7 million at December 31, 2005 to \$68.7 million at September 30, 2006. The decrease in the portfolio is due to principal payments on mortgage-backed securities.

Federal Home Loan Bank Stock

Bancorp's investment in the capital stock of the Federal Home Loan Bank increased \$1.4 million to \$2.7 million at September 30, 2006 from \$1.3 million at December 31, 2005. As a member of the Federal Home Loan Bank, the Bank's required investment in Federal Home Loan Bank stock takes into consideration the level of outstanding Federal Home Loan Bank advances, among other factors. This increase is a direct result of an increase in Federal Home Loan Bank advances discussed later.

Loans

Bancorp's net loan portfolio increased \$90.8 million, or 25%, from \$364.2 million at December 31, 2005 to \$455.0 million at September 30, 2006. Significant increases in the portfolio included a \$64.0 million increase in construction loans, a \$24.7 million increase in commercial real estate loans and a \$14.6 million increase in residential real estate loans. The growth in these segments of the loan portfolio were partially offset by a decrease in home equity loans of \$12.2 million due in part to an increase in the prime rate, to which these loans are tied, prompting a number of borrowers to refinance and roll home equity debt into first mortgages. Although short term interest rates have increased, the growth in loans reflects the continued strong demand for real estate based financing in the Fairfield County, Connecticut and Westchester County, New York market areas where the Bank primarily conducts its lending business.

At September 30, 2006, the net loan to deposit ratio was 90% and the net loan to total assets ratio was 74%. At December 31, 2005, the net loan to deposit ratio was 87% and the net loan to total assets ratio was 77%. Based on loan applications in process and the recent and planned hiring of additional loan officers, management anticipates continued loan growth during the remainder of 2006.

Allowance for Loan Losses

Management believes the allowance for loan losses of \$5.6 million at September 30, 2006, which represents 1.22% of gross loans outstanding, is adequate, under prevailing economic conditions, to absorb losses on existing loans. At December 31, 2005, the allowance for loan losses was \$4.6 million or 1.25% of gross loans outstanding.

Non-Accrual, Past Due and Restructured Loans

The following table presents non-accruing loans and loans past due 90 days or more and still accruing:

| (Thousands of dollars) | September 30, 2006 | December 31, 2005 |
|---|-----------------------|----------------------|
| Loans delinquent over 90 days still accruing | \$ 50 | \$ 275 |
| Non accruing loans | 3,612 | 1,935 |
| Total | \$ 3,662 | \$ 2,210 |
| % of Total Loans | 0.79% | 0.60% |
| % of Total Assets | 0.60% | 0.47% |

Potential Problem Loans

The \$3.6 million of non-accrual loans at September 30, 2006 was comprised of two loans. One loan in the amount of \$1.1 million matured in June 2005. The borrower has continued to make principal, interest and property tax escrow payments on this loan. However, the borrower is currently in bankruptcy proceedings. The Bank expects that the borrower will refinance the two properties held as collateral upon emerging from bankruptcy, and the proceeds of the refinancing will be used to repay the outstanding indebtedness due to the Bank. While no assurances can be given, the Bank expects this will occur during the fourth quarter of 2006. The remaining loan in the amount of \$2.5 million is in the process of collection and is adequately collateralized. In July 2006, the Bank obtained a judgment for foreclosure on this loan, with a sale date scheduled for December 2, 2006. Included in non-accrual loans at December 31, 2005, was a loan in the amount of \$840,000 for which the Bank obtained a judgment for strict foreclosure at the end of the third quarter of 2006; the property was transferred to other real estate owned and is reflected in other assets.

At September 30, 2006, Bancorp had no loans, other than those disclosed in the table above, for which management has significant doubts as to the ability of the borrower to comply with the present repayment terms.

Deposits

Total deposits increased \$85.4 million or 20% from \$419.1 million at December 31, 2005 to \$504.5 million at September 30, 2006. Noninterest bearing deposits increased \$2.1 million, or 4%; increases in commercial demand and internal accounts of \$3.2 million and \$0.5 million, respectively, were partially offset by a decrease in personal checking accounts of \$1.5 million. Interest bearing deposits increased \$83.3 million or

23% from \$370.3 million at December 31, 2005 to \$453.6 million at September 30, 2006. NOW accounts increased \$8.0 million or 31% as compared to December 31, 2005; increased volume in attorney escrow accounts of \$9.0 million and municipal accounts transferred from money market accounts of \$1.3 million were partially offset by decreases in other NOW account products of \$2.3 million. Money market fund accounts decreased \$19.0 million or 33%, from \$57.8 million at December 31, 2005 to \$38.8 million at September 30, 2006 primarily due to increases in certificate of deposit rates offered by both the Bank and its competitors which prompted money market fund account holders to transfer funds to higher rate certificates of deposit. Additionally, as indicated above, municipal money market accounts decreased \$1.3 million as a result of a transfer to a NOW account. Certificates of deposit increased \$90.6 million, or 34%, from \$267.0 million at December 31, 2005 to \$357.6 million at September 30, 2006. Included in the growth of certificates of deposits is \$14.5 million of brokered deposits which mature in October 2006. The remaining growth in certificates of deposit is the result of the competitive rates the Bank continues to offer in order to remain a viable source of deposit products in an increasingly competitive market.

Borrowings

At September 30, 2006, total borrowings were \$42.2 million. This represents an increase of \$25.0 million compared to total borrowings of \$17.2 million at December 31, 2005. The increase in borrowings supplemented deposit inflow in order to fund loan demand.

Capital

Capital increased \$31.9 million or 102% from \$31.4 million at December 31, 2005 to \$63.3 million at September 30, 2006. A stock offering, completed at the end of the third quarter, combined with the exercise of certain stock options and shares issued to outside directors (disclosed in Item 2 of Part II), resulted in an increase in common stock of 1,508,845 shares representing net proceeds of \$30.6 million. Year to date income of \$1.6 million and an increase in the market value of the available for sale securities portfolio of \$249,000, net of deferred taxes, was partially offset by the declaration of dividends of \$488,000 and resulted in a net increase in retained earnings and accumulated other comprehensive income of \$1.3 million.

Off-Balance Sheet Arrangements

There were no significant changes in Bancorp's off-balance sheet arrangements which primarily consist of commitments to lend, during the quarter and nine months ended September 30, 2006.

RESULTS OF OPERATIONS***Interest and dividend income and expense***

The following tables present average balance sheets (daily averages), interest income, interest expense and the corresponding yields earned and rates paid for major balance sheet components:

| | Three months ended September 30, | | | | | |
|--|----------------------------------|--|-----------------|--------------------|--|-----------------|
| | Average Balance | 2006 Interest Income/ Expense | Average Rate | Average Balance | 2005 Interest Income/ Expense | Average Rate |
| <i>(dollars in thousands)</i> | | | | | | |
| Interest earning assets: | | | | | | |
| | | | | \$ | | |
| Loans | \$ 454,672 | \$ 8,962 | 7.88% | 321,931 | \$ 5,536 | 6.88% |
| Federal funds sold and other cash equivalents | 12,516 | 166 | 5.31% | 17,199 | 142 | 3.30% |
| Investments | 74,646 | 729 | 3.91% | 86,832 | 761 | 3.51% |
| Total interest earning assets | 541,834 | 9,857 | 7.28% | 425,962 | 6,439 | 6.05% |
| Cash and due from banks | 4,902 | | | 5,280 | | |
| Premises and equipment, net | 2,371 | | | 2,282 | | |
| Allowance for loan losses | (5,513) | | | (3,954) | | |
| Other assets | 7,020 | | | 5,783 | | |
| Total Assets | \$ 550,614 | | | \$ 435,353 | | |
| Interest bearing liabilities: | | | | | | |
| | | | | \$ | | |
| Deposits | \$ 420,813 | \$ 4,153 | 3.95% | 350,262 | \$ 2,515 | 2.87% |
| FHLB advances | 36,837 | 491 | 5.33% | 8,783 | 80 | 3.64% |
| Subordinated debt | 8,248 | 177 | 8.58% | 8,248 | 137 | 6.64% |
| Other borrowings | 46 | 1 | 8.70% | 134 | 1 | 2.99% |
| Total interest bearing liabilities | 465,944 | 4,822 | 4.14% | 367,427 | 2,733 | 2.98% |
| Demand deposits | 47,063 | | | 42,515 | | |
| Accrued expenses and other liabilities | 4,207 | | | 3,652 | | |
| Shareholders' equity | 33,400 | | | 21,759 | | |
| Total liabilities and equity | \$ 550,614 | | | \$ 435,353 | | |
| Net interest income | | \$ 5,035 | | | \$ 3,706 | |
| Interest margin | | | 3.72% | | | 3.48% |
| Interest spread | | | 3.14% | | | 3.07% |

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Nine months ended September 30,

| | Average Balance | 2006 Interest Income/ Expense | Average Rate | Average Balance | 2005 Interest Income/ Expense | Average Rate |
|--|-------------------------------|--|-----------------|--------------------|--|-----------------|
| | <i>(dollars in thousands)</i> | | | | | |
| Interest earning assets: | | | | | | |
| | | | | \$ | | |
| Loans | \$ 428,211 | \$ 24,473 | 7.62% | 302,134 | \$ 15,129 | 6.68% |
| Federal funds sold and other cash equivalents | 8,348 | 309 | 4.94% | 18,717 | 383 | 2.73% |
| Investments | 77,382 | 2,268 | 3.91% | 89,051 | 2,331 | 3.49% |
| Total interest earning assets | 513,941 | 27,050 | 7.02% | 409,902 | 17,843 | 5.80% |
| Cash and due from banks | 5,729 | | | 4,933 | | |
| Premises and equipment, net | 2,348 | | | 2,133 | | |
| Allowance for loan losses | (5,220) | | | (3,767) | | |
| Other assets | 6,695 | | | 5,594 | | |
| Total Assets | \$ 523,493 | | | \$ 418,795 | | |
| Interest bearing liabilities: | | | | | | |
| | | | | \$ | | |
| Deposits | \$ 401,707 | \$ 10,834 | 3.60% | 332,728 | \$ 6,543 | 2.62% |
| FHLB advances | 29,045 | 1,100 | 5.05% | 11,634 | 304 | 3.48% |
| Subordinated debt | 8,248 | 497 | 8.03% | 8,248 | 380 | 6.14% |
| Other borrowings | 129 | 5 | 5.17% | 45 | 1 | 2.96% |
| Total interest bearing liabilities | 439,129 | 12,436 | 3.78% | 352,655 | 7,228 | 2.73% |
| Demand deposits | 47,727 | | | 42,286 | | |
| Accrued expenses and other liabilities | 4,176 | | | 3,207 | | |
| Shareholders' equity | 32,461 | | | 20,647 | | |
| Total liabilities and equity | \$ 523,493 | | | \$ 418,795 | | |
| Net interest income | | \$ 14,614 | | | \$ 10,615 | |
| Interest margin | | | 3.79% | | | 3.45% |
| Interest spread | | | 3.24% | | | 3.07% |

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The following rate volume analysis reflects the changes in net interest income arising from changes in interest rates and from asset and liability volume, including mix. The change in interest attributable to volume includes changes in interest attributable to mix.

| | Three months ended September 30, 2006 vs 2005 | | | Nine months ended September 30, 2006 vs 2005 | | |
|--|---|----------|----------|---|----------|----------|
| | Fluctuations in Interest Income/Expense Due to change in: | | | Fluctuations in Interest Income/Expense Due to change in: | | |
| | Volume | Rate | Total | Volume | Rate | Total |
| | <i>(dollars in thousands)</i> | | | | | |
| Interest earning assets: | | | | | | |
| Loans | \$ 2,529 | \$ 897 | \$ 3,426 | \$ 6,987 | \$ 2,357 | \$ 9,344 |
| Federal funds sold and other cash equivalents | (104) | 128 | 24 | (200) | 126 | (74) |
| Investments | (401) | 369 | (32) | (392) | 329 | (63) |
| Total interest earning assets | 2,024 | 1,394 | 3,418 | 6,395 | 2,812 | 9,207 |
| Interest bearing liabilities: | | | | | | |
| Deposits | \$ 573 | \$ 1,065 | \$ 1,638 | \$ 1,537 | \$ 2,754 | \$ 4,291 |
| FHLB advances | 359 | 52 | 411 | 602 | 194 | 796 |
| Subordinated debt | - | 40 | 40 | - | 117 | 117 |
| Other borrowings | (2) | 2 | - | 1 | 3 | 4 |
| Total interest bearing liabilities | 930 | 1,159 | 2,089 | 2,140 | 3,068 | 5,208 |
| Net interest income | \$ 1,094 | \$ 235 | \$ 1,329 | \$ 4,255 | \$ (256) | \$ 3,999 |

An increase in average interest earning assets of \$116.6 million, or 27%, combined with an increase in interest rates increased Bancorp's interest income \$3.4 million or 53% for the quarter ended September 30, 2006 as compared to the same period in 2005. Interest and fees on loans increased \$3.4 million, or 62%, from \$5.5 million for the quarter ended September 30, 2005 to \$8.9 million for the quarter ended September 30, 2006. This increase was primarily the result of the increase in the average outstanding balances of the loan portfolio followed by the impact of a rising rate environment. Interest income on investments decreased slightly; the decrease in interest income from the reduction in the portfolio due to principal payments on mortgage backed securities was offset by an increase in the interest rates on the remaining portfolio. Interest income on federal funds and other cash equivalents increased as a result of an increase in short term interest rates. For the nine months ended September 30, 2006, interest and dividend income was \$27.0 million which represents an increase of \$9.2 million, or 52%, as compared to

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interest and dividend income of \$17.8 million for the same period last year. This increase was due to the reasons cited earlier.

Total interest expense for the quarter ended September 30, 2006 of \$4.8 million represents an increase of \$2.1 million or 76% as compared to the same period last year. The increase in interest expense is primarily the result of higher interest rates paid on deposit accounts and a higher volume of FHLB advances; an increase in total average interest bearing liabilities of \$98.5 million or 27% also contributed to the increase in interest expense. The increase in interest rates combined with the increase in the average balances of deposit accounts of \$70.5 million, or 20%, resulted in an increase in interest expense of \$1.6 million, or 65%. Average FHLB advances increased \$28.1 million or 319%; this increase in average balances combined with the increase in interest paid on FHLB advances resulted in an increase in interest expense of \$411,000, or 514%. The increase in the index to which the junior subordinated debt is tied resulted in an increase in interest expense of \$40,000, or 29%. For the nine months ended September 30, 2006 total interest expense increased \$5.2 million, or 72%, to \$12.4 million as compared to \$7.2 million for the nine months ended September 30, 2005. This increase in interest expense was due to the reasons cited earlier.

As a result of the above, Bancorp's net interest income increased \$1.3 million, or 36%, to \$5.0 million for the three months ended September 30 2006 as compared to \$3.7 million for the same period last year. Net interest income increased \$4.0 million, or 38%, to \$14.6 million for the nine months ended September 30, 2006 as compared to \$10.6 million for the nine months ended September 30, 2005.

Provision for loan losses

The provision for loan losses charged to operations for the quarter ended September 30, 2006 was \$117,000 as compared to \$350,000 for the same period last year. For the nine months ended September 30, 2006, the provision for loan losses was \$1,040,000 as compared to \$710,000 for the nine months ended September 30, 2005. These variances were due to the credit risk factors assigned to the loan portfolio, as well as, to the growth in the loan portfolio and not to any adverse or more favorable changes in the credit quality of the loan portfolio or changes in non-performing loans.

An analysis of the changes in the allowance for loan losses is presented under "Allowance for Loan Losses."

Noninterest income

Noninterest income decreased \$353,000, or 36%, from \$986,000 for the quarter ended September 30, 2005 to \$633,000 for the three months ended September 30, 2006. A decrease in the volume of loans placed with outside investors resulted in a decrease in mortgage brokerage and referral fee income of \$300,000 and a decrease in loan origination

and processing fee income of \$61,000. Fees and service charges for the three months ended September 30, 2006 increased \$23,000, or 16%, as compared to the same period last year. This increase was primarily due to an increase in the service charges on deposit accounts. Other income decreased \$15,000 as compared to the same period last year which reflected the settlement of an insurance claim.

For the nine months ended September 30, 2006, noninterest income decreased \$673,000, or 27% to \$1.8 million as compared to \$2.5 million for the nine months ended September 30, 2005. This decrease was due to a decrease in mortgage brokerage and referral fee income and loan origination and processing fee income partially offset by an increase in service charges for similar reasons cited above.

Noninterest expenses

Noninterest expenses increased \$621,000, or 16%, to \$4.5 million for the quarter ended September 30, 2006 from \$3.9 million for the quarter ended September 30, 2005. Salaries and benefits expense increased \$402,000, or 17%, to \$2.8 million for the quarter ended September 30, 2006 from \$2.4 million for the quarter ended September 30, 2005. This increase was primarily due to staff additions, increases in bonuses and incentive compensation and salary increases made during the last quarter of 2005. Occupancy and equipment expense, net, increased \$156,000, or 29% to \$695,000 for the quarter ended September 30, 2006 from \$539,000 for the quarter ended September 30, 2005 due to the leasing of additional space for the Bank's lending and credit administration functions during the last quarter of 2005, lease expense during 2006 for branches under renovation and a new metropolitan New York loan production office. Increased marketing campaigns and related activities resulted in an increase in advertising and promotional expenses of \$40,000, or 36%, to \$153,000 for the three months ended September 30, 2006 from \$112,000 for the three months ended September 30, 2005. Data processing and other outside services decreased \$40,000, or 12%, from \$333,000 for the three months ended September 30, 2005 to \$294,000 for the three months ended September 30, 2006 primarily due to decreases in personnel placement fees, information technology consulting and temporary office staffing which were partially offset by increases in data processing and correspondent banking expenses. The increases in data processing and correspondent banking expenses were a result of the growth in the branch network as well as increased ongoing maintenance charges for the implementation of new products and services.

For the nine months ended September 30, 2006, noninterest expenses increased \$2.0 million, or 19%, to \$12.9 million as compared to \$10.9 million for the nine months ended Septemeber 30, 2005. Salaries and benefits expense increased \$1.1 million, or 16% to \$7.7 million; occupancy and equipment expense, net increased \$507,000 or 33%. These increases are due to similar reasons cited above and to the full year impact in 2006 of the staffing additions and occupancy and equipment expenses incurred with an additional branch location established during the second quarter of 2005. Data processing and other outside services and advertising and promotional expenses increased \$283,000

and \$113,000, respectively, for the nine months ended September 30, 2006 as compared to the same period last year. These increases were due to similar reasons cited earlier.

Income Taxes

Bancorp recorded income tax expense of \$390,000 for the quarter ended September 30, 2006 as compared to \$191,000 for the quarter ended September 30, 2005. For the nine months ended September 30, 2006, income tax expense was \$916,000 as compared to \$625,000 for the same period last year. These changes were related primarily to the change in pre-tax income and the exclusion for state tax purposes of certain holding company expenses. The effective tax rates for the quarters ended September 30, 2006 and September 30, 2005 were 37% and 40%, respectively; the effective tax rates for the nine months ended September 30, 2006 and September 30, 2005 were 37% and 40%, respectively.

LIQUIDITY

Bancorp's liquidity ratio was 23% at both September 30, 2006 and 2005. The liquidity ratio is defined as the percentage of liquid assets to total assets. The following categories of assets as described in the accompanying consolidated balance sheets are considered liquid assets: cash and due from banks, federal funds sold, short term investments and available for sale securities. Liquidity is a measure of Bancorp's ability to generate adequate cash to meet financial obligations. The principal cash requirements of a financial institution are to cover downward fluctuations in deposit accounts and increases in its loan portfolio. Management believes Bancorp's short-term assets provide sufficient liquidity to cover loan demand, potential fluctuations in deposit accounts and to meet other anticipated cash operating requirements.

CAPITAL

The following table illustrates Bancorp's regulatory capital ratios at September 30, 2006 and December 31, 2005 respectively:

| | September 30, 2006 | December 31, 2005 |
|---------------------------|--------------------|-------------------|
| Total Risk-based Capital | 16.70% | 12.70% |
| Tier 1 Risk-based Capital | 15.47% | 11.45% |
| Leverage Capital | 12.94% | 8.56% |

The following table illustrates the Bank's regulatory capital ratios at September 30, 2006 and December 31, 2005 respectively:

| | September 30, 2006 | December 31, 2005 |
|---------------------------|--------------------|-------------------|
| Total Risk-based Capital | 16.35% | 12.52% |
| Tier 1 Risk-based Capital | 15.13% | 11.27% |
| Leverage Capital | 12.65% | 8.42% |

Capital adequacy is one of the most important factors used to determine the safety and soundness of individual banks and the banking system. Based on the above ratios, the Bank is considered to be "well capitalized" at September 30, 2006 under applicable regulations. To be considered "well-capitalized," an institution must generally have a leverage capital ratio of at least 5%, a Tier 1 risk-based capital ratio of at least 6% and a total risk-based capital ratio of at least 10%.

The increase in capital ratios is due to the stock offering and the increase in retained earnings partially offset by the growth of the Bank. Management continuously assesses the adequacy of the Bank's capital to ensure that the Bank remains a "well capitalized" institution. Management's strategic and capital plans contemplate various options to maintain the "well capitalized" classification.

IMPACT OF INFLATION AND CHANGING PRICES

Bancorp's consolidated financial statements have been prepared in terms of historical dollars, without considering changes in the relative purchasing power of money over time due to inflation. Unlike most industrial companies, virtually all of the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates have a more significant impact on a financial institution's performance than the general levels of inflation. Interest rates do not necessarily move in the same direction or with the same magnitude as the prices of goods and services. Notwithstanding this, inflation can directly affect the value of loan collateral, in particular, real estate. Inflation, or disinflation, could significantly affect Bancorp's earnings in future periods.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Market risk is defined as the sensitivity of income to fluctuations in interest rates, foreign exchange rates, equity prices, commodity prices and other market-driven rates or prices. Based upon the nature of Bancorp's business, market risk is primarily limited to interest rate risk, which is the impact, that changing interest rates have on current and future earnings.

Qualitative Aspects of Market Risk

Bancorp's goal is to maximize long term profitability while minimizing its exposure to interest rate fluctuations. The first priority is to structure and price Bancorp's assets and liabilities to maintain an acceptable interest rate spread while reducing the net effect of changes in interest rates. In order to accomplish this, the focus is on maintaining a proper balance between the timing and volume of assets and liabilities re-pricing within the balance sheet. One method of achieving this balance is to originate variable rate loans for the portfolio and purchase short term investments to offset the increasing short term re-pricing of the liability side of the balance sheet. In fact, a number of the interest bearing deposit products have no contractual maturity. Therefore, deposit balances may run off unexpectedly due to changing market conditions. Additionally, loans and investments with longer term rate adjustment frequencies are matched against longer term deposits and borrowings to lock in a desirable spread.

The exposure to interest rate risk is monitored by the Management Asset and Liability Committee consisting of senior management personnel. The Committee meets on a monthly basis, but may convene more frequently as conditions dictate. The Committee reviews the interrelationships within the balance sheet to maximize net interest income within acceptable levels of risk. This Committee reports to the Board of Directors on a monthly basis regarding its activities. In addition to the Management Asset and Liability Committee, there is a Board Asset and Liability Committee ("ALCO") which meets quarterly. ALCO monitors the interest rate risk analyses, reviews investment transaction during the period and determines compliance with Bank policies.

Quantitative Aspects of Market Risk

Management analyzes Bancorp's interest rate sensitivity position to manage the risk associated with interest rate movements through the use of interest income simulation and GAP analysis. The matching of assets and liabilities may be analyzed by examining the extent to which such assets and liabilities are "interest sensitive." An asset or liability is said to be interest sensitive within a specific time period if it will mature or reprice within that time period.

Management's goal is to manage asset and liability positions to moderate the effects of interest rate fluctuations on net interest income. Interest income simulations are completed

quarterly and presented to ALCO. The simulations provide an estimate of the impact of changes in interest rates on net interest income under a range of assumptions. Changes to these assumptions can significantly affect the results of the simulations. The simulation incorporates assumptions regarding the potential timing in the repricing of certain assets and liabilities when market rates change and the changes in spreads between different market rates.

Simulation analysis is only an estimate of Bancorp's interest rate risk exposure at a particular point in time. Management regularly reviews the potential effect changes in interest rates could have on the repayment of rate sensitive assets and funding requirements of rate sensitive liabilities.

Management has established interest rate risk guidelines measured by behavioral GAP analysis calculated at the one year cumulative GAP level and a net interest income and economic value of portfolio equity simulation model measured by a 200 basis point interest rate shock.

The table below sets forth an approximation of Bancorp's exposure to changing interest rates using management's behavioral GAP analysis and as a percentage of estimated net interest income and estimated net portfolio value using interest income simulation. The calculations use projected repricings of assets and liabilities at September 30, 2006 and December 31, 2005 on the basis of contractual maturities, anticipated repayments and scheduled rate adjustments.

| | Basis Points | Interest Rate Risk Guidelines | September 30, 2006 | December 31, 2005 |
|----------------------|-----------------|----------------------------------|-----------------------|----------------------|
| Gap percentage total | | +/- 15% | 8.33% | 4.98% |
| Net interest income | 200 | +/- 15% | 15.75% | 14.49% |
| | -200 | +/- 15% | -17.87% | -14.24% |
| Net portfolio value | 200 | +/- 25% | -1.90% | 0.45% |
| | -200 | +/- 25% | -2.87% | -7.89% |

Bancorp benefited during 2006 from a rising interest rate environment as assets re-priced faster than liabilities and, combined with a 25% increase in the loan portfolio, resulted in an expanding net interest margin. These factors contributed to higher levels of net interest income and net portfolio value in the base case scenario at September 30, 2006 as compared to December 31, 2005 using Bancorp's interest income simulation model. Bancorp's interest rate risk position was within its gap percentage total and net portfolio value guidelines at September 30, 2006. Bancorp exceeded its net interest income guidelines at September 30, 2006; this is primarily due to the receipt of the stock offering proceeds on the last business day of the quarter which were placed in short term investments. This is a temporary situation and will be remedied once the excess funds are

redeployed into longer term assets. The interest rate risk position is monitored on an ongoing basis and management reviews strategies to maintain all categories within guidelines.

The table below sets forth examples of changes in estimated net interest income and the estimated net portfolio value based on projected scenarios of interest rate increases and decreases. The analyses indicate the rate risk embedded in Bancorp's portfolio at the dates indicated should all interest rates instantaneously rise or fall. The results are derived by adding to or subtracting from all current rates; however, there are certain limitations to these types of analyses. Rate changes are rarely instantaneous and these analyses may also overstate the impact of short term repricings.

Net Interest Income and Economic Value
Summary Performance

September 30, 2006

| Projected Interest Rate Scenario | Net Interest Income | | | Net Portfolio Value | | |
|----------------------------------|---------------------|---------------------|--------------------|---------------------|---------------------|--------------------|
| | Estimated Value | \$ Change from Base | % Change from Base | Estimated Value | \$ Change from Base | % Change from Base |
| + 200 | 23,663 | 3,220 | 15.75% | 80,842 | (1,569) | -1.90% |
| + 100 | 22,066 | 1,623 | 7.94% | 82,034 | (377) | -0.46% |
| BASE | 20,443 | | | 82,411 | | |
| - 100 | 18,707 | (1,736) | -8.49% | 82,264 | (147) | -0.18% |
| - 200 | 16,790 | (3,653) | -17.87% | 80,044 | (2,367) | -2.87% |

December 31, 2005

| Projected Interest Rate Scenario | Net Interest Income | | | Net Portfolio Value | | |
|----------------------------------|---------------------|---------------------|--------------------|---------------------|---------------------|--------------------|
| | Estimated Value | \$ Change from Base | % Change from Base | Estimated Value | \$ Change from Base | % Change from Base |
| + 200 | 18,650 | 2,360 | 14.49% | 47,153 | 211 | 0.45% |
| + 100 | 17,478 | 1,188 | 7.29% | 47,606 | 664 | 1.41% |
| BASE | 16,290 | | | 46,942 | | |
| - 100 | 15,115 | (1,175) | -7.21% | 45,432 | (1,510) | -3.22% |
| - 200 | 13,970 | (2,320) | -14.24% | 43,239 | (3,703) | -7.89% |

Item 4. Controls and Procedures

Based on an evaluation of the effectiveness of Bancorp's disclosure controls and procedures performed by Bancorp's management, with the participation of Bancorp's Chief Executive Officer and its Chief Financial Officer as of the end of the period covered by this report, Bancorp's Chief Executive Officer and Chief Financial Officer concluded that Bancorp's disclosure controls and procedures have been effective.

As used herein, "disclosure controls and procedures" means controls and other procedures of Bancorp that are designed to ensure that information required to be disclosed by Bancorp in the reports that it files or submits under the Securities Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by Bancorp in the reports that it files or submits under the Securities Exchange Act is accumulated and communicated to Bancorp's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

There were no changes in Bancorp's internal control over financial reporting identified in connection with the evaluation described in the preceding paragraph that occurred during Bancorp's fiscal quarter ended September 30, 2006 that has materially affected, or is reasonably likely to materially affect, Bancorp's internal control over financial reporting.

PART II - OTHER INFORMATION.

Item 1A. Risk Factors

Management intends to continue Bancorp's emphasis on growth over earnings for the foreseeable future.

Management has actively sought growth of the institution in recent years by opening additional branches, initiating internal growth programs, and completing one acquisition of a mortgage company. Bancorp may not be able to sustain its historical rate of growth or may not even be able to continue to grow at all. Various factors, such as economic conditions and competition, may impede or prohibit the Bank from opening new branches. In addition, Bancorp may not be able to obtain the financing necessary to fund additional growth and may not be able to find suitable candidates for acquisition. Sustaining Bancorp's growth has placed significant demands on management as well as on administrative, operational and financial resources. For Bancorp to continue to grow, it must: attract and retain qualified management and experienced bankers, find suitable markets for expansion, find suitable, affordable branch office locations; attract funding to

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support additional growth; maintain high asset quality levels; maintain adequate regulatory capital; and maintain adequate controls. Although management believes that earnings will increase as the franchise is expanded, earnings are expected to continue to be adversely affected by the costs associated with opening new branches and the time necessary to build a customer base in each new branch's market area.

If Bancorp is unable to continue its historical levels of growth, or if growth comes at greater financial expense than has been incurred in the past, Bancorp may not be able to achieve its financial goals and profitability may be adversely affected.

Because Bancorp intends to increase its commercial real estate, construction and commercial business loan originations, its lending risk will increase, and downturns in the real estate market could adversely affect its earnings.

Commercial real estate, construction and commercial business loans generally have more risk than residential mortgage loans. Both commercial real estate and construction loans, for example, often involve larger loan balances concentrated with single borrowers or groups of related borrowers as compared to single-family residential loans. Construction loans are secured by the property under construction, the value of which is uncertain prior to completion. Thus, it is more difficult to evaluate accurately the total loan funds required to complete a project and the related loan-to-value ratios. Speculative construction loans involve additional risk because the builder does not have a contract for the sale of the property at the time of construction.

Because the repayment of commercial real estate, construction and commercial business loans depends on the successful management and operation of the borrower's properties or related businesses, repayment of such loans can be affected by adverse conditions in the real estate market or the local economy. A significant portion of Bancorp's total loan portfolio is secured by real estate located in Fairfield County, Connecticut and Westchester County, New York. As a result, a downturn in the real estate market, especially within Bancorp's market area, could adversely impact the value of properties securing these loans. Bancorp's ability to recover on defaulted loans by selling the underlying real estate would be diminished, and Bancorp would be more likely to suffer losses on defaulted loans. As its commercial real estate, construction and commercial business loan portfolios increase, the corresponding risks and potential for losses from these loans may also increase.

Bancorp's business is subject to various lending and other economic risks that could adversely impact Bancorp's results of operations and financial condition.

Changes in economic conditions, particularly an economic slowdown in Fairfield County, Connecticut and the New York metropolitan area, could hurt Bancorp's financial

performance. Bancorp's business is directly affected by political and market conditions, broad trends in industry and finance, legislative and regulatory changes and changes in governmental monetary and fiscal policies and inflation, all of which are beyond Bancorp's control. A deterioration in economic conditions, in particular an economic slowdown within Fairfield County, Connecticut and/or the New York metropolitan area, could result in the following consequences, any of which may hurt the business of Bancorp materially: loan delinquencies may increase; problem assets and foreclosures may increase; demand for the Bank's products and services may decline; and assets and collateral associated with the Bank's loans, especially real estate, may decline in value, thereby reducing a customer's borrowing power.

The Bank may suffer losses in its loan portfolio despite its underwriting practices. The Bank seeks to mitigate the risks inherent in its loan portfolio by adhering to specific underwriting practices. These practices include analysis of a borrower's prior credit history, financial statements, tax returns and cash flow projections, valuation of collateral based on reports of independent appraisers and verification of liquid assets. Although the Bank believes that its underwriting criteria is appropriate for the various types of loans the Bank makes, the Bank may still incur losses on loans, and these losses may exceed the amounts set aside as reserves in the allowance for loan losses.

Bancorp's allowance for loan losses may not be adequate to cover actual losses.

Like all financial institutions, the Bank maintains an allowance for loan losses to provide for loan defaults and non-performance. The allowance for loan losses may not be adequate to cover actual loan losses and future provisions for loan losses could materially and adversely affect Bancorp's operating results. The allowance for loan losses is based on an evaluation of the risks associated with the Bank's loans receivable as well as the Bank's prior loss experience. A substantial portion of the Bank's loans are unseasoned and lack an established record of performance. To date, losses have been negligible. The amount of future losses is susceptible to changes in economic, operating and other conditions, including changes in interest rates that may be beyond the Bank's control and these losses may exceed current estimates. Federal regulatory agencies, as an integral part of their examination process, review the Bank's loans and assess the adequacy of the allowance for loan losses. While management believes that the allowance for loan losses is adequate to cover current losses, management cannot assure shareholders that there will not be a need to increase the allowance for loan losses or that the regulators will not require management to increase this allowance. Either of these occurrences could materially and adversely affect Bancorp's earnings and profitability.

Bancorp's business is subject to interest rate risk and variations in interest rates may negatively affect Bancorp's financial performance.

Bancorp is unable to predict fluctuations of market interest rates, which are affected by many factors including: inflation, recession, a rise in unemployment, a tightening money

supply and domestic and international disorder and instability in domestic and foreign financial markets. Changes in the interest rate environment may reduce Bancorp's profits. Bancorp realizes income from the differential or "spread" between the interest earned on loans, securities and other interest-earning assets, and interest paid on deposits, borrowings and other interest-bearing liabilities. Net interest spreads are affected by the difference between the maturities and repricing characteristics of interest-earning assets and interest-bearing liabilities. Bancorp is vulnerable to a decrease in interest rates because its interest-earning assets generally have shorter durations than its interest-bearing liabilities. As a result, material and prolonged decreases in interest rates would decrease Bancorp's net interest income. In contrast, an increase in the general level of interest rates may adversely affect the ability of some borrowers to pay the interest on and principal of their obligations. Accordingly, changes in levels of market interest rates could materially and adversely affect Bancorp's net interest spread, asset quality, levels of prepayments and cash flow as well as the market value of its securities portfolio and overall profitability.

Mortgage brokerage activity is also affected by interest rate fluctuations. Generally increases in interest rates often lead to decreases in home refinancing activity, thus reducing the number of mortgage loans that Bancorp originates.

Bancorp's investment portfolio includes securities which are sensitive to interest rates and variations in interest rates may adversely impact Bancorp's profitability.

Bancorp's securities portfolio is classified as available-for-sale, and is comprised of mortgage-backed securities which are insured or guaranteed by U.S. government agencies or government-sponsored enterprises, U.S. government agency securities and money market preferred equity securities. These securities are sensitive to interest rate fluctuations. Unrealized gains or losses in the available-for-sale portfolio are reported as a separate component of shareholders' equity. As a result, future interest rate fluctuations may impact shareholders' equity, causing material fluctuations from quarter to quarter. Failure to hold its securities until payments are received on mortgage-backed securities or until maturity on other investments or until market conditions are favorable for a sale could adversely affect Bancorp's earnings and profitability.

Bancorp is dependent on its management team, and the loss of its senior executive officers or other key employees could impair its relationship with its customers and adversely affect its business and financial results.

Bancorp's success is dependent upon the continued services and skills of Angelo De Caro, Charles F. Howell, Robert F. O'Connell, Philip W. Wolford and other senior officers including Martin G. Noble, its chief lender, Marcus Zavattaro, its residential lending sales manager, and John Kantzas, a founder and an executive vice president. While Bancorp has employment agreements containing non-competition provisions with Messrs. Howell, O'Connell and Zavattaro, these agreements do not prevent any of them from terminating their employment with Bancorp. The unexpected loss of services of one or more of these

key personnel could have an adverse impact on Bancorp's business because of their skills, knowledge of Bancorp's market, years of industry experience and the difficulty of promptly finding qualified replacement personnel.

Bancorp's success also depends, in part, on its continued ability to attract and retain experienced commercial lenders and residential mortgage originators, as well as other management personnel. The loss of the services of several of such key personnel could adversely affect Bancorp's growth strategy and prospects to the extent it is unable to replace such personnel. In the past year, Bancorp has hired several experienced commercial loan officers who have strong business relationships in order to expand and enhance its current deposit and commercial banking operations. Competition for commercial lenders and residential mortgage originators is strong within the commercial banking and mortgage banking industries, and Bancorp may not be successful in retaining or attracting additional personnel necessary to maintain its growth plans.

A breach of information security could negatively affect Bancorp's earnings.

Bancorp increasingly depends upon data processing, communications and information exchange on a variety of computing platforms and networks, and over the internet to conduct its business. Bancorp cannot be certain that all of its systems are entirely free from vulnerability to attack, despite safeguards it has instituted. In addition, Bancorp relies on the services of a variety of vendors to meet its data processing and communication needs. If information security is breached, information can be lost or misappropriated; this could result in financial loss or costs to Bancorp or damages to others. These costs or losses could materially exceed the amount of insurance coverage, if any, which would have an adverse effect on Bancorp's results of operations and financial condition. In addition, the Bank's reputation could be harmed, which also could materially adversely affect Bancorp's financial condition and results of operation.

Risks Related to Bancorp's industry

Strong competition within Bancorp's market area may limit the growth and profitability of the Company.

Competition in the banking and financial services industry is intense. The Fairfield County, Connecticut and the New York City metropolitan areas have a high concentration of financial institutions including large money center and regional banks, community banks and credit unions. Some of Bancorp's competitors offer products and services that the Bank currently does not offer, such as private banking and trust services. The Bank's planned purchase of a small branch in New York City, New York and anticipated future expansion into Westchester County, New York, will expose the Bank to more competition and in markets where it is not well known. Many of these competitors have substantially greater resources and lending limits than Bancorp and may offer certain services that it does not or cannot provide. Price competition for loans and deposits might result in the

Bank earning less on its loans and paying more for deposits, which reduces net interest income. Bancorp expects competition to increase in the future as a result of legislative, regulatory and technological changes. Bancorp's profitability depends upon its continued ability to successfully compete in its market area.

Government regulation may have an adverse effect on Bancorp's profitability and growth.

Bancorp is subject to extensive regulation, supervision and examination by the Office of the Comptroller of the Currency, or the OCC, as the Bank's chartering authority, by the FDIC, as insurer of the deposits, and by the Federal Reserve Board as regulator of Bancorp. Changes in state and federal banking laws and regulations or in federal monetary policies could adversely affect the Bank's ability to maintain profitability and continue to grow. For example, new legislation or regulation could limit the manner in which Bancorp may conduct its business, including the Bank's ability to obtain financing, attract deposits, make loans and achieve satisfactory interest spreads. Many of these regulations are intended to protect depositors, the public and the FDIC, not shareholders. In addition, the burden imposed by federal and state regulations may place the Company at a competitive disadvantage compared to competitors who are less regulated. The laws, regulations, interpretations and enforcement policies that apply to Bancorp have been subject to significant, and sometimes retroactively applied, changes in recent years, and may change significantly in the future. Future legislation or government policy may also adversely affect the banking industry or Bancorp's operations.

Changing regulation of corporate governance and public disclosure.

Recently enacted laws, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002, new SEC regulations and NASDAQ rules, are adding to the responsibilities that companies, such as Bancorp, have. These laws, regulations and standards are subject to varying interpretations, and as a result, their application in practice may evolve over time as new guidance is provided by regulatory and governing bodies, which could make compliance more difficult and result in higher costs due to ongoing revisions to disclosure and governance practices. Bancorp is committed to maintaining high standards of corporate governance and public disclosure. As a result, Bancorp's efforts to comply with evolving laws, regulations and standards have resulted in, and are likely to continue to result in, increased general and administrative expenses and a diversion of management time and attention from revenue-generating activities to compliance activities. In addition, during the fiscal year ending December 31, 2007, Bancorp will be required to comply with Section 404 of the Sarbanes-Oxley Act of 2002 and the related regulations regarding its required assessment of its internal controls over financial reporting and its external auditors' audit of that assessment. In order to prepare for this, Bancorp will need to commit significant financial and managerial resources beginning in 2006. If Bancorp does not effectively comply with these laws, regulations and standards, its reputation may be harmed.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

- (a) On July 14, 2006, the Company issued 845 shares of its common stock to its five outside directors. Pursuant to a policy adopted by the Board of Directors, outside directors serving on the board receive an annual award of the Company's common stock valued at \$5,000; the award is prorated for directors who have served less than a full year. The shares have not been registered under the Securities Act of 1933 and therefore were issued in a private placement transaction exempt from registration under Section 4(2) of the Securities Act. For purposes of this transaction, the Company shares were valued at approximately \$29.50 per share, or a total value of approximately \$25,000.
- (b) Not applicable
- (c) Not applicable
- (d) Not applicable

Item 6. Exhibits

| <u>No.</u> | <u>Description</u> |
|------------|---|
| 2 | Agreement and Plan of Reorganization dated as of June 28, 1999 between Bancorp and the Bank (incorporated by reference to Exhibit 2 to Bancorp's Current Report on Form 8-K dated December 1, 1999 (Commission File No. 000-29599)). |
| 3(i) | Certificate of Incorporation of Bancorp, (incorporated by reference to Exhibit 3(i) to Bancorp's Current Report on Form 8-K dated December 1, 1999 (Commission File No. 000-29599)). |
| 3(i)(A) | Certificate of Amendment of Certificate of Incorporation of Patriot National Bancorp, Inc. dated July 16, 2004 (incorporated by reference to Exhibit 3(i)(A) to Bancorp's Annual Report on Form 10-KSB for the year ended December 31, 2004 (Commission File No. 000-29599)). |
| 3(i)(B) | Certificate of Amendment of Certificate of Incorporation of Patriot National Bancorp, Inc. dated June 15, 2006. |

| <u>No.</u> | <u>Description</u> |
|------------|--|
| 3(ii) | By-laws of Bancorp (incorporated by reference to Exhibit 3(ii) to Bancorp's Current Report on Form 8-K dated December 1, 1999 (Commission File No. 000-29599)). |
| 4 | Reference is made to the Rights Agreement dated April 19, 2004 by and between Patriot National Bancorp, Inc. and Registrar and Transfer Company filed as Exhibit 99.2 to Bancorp's Report on Form 8-K filed on April 19, 2004, which is incorporated herein by reference. |
| 10(a)(1) | 2001 Stock Appreciation Rights Plan of Bancorp (incorporated by reference to Exhibit 10(a)(1) to Bancorp's Annual Report on Form 10-KSB for the year ended December 31, 2001 (Commission File No. 000-29599)). |
| 10(a)(3) | Employment Agreement, dated as of October 23, 2000, as amended by a First Amendment, dated as of March 21, 2001, among the Bank, Bancorp and Charles F. Howell (incorporated by reference to Exhibit 10(a)(4) to Bancorp's Annual Report on Form 10-KSB for the year ended December 31, 2000 (Commission File No. 000-29599)). |
| 10(a)(4) | Change of Control Agreement, dated as of May 1, 2001 between Martin G. Noble and Patriot National Bank (incorporated by reference to Exhibit 10(a)(4) to Bancorp's Annual Report on Form 10-KSB for the year ended December 31, 2004 (Commission File No. 000-29599)). |
| 10(a)(5) | Employment Agreement dated as of November 3, 2003 among Patriot National Bank, Bancorp and Robert F. O'Connell (incorporated by reference to Exhibit 10(a)(5) to Bancorp's Annual Report on Form 10-KSB for the year ended December 31, 2003 (Commission File No. 000-29599)). |
| 10(a)(6) | Change of Control Agreement, dated as of November 3, 2003 between Robert F. O'Connell and Patriot National Bank (incorporated by reference to Exhibit 10(a)(6) to Bancorp's Annual Report on Form 10-KSB for the year ended December 31, 2003 (Commission File No. 000-29599)). |

| <u>No.</u> | <u>Description</u> |
|------------|---|
| 10(a)(8) | Employment Agreement dated as of January 1, 2006 between Patriot National Bank and Marcus Zavattaro (incorporated by reference to Exhibit 10(a)(8) to Bancorp's Annual Report on Form 10-KSB for the year ended December 31, 2005 (Commission File No. 000-29599)). |
| 10(a)(9) | License agreement dated July 1, 2003 between Patriot National Bank and L. Morris Glucksman (incorporated by reference to Exhibit 10(a)(9) to Bancorp's Annual Report on Form 10-KSB for the year ended December 31, 2003 (Commission File No. 000-29599)). |
| 10(a)(10) | Employment Agreement dated as of October 23, 2003 among the Bank, Bancorp and Charles F. Howell (incorporated by reference to Exhibit 10(a)(10) to Bancorp's Annual Report on form 10-KSB for the year ended December 31, 2003 (Commission file No. 000-29599)). |
| 10(a)(11) | Amendment No. 1 to the Amended and Restated Change of control Agreement, dated March 30, 2006, between Robert F. O'Connell and Patriot National Bank (incorporated by reference to Exhibit 10(a)(11) to Bancorp's Annual Report on Form 10-KSB for the year ended December 31, 2005 (Commission File No. 000-29599)). |
| 10(a)(12) | 2005 Director Stock Award Plan (incorporated by reference to Exhibit 10(a)(12) to Bancorp's Quarterly Report on Form 10-Q for the quarter ended June 30, 2006 (Commission File No. 000-295999)). |
| 10(c) | 1999 Stock Option Plan of the Bank (incorporated by reference to Exhibit 10(c) to Bancorp's Current Report on Form 8-K dated December 1, 1999 (Commission File No. 000-29599)). |
| 14 | Code of Conduct for Senior Financial Officers (incorporated by reference to Exhibit 14 to Bancorp's Annual Report on Form 10-KSB for the year ended December 31, 2004 (Commission File No. 000-29599)). |

| <u>No.</u> | <u>Description</u> |
|------------|---|
| 21 | Subsidiaries of Bancorp (incorporated by reference to Exhibit 21 to Bancorp's Annual Report on Form 10-KSB for the year ended December 31, 1999 (Commission File No. 000-29599)). |
| 31(1) | Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer |
| 31(2) | Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer |
| 32 | Section 1350 Certifications |

SIGNATURES

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

Patriot National Bancorp, inc.
Registrant)

By: /s/ Robert F. O'Connell
Robert F. O'Connell,
Senior Executive Vice President
Chief Financial Officer

(On behalf of the registrant and as
chief financial officer)

November 14, 2006