

PATRIOT NATIONAL BANCORP INC  
Form 10-K  
March 29, 2007

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**U. S. SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10 - K**

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

For the Fiscal Year Ended December 31, 2006

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

**Commission file number 000-29599**

**PATRIOT NATIONAL BANCORP, INC.**

(Exact name of registrant as specified in its charter)

**Connecticut**

(State or other jurisdiction of incorporation or  
organization)

**900 Bedford Street**  
**Stamford, Connecticut**

(Address of principal executive offices)

**06-1559137**

(IRS Employer Identification Number)

**06901**

(Zip Code)

Registrant's telephone number, including area code:

**(203) 324-7500**

Securities registered under Section 12(b) of the Exchange Act: None

Securities registered under Section 12(g) of the Exchange Act: Common Stock, par value \$2.00 per share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act of 1933. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes  No

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

Check if disclosure of delinquent filers in response to Item 405 of Regulation S-K is not contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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Check whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer in Rule 12(b) of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

Yes  No

Aggregate market value of the voting stock held by nonaffiliates of the registrant as of February 28, 2007 based on the last sale price as reported on the NASDAQ Global Market: \$ 87,306,174.

Number of shares of the registrant's Common Stock, par value \$2.00 per share, outstanding as of February 28, 2007: 4,739,494.

Documents Incorporated by Reference

Proxy Statement for 2006 Annual Meeting of Shareholders. (A definitive proxy statement will be filed with the Securities and Exchange Commission within 120 days after the close of the fiscal year covered by this Form 10-K.)

Incorporated into Part III of this Form 10-K.

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**Patriot National Bancorp, Inc.  
2006 Form 10-K Annual Report**

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**“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 Bank and the conduct of its business, (5) changes in competition among financial service 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 which it is impracticable for Bancorp to provide, (7) the effect of Bancorp’s opening of branches, (8) the effect of any decision by Bancorp to engage in any business not historically operated by it 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 other filings with the SEC.

Although Bancorp believes that it offers the loan and deposit products and has the resources needed for continued success, future revenues and interest spreads and yields cannot be reliably predicted. These trends may cause Bancorp to adjust its operations in the future. Because of the foregoing and other factors, recent trends should not be considered reliable indicators of future financial results or stock prices.

## PART I

### Item 1. Business

#### General

Patriot National Bancorp, Inc. (“*Bancorp*”), a Connecticut corporation, was organized in 1999 for the purpose of becoming a one-bank holding company (the “*Reorganization*”) for Patriot National Bank, a national banking association headquartered in Stamford, Fairfield County, Connecticut (the “*Bank*”). Following receipt of regulatory and shareholder approvals, the *Reorganization* became effective as of the opening of business on December 1, 1999. Upon consummation of the *Reorganization*, each outstanding share of Common Stock, par value \$2.00 per share, of the Bank (“*Bank Common Stock*”), was converted into the right to receive one share of Common Stock, par value \$2.00 per share, of Bancorp (“*Bancorp Common Stock*”), and each outstanding option or warrant to purchase Bank Common Stock became an option or warrant to purchase an equal number of shares of Bancorp Common Stock.

The Bank was granted preliminary approval by the Comptroller of the Currency (the “*OCC*”) on March 5, 1993. It received its charter and commenced operations as a national bank on August 31, 1994. Since then, the Bank has opened branch offices in Greenwich and Old Greenwich, Connecticut, two branch offices in Norwalk, Connecticut, a second Stamford location, two branch offices in Wilton, Connecticut, a branch office in Darien, Connecticut, a branch office in Southport, Connecticut, a branch office in Milford, Connecticut and two branch offices in Fairfield, Connecticut. The Bank also expanded into New York State through the purchase of a small branch office in New York City. The Bank recently received regulatory approval to open six additional branch offices.

On June 30, 1999, the Bank through its wholly-owned subsidiary, PinPat Acquisition Corporation, acquired all of the outstanding capital stock of Pinnacle Financial Corp., a Connecticut corporation, Pinnacle Financial Corp., a New Jersey corporation, and Pinnacle Financial Corp., a New York corporation (collectively, “*Pinnacle*”), a residential mortgage broker. Pinnacle surrendered its mortgage licenses and the mortgage brokerage business of Pinnacle is now conducted through the lending function of Patriot National Bank.

PinPat Acquisition Corporation currently holds one commercial property as other real estate owned transferred from the bank upon the conclusion of foreclosure proceedings in the third quarter of 2006.

On March 11, 2003, Bancorp formed Patriot National Statutory Trust I (the “*Trust*”) for the sole purpose of issuing trust preferred securities and investing the proceeds in subordinated debentures issued by Bancorp. Bancorp primarily invested the funds from the issuance of the debt in the Bank, which in turn used the proceeds to fund general operations of the Bank.

On November 17, 2006 the Bank acquired a small branch office and related deposits at 45 West End Avenue, New York, New York, from Millennium bcpbank, a national bank headquartered in Newark, New Jersey. The acquisition is in furtherance of Bancorp’s growth

strategy and will permit the Bank to establish additional branches in New York State. The Bank assumed the existing lease and plans to operate from the branch at 45 West End Avenue.

As of the date hereof, the only business of Bancorp is its ownership of all of the issued and outstanding capital stock of the Bank and the Trust. Except as specifically noted otherwise herein, the balance of the description of Bancorp's business is a description of the Bank's business.

### Commercial Banking

The Bank conducts business at its main office located at 900 Bedford Street, Stamford, Connecticut and at branch offices located at: 838 High Ridge Road, Stamford, Connecticut, 100 Mason Street, Greenwich, Connecticut, 184 Sound Beach Avenue, Old Greenwich, Connecticut, 16 River Street and 365 Westport Avenue in Norwalk, Connecticut, One Danbury Road and 5 River Road in Wilton, Connecticut, 800 Post Road in Darien, Connecticut, 3695 Post Road in Southport, Connecticut, 771 Boston Post Road in Milford, Connecticut, 45 West End Avenue in New York City, New York and 1127 Post Road and 1755 Black Rock Turnpike in Fairfield, Connecticut. The Bank also operates loan origination offices at 1177 Summer Street, Stamford, Connecticut and 200 Broad Hollow Road, Melville, New York.

The Bank offers a broad range of consumer and commercial banking services with an emphasis on serving the needs of individuals, small and medium-sized businesses and professionals. The Bank offers consumer and commercial deposit accounts that include: checking accounts, interest-bearing "NOW" accounts, insured money market accounts, time certificates of deposit, savings accounts, IRA's (Individual Retirement Accounts) and health savings accounts (HSA's). Other services include money orders, traveler's checks, ATM's (automated teller machines), internet banking and debit cards. In addition, the Bank may in the future offer Keogh accounts and other financial services.

The Bank offers commercial real estate and construction loans to area businesses and developers. Real estate loans made to individuals include home mortgages, home improvement loans, bridge loans and home equity lines of credit. Other personal loans include lines of credit, installment loans and credit cards. Commercial loans offered to small and medium-sized businesses include secured and unsecured loans to service companies, real estate developers, manufacturers, restaurants, wholesalers, retailers and professionals doing business in the region. The Bank also offers residential mortgages; the bank solicits and processes mortgage loan applications from consumers on behalf of permanent investors and originates loans for sale.

### Competition

The Bank competes with a variety of financial institutions in its market area. Most have greater financial resources and capitalization, which gives them higher lending limits and the ability to conduct larger advertising campaigns to attract business. Generally the larger institutions offer services such as trust and international banking which the Bank is not equipped to offer directly. When the need arises, arrangements are made with correspondent institutions to provide such services. In the future, if the Bank desires to offer trust services, prior approval of the OCC will be required. To attract business in this competitive environment, the Bank relies on local

promotional activities and personal contact by officers, directors and shareholders and on its ability to offer personalized services.

The customer base of the Bank is diversified so that there is not a concentration of either loans or deposits within a single industry, a group of industries, a single person or groups of people. The Bank is not dependent on one or a few major customers for either its deposit or lending activities, the loss of any one of which would have a material adverse effect on the business of the Bank.

Residents and businesses in Stamford, Greenwich, Norwalk, Wilton, Darien, Southport, Fairfield and Milford, Connecticut provide the majority of the Bank's deposits. The Bank has focused its attention on serving the segments of its market area historically served by community banks. The Bank competes in its market by providing a high level of personalized and responsive banking service for which the Bank believes there is a need. This area is bordered by New York State to the west, the Town of Ridgefield to the north, the Town of Orange to the east, and the Long Island Sound to the south.

The Bank's loan customers extend beyond Stamford, Greenwich, Norwalk, Wilton, Darien, Southport, Milford and Fairfield to include nearby towns in Fairfield County, Connecticut, and towns in Westchester County, New York, although the Bank's loan business is not necessarily limited to these areas. The Bank's mortgage brokerage business is concentrated primarily in the areas surrounding its loan origination offices. While the Bank does not currently hold or intend to attract significant deposit or loan business from major corporations with headquarters in the Fairfield County area, the Bank believes that the service, professional and related businesses which have been attracted to this area, as well as the individuals that reside in this area, represent current and potential customers of the Bank.

As the Bank expands with full service branch banking offices into Westchester County, New York, it will solicit deposits from residents and businesses located within the New York metropolitan area in addition to further developing its loan production efforts. This expansion effort will involve material deployment of the Bank's capital.

In the normal course of business and subject to applicable government regulations, the Bank invests a portion of its assets in investment securities, which may include certain debt and equity securities, including government securities. An objective of the Bank's investment policy is to seek to optimize its return on assets while limiting its exposure to interest rate movements and to maintain adequate levels of liquidity.

The Bank's employees perform most routine day-to-day banking transactions at the Bank. However, the Bank has entered into a number of arrangements with third parties for banking services such as correspondent banking, check clearing, data processing services, credit card processing and armored carrier service.

The cities of Stamford and Norwalk and the towns of Greenwich, Wilton, Darien, Southport, Milford and Fairfield are presently served by over 200 branches of commercial banks and savings banks, most of which are offices of banks which have headquarters outside of the state or area or are subsidiaries of bank or financial holding companies whose headquarters are outside of

the areas served by the Bank. In addition to banks with branches in the same areas as the Bank, there are numerous banks and financial institutions serving the communities surrounding these areas, which also draw customers from Stamford, Greenwich, Norwalk, Wilton, Darien, Southport, Milford and Fairfield, posing significant competition to the Bank for deposits and loans. Many of those banks and financial institutions are well established and well capitalized.

In recent years, intense market demands, economic pressures and significant legislative and regulatory actions have eroded banking industry classifications which were once clearly defined and have increased competition among banks, as well as other financial institutions including non-bank competitors. This increase in competition has caused banks and other financial service institutions to diversify their services and become more cost effective. The impact on Bancorp of federal legislation authorizing increased services by financial holding companies and interstate branching of banks has also resulted in increased competition. These events have resulted in increasing homogeneity in the financial services offered by banks and other financial institutions. The impact on banks and other financial institutions of these market dynamics and legislative and regulatory changes has been increased customer awareness of product and service differences among competitors and increased merger activity.

### Supervision and Regulation

As a bank holding company, Bancorp's operations are subject to regulation, supervision and examination by the Board of Governors of the Federal Reserve Board (the "*Federal Reserve Board*"). The Federal Reserve Board has established capital adequacy guidelines for bank holding companies that are similar to the OCC's capital guidelines applicable to the Bank. The Bank Holding Company Act of 1956, as amended (the "*BHC Act*"), limits the types of companies that a bank holding company may acquire or organize and the activities in which it or they may engage. In general, bank holding companies and their subsidiaries are only permitted to engage in, or acquire direct control of, any company engaged in banking or in a business so closely related to banking as to be a proper incident thereto. Federal legislation enacted in 1999 authorizes certain entities to register as financial holding companies. Registered financial holding companies are permitted to engage in businesses, including securities and investment banking businesses, which are prohibited to bank holding companies. While the creation of financial holding companies is evolving, to date there has been no significant impact on Bancorp.

Under the BHC Act, Bancorp is required to file annually with the Federal Reserve Board a report of its operations. Bancorp, the Bank and any other subsidiaries are subject to examination by the Federal Reserve Board. In addition, Bancorp will be required to obtain the prior approval of the Federal Reserve Board to acquire, with certain exceptions, more than 5% of the outstanding voting stock of any bank or bank holding company, to acquire all or substantially all of the assets of a bank or to merge or consolidate with another bank holding company. Moreover, Bancorp, the Bank and any other subsidiaries are prohibited from engaging in certain tying arrangements in connection with any extension of credit or provision of any property or services. The Bank is also subject to certain restrictions imposed by the Federal Reserve Act on issuing any extension of credit to Bancorp or any of its subsidiaries or making any investments in the stock or other securities thereof and on the taking of such stock or securities as collateral for loans to any borrower. If Bancorp wants to engage in businesses permitted to financial holding companies

but not to bank holding companies, it would need to register with the Federal Reserve Board as a financial holding company.

The Federal Reserve Board has issued a policy statement on the payment of cash dividends by bank holding companies, which expresses its view that a bank holding company should pay cash dividends only to the extent that the bank holding company's net income for the past year is sufficient to cover both the cash dividend and a rate of earnings retention that is consistent with the bank holding company's capital needs, asset quality and overall financial condition. The Federal Reserve Board has also indicated that it would be inappropriate for a company experiencing serious financial problems to borrow funds to pay dividends. Furthermore, under the prompt corrective action regulations adopted by the Federal Reserve Board pursuant to applicable law, the Federal Reserve Board may prohibit a bank holding company from paying any dividends if its bank subsidiary is classified as "undercapitalized."

A bank holding company is required to give the Federal Reserve Board prior written notice of any purchase or redemption of its outstanding equity securities if the gross consideration for the purchase or redemption, when combined with the net consideration paid for all such purchases or redemptions during the preceding 12 months, is equal to 10% or more of its consolidated retained earnings. The Federal Reserve Board may disapprove such a purchase or redemption if it determines that the proposal would constitute an unsafe or unsound practice or would violate any law, regulation, Federal Reserve Board order, or any condition imposed by, or written agreement with, the Federal Reserve Board.

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, ("*Riegle-Neal Act*") was enacted to ease restrictions on interstate banking. Effective September 29, 1995, the Riegle-Neal Act allows the Federal Reserve Board to approve an application of an adequately capitalized and adequately managed bank holding company to acquire control of, or acquire all or substantially all of the assets of, a bank located in a state other than such holding company's state, without regard to whether the transaction is prohibited by the laws of any state. The Federal Reserve Board may not approve the acquisition of a bank that has not been in existence for the minimum time period (not exceeding five years) specified by the statutory law of the host state. The Riegle-Neal Act also prohibits the Federal Reserve Board from approving an application if the applicant (and its depository institution affiliates) controls or would control more than 10% of the insured deposits in the United States or 30% or more of the deposits in the target bank's home state or in any state in which the target bank maintains a branch. The Riegle-Neal Act does not affect the authority of states to limit the percentage of total insured deposits in the state which may be held or controlled by a bank or bank holding company to the extent that such limitation does not discriminate against out-of-state banks or bank holding companies. Individual states may also waive the 30% statewide concentration limits contained in the Riegle-Neal Act. The Riegle-Neal Act also allows banks to establish branch offices in other than the bank's home state if the target state has "opted in" to interstate branching. Connecticut has "opted in"; New York has not, so at the present time the bank cannot establish a branch (deposit taking and loan making facility) in New York State except through the purchase of an existing New York bank or branch of a New York bank. The bank consummated such a purchase in November 2006.

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Bancorp is subject to capital adequacy rules and guidelines issued by the OCC, the Federal Reserve Board and the Federal Deposit Insurance Corporation (“*FDIC*”), and the Bank is subject to capital adequacy rules and guidelines issued by the OCC. These substantially identical rules and guidelines require Bancorp to maintain certain minimum ratios of capital to adjusted total assets and/or risk-weighted assets. Under the provisions of the Federal Deposit Insurance Corporation Improvements Act of 1991, the Federal regulatory agencies are required to implement and enforce these rules in a stringent manner. Bancorp is also subject to applicable provisions of Connecticut law insofar as they do not conflict with, or are not otherwise preempted by, Federal banking law.

Bancorp is subject to the reporting requirements of the Securities Exchange Act of 1934, as amended (the “*Exchange Act*”), and, in accordance with the Exchange Act, files periodic reports, proxy statements and other information with the Securities and Exchange Commission (the “*SEC*”).

The Bank’s operations are subject to regulation, supervision and examination by the OCC and the FDIC.

Federal and state banking regulations regulate, among other things, the scope of the business of a bank, a bank holding company or a financial holding company, the investments a bank may make, deposit reserves a bank must maintain, the establishment of branches and the activities of a bank with respect to mergers and acquisitions. The Bank is a member of the Federal Reserve System and is subject to applicable provisions of the Federal Reserve Act and regulations thereunder. The Bank is subject to the federal regulations promulgated pursuant to the Financial Institutions Supervisory Act to prevent banks from engaging in unsafe and unsound practices, as well as various other federal and state laws and consumer protection laws. The Bank is also subject to the comprehensive provisions of the National Bank Act.

The OCC regulates the number and locations of the branch offices of a national bank. The OCC may only permit a national bank to maintain branches in locations and under the conditions imposed by state law upon state banks. At this time, applicable Connecticut banking laws do not impose any material restrictions on the establishment of branches by Connecticut banks throughout Connecticut. New York State law is similar; however, the Bank cannot establish a branch in a town with a population of less than 50,000 that is the headquarter town of another bank.

The earnings and growth of Bancorp, the Bank and the banking industry are affected by the monetary and fiscal policies of the United States Government and its agencies, particularly the Federal Reserve Board. The Open Market Committee of the Federal Reserve Board implements national monetary policy to curb inflation and combat recession. The Federal Reserve Board uses its power to adjust interest rates in United States Government securities, the Discount Rate and deposit reserve retention rates. The actions of the Federal Reserve Board influence the growth of bank loans, investments and deposits. They also affect interest rates charged on loans and paid on deposits. The nature and impact of any future changes in monetary policies cannot be predicted.

In addition to other laws and regulations, Bancorp and the Bank are subject to the Community Reinvestment Act (“CRA”), which requires the Federal bank regulatory agencies, when considering certain applications involving Bancorp or the Bank, to consider Bancorp’s and the Bank’s record of helping to meet the credit needs of its entire community, including low- and moderate-income neighborhoods. The CRA was originally enacted because of concern over unfair treatment of prospective borrowers by banks and over unwarranted geographic differences in lending patterns. Existing banks have sought to comply with CRA in various ways; some banks have made use of more flexible lending criteria for certain types of loans and borrowers (consistent with the requirement to conduct safe and sound operations), while other banks have increased their efforts to make loans to help meet identified credit needs within the consumer community, such as those for home mortgages, home improvements and small business loans. This may include participation in various government insured lending programs, such as Federal Housing Administration insured or Veterans Administration guaranteed mortgage loans, Small Business Administration loans, and participation in other types of lending programs such as high loan-to-value ratio conventional mortgage loans with private mortgage insurance. To date, the market area from which the Bank draws much of its business is Stamford, Greenwich, Norwalk, Wilton, Darien, Southport and Milford, which are characterized by a very diverse ethnic, economic and racial cross-section of the population. As the Bank expands further, the market areas served by the Bank will continue to evolve. Bancorp and the Bank have not and will not adopt any policies or practices, which discourage credit applications from, or unlawfully discriminate against, individuals or segments of the communities served by the Bank.

On October 26, 2001, the United and Strengthening America by Providing Tools Required to Intercept and Obstruct Terrorism Act of 2001, or the *USA Patriot Act*, was enacted to further strengthen domestic security following the September 11, 2001 attacks. This Act amends various federal banking laws, particularly the Bank Secrecy Act, with the intent to curtail money laundering and other activities that might be undertaken to finance terrorist actions. The Act also requires that financial institutions in the United States enhance already established anti-money laundering policies, procedures and audit functions and ensure that controls are reasonably designed to detect instances of money laundering through certain correspondent or private banking accounts. Verification of customer identification, maintenance of said verification records and cross checking names of new customers against government lists of known or suspected terrorists is also required. The Patriot Act was recently reauthorized and modified with the enactment of The USA Patriot Act Improvement and Reauthorization Act of 2005.

On July 20, 2002, the Sarbanes-Oxley Act of 2002 was enacted, the primary purpose of which is to protect investors through improved corporate governance and responsibilities of, and disclosures by, public companies. The Act contains provisions for the limitations of services that external auditors may provide as well as requirements for the credentials of Audit Committee members. In addition, the principal executive and principal financial officers are required to certify in quarterly and annual reports that they have reviewed the report; and based on the officers’ knowledge, the reports accurately present the financial condition and results of operations of the company and contain no untrue statement or omission of material fact. The officers also certify their responsibility for establishing and maintaining a system of internal controls which insure that all material information is made known to the officers; this certification also includes the evaluation of the effectiveness of disclosure controls and

procedures and their impact upon financial reporting. Section 404 of the Act entitled Management Assessment of Internal Controls, requires that each annual report include an internal control report which states that it is the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting, as well as an assessment by management of the effectiveness of the internal control structure and procedures for financial reporting. This section further requires that the external auditors attest to, and report on, the assessment made by management. On September 21, 2005, the SEC extended the Section 404 compliance dates for non-accelerated filers (those issuers with non-affiliated public float of less than \$75 million) to fiscal years ending on or after July 15, 2007.

Bancorp does not anticipate that compliance with applicable federal and state banking laws will have a material adverse effect on its business or the business of the Bank. Neither Bancorp nor the Bank has any material patents, trademarks, licenses, franchises, concessions and royalty agreements or labor contracts, other than the charter granted to the Bank by the OCC.

#### Employees

As of December 31, 2006, Bancorp had 107 full-time employees and five part-time employees. None of the employees of Bancorp is covered by a collective bargaining agreement.

#### 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, one through acquisition, 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, or the unavailability of suitable sites, 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 locations, attract funding to 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, the rate of increase in earnings will 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.

**Bancorp intends to expand into a new geographic market in which current senior management has limited experience.**

Bancorp intends to expand into Westchester County and the surrounding counties in New York State. In November 2006, Bancorp acquired a small branch office in New York City, New York from another financial institution. This acquisition will allow Bancorp to establish additional bank branch offices in Westchester County, New York, which was the primary purpose for the acquisition. Bancorp does not plan further branch expansion in New York City at this time. Bancorp has received regulatory approval for and entered into a lease agreement to establish a branch in Bedford, New York; management anticipates that this office will open during the second quarter of 2007.

The vast majority of Bancorp's deposits and loans are derived from and made to customers who live and work in Fairfield County, Connecticut. Although management believes that the demographics for Westchester County, New York closely resemble those of Fairfield County Connecticut, the Bank does not currently conduct significant deposit activity in New York State. The senior management team includes several individuals with substantial banking experience in Connecticut, but with less experience in New York. Bancorp's ability to compete effectively in New York State will depend in part on management's ability to hire and retain key employees who have extensive banking experience in the Westchester County.

**Bancorp has no experience opening bank branch offices in Westchester County, New York.**

Historically, Bancorp's investment in capital equipment to establish a new branch office has ranged between \$315,000 and \$450,000; however, total branch operating costs also include a variety of variable costs, including the prevailing rental rates in the local branch office area, the size of the branch, the availability of facilities that are ready to be operated as bank branches, and the number of employees. Bancorp has not opened branches in Westchester County in the past and may not be able to accurately estimate the variable costs associated with opening branch offices in this area. If management underestimates these variable costs, then the branches Bancorp establishes in these areas may prove to be more costly than anticipated and, as a further consequence, Bancorp's branch expansion program may be delayed or reduced in scope, or both, which may have an adverse effect on Bancorp's business and results of operations.

**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, repayments of such loans can be affected by adverse conditions in the real estate market or 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, other investments mature or 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 sales manager of retail brokerage, 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 recent purchase of a small branch in New York City, New York and future expansion into Westchester County, New York, will expose the Bank to more competition 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. 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 began committing significant financial and managerial resources to this effort in 2006. If Bancorp does not effectively comply with these laws, regulations and standards, its reputation may be harmed.

Item 1B. Unresolved Staff Comments

Bancorp has no unresolved comments from the SEC staff.

Item 2. Properties

Patriot National Bancorp Inc.'s corporate headquarters and main branch banking office is located at 900 Bedford Street in Stamford, Connecticut. The building is leased by the Bank as are its thirteen other branch banking offices and two loan origination offices. The Bank also leases space at its main office for additional parking. Lease commencement dates for office locations range from July 2002 to January 2007 and lease expiration dates fall between June 30, 2007 and January 2022. Subsequent to December 31, 2006 the Bank entered into two leases for new branch locations scheduled to open in 2007. Most of the leases contain rent escalation provisions as well as renewal options for one or more periods.

The Bank has sublet and licensed excess space in three of its locations, two to an attorney and one to a retail eyeglass store. See also, "Item 12. Certain Relationships and Related Transactions." For additional information regarding the Bank's lease obligations, see Note 9 to the Consolidated Financial Statements.

All leased properties are in good condition.

Item 3. Legal Proceedings

Neither Bancorp nor the Bank has any pending legal proceedings, other than ordinary routine litigation incidental to its business, to which Bancorp or the Bank is a party or any of its property is subject.

Item 4. Submission of Matters to a Vote of Security Holders

During the fourth quarter of 2006, no matter was submitted to a vote of shareholders.

**PART II**

Item 5. Market for Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities

Market Information

Bancorp Common Stock is traded on the NASDAQ Global Market under the Symbol "PNBK." On December 31, 2006, the last sale price for Bancorp Common Stock on the NASDAQ Global Market was \$26.45.

The following table sets forth the high and low sales price and dividends per share of Bancorp Common Stock for the last two fiscal years for each quarter as reported on the NASDAQ Small Cap Market and the NASDAQ Global Market. Bancorp's common stock has traded on the NASDAQ Global Market since August 29, 2006; previously, it was traded on the NASDAQ Small Cap Market.

Quarter Ended	2006			2005		
	Sales Price		Cash Dividends	Sales Price		Cash Dividends
	High	Low	Declared	High	Low	Declared
March 31	\$ 26.05	\$ 20.00	\$ 0.040	\$ 18.40	\$ 17.00	\$ 0.035
June 30	30.24	23.75	0.045	19.96	18.05	0.040
September 30	30.50	23.00	0.045	19.45	18.01	0.040
December 31	27.25	23.50	0.045	21.64	18.50	0.040

Holdings

There were approximately 666 shareholders of record of Bancorp Common Stock as of December 31, 2006. This number does not reflect the number of persons or entities holding stock in nominee name through banks, brokerage firms or other nominees.

Dividends

2001 marked the first year in which Bancorp paid a dividend on Bancorp Common Stock; since then, the Company has consistently paid dividends.

Bancorp's ability to pay future dividends on its Common Stock depends on the Bank's ability to pay dividends to Bancorp. In accordance with OCC rules and regulations, the Bank may continue to pay dividends only if the total amount of all dividends that will be paid, including the proposed dividend in any calendar year does not exceed the total of the Bank's retained net income of that year to date, combined with the retained net income of the preceding two years, unless the proposed dividend is approved by the OCC. In addition, the OCC and/or the FDIC may impose further restrictions on dividends. Future dividends depend on many factors,

including management's estimates of future earnings and Bancorp's need for capital. At December 31, 2006, Patriot National Bank was in compliance with all applicable minimum capital requirements and had the ability to pay dividends of \$ 4.2 million to Bancorp without obtaining the prior approval of the OCC.

Recent Sales of Unregistered Securities

During the fourth quarter of 2006, Bancorp did not have any sales of unregistered securities.

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

During the fourth quarter of 2006 there were no such purchases of Bancorp Common Stock.

Securities Authorized for Issuance under Equity Compensation Plans

The following table presents information as of December 31, 2006 for equity compensation plans maintained by Bancorp.

**Equity Compensation Plan Information**

	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
	(a)	(b)	(c)
Equity compensation plans approved by security holders	65,000	\$10.13	-
Equity compensation plans not approved by security holders	-	-	-
Total	65,000	\$10.13	-

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Performance Graph

The performance graph compares the yearly percentage change in Bancorp's cumulative total shareholder return on its common stock over the last five fiscal years to the cumulative total return of the S&P 500 Index and the NASDAQ Bank Index. Total shareholder return is measured by dividing the sum of the cumulative amount of dividends for the measurement period (assuming dividend reinvestment) and the difference between Bancorp's share price at the end and the beginning of the measurement period, by the share price at the beginning of the measurement period.

**Comparison of Five Year Cumulative Total Return Among  
Patriot National Bancorp, Inc., S & P 500 Index and NASDAQ Bank Index**

Index	Period Ending					
	12/31/01	12/31/02	12/31/03	12/31/04	12/31/05	12/31/06
Patriot National Bancorp, Inc.	100.00	114.51	153.54	228.58	261.74	333.46
S & P 500	100.00	77.90	100.24	111.15	116.60	135.02
NASDAQ Bank Index	100.00	104.52	135.80	150.73	144.20	160.07

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Item 6. Selected Financial Data

	At or for the year ended December 31,				
	2006	2005	2004	2003	2002
<b>Operating Data:</b>					
Interest and dividend income	\$ 38,009,526	\$ 25,148,701	\$ 18,678,251	\$ 15,214,702	\$ 12,604,718
Interest expense	18,069,648	10,269,625	7,008,508	5,588,255	4,764,693
Net interest income	19,939,878	14,879,076	11,669,743	9,626,447	7,840,025
Provision for loan losses	1,040,000	1,110,000	556,000	563,000	468,000
Noninterest income	2,359,149	3,229,037	2,702,204	4,813,740	4,113,820
Noninterest expense	17,576,872	14,634,487	12,256,550	11,659,467	9,812,838
Provision for income taxes	1,267,000	957,000	633,000	877,000	621,000
Net income	2,415,155	1,406,626	926,397	1,340,720	1,052,007

**Per Share Data:**

Basic income per share	0.67	0.52	0.38	0.56	0.44
Diluted income per share	0.66	0.51	0.37	0.55	0.43
Dividends per share	0.175	0.155	0.135	0.115	0.095

**Balance Sheet  
Data 3/22/2007**

Cash and due from banks	3,868,670	7,220,577	6,670,409	4,023,732	5,385,757
Federal funds sold	27,000,000	6,500,000	37,500,000	15,000,000	3,000,000
Short term investments	24,605,869	2,247,028	11,460,057	10,430,939	3,348,968
Investment securities	70,222,035	80,991,068	78,258,775	92,330,533	61,720,716
Loans, net	506,884,155	364,243,777	263,874,820	214,420,528	170,794,939
Total assets	645,982,795	470,641,162	405,046,955	342,469,049	248,496,753
Total deposits	561,451,664	419,075,288	367,005,325	289,992,182	217,911,260
Total borrowings	16,248,000	17,248,000	16,248,000	31,301,385	10,292,675
Total shareholders' equity	64,283,345	31,374,615	19,756,434	18,779,913	18,544,955

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation

**Summary**

During 2006 Bancorp's subsidiary, Patriot National Bank established two additional branch banking offices, one through acquisition, increasing its branch banking network to 12 offices. In addition, Bancorp successfully completed a stock offering during September 2006 resulting in an increase in capital of \$30.7 million, net of offering fees and expenses. Bancorp received subscriptions for a total of 1,500,000 shares.

Bancorp reported earnings of \$2,415,000 (\$0.67 basic income per share and \$0.66 diluted income per share) for 2006 compared to \$1,407,000 (\$0.52 basic income per share and \$0.51 diluted income per share) for 2005. Total assets ended the year at a record high of \$646.0 million, an increase of \$175.4 million from December 31, 2005.

Net interest income for the year ended December 31, 2006 increased \$5.0 million or 34% to \$19.9 million as compared to \$14.9 million for the year ended December 31, 2005.

Total assets increased by 37% during the year as total loans increased from \$364.2 million at December 31, 2005 to \$506.9 million at December 31, 2006. The available for sale securities portfolio decreased \$11.6 million or 15% to \$67.1 million from \$78.7 million at December 31, 2005; due to the current interest rate environment, management deemed it prudent to maintain funds from the decrease in the investment portfolio in short term investments. Loan growth was funded through deposit growth and the proceeds raised in the stock offering. Deposits increased \$142.4 million to \$561.5 million at December 31, 2006; interest bearing deposits increased \$134.5 million, or 36%, and non-interest bearing deposits increased \$7.9 million or 16%. Shareholders' equity increased \$32.9 million; this increase is the result of the stock offering, the exercise of certain stock options, the increase in retained earnings from net income, net of dividend payments and the decrease in accumulated other comprehensive loss due to a decrease in unrealized losses on the available for sale securities portfolio.

**FINANCIAL CONDITION**

*Assets*

Bancorp's total assets increased \$175.3 million or 37% from \$470.6 million at December 31, 2005 to \$646.0 million at December 31, 2006. The growth in total assets was funded primarily by deposit growth of \$142.4 million and \$30.7 million in capital raised through the September 2006 stock offering and options exercised. Federal funds sold and short term investments increased \$20.5 million and \$22.4 million, respectively; these increases are due to the rapid rate of deposit growth, particularly during the fourth quarter.

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**Investments**

The following table is a summary of Bancorp's investment portfolio at December 31 for the years shown.

	2006	2005	2004
<b>U. S. Government Sponsored</b>			
Agency Obligations	\$ 16,566,822	\$ 16,476,684	\$ 14,823,295
Mortgage-backed securities	43,476,313	56,195,384	52,446,180
Marketable equity securities	7,050,000	6,000,000	9,000,000
Federal Reserve Bank stock	1,911,700	1,022,300	692,600
Federal Home Loan Bank stock	1,217,200	1,296,700	1,296,700
<b>Total Investments</b>	<b>\$ 70,222,035</b>	<b>\$ 80,991,068</b>	<b>\$ 78,258,775</b>

Total investments decreased \$10.7 million to \$70.2 million; principal payments on mortgage-backed securities were partially offset by an increase in marketable equity securities as management decided to maintain its liquidity position over increasing the investment portfolio due to the interest rate environment.

The following table presents the maturity distribution of available for sale investment securities at December 31, 2006 and the weighted average yield of such securities. The weighted average yields were calculated on the amortized cost and effective yields to maturity of each security.

	One year or less	Over one through five years	Over five through ten years	Over ten years	No maturity	Total	Weighted Average Yield
<b>U. S. Government Sponsored</b>							
Agency Obligations	\$ -	\$ 16,999,984	\$ -	\$ -	\$ -	\$ 16,999,984	3.59%
Mortgage-backed securities	-	-	-	-	44,141,476	44,141,476	4.37%
Money market preferred equity securities	-	-	-	-	7,050,000	7,050,000	4.20%
<b>Total</b>	\$ -	\$ 16,999,984	\$ -	\$ -	\$ 51,191,476	\$ 68,191,460	4.16%
<b>Weighted average yield</b>	-	3.59%	-	-	4.35%	4.16%	

The following table presents a summary of investments for any issuer that exceeds 10% of shareholders' equity at December 31, 2006:

	Amortized Cost	Fair Value
<b>Available for sale securities:</b>		
U. S. Government Sponsored Agency Obligations	\$ 16,999,984	\$ 16,566,822
Mortgage-backed securities	44,141,476	43,476,313



**Loans**

The following table is a summary of Bancorp's loan portfolio at December 31 for the years shown.

	2006	2005	2004
Real Estate			
Commercial	\$ 166,799,341	\$ 129,178,889	\$ 106,771,441
Residential	91,077,687	77,391,833	36,965,661
Construction	203,828,453	107,232,587	74,598,919
Commercial	23,997,640	15,591,818	17,562,523
Consumer installment	1,251,300	1,106,648	1,386,709
Consumer home equity	26,933,277	39,097,450	30,874,894
Total loans	513,887,698	369,599,225	268,160,147
Premiums on purchased loans	292,543	367,491	313,754
Net deferred fees	(1,665,654)	(1,134,604)	(1,117,556)
Allowance for loan losses	(5,630,432)	(4,588,335)	(3,481,525)
Loans, net	\$ 506,884,155	\$ 364,243,777	\$ 263,874,820

Bancorp's net loan portfolio increased \$142.7 million or 39% to \$506.9 million at December 31, 2006 from \$364.2 million at December 31, 2005. Loan growth was funded through an increase in total deposits as well as by the proceeds raised in the September 2006 stock offering. Significant increases in the portfolio include a \$96.6 million increase in construction loans, \$30.0 million of which represents construction phase to permanent financing arrangements, a \$37.6 million increase in commercial real estate loans, a \$13.7 million increase in residential real estate loans and an \$8.4 million increase in commercial and industrial 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 mortgage loans.

The Bank has continued to hire additional lenders and credit analysts while offering a competitively priced and expanded product line which contributed to the growth in the portfolio. Although short term 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 areas where the Bank primarily conducts its lending business. The Bank plans to further increase its lending and credit staff as it expands its franchise which should result in sustained strong loan demand, but from a wider market area.

At December 31, 2006, the net loan to deposit ratio was 90% and the net loan to asset ratio was 78%. At December 31, 2005, the net loan to deposit ratio was 87%, and the net loan to asset ratio was 77%.

Maturities and Sensitivities of Loans to Changes in Interest Rates

The following table presents the maturities of loans in Bancorp's portfolio at December 31, 2006, by type of loan:

(thousands of dollars)	Due in one year or less	Due after one year through five years	Due after five years	Total
Commercial real estate	\$ 37,075	\$ 30,969	\$ 98,755	\$ 166,799
Residential real estate	4,084	3,997	82,997	91,078
Construction loans	118,274	54,247	31,307	203,828
Commercial loans	10,056	12,419	1,523	23,998
Consumer installment	1,146	105	-	1,251
Consumer home equity	27	3,450	23,457	26,934
Total	\$ 170,662	\$ 105,187	\$ 238,039	\$ 513,888
Fixed rate loans	\$ 23,551	\$ 27,211	\$ 3,675	\$ 54,437
Variable rate loans	147,111	77,976	234,364	459,451
Total	\$ 170,662	\$ 105,187	\$ 238,039	\$ 513,888

Loan Concentrations

The Bank has no concentrations of loans other than those disclosed in the summary loan portfolio table.

Critical Accounting Policies

In the ordinary course of business, Bancorp has made a number of estimates and assumptions relating to reporting results of operations and financial condition in preparing its financial statements in conformity with accounting principles generally accepted in the United States of America. 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 which are based on historical loss experience adjusted for qualitative factors are multiplied against the balances in each risk rating category to arrive at the appropriate level for 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. Loan quality control 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.

Based upon this evaluation, management believes the allowance for loan losses of \$5.6 million, at December 31, 2006, which represents 1.10% 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.

The accrual of interest income on loans is discontinued whenever reasonable doubt exists as to its collectibility and generally is discontinued when loans are past due 90 days, based on contractual terms, as to either principal or interest. When the accrual of interest income is discontinued, all previously accrued and uncollected interest is reversed against interest income. The accrual of interest on loans past due 90 days or more, including impaired loans, may be continued if the loan is well secured, and it is believed all principal and accrued interest income due on the loan will be realized, and the loan is in the process of collection. A non-accrual loan is restored to accrual status when it is no longer delinquent and collectibility of interest and principal is no longer in doubt.

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Management considers all non-accrual loans and restructured loans to be impaired. In most cases, loan payments that are past due less than 90 days, based on contractual terms, are considered minor collection delays and the related loans are not considered to be impaired. The Bank considers consumer installment loans to be pools of smaller balance homogeneous loans, which are collectively evaluated for impairment.

Analysis of Allowance for Loan Losses

	2006		2005		2004		2003		2002	
	(thousands of dollars)									
Balance at beginning of period	\$	4,588	\$	3,481	\$	2,934	\$	2,372	\$	1,894
Charge-offs		(1)		(3)		(9)		(1)		-
Recoveries		3		-		-		-		10
Net recoveries (charge-offs)		2		(3)		(9)		(1)		10
Additions charged to operations		1,040		1,110		556		563		468
Balance at end of period	\$	5,630	\$	4,588	\$	3,481	\$	2,934	\$	2,372
Ratio of net recoveries (charge-offs) during the period to average loans outstanding during the period		0.00%		(0.00%)		(0.01%)		(0.00%)		0.01%

Allocation of the Allowance for Loan Losses

Balance at end of each period applicable to:	Amounts (thousands of dollars)					Percent of loans in each category to total loans				
	2006	2005	2004	2003	2002	2006	2005	2004	2003	2002
<b>Real Estate:</b>										
Commercial	\$ 1,943	\$ 1,607	\$ 1,319	\$ 1,183	\$ 893	32.46%	34.95%	39.82%	44.15%	37.97%
Residential	245	511	304	230	276	17.72%	20.94%	13.78%	9.98%	15.54%
Construction	2,998	1,963	1,358	972	726	39.67%	29.01%	27.82%	26.17%	22.56%
Commercial	290	164	185	155	129	4.67%	4.22%	6.55%	7.12%	7.49%
<b>Consumer</b>										
installment	31	10	11	12	11	0.24%	0.30%	0.52%	0.85%	1.01%
Consumer home equity	72	260	233	285	283	5.24%	10.58%	11.51%	11.73%	15.43%
Unallocated	51	73	71	97	54	N/A	N/A	N/A	N/A	N/A
<b>Total</b>	<b>\$ 5,630</b>	<b>\$ 4,588</b>	<b>\$ 3,481</b>	<b>\$ 2,934</b>	<b>\$ 2,372</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>

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Non-Accrual, Past Due and Restructured Loans

The following table is a summary of non-accrual and past due loans at the end of each of the last five years.

	2006	2005	2004	2003	2002
	(thousands of dollars)				
<b>Loans delinquent over 90 days still accruing</b>					
	\$ 1,897	\$ 275	\$ 373	\$ 165	\$ 1,172
<b>Non-accruing loans</b>					
	2,904	1,935	3,669	150	201
	\$ 4,801	\$ 2,210	\$ 4,042	\$ 315	\$ 1,373
<b>% of Total Loans</b>					
	0.93%	0.60%	1.51%	0.14%	0.79%
<b>% of Total Assets</b>					
	0.74%	0.47%	1.00%	0.09%	0.56%
<b>Additional income on non-accrual loans if recognized on an accrual basis</b>					
	\$ 141	\$ 6	\$ 18	\$ 18	\$ 67

There were no loans in either 2006 or 2005 considered as “troubled debt restructurings.”

Potential Problem Loans

The \$2.9 million of non-accruing loans at December 31, 2006 is comprised of three loans, all to the same borrower of which \$1.07 million was guaranteed by the U.S. Small Business Administration. The loans are secured by commercial and residential real estate as well as all associated business assets. Based on the Bank’s analysis for loan impairment, a specific reserve in the amount of \$250,000 has been established; however, management believes that the business is viable and subsequent to December 31, 2006 issued a proposal to the borrower for a modification under consideration by the Bank.

Loans delinquent over 90 days and still accruing are comprised of six loans, five of which totaling \$1.2 million were past maturity, but current as to loan payments; the remaining loan in the amount of \$695,000 was subsequently paid off.

At December 31, 2006, Bancorp had no loans other than those described above, as to which management has significant doubts as to the ability of the borrower to comply with the present repayment terms.

**Deposits**

The following table is a summary of Bancorp's deposits at December 31 for each of the years shown.

	2006	2005	2004
Non-interest bearing	\$ 56,679,836	\$ 48,797,389	\$ 42,584,120
<b>Interest bearing</b>			
Time certificates, less than \$100,000	248,414,014	168,565,756	131,764,662
Time certificates, \$100,000 or more	162,546,807	98,440,248	71,287,106
Money markets	40,935,628	57,798,772	72,450,663
Savings	25,993,452	20,089,889	22,104,121
NOW	26,881,927	25,383,234	26,814,653
Total interest bearing	504,771,828	370,277,899	324,421,205
Total deposits	\$ 561,451,664	\$ 419,075,288	\$ 367,005,325

Total deposits increased \$142.4 million or 34% to \$561.4 million at December 31, 2006. Non-interest bearing deposits increased \$7.9 million or 16% to \$56.7 million at December 31, 2006; interest bearing deposits increased \$134.5 million or 36% to \$504.8 million at December 31, 2006.

Due to the Bank's continued expansion and the increased penetration into the areas served by the Bank, commercial demand accounts increased \$5.7 million, a 20% increase as compared to last year, and personal demand accounts increased \$5.4 million, an increase of 39% when compared to last year. Internal accounts decreased \$3.3 million or 60% from \$5.5 million at December 31, 2005 to \$2.2 million at December 31, 2006; this decrease is due primarily to fewer outstanding official checks at the end of 2006 as compared to 2005.

During 2006, the Bank established two additional branch banking offices, a new office in Milford, Connecticut and the acquisition of one in New York City, New York. The promotional campaign run in conjunction with the grand opening of the Milford branch was also a contributing factor to the growth of deposits in established branches. Certificates of deposit increased \$144.0 million which represents an increase of 54% when compared to last year; much of the growth in certificates of deposit is attributable to the promotional campaign run in conjunction with the new branch opening as well as the transfer of funds from lower rate money market fund products, which decreased as compared to last year. The increase in certificates of deposit greater than \$100 thousand of \$64.1 million is the result of successful sales efforts and branch expansion. At December 31, 2006 the bank had no brokered deposits. Savings accounts increased \$5.9 million, an increase of 29% as compared to last year; this increase is due to a more competitively priced commercial savings product introduced during 2006. Money market fund accounts decreased \$16.8 million or 29%; a portion of this decrease represents transfers to certificates of deposit as a result of promotional campaigns and general increases in interest rates offered on certificates of deposit accounts. The Bank continues to offer attractive interest rates

in the very competitive Fairfield County marketplace in order to attract additional deposits to fund loan growth.

As of December 31, 2006, the Bank's maturities of time deposits were:

(thousands of dollars)	\$100,000 or greater	Less than \$100,000	Totals
Three months or less	\$ 39,441	\$ 55,475	\$ 94,916
Three to six months	42,712	69,094	111,806
Six months to one year	47,822	72,695	120,517
Over one year	32,572	51,150	83,722
Total	\$ 162,547	\$ 248,414	\$ 410,961

### **Borrowings**

Borrowings decreased \$1.0 million to \$16.2 million at December 31, 2006.

Borrowings are comprised of Federal Home Loan Bank Advances and junior subordinated debentures.

The following table sets forth certain information concerning short term borrowing amounts arising from Federal Home Loan Bank advances at the dates and for the years indicated:

December 31, 2006				December 31, 2005			
Amount	Maturity	Rate	Average amount outstanding	Amount	Maturity	Rate	Average amount outstanding
\$ 5,000,000	4/12/2007	5.240%	\$ 3,630,137	\$ 5,000,000	3/13/2006	4.490%	\$ 273,973
1,000,000	4/30/2007	2.960%	\$ 1,000,000	1,000,000	5/1/2006	2.490%	\$ 1,000,000
2,000,000	5/14/2007	5.110%	2,000,000				
\$ 8,000,000		4.923%	\$ 6,630,137	\$ 6,000,000		4.157%	\$ 1,273,973

The maximum amount of short term borrowings outstanding under Federal Home Loan Bank advances during 2006 and 2005 was \$46,000,000 and \$15,000,000, respectively.

*Other*

The increase in premises and equipment is due primarily to the capitalized costs associated with leasehold improvements and equipment for a new branch office as well as construction in progress for branches under renovation that are planned to open early in 2007.

The increase in accrued interest receivable is due primarily to higher outstanding balances in loans at December 31, 2006 as compared to those in effect at December 31, 2005.

The increase in goodwill and other intangible assets relates to the goodwill and core deposit intangible recorded in conjunction with the acquisition of the New York City branch banking office.

The increase in other assets includes other real estate owned of \$834,000 which is comprised of one commercial property obtained through loan foreclosure proceedings completed at the end of the third quarter of 2006. Subsequent to December 31, 2006 the Bank entered into a contract with a buyer for the property. Management anticipates that the sale should be consummated in 2007 in an amount in excess of the recorded investment in the property.

The increase in accrued expenses and other liabilities is due primarily to increases in accruals for sales and performance based incentive programs and higher balances in accrual estimates for other unpaid expenses.

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The following table presents average balance sheets (daily averages), interest income, interest expense and the corresponding yields earned and rates paid:

**Distribution of Assets, Liabilities and Shareholder's Equity**  
**Interest Rates and Interest Differential and Rate Volume Variance Analysis**  
(thousands of dollars)<sup>(1)</sup>

2006	Interest Income/Average Balance		2005	Interest Income/Average Balance		2004	Interest Income/Average Balance		2006 vs. 2005			2005 vs. 2004		
									Fluctuations			Fluctuations		
Average		Average	Average		Average	Average		Interest Income/Expense (3)			Interest Income/Expense (3)			
Balance		Rate	Balance		Rate	Balance		Due to Change in:			Due to Change in:			
								Volume	Rate	Total	Volume	Rate	Total	
<b>Interest earning assets:</b>														
Loans		7.69			6.82			6.53						
\$442,612	\$34,052	%	\$316,058	\$21,561	%	\$239,239	\$15,632	%	\$7,789	\$4,702	\$12,491	\$4,824	\$1,105	\$99
<b>Federal funds sold and other cash equivalents</b>														
Investments		5.12			2.94			1.39						200
\$18,161	\$955	%	\$16,777	\$494	%	\$21,089	\$294	%	50	411	461	(49)	249	
(4) 75,869	3,003	%	87,164	3,094	%	87,631	2,752	%	(376)	285	(91)	(15)	357	342
<b>Total interest earning assets</b>														
\$536,142	\$38,010	%	\$419,999	\$25,149	%	\$347,959	\$18,678	%	7,463	5,398	12,861	4,760	1,761	471
<b>Cash and due from banks</b>														
5,231			5,117			4,159								
<b>Allowance for loan losses</b>														
(6,324)			(3,897)			(3,190)								
<b>Other assets</b>														
8,671			8,446			8,017								
<b>Total assets</b>														
\$544,720			\$429,665			\$356,945								
<b>Interest bearing liabilities:</b>														
Time deposits		4.51			3.58			3.13						
\$21,522	\$14,687	%	\$224,526	\$8,040	%	\$156,623	\$4,901	%	\$3,018	\$3,629	\$6,647	\$1,895	\$1,244	\$19
23,291	435		21,792	277		23,666	294		18	140	158	(22)	5	(17)

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Savings accounts	1.87 %			1.27 %			1.24 %					
Money market accounts	1.44 %	67,943	862	1.27 %	70,264	867	1.23 %	(265)	49	(216)	(29)	24 (5)
NOW accounts	1.43 %	26,072	188	0.72 %	23,107	152	0.66 %	6	189	195	19	17
FHLB advances	5.07 %	10,422	374	3.59 %	14,197	372	2.62 %	346	521	867	(84)	86
Subordinated debt	8.16 %	8,248	528	6.40 %	8,248	380	4.61 %	-	145	145	-	148
Other borrowings	5.21 %	34	1	2.94 %	2,469	42	1.70 %	1	3	4	(23)	(18)(41)
Total interest bearing liabilities	3.99 %	\$ 359,037	\$ 10,270	2.86 %	\$ 298,574	\$ 7,008	2.35 %	3,124	4,676	7,800	1,756	1,506
Demand deposits		43,813			36,456							
Accrued expenses and other liabilities		3,380			2,362							
Shareholder's equity		23,435			19,553							
Total liabilities and equity		\$ 46,720			\$ 356,945							
Net interest income		\$ 19,940		\$ 14,879		\$ 11,670		\$ 4,339	\$ 722	\$ 5,061	\$ 3,004	\$ 20,209
Interest margin	3.71 %			3.54 %				3.35 %				
Interest spread	3.09 %			3.13 %				3.02 %				

(1) The 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.

(2) Includes non-accruing loans.

(3) Favorable/(unfavorable) fluctuations.

(4) Yields are calculated at historical cost and excludes the effects of unrealized gains or losses on available for sale securities.

## RESULTS OF OPERATIONS

For the year ended December 31, 2006, Bancorp earned \$2,415,000 (\$0.67 basic income per share and \$0.66 diluted income per share) an increase of 72% as compared to 2005 when Bancorp earned \$1,407,000 (\$0.52 basic income per share and \$0.51 diluted income per share).

Interest and dividend income increased \$12.9 million to \$38.0 million in 2006 as compared to 2005 when interest and dividend income was \$25.1 million. This increase is due primarily to the growth in the loan portfolio combined with a general increase in interest rates.

Interest expense increased \$7.8 million or 76% to \$18.1 million in 2006 compared to \$10.3 million in 2005. The increase in interest expense is due largely to the increase in total deposits as well as to a general increase in interest rates.

Noninterest income decreased \$870,000 or 26% to \$2.4 million in 2006 as compared to \$3.2 million in 2005. Noninterest expenses for 2006 totaled \$17.6 million which represents an increase of \$2.9 million or 20% over the prior year. The higher operating costs were primarily the result of increases in employee expenses related to staff additions primarily in the lending area which contributed to the growth in the loan portfolio, occupancy expenses associated with securing additional branch locations in furtherance of the Bank's growth strategy and increased advertising expenses related to increasing name recognition.

The following are measurements relating to Bancorp's earnings.

	2006	2005	2004
Return on average assets	0.44%	0.33%	0.26%
Return on average equity	5.97%	6.00%	4.74%
Dividend payout ratio	26.12%	29.81%	35.26%
Average equity to average assets	7.41%	5.46%	5.48%
Basic income per share	\$ 0.67	\$ 0.52	\$ 0.38
Diluted income per share	\$ 0.66	\$ 0.51	\$ 0.37

### *Interest income and expense*

Bancorp's net interest income increased \$5.0 million or 34%, to \$19.9 million in 2006 from \$14.9 million in 2005. An increase in average earning assets of \$117.1 million, or 28%, increased Bancorp's interest income \$12.9 million or 51% from \$25.1 million in 2005 to \$38.0 million in 2006. Average loans outstanding increased \$126.6 million, or 40%, led by growth in construction and real estate loans, which reflects the continuing strength of the local real estate market. The increase in the yields on investments partially offset the decrease in the volume of investments which resulted in a net decrease in interest and dividends on investments of \$91,000. Higher yields on federal funds sold and short term investments combined with an increase in the average balances of both resulted in an increase in interest income of \$461,000.

Total average interest bearing liabilities increased by \$94.0 million or 26%; average certificates of deposit increased by \$101.0 million or 45%; average money market deposits decreased \$23.1 million or 34%; average FHLB advances increased \$14.1 million or 135%. Interest expense increased \$7.8 million or 76% from \$10.3 million in 2005 to \$18.1 million in 2006. Interest expense on certificates of deposit increased \$3.6 million as a result of an increase in the cost of funds for that portfolio from 3.58% in 2005 to 4.51% in 2006; and increased \$3.0 million in 2006 due to higher average outstanding balances. Increases in both the interest rates paid and the average balances outstanding of FHLB advances resulted in increases in interest expense of \$521,000 and \$346,000, respectively, during 2006 over amounts paid in 2005. Rising interest rates also contributed to the increase in the interest expense on subordinated debentures of \$145,000 or 27% from \$528,000 in 2005 to \$673,000 in 2006 resulting in an increase in the cost of the debt from 6.40% in 2005 to 8.16% in 2006.

Management regularly reviews loan and deposit rates and attempts to price Bancorp's products competitively. Bancorp tracks its mix of asset/liability maturities and strives to maintain a reasonable match. Performance ratios are reviewed monthly by management and the Board and are used to set strategies.

### ***Provision for loan losses***

The provision for loan losses charged to operations for the year ended December 31, 2006 of \$1.0 million represents a decrease of \$70,000 when compared to the provision of \$1.1 million for the year ended December 31, 2005. This change is due to the credit risk factors applied against the 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 the discussion entitled "Allowance for Loan Losses."

### ***Noninterest income***

Noninterest income decreased \$870,000 or 27% from \$3.2 million in 2005 to \$2.4 million in 2006. A decrease in the volume of loans placed with outside investors resulted in a decrease in mortgage brokerage and referral fee income of \$864,000 or 41% and a decrease in loan application, inspection and processing fee income of \$102,000 or 25%. Increases in deposit accounts and transaction volumes resulted in an increase in fees and service charges of \$83,000 or 15% from \$562,000 for the year ended December 31, 2005 to \$645,000 for the year ended December 31, 2006. Other noninterest income increased 8% or \$12,000 to \$173,000 for the year ended December 31, 2006 from \$161,000 for the year ended December 31, 2005; this increase is due mainly to increased fees from debit card transactions.

### *Noninterest expenses*

Noninterest expenses increased \$3.0 million or 20% in 2006 from \$14.6 million in 2005 to \$17.6 million in 2006. Salaries and benefits increased \$1.4 million or 16% in 2006 as compared to 2005, due primarily to higher compensation levels and performance related incentive programs, as well as staff additions resulting primarily from the full year impact in 2006 of the branch opened in 2005 and the two new branches opened in 2006. Higher staffing levels and incentive compensation also resulted in higher payroll taxes, employee benefit costs and the expenses associated with training programs. Occupancy and equipment expenses increased \$714,000 or 34% from \$2.1 million in 2005 to \$2.8 million in 2006; this increase is due primarily to the full year impact in 2006 of opening one new branch office in 2005, opening two branches in 2006 and the lease expenses associated with new branches scheduled to open in 2007 that are under renovation. Increased marketing campaigns and related activities, such as mailings and solicitations, and the sponsorship of community events resulted in an increase in advertising and promotional expense of \$283,000 or 67% to \$703,000 for the year ended December 31, 2006 as compared to \$420,000 for the year ended December 31, 2005. For the year ended December 31, 2006 data processing and other outside services increased \$175,000 or 15% to \$1.3 million from \$1.1 million for the year ended December 31, 2005; this increase is due primarily to increases in data processing services, correspondent banking charges and an increase in personnel placement fees. 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.

Management believes that additional branch offices will contribute to the future growth and earnings of Bancorp. While the opening of these new branches will result in increased operating expenses, the openings will be strategically planned to maintain profitable operations.

### *Income Taxes*

The provision for income taxes represents the tax expense recognized for both federal and state income taxes. The income tax provision for 2006 of \$1,267,000 represents an effective tax rate of 34.4%; the income tax provision for 2005 of \$957,000 represents an effective tax rate of 40.5%.

### **Comparison of Results of Operations for the years 2005 and 2004**

For the year ended December 31, 2005, Bancorp earned \$1,407,000 (\$0.52 basic income per share and \$0.51 diluted income per share) an increase of 52% as compared to 2004 when Bancorp earned \$926,000 (\$0.38 basic income per share and \$0.37 diluted income per share).

Interest and dividend income increased \$6.4 million to \$25.1 million in 2005 as compared to 2004 when interest and dividend income was \$18.7 million. This increase was due primarily to the growth in the loan portfolio combined with a general increase in interest rates.

Interest expense increased \$3.3 million or 47% to \$10.3 million in 2005 compared to \$7.0 million in 2004. The increase in interest expense was due largely to the increase in total deposits as well as to a general increase in interest rates.

Noninterest income increased \$527,000 or 20% to \$3.2 million in 2005 as compared to \$2.7 million in 2004. An increase in the volume and size of loan transactions resulted in an increase in mortgage brokerage and referral fee income of \$386,000 or 22%.

Noninterest expenses for 2005 totaled \$14.6 million which represents an increase of \$2.3 million or 19% over 2004. The higher operating costs were primarily the result of the full year impact in 2005 of the two branch offices opened in 2004, the new branch office opened in 2005 and increased commission expense.

#### ***Interest income and expense***

Bancorp's net interest income increased \$3.2 million or 28%, to \$14.9 million in 2005 from \$11.7 million in 2004. An increase in average earning assets of \$72.0 million, or 21%, increased Bancorp's interest income \$6.5 million or 35% from \$18.7 million in 2004 to \$25.1 million in 2005. Average loans outstanding increased \$76.8 million, or 32%, led by growth in construction and real estate loans, which reflected the strength of the local real estate market. The increase in the yields on investments was partially offset by a decrease in the volume of investments resulting in a net increase in interest and dividends on investments of \$342,000. Higher yields on federal funds sold and short term investments, partially offset by a decrease in the average balances of both, resulted in an increase in interest income of \$127,000 and \$73,000, respectively. Total average interest bearing liabilities increased by \$60.4 million or 20%; average certificates of deposit and NOW accounts increased by \$67.9 million and \$3.0 million, respectively; average money market deposits and savings deposits decreased \$2.3 million and \$1.9 million, respectively; average FHLB advances and other borrowings decreased \$3.8 million and \$2.4 million respectively. Interest expense increased from \$7.0 million in 2004 to \$10.3 million in 2005. Interest expense on certificates of deposit increased \$3.1 million as a result of higher average outstanding balances combined with an increase in the cost of funds for that portfolio from 3.13% in 2004 to 3.58% in 2005. Rising interest rates also contributed to the increase in the interest expense on subordinated debentures of \$148,000 or 39% from \$380,000 in 2004 to \$528,000 in 2005 resulting in an increase in the cost of the debt from 4.61% in 2004 to 6.40% in 2005.

#### ***Provision for loan losses***

The provision for loan losses charged to operations for the year ended December 31, 2005 of \$1.1 million represented an increase of \$554,000 when compared to the provision of \$556,000 for the year ended December 31, 2004. This increase was due to the loan growth and the credit risk factors applied against the portfolio and not to any adverse changes in the credit quality of the loan portfolio or in non-performing loans.

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

***Noninterest income***

Noninterest income increased \$527,000 or 20% from \$2.7 million in 2004 to \$3.2 million in 2005. An increase in the volume and size of loan transactions and loan origination staff resulted in an increase in mortgage brokerage and referral fees of \$386,000 or 22% from \$1.7 million in 2004 to \$2.1 million in 2005. Increases in deposit accounts and transaction volumes resulted in an increase in fees and service charges of \$97,000 or 21% from \$465,000 for the year ended December 31, 2004 to \$562,000 for the year ended December 31, 2005. Other noninterest income increased 44% or \$50,000 to \$161,000 for the year ended December 31, 2005 from \$111,000 for the year ended December 31, 2004; this increase is due mainly to increased fees from debit card transactions and the settlement of an insurance claim.

***Noninterest expenses***

Noninterest expenses increased \$2.3 million in 2005 from \$12.3 million in 2004 to \$14.6 million in 2005. Salaries and benefits increased \$1.5 million or 19% in 2005 as compared to 2004, due primarily to staff additions resulting from the full year impact in 2005 of the two branches opened in 2004 and one branch opened in 2005 and higher levels of commissions as a direct result of the increase in the revenue generated by mortgage brokerage operations. Higher staffing levels and incentive compensation also resulted in higher payroll taxes, employee benefit costs and the expenses associated with training programs. Occupancy and equipment expenses increased \$375,000 from \$1.7 million in 2004 to \$2.1 million in 2005; this increase was due primarily to the full year impact in 2005 of opening two new branch offices in 2004 and of opening one branch in 2005. For the year ended December 31, 2005 data processing and other outside services increased \$345,000 or 43% to \$1.1 million from \$0.8 million for the year ended December 31, 2004; much of this increase is due to an increase in personnel placement fees, data processing expenses and information technology consulting. The increase in data processing expenses is a result of the growth in the branch network as well as to increases due to ongoing maintenance charges for the implementation of additional products and services.

***Income Taxes***

The provision for income taxes of \$957,000 in 2005 and \$633,000 for 2004 represents the tax expense recognized for both federal and state income tax. The effective tax rate for both 2005 and 2004 was 40.5%.

**LIQUIDITY**

Bancorp's liquidity position was 19% and 20% at December 31, 2006 and 2005, respectively. The liquidity ratio is defined as the percentage of liquid assets to total assets. The following categories of assets as described in the accompanying 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 increases in its loan portfolio and downward fluctuations in deposit accounts. Management

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believes Bancorp's short-term assets have sufficient liquidity to satisfy loan demand, cover potential fluctuations in deposit accounts and to meet other anticipated cash requirements.

At December 31, 2006, cash and cash equivalents and securities classified as available for sale were \$55.5 million and \$67.1 million, respectively. In addition to Federal Home Loan Bank advances outstanding at December 31, 2006, the Bank had the ability to borrow an additional \$102.0 million from the Federal Home Loan Bank of Boston, which included a \$2.0 million overnight line of credit. At December 31, 2006, the Bank had \$8.0 million in Federal Home Loan Bank advances, none of which were under the overnight line of credit. At December 31, 2006 the Bank also had available a \$3.0 million overnight line of credit from a correspondent bank as well as the ability to borrow \$10.0 million under a repurchase agreement. There were no amounts outstanding under either arrangement at December 31, 2006.

The following table presents Bancorp's contractual obligations as of December 31, 2006:

	Total	Less than one year	One to three years	Three to five years	Over five years
Certificates of deposit	\$ 410,960,821	\$ 327,238,523	\$ 64,043,306	\$ 19,678,992	-
Junior subordinated debt owed to unconsolidated trust	8,248,000	-	-	-	8,248,000
FHLB Advances	8,000,000	8,000,000	-	-	-
Operating lease obligations	14,632,741	1,884,072	3,344,683	3,163,707	6,240,279
<b>Total contractual obligations</b>	<b>\$ 441,841,562</b>	<b>\$ 337,122,595</b>	<b>\$ 67,387,989</b>	<b>\$ 22,842,699</b>	<b>\$ 14,488,279</b>

The following table presents Bancorp's off-balance sheet commitments as of December 31, 2006. These commitments 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 or are contingent upon the customer adhering to the terms of the agreements, the total commitment amounts do not necessarily represent future cash requirements.

Future loan commitments	\$ 54,134,247
Unused lines of credit	43,900,007
Undisbursed construction loans	97,977,899
Financial Standby letters of credit	264,483
<b>Total commitments</b>	<b>\$ 196,276,636</b>

**CAPITAL**

The following table illustrates Bancorp's regulatory capital ratios for each of the years shown:

	2006	December 31, 2005	2004
Total Risk-Based Capital	15.34%	12.70%	10.70%
Tier 1 Risk- Based Capital	14.22%	11.45%	9.04%
Leverage Capital	11.63%	8.56%	6.79%

The following table illustrates the Bank's regulatory capital ratios for each of the years shown:

	2006	December 31, 2005	2004
Total Risk-Based Capital	15.02%	12.52%	10.50%
Tier 1 Risk- Based Capital	13.90%	11.27%	9.29%
Leverage Capital	11.37%	8.42%	6.98%

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" 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 during 2006 was due primarily to the issuance of additional capital stock combined with the increase in retained earnings and partially offset by the growth of the Bank.

Management continuously assesses the adequacy of the Bank's capital with the goal to maintain its "well capitalized" classification. Management's strategic and capital plans contemplate various alternatives to raise additional capital to support the planned growth of the Bank which includes the opening of additional branches in 2007.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

**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 Liability Committee, there is a Board Asset and Liability Committee (“ALCO”) which meets quarterly. ALCO monitors the interest rate risk analyses, reviews investment transactions 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 December 31, 2006 and 2005 on the basis of contractual maturities, anticipated repayments and scheduled rate adjustments.

	Basis Points	Interest Rate Risk Guidelines	December 31, 2006	December 31, 2005
Gap percentage total		+/- 15%	1.53%	4.98%
Net interest income	200	+/- 15%	11.22%	14.49%
	-200	+/- 15%	-12.04%	-14.24%
Net portfolio value	200	+/- 25%	-3.25%	0.45%
	-200	+/- 25%	1.19%	-7.89%

Bancorp benefited during 2006 from a rising interest rate environment as assets re-priced faster than liabilities and, combined with a 39% 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 December 31, 2006 as compared to December 31, 2005 using Bancorp's interest income simulation model. Bancorp's interest rate risk position was within guidelines in all categories at December 31, 2006. 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**

December 31, 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	23,940	2,415	11.22%	68,230	(2,290)	-3.25%
+ 100	22,750	1,225	5.69%	69,491	(1,029)	-1.46%
BASE	21,525			70,520		
- 100	20,307	(1,218)	-5.66%	71,533	1,013	1.44%
- 200	18,934	(2,591)	-12.04%	71,359	839	1.19%

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%

**Impact of Inflation and Changing Prices**

Bancorp's financial statements have been prepared in terms of historical dollars, without considering changes in 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 effect of general levels of inflation. Interest rates do not necessarily move in the same direction or in 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 8. Financial Statements and Supplementary Data

The consolidated balance sheets of Bancorp as of December 31, 2006 and December 31, 2005 and the related consolidated statements of income, shareholders' equity and cash flows for the years ended December 31, 2006, December 31, 2005 and December 31, 2004, together with the report thereon of McGladrey & Pullen, LLP dated March 26, 2007, are included as part of this Form 10-K in the "Financial Report" following page 48 hereof.

The following table presents selected quarterly financial information (unaudited):

	<b>First Quarter</b>	<b>Second Quarter</b>	<b>Third Quarter</b>	<b>Fourth Quarter</b>
<b>2006:</b>				
Interest income	\$ 8,040,092	\$ 9,152,592	\$ 9,856,854	\$ 10,959,988
Interest expense	3,428,785	4,185,462	4,821,600	5,633,801
Net interest income	4,611,307	4,967,130	5,035,254	5,326,187
Provision for loan losses	572,800	350,700	116,500	-
Noninterest income	630,265	581,329	632,563	514,992
Noninterest expenses	4,038,829	4,394,967	4,490,679	4,652,397
Income before income taxes	629,943	802,792	1,060,638	1,188,782
Income taxes	231,000	295,000	390,000	351,000
Net income	\$ 398,943	\$ 507,792	\$ 670,638	\$ 837,782
<b>Net income per common share:</b>				
Basic	\$ 0.12	\$ 0.16	\$ 0.20	\$ 0.19
Diluted	0.12	0.16	0.20	0.18
<b>2005:</b>				
Interest income	\$ 5,594,456	\$ 5,809,046	\$ 6,439,258	\$ 7,305,941
Interest expense	2,179,914	2,315,236	2,733,111	3,041,364
Net interest income	3,414,542	3,493,810	3,706,147	4,264,577
Provision for loan losses	260,000	100,000	350,000	400,000
Noninterest income	711,015	820,881	985,582	711,559
Noninterest expenses	3,383,376	3,624,595	3,870,018	3,756,498
Income before income taxes	482,181	590,096	471,711	819,638
Income taxes	195,000	239,000	191,000	332,000
Net income	\$ 287,181	\$ 351,096	\$ 280,711	\$ 487,638
<b>Net income per common share:</b>				
Basic	\$ 0.12	\$ 0.14	\$ 0.11	\$ 0.15
Diluted	0.11	0.14	0.11	0.15

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. 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" mean 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 year ended December 31, 2006 that has materially affected, or is reasonably likely to materially affect, Bancorp's internal control over financial reporting.

Item 9B. Other Information

None.

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**PART III**

Item 10. Directors, Executive Officers and Corporate Governance

The information required by Items 401, 405, 406 and 407 (c)(3); (d)(4) and (d)(5) of Regulation S-K is incorporated into this Form 10-K by reference to Bancorp's definitive proxy statement (the "*Definitive Proxy Statement*") for its 2007 Annual Meeting of Shareholders, to be filed within 120 days following December 31, 2006.

The Company has adopted a Code of Ethics for its senior financial officers. The information required by Item 406 is contained in Exhibit 14 to this Form 10-K. A copy of this Code of Ethics will be provided to any person so requesting by writing to Patriot National Bancorp, Inc., 900 Bedford Street, Stamford, Connecticut 06901, Attn: Robert F. O'Connell, Chief Financial Officer.

Item 11. Executive Compensation

The information required by Item 402 of Regulation S-K is incorporated into this Form 10-K by reference to the Definitive Proxy Statement.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters

The information required by Item 201(d) and Item 403 of Regulation S-K is incorporated into this Form 10-K by reference to the Definitive Proxy Statement.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information required by Items 404 and 407(a) of Regulation S-K is incorporated into this Form 10-K by reference to the Definitive Proxy Statement.

Item 14. Principal Accountant Fees and Services

The information required by Item 9(e) of Schedule 14A of Regulation S-K is incorporated into this Form 10-K by reference to the Definitive Proxy Statement.

**Part IV**

Item 15. Exhibits and Financial Statement Schedules

(a) Exhibits

Exhibit No. Description

- 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 (incorporated by reference to Exhibit 3(i)(B) to Bancorp's Quarterly Report on Form 10-Q for the quarter ended September 30, 2006 (Commission File No. 000-29599)).
- 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)).

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Exhibit No.	Description
10(a)(4)	Change of Control Agreement, dated as of January 1, 2007 among Angelo De Caro, and Patriot National Bank and Bancorp.
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 January 1, 2007 among Robert F. O'Connell and Patriot National Bank and Bancorp.
10(a)(8)	Employment Agreement dated as of January 1, 2007 between Patriot National Bank and Marcus Zavattaro.
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 January 1, 2007 among the Bank, Bancorp and Charles F. Howell.
10(a)(11)	Change of Control Agreement, dated as of January 1, 2007 among Charles F. Howell, Patriot National Bank and Bancorp.
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. 000-29599)).
10(a)(13)	Change of Control Agreement, dated as of January 1, 2007 between Martin G. Noble and Patriot National Bank.
10(a)(14)	Change of Control Agreement, dated as of January 1, 2007 among Philip W. Wolford, Patriot National Bank and Bancorp.
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)).

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Exhibit No.	Description
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)).
23	Consent of McGladrey & Pullen, LLP.
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 Certification

**SIGNATURES**

In accordance with Section 13 or 15(d) of the Exchange Act, 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/ Angelo De Caro  
Name: Angelo De Caro  
Title: Chairman & Chief Executive Officer

Date: March 28, 2007

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in capacities and on the dates indicated.

/s/ Angelo De Caro  
Angelo De Caro, Chairman, Chief Executive  
Officer and Director

March 28, 2007  
Date

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

March 28, 2007  
Date

/s/ Michael A. Capodanno  
Michael A. Capodanno  
Senior Vice President & Controller

March 28, 2007  
Date

/s/ John J. Ferguson  
John J. Ferguson  
Director

March 28, 2007  
Date

/s/ Brian A. Fitzgerald  
Brian A. Fitzgerald  
Director

March 28, 2007  
Date

**Form 10 K - Signatures continued**

John A. Geoghegan  
Director

Date

/s/ L. Morris Glucksman  
L. Morris Glucksman  
Director

March 28, 2007  
Date

/s/ Charles F. Howell  
Charles F. Howell  
Director

March 28, 2007  
Date

/s/ Michael F. Intrieri  
Michael F. Intrieri  
Director

March 28, 2007  
Date

/s/ Philip W. Wolford  
Philip W. Wolford  
Director

March 28, 2007  
Date

**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**

**FINANCIAL REPORT  
DECEMBER 31, 2006 and 2005**

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**McGladrey & Pullen**  
**Certified Public Accountants**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Shareholders and Board of Directors  
Patriot National Bancorp, Inc. and Subsidiary  
Stamford, Connecticut

We have audited the accompanying consolidated balance sheets of Patriot National Bancorp, Inc. and Subsidiary (the "Company") as of December 31, 2006 and 2005, and the related consolidated statements of income, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2006. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Patriot National Bancorp, Inc. and Subsidiary as of December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1, the Company adopted Financial Accounting Standards No. 123(R) on January 1, 2006 and changed its method of accounting for share-based payments.

/S/ McGladrey & Pullen, LLP

New Haven, Connecticut  
March 26, 2007

McGladrey & Pullen, LLP is a member firm of RSM International,  
an affiliation of separate and independent legal entities.

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## PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

## CONSOLIDATED BALANCE SHEETS

December 31, 2006 and 2005

	2006	2005
<b>ASSETS</b>		
Cash and due from banks (Note 2):		
Noninterest bearing deposits and cash	\$ 3,865,468	\$ 7,180,391
Interest bearing deposits	3,202	40,186
Federal funds sold	27,000,000	6,500,000
Short-term investments	24,605,869	2,247,028
<b>Cash and cash equivalents</b>	<b>55,474,539</b>	<b>15,967,605</b>
Available for sale securities (at fair value) (Note 3)	67,093,135	78,672,068
Federal Reserve Bank stock	1,911,700	1,022,300
Federal Home Loan Bank stock (Note 8)	1,217,200	1,296,700
Loans receivable (net of allowance for loan losses: 2006 \$5,630,432; 2005 \$4,588,335) (Note 4)	506,884,155	364,243,777
Accrued interest and dividends receivable	3,542,173	2,445,417
Premises and equipment, net (Notes 5 and 9)	3,690,861	2,474,153
Deferred tax asset (Note 10)	2,914,562	2,675,595
Goodwill and other intangible assets (Note 11)	1,487,651	930,091
Other assets (Notes 6 and 8)	1,766,819	913,456
<b>Total assets</b>	<b>\$ 645,982,795</b>	<b>\$ 470,641,162</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Liabilities		
Deposits (Note 7):		
Noninterest bearing deposits	\$ 56,679,836	\$ 48,797,389
Interest bearing deposits	504,771,828	370,277,899
<b>Total deposits</b>	<b>561,451,664</b>	<b>419,075,288</b>
Federal Home Loan Bank borrowings (Note 8)	8,000,000	9,000,000
Junior subordinated debt owed to unconsolidated trust (Note 8)	8,248,000	8,248,000
Accrued expenses and other liabilities	3,999,786	2,943,259
<b>Total liabilities</b>	<b>581,699,450</b>	<b>439,266,547</b>
Commitments and Contingencies (Notes 8, 9 and 14)		
Shareholders' equity (Notes 12 and 15)		
Preferred stock, no par value; 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	<b>9,478,988</b>	6,461,298
Additional paid-in capital	<b>49,463,307</b>	21,709,224
Retained earnings	<b>6,022,012</b>	4,308,242
Accumulated other comprehensive loss - net unrealized loss		
on available for sale securities, net of taxes	<b>(680,962)</b>	(1,104,149)
<b>Total shareholders' equity</b>	<b>64,283,345</b>	31,374,615
<b>Total liabilities and shareholders' equity</b>	<b>\$ 645,982,795</b>	<b>\$ 470,641,162</b>

See Notes to Consolidated Financial Statements.

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**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY****CONSOLIDATED STATEMENTS OF INCOME****Years Ended December 31, 2006, 2005 and 2004**

	2006	2005	2004
<b>Interest and Dividend Income</b>			
Interest and fees on loans	\$ 34,052,444	\$ 21,561,121	\$ 15,631,838
Interest on investment securities	2,541,678	2,750,205	2,496,065
Dividends on investment securities	815,014	510,657	358,012
Interest on Federal funds sold	582,952	315,942	189,485
Other interest income	17,438	10,776	2,851
<b>Total interest and dividend income</b>	<b>38,009,526</b>	<b>25,148,701</b>	<b>18,678,251</b>
<b>Interest Expense</b>			
Interest on deposits (Note 7)	16,151,297	9,366,563	6,213,732
Interest on Federal Home Loan Bank borrowings	1,240,582	374,315	371,699
Interest on subordinated debt	672,971	527,435	380,194
Interest on other borrowings	4,798	1,312	42,883
<b>Total interest expense</b>	<b>18,069,648</b>	<b>10,269,625</b>	<b>7,008,508</b>
<b>Net interest income</b>	<b>19,939,878</b>	<b>14,879,076</b>	<b>11,669,743</b>
Provision for Loan Losses (Note 4)	1,040,000	1,110,000	556,000
<b>Net interest income after provision for loan losses</b>	<b>18,899,878</b>	<b>13,769,076</b>	<b>11,113,743</b>
<b>Noninterest Income</b>			
Mortgage brokerage referral fees	1,240,545	2,104,065	1,717,756
Loan application, inspection and processing fees	300,907	402,723	408,152
Fees and service charges	644,845	561,651	465,018
Other income	172,852	160,598	111,278
<b>Total noninterest income</b>	<b>2,359,149</b>	<b>3,229,037</b>	<b>2,702,204</b>
<b>Noninterest Expenses</b>			
Salaries and benefits (Notes 9 and 13)	10,436,127	8,997,255	7,544,055
Occupancy and equipment expense, net	2,797,089	2,082,593	1,707,769
Data processing and other outside services	1,322,423	1,147,378	802,536
Advertising and promotional expenses	703,007	420,222	369,638
Professional services	531,611	419,921	386,110
Loan administration and processing expenses	163,930	190,139	209,283
Other real estate operations (Note 6)	(19,715)	-	-
Other operating expenses	1,642,400	1,376,979	1,237,159
<b>Total noninterest expenses</b>	<b>17,576,872</b>	<b>14,634,487</b>	<b>12,256,550</b>
<b>Income before income taxes</b>	<b>3,682,155</b>	<b>2,363,626</b>	<b>1,559,397</b>

Provision for Income Taxes (Note 10)	<b>1,267,000</b>	957,000	633,000
<b>Net income</b>	<b>\$ 2,415,155</b>	\$ 1,406,626	\$ 926,397
<b>Basic income per share (Note 12)</b>	<b>\$ 0.67</b>	\$ 0.52	\$ 0.38
<b>Diluted income per share (Note 12)</b>	<b>\$ 0.66</b>	\$ 0.51	\$ 0.37
<b>Dividends per share</b>	<b>\$ 0.175</b>	\$ 0.155	\$ 0.135

See Notes to Consolidated Financial Statements.

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## PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

## CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

Years Ended December 31, 2006, 2005 and 2004

	Number of Shares	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total
Balance at December 31, 2003	2,408,607	\$ 4,817,214	\$ 11,519,037	\$ 2,752,541	\$ (308,879)	\$ 18,779,913
<b>Comprehensive income</b>						
Net income	-	-	-	926,397	-	926,397
Unrealized holding loss on available for sale securities, net of taxes (Note 17)	-	-	-	-	(84,360)	(84,360)
<b>Total comprehensive income</b>						842,037
Dividends	-	-	-	(332,220)	-	(332,220)
Issuance of capital stock	77,784	155,568	311,136	-	-	466,704
Balance at December 31, 2004	2,486,391	4,972,782	11,830,173	3,346,718	(393,239)	19,756,434
<b>Comprehensive income</b>						
Net income	-	-	-	1,406,626	-	1,406,626
Unrealized holding loss on available for sale securities, net of taxes (Note 17)	-	-	-	-	(710,910)	(710,910)
<b>Total comprehensive income</b>						695,716
Dividends	-	-	-	(445,102)	-	(445,102)
Issuance of capital stock	744,258	1,488,516	9,879,051	-	-	11,367,567
Balance at December 31, 2005	3,230,649	6,461,298	21,709,224	4,308,242	(1,104,149)	31,374,615

<b>Comprehensive income</b>								
Net income	-	-	-	2,415,155	-	2,415,155		
<b>Unrealized holding gain on available for sale securities, net of taxes (Note 17)</b>								
	-	-	-	-	423,187	423,187		
<b>Total comprehensive income</b>							2,838,342	
<b>Dividends</b>								
	-	-	-	(701,385)	-	(701,385)		
<b>Issuance of capital stock (Note 12)</b>								
	1,508,845	3,017,690	27,754,083	-	-	30,771,773		
<b>Balance, December 31, 2006</b>								
	<b>4,739,494</b>	<b>\$ 9,478,988</b>	<b>\$ 49,463,307</b>	<b>\$ 6,022,012</b>	<b>\$ (680,962)</b>	<b>\$ 64,283,345</b>		

See Notes to Consolidated Financial Statements.

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## PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

## CONSOLIDATED STATEMENTS OF CASH FLOWS

Years Ended December 31, 2006, 2005 and 2004

	2006	2005	2004
Cash Flows from Operating Activities			
Net income	\$ 2,415,155	\$ 1,406,626	\$ 926,397
Adjustments to reconcile net income to net cash provided by operating activities:			
Amortization and accretion of investment premiums and discounts, net	231,541	394,827	500,847
Amortization of core deposit intangible	2,440	-	-
Provision for loan losses	1,040,000	1,110,000	556,000
Depreciation and amortization of premises and equipment	644,472	604,399	536,029
Loss on disposal of bank premises and equipment	5,262	-	3,804
Deferred income taxes	(498,342)	(562,833)	(101,212)
Change in assets and liabilities:			
Increase in deferred loan fees	531,050	17,048	235,734
Increase in accrued interest and dividends receivable	(1,096,756)	(687,078)	(287,717)
(Increase) decrease in other assets	(19,022)	(128,667)	132,592
Increase (decrease) in accrued expenses and other liabilities	972,477	863,861	(373,139)
<b>Net cash provided by operating activities</b>	<b>4,228,277</b>	<b>3,018,183</b>	<b>2,129,335</b>
Cash Flows from Investing Activities			
Purchases of available for sale securities	(2,050,000)	(28,208,359)	(16,020,313)
Proceeds from sales of available for sale securities	-	-	-
Principal repayments on available for sale securities	13,079,953	21,264,308	23,676,009
Cash received in conjunction with branch acquisition	2,586,471	-	-
Purchase of Federal Reserve Bank stock	(889,400)	(329,700)	(1,450)
Purchase of Federal Home Loan Bank stock	(1,430,500)	-	(219,400)
Proceeds from repurchase of excess stock by the Federal Home Loan Bank	1,510,000	-	-
Net increase in loans	(145,045,769)	(101,496,005)	(50,246,026)

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Purchases of premises and equipment	(1,866,442)	(945,919)	(1,251,368)
<b>Net cash used in investing activities</b>	<b>(133,105,687)</b>	<b>(106,715,675)</b>	<b>(38,062,548)</b>

## Cash Flows from Financing Activities

Net (decrease) increase in demand, savings and money market deposits	(3,663,822)	(11,884,273)	17,330,022
Net increase in time certificates of deposit	142,893,727	63,954,236	59,683,121
Decrease in securities sold under repurchase agreements	-	-	(5,700,000)
Proceeds from FHLB borrowings	93,718,000	46,001,000	17,000,000
Principal repayments of FHLB borrowings	(94,718,000)	(45,001,000)	(26,000,000)
Decrease in other borrowings	-	-	(353,385)
Proceeds from issuance of common stock	30,771,773	11,367,567	466,704
Dividends paid on common stock	(617,334)	(402,899)	(317,454)
<b>Net cash provided by financing activities</b>	<b>168,384,344</b>	<b>64,034,631</b>	<b>62,109,008</b>

<b>Net increase (decrease) in cash and cash equivalents</b>	<b>39,506,934</b>	<b>(39,662,861)</b>	<b>26,175,795</b>
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## Cash and cash equivalents

Beginning	15,967,605	55,630,466	29,454,671
Ending	\$ 55,474,539	\$ 15,967,605	\$ 55,630,466

(Continued)

**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY****CONSOLIDATED STATEMENTS OF CASH FLOWS, Continued**  
**Years Ended December 31, 2006, 2005 and 2004**

	2006	2005	2004
<b>Supplemental Disclosures of Cash Flow Information</b>			
Cash paid for:			
Interest	\$ 17,932,039	\$ 10,265,152	\$ 7,020,278
Income taxes	\$ 1,914,020	\$ 1,234,761	\$ 850,970
<b>Supplemental Disclosure of Noncash Investing and Financing Activities</b>			
Unrealized holding gains (losses) on available for sale securities arising during the period			
	\$ 682,562	\$ (1,146,631)	\$ (136,065)
Accrued dividends declared on common stock			
	\$ 213,277	\$ 129,226	\$ 87,024
Transfer of loan to other real estate owned			
	\$ 834,341	\$ -	\$ -
Details of branch acquisition:			
Fair value of assets acquired	\$ 560,000	-	-
Fair value of liabilities assumed	(3,146,471)	-	-
Net cash received	\$ (2,586,471)	\$ -	\$ -

See Notes to Consolidated Financial Statements.

**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2006 and 2005**

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**Note 1. Nature of Operations and Summary of Significant Accounting Policies**

Patriot National Bancorp, Inc. (the "Company"), a Connecticut corporation, is a bank holding company that was organized in 1999. On December 1, 1999, all the issued and outstanding shares of Patriot National Bank (the "Bank") were converted into Company common stock and the Bank became a wholly owned subsidiary of the Company. The Bank is a nationally chartered commercial bank whose deposits are insured under the Bank Insurance Fund, which is administered by the Federal Deposit Insurance Corporation. The Bank provides a full range of banking services to commercial and consumer customers through its main office in Stamford, Connecticut, twelve branch offices in Fairfield County, Connecticut and one branch office in New York City, New York. The Bank's customers are concentrated in Fairfield County, Connecticut and Westchester County, New York. The Bank also conducts mortgage brokerage operations through loan production offices in Connecticut and New York.

On March 11, 2003, the Company formed Patriot National Statutory Trust I (the "Trust") for the purpose of issuing trust preferred securities and investing the proceeds in subordinated debentures issued by the Company, and on March 26, 2003, the first series of trust preferred securities were issued. In accordance with FASB Interpretation No. 46R, "Consolidation of Variable Interest Entities," ("FIN 46R") the Trust is not included in the Company's consolidated financial statements.

The following is a summary of the Company's significant accounting policies:

Significant group concentrations of credit risk

Most of the Company's activities are with customers located within Fairfield County, Connecticut and Westchester County, New York. Note 3 discusses the types of securities in which the Company invests. Note 4 discusses the types of lending in which the Company engages. The Company does not have any significant concentrations to any one industry or customer; however, its short term investment is in a mutual fund of a single issuer.

Principles of consolidation and basis of financial statement presentation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiary, the Bank, and the Bank's wholly owned subsidiary, PinPat Acquisition Corporation; and have been prepared in accordance with accounting principles generally accepted in the United States of America and general practices within the banking industry. All significant intercompany balances and transactions have been eliminated. In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosures of contingent assets and liabilities, as of the balance sheet date and reported amounts of revenues and expenses for the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses and the evaluation of goodwill and other intangible assets for impairment.

**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued**

**December 31, 2006 and 2005**

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Cash and cash equivalents

Cash and due from banks, Federal funds sold and short-term investments are recognized as cash equivalents in the consolidated financial statements. Federal funds sold generally mature in one day. For purposes of reporting cash flows, the Company considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents. Cash flows from loans and deposits are reported net. The Company maintains amounts due from banks and Federal funds sold which, at times, may exceed Federally insured limits. The Company has not experienced any losses from such concentrations. The short-term investment represents an investment in a money market mutual fund of a single issuer.

Investments in debt and marketable equity securities

Management determines the appropriate classification of securities at the date individual investment securities are acquired, and the appropriateness of such classification is reassessed at each balance sheet date.

Debt securities, if any, that management has the positive intent and ability to hold to maturity are classified as “held to maturity” and are recorded at amortized cost. “Trading” securities, if any, are carried at fair value with unrealized gains and losses recognized in earnings. Securities not classified as held to maturity or trading, including equity securities with readily determinable fair values, are classified as “available for sale” and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income, net of taxes.

Purchase premiums and discounts are recognized in interest income using the interest method over the lives of the securities. Declines in the fair value of available for sale and held to maturity securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

The sale of a held to maturity security within three months of its maturity date or after collection of at least 85% of the principal outstanding at the time the security was acquired is considered a maturity for purposes of classification and disclosure.

Loans held for sale

Loans held for sale are those loans the Company has the intent to sell in the foreseeable future, and are carried at the lower of aggregate cost or market value. Gains and losses on sales of loans are recognized on the trade dates, and are determined by the difference between the sales proceeds and the carrying value of the loans. Loans are sold with servicing released.

**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued**

**December 31, 2006 and 2005**

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Loans receivable

Loans receivable are stated at their current unpaid principal balances and are net of the allowance for loan losses, net deferred loan origination fees and purchased loan premiums and discounts. The Company has the ability and intent to hold its loans for the foreseeable future or until maturity or payoff.

Management considers all nonaccrual loans and restructured loans to be impaired. In most cases, loan payments that are past due less than 90 days, based on contractual terms, are considered minor collection delays, and the related loans are not considered to be impaired. The Company considers consumer installment loans to be pools of smaller balance homogeneous loans, which are collectively evaluated for impairment.

A loan is classified as a restructured loan when certain concessions have been made to the original contractual terms, such as reductions in interest rates or deferral of interest or principal payments, due to the borrower's financial condition.

Impaired loans are measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or, as a practical expedient, at the loan's observable market price or the fair value of the collateral if the loan is collateral dependent. The amount of impairment, if any, and any subsequent changes are recorded as adjustments to the allowance for loan losses. A loan is impaired when it is probable the Company will be unable to collect all contractual principal and interest payments due in accordance with the terms of the loan agreement.

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. For impaired loans, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. A risk rating system is utilized to measure 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

**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued**

**December 31, 2006 and 2005**

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nine reflecting the most risk or a complete loss. Risk ratings are assigned based upon the recommendations of the credit analyst and the 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 which are based on historical loss experience adjusted for qualitative factors are multiplied against the balances in each risk rating category to arrive at the appropriate level for the allowance for loan losses. Loans assigned a risk rating of six or above are monitored more closely by the credit administration officers and loan committee.

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.

The Company's real estate loans are collateralized by real estate located principally in Fairfield County, Connecticut and Westchester County, New York, and accordingly, the ultimate collectibility of a substantial portion of the Company's loan portfolio is susceptible to changes in regional real estate market conditions.

Interest and fees on loans

Interest on loans is accrued and included in operating income based on contractual rates applied to principal amounts outstanding. The accrual of interest income is discontinued whenever reasonable doubt exists as to its collectibility and generally is discontinued when loans are past due 90 days, based on contractual terms, as to either principal or interest. When the accrual of interest income is discontinued, all previously accrued and uncollected interest is reversed against interest income. The accrual of interest on loans past due 90 days or more, including impaired loans, may be continued if the loan is well secured, and it is believed all principal and accrued interest income due on the loan will be realized, and the loan is in the process of collection. A nonaccrual loan is restored to an accrual status when it is no longer delinquent and collectibility of interest and principal is no longer in doubt. Interest collected on nonaccrual loans and impaired loans is recognized only to the extent cash payments are received, and may be recorded as a reduction to principal if the collectibility of all loan principal is unlikely.

Loan origination fees and direct loan origination costs are deferred and amortized as an adjustment to the loan's yield, generally over the contractual life of the loan, utilizing the interest method.

Loan brokerage activities

The Company receives loan brokerage fees for soliciting and processing conventional loan applications on behalf of permanent investors. Brokerage fee income is recognized upon closing of loans for permanent investors.

Transfers of financial assets

Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been



**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued**

**December 31, 2006 and 2005**

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isolated from the Company, (2) the transferee obtains the right to pledge or exchange the transferred assets and no condition both constrains the transferee from taking advantage of that right and provides more than a trivial benefit for the transferor, and (3) the transferor does not maintain effective control over the transferred assets through either (a) an agreement that both entitles and obligates the transferor to repurchase or redeem the assets before maturity or (b) the ability to unilaterally cause the holder to return specific assets, other than through a cleanup call.

Other real estate owned

Other real estate owned consists of properties acquired through, or in lieu of, loan foreclosure or other proceedings and is initially recorded at fair value at the date of foreclosure, which establishes a new cost basis. After foreclosure, the properties are held for sale and are carried at the lower of cost or fair value less estimated costs of disposal. Any write-down to fair value at the time of acquisition is charged to the allowance for loan losses. Properties are evaluated regularly to ensure the recorded amounts are supported by current fair values, and valuation allowances are recorded as necessary to reduce the carrying amount to fair value less estimated cost of disposal. Revenue and expense from the operation of other real estate owned and valuation allowances are included in operations. Costs relating to the development and improvement of the property are capitalized, subject to the limit of fair value of the collateral. Gains or losses are included in operations upon disposal.

Premises and equipment

Premises and equipment are stated at cost net of accumulated depreciation and amortization. Leasehold improvements are capitalized and amortized over the shorter of the terms of the related leases or the estimated economic lives of the improvements. Depreciation is charged to operations for furniture, equipment and software using the straight-line method over the estimated useful lives of the related assets which range from three to ten years. Gains and losses on dispositions are recognized upon realization. Maintenance and repairs are expensed as incurred and improvements are capitalized.

Impairment of assets

Long-lived assets, which are held and used by the Company, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If impairment is indicated by that review, the asset is written down to its estimated fair value through a charge to noninterest expense.

Goodwill and other intangible assets

Goodwill and other identified intangible assets with indefinite lives represent the cost in excess of net assets of businesses acquired and are not subject to amortization. Other identified intangible assets with finite lives consist of a core deposit intangible recorded in connection with a branch acquisition and is amortized over its estimated useful life. The Company's unamortized goodwill and other intangible assets are tested for impairment annually, or more frequently under prescribed conditions.

**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued**

**December 31, 2006 and 2005**

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Income taxes

The Company recognizes income taxes under the asset and liability method. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, and loss carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

Related party transactions

Directors and officers of the Company and the Bank and their affiliates have been customers of and have had transactions with the Bank, and it is expected that such persons will continue to have such transactions in the future. Management believes that all deposit accounts, loans, services and commitments comprising such transactions were made in the ordinary course of business, and on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other customers who are not directors or officers. In the opinion of management, the transactions with related parties did not involve more than normal risks of collectibility or favored treatment or terms, or present other unfavorable features. Note 16 contains details regarding related party transactions.

Earnings per share

Basic earnings per share represents income available to common stockholders and is computed by dividing net income by the weighted-average number of common shares outstanding. Diluted earnings 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 the Company relate to outstanding stock options and warrants, and are determined using the treasury stock method.

Stock compensation plans

Statement of Financial Accounting Standards (SFAS) No. 123R, "Share-Based Payment," requires companies to account for share-based compensation transactions using a fair-value method and to recognize the related 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. The adoption of this statement had no impact on the Company's financial statements; however, such adoption 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.

**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued**

**December 31, 2006 and 2005**

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Comprehensive income

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

Fair values of financial instruments

The following methods and assumptions were used by the Company in estimating the fair value of its financial instruments:

*Cash and due from banks, federal funds sold, short-term investments and accrued interest receivable and payable and dividends receivable*

The carrying amount is a reasonable estimate of fair value.

*Securities*

Fair values, excluding restricted Federal Reserve Bank stock and Federal Home Loan Bank stock, are based on quoted market prices or dealer quotes, if available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities. The carrying values of the Federal Reserve Bank stock and Federal Home Loan Bank stock approximate fair value based on the redemption provisions of the related stock.

*Loans receivable*

For variable rate loans which reprice frequently, and have no significant changes in credit risk, fair value is based on the loans' carrying value. The fair value of fixed rate loans is estimated by discounting the future cash flows using the year end rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.

*Deposits*

The fair value of demand deposits, regular savings and certain money market deposits is the amount payable on demand at the reporting date. The fair value of certificates of deposit and other time deposits is estimated using a discounted cash flow calculation that applies interest rates currently being offered for deposits of similar remaining maturities to a schedule of aggregated expected maturities on such deposits.

**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued**

**December 31, 2006 and 2005**

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***Borrowings***

For variable rate borrowings which reprice frequently, and short-term borrowings, fair value is based on carrying value. The fair value of fixed rate borrowings is estimated by discounting the future cash flows using current interest rates for similar available borrowings with the same remaining maturities.

***Off-balance-sheet instruments***

Fair values for the Company's off-balance-sheet instruments (lending commitments and standby letters of credit) are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing.

**Recent accounting pronouncements**

In May 2005, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 154, ("SFAS 154"), "Accounting Changes and Error Corrections," replacing APB Opinion No. 20 and FASB Statement No. 3, which changes the treatment and reporting requirements for both accounting errors and changes of accounting principles, and provides guidance on determining the treatment of the retrospective application of a change. This Statement applies to all voluntary changes in accounting principles. The adoption of this statement by the Company in 2006 had no impact on the Company's financial statements.

In February 2006, the FASB issued SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments," which permits, but does not require, fair value accounting for any hybrid financial instrument that contains an embedded derivative that would otherwise require bifurcation in accordance with SFAS 133, "Accounting for Derivative Instruments and Hedging Activities." The statement also subjects beneficial interests in securitized financial assets to the requirements of SFAS 133. This statement is effective for all financial instruments acquired, issued, or subject to re-measurement after December 31, 2006. The Company does not expect that the adoption of this statement will have a material impact on its financial statements.

In March 2006, the FASB issued SFAS No. 156, "Accounting for Servicing of Financial Assets, an Amendment of FASB Statement No. 140." The statement amends SFAS No. 140 by (1) requiring the separate accounting for servicing assets and servicing liabilities, which arise from the sale of financial assets; (2) requiring all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable; and (3) permitting an entity to choose between an amortization method or a fair value method for subsequent measurement for each class of separately recognized servicing assets and servicing liabilities. This statement is effective for fiscal years beginning after September 15, 2006. The Company does not expect that the adoption of this Statement will have a material impact on its financial statements.

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



**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued**

**December 31, 2006 and 2005**

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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. The Company is required to adopt FIN 48 in 2007 and management is currently assessing the impact of FIN 48 on its financial statements.

In September 2006, the FASB issued SFAS No. 157, “Fair Value Measurements.” This statement defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. It clarifies that fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the market in which the reporting entity operates. This statement does not require any new fair value measurements, but rather, it provides enhanced guidance to other pronouncements that require or permit assets or liabilities to be measured at fair value. This statement is effective for fiscal years beginning after November 15, 2007, with earlier adoption permitted. The Company does not expect that the adoption of this statement will have a material impact on its financial statements.

In September 2006, the FASB issued SFAS No. 158, “Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans, an Amendment of FASB Statements No. 87, 88, 106 and 132(R).” This Statement requires recognition of the overfunded or underfunded status of defined benefit postretirement plans as an asset or liability in the statement of financial position and to recognize changes in that funded status in comprehensive income in the year in which the changes occur. SFAS No. 158 requires prospective application, recognition and disclosure requirements and is effective for fiscal years ending after December 31, 2006. Additionally, SFAS No. 158 requires companies to measure plan assets and obligations as of the entity’s fiscal year end. This requirement is effective for the year ending December 31, 2008. The Company does not expect that SFAS 158 will have a material impact on its financial statements.

At its September 2006 meeting, the Emerging Issues Task Force (“EITF”) reached a final consensus on Issue 06-04, “Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements.” The consensus stipulates that an agreement by an employer to share a portion of the proceeds of a life insurance policy with an employee during the postretirement periods is a postretirement benefit arrangement required to be accounted for under SFAS No. 106 or Accounting Principles Board Opinion (“APB”) No. 12, “Omnibus Opinion - 1967.” The consensus concludes that the purchase of a split-dollar life insurance policy does not constitute a settlement under SFAS No. 106 and, therefore, a liability for the postretirement obligation must be recognized under SFAS No. 106 if the benefit is offered under an arrangement that constitutes a plan, or under APB No. 12 if it is not part of a plan. Issue 06-04 is effective for annual or interim reporting periods beginning after December 15, 2007.

## PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued

December 31, 2006 and 2005

The Company does not expect that the adoption of EITF 06-04 will have a material impact on its financial statements.

**Note 2. Restrictions on Cash and Due From Banks**

The Company is required to maintain reserves against its respective transaction accounts and non-personal time deposits. At December 31, 2006 and 2005, the Bank was required to have cash and liquid assets of approximately \$315,000 and \$3,566,000, respectively, to meet these requirements. In addition, at December 31, 2006 and 2005, the Company was required to maintain \$25,000 in the Federal Reserve Bank for clearing purposes.

**Note 3. Available for Sale Securities**

The amortized cost, gross unrealized gains, gross unrealized losses and approximate fair values of available for sale securities at December 31, 2006 and 2005 are as follows:

<u>2006</u>	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>U.S. Government sponsored agency obligations</b>	\$ 16,999,984	\$ -	\$ (433,162)	\$ 16,566,822
<b>Mortgage-backed securities</b>	44,141,476	32,805	(697,968)	43,476,313
	61,141,460	32,805	(1,131,130)	60,043,135
<b>Money market preferred equity securities</b>	7,050,000	-	-	7,050,000
	\$ 68,191,460	\$ 32,805	\$ (1,131,130)	\$ 67,093,135

<u>2005</u>	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>U.S. Government sponsored agency obligations</b>	\$ 16,999,341	\$ -	\$ (522,657)	\$ 16,476,684
<b>Mortgage-backed securities</b>	57,453,614	2,330	(1,260,560)	56,195,384
	74,452,955	2,330	(1,783,217)	72,672,068
<b>Money market preferred equity securities</b>	6,000,000	-	-	6,000,000
	\$ 80,452,955	\$ 2,330	\$ (1,783,217)	\$ 78,672,068

## PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued

December 31, 2006 and 2005

The following table presents the Company's available for sale securities' gross unrealized losses and fair value, aggregated by the length of time the individual securities have been in a continuous loss position, at December 31, 2006 and 2005:

<u>2006</u>	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
<b>U.S. Government sponsored</b>						
agency obligations	\$ -	\$ -	\$ 16,566,822	\$ (433,162)	\$ 16,566,822	\$ (433,162)
Mortgage-backed securities	1,117,429	(2,423)	35,262,041	(695,545)	36,379,470	(697,968)
<b>Totals</b>	<b>\$ 1,117,429</b>	<b>\$ (2,423)</b>	<b>\$ 51,828,863</b>	<b>\$ (1,128,707)</b>	<b>\$ 52,946,292</b>	<b>\$ (1,131,130)</b>
<u>2005</u>	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
<b>U.S. Government sponsored</b>						
agency obligations	\$ 1,985,625	\$ (13,716)	\$ 14,491,059	\$ (508,941)	\$ 16,476,684	\$ (522,657)
Mortgage-backed securities	27,846,559	(459,646)	25,315,920	(800,914)	53,162,479	(1,260,560)
<b>Totals</b>	<b>\$ 29,832,184</b>	<b>\$ (473,362)</b>	<b>\$ 39,806,979</b>	<b>\$ (1,309,855)</b>	<b>\$ 69,639,163</b>	<b>\$ (1,783,217)</b>

At December 31, 2006, thirty-nine securities have unrealized losses with aggregate depreciation of 2.1% from the amortized cost. There were no securities with unrealized losses greater than 5% of amortized cost.

Management believes that none of the unrealized losses on available for sale securities are other than temporary due to the fact that they relate to debt and mortgage-backed securities issued by U.S. Government agencies and Government sponsored agencies, which the Company has both the intent and ability to hold until maturity or until the fair value fully recovers. Additionally, management considers the issuers of the securities to be financially sound, and expects to receive all contractual principal and interest related to these investments.

At December 31, 2006 and 2005, available for sale securities with a carrying value of \$2,817,000 and \$1,486,000, respectively, were pledged to secure obligations under municipal deposits.

## PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued

December 31, 2006 and 2005

The amortized cost and fair value of available for sale debt securities at December 31, 2006 by contractual maturity are presented below. Actual maturities of mortgage-backed securities may differ from contractual maturities because the mortgages underlying the securities may be called or repaid without any penalties. Because mortgage-backed securities are not due at a single maturity date, they are not included in the maturity categories in the following maturity summary.

	Amortized Cost	Fair Value
Maturity:		
1-5 years	\$ 16,999,984	\$ 16,566,822
Mortgage-backed securities	44,141,476	43,476,313
Total	\$ 61,141,460	\$ 60,043,135

During 2006, 2005 and 2004, there were no sales of available for sale securities.

**Note 4. Loans Receivable and Allowance for Loan Losses**

A summary of the Company's loan portfolio at December 31, 2006 and 2005 is as follows:

	2006	2005
Real estate:		
Commercial	\$ 166,799,341	\$ 129,178,889
Residential	91,077,687	77,391,833
Construction	203,828,453	107,232,587
Commercial	23,997,640	15,591,818
Consumer installment	1,251,300	1,106,648
Consumer home equity	26,933,277	39,097,450
<b>Total loans</b>	<b>513,887,698</b>	<b>369,599,225</b>
Premiums on purchased loans	292,543	367,491
Net deferred loan fees	(1,665,654)	(1,134,604)
Allowance for loan losses	(5,630,432)	(4,588,335)
<b>Loans receivable, net</b>	<b>\$ 506,884,155</b>	<b>\$ 364,243,777</b>

## PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued

December 31, 2006 and 2005

The changes in the allowance for loan losses for the years ended December 31, 2006, 2005 and 2004 are as follows:

	2006	2005	2004
Balance, beginning of year	\$ 4,588,335	\$ 3,481,525	\$ 2,934,675
Provision for loan losses	1,040,000	1,110,000	556,000
Recoveries of loans previously charged-off	3,190	-	-
Loans charged-off	(1,093)	(3,190)	(9,150)
Balance, end of year	\$ 5,630,432	\$ 4,588,335	\$ 3,481,525

At December 31, 2006 and 2005, the unpaid principal balances of loans delinquent 90 days or more and still accruing were \$1,896,984 and \$274,622, respectively, and the unpaid principal balances of loans placed on nonaccrual status were \$2,904,015 and \$1,934,614, respectively. If nonaccrual loans had been performing in accordance with their original terms, the Company would have recorded approximately \$141,237, \$6,000 and \$18,000, respectively, of additional income during the years ended December 31, 2006, 2005 and 2004.

The following information relates to impaired loans as of and for the years ended December 31, 2006 and 2005:

	2006	2005
Impaired loans receivable for which there is a related allowance for credit losses	\$ 1,422,359	\$ -
Impaired loans receivable for which there is no related allowance for credit losses	\$ 1,481,656	\$ 1,934,614
Allowance for credit losses related to impaired loans	\$ 250,000	\$ -
Average recorded investment in impaired loans	\$ 4,394,509	\$ 2,668,531

During 2006, 2005 and 2004, interest income collected and recognized on impaired loans was \$149,313, \$223,261 and \$184,565, respectively. The Company has no commitments to lend additional funds to borrowers whose loans are impaired.

The Company's lending activities are conducted principally in Fairfield County, Connecticut and Westchester County, New York. The Company grants commercial real estate loans, commercial business loans and a variety of consumer loans. In addition, the Company grants loans for the construction of residential homes, residential developments and for land development projects. All residential and commercial mortgage loans are collateralized by first or second mortgages on real estate. The ability and willingness of borrowers to satisfy their loan obligations is dependent in large part upon the status of the



**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued****December 31, 2006 and 2005**

regional economy and regional real estate market. Accordingly, the ultimate collectibility of a substantial portion of the loan portfolio and the recovery of a substantial portion of any resulting real estate acquired is susceptible to changes in market conditions.

The Company has established credit policies applicable to each type of lending activity in which it engages, evaluates the creditworthiness of each customer and, in most cases, extends credit of up to 75% of the market value of the collateral at the date of the credit extension depending on the Company's evaluation of the borrowers' creditworthiness and type of collateral. The market value of collateral is monitored on an ongoing basis and additional collateral is obtained when warranted. Real estate is the primary form of collateral. Other important forms of collateral are accounts receivable, inventory, other business assets, marketable securities and time deposits. While collateral provides assurance as a secondary source of repayment, the Company ordinarily requires the primary source of repayment to be based on the borrower's ability to generate continuing cash flows.

**Note 5. Premises and Equipment**

At December 31, 2006 and 2005, premises and equipment consisted of the following:

	2006	2005
Construction in progress	\$ 803,149	\$ -
Leasehold improvements	2,676,805	2,217,690
Furniture, equipment and software	3,408,419	2,867,738
	6,888,373	5,085,428
Less accumulated depreciation and amortization	(3,197,512)	(2,611,275)
	\$ 3,690,861	\$ 2,474,153

For the years ended December 31, 2006, 2005 and 2004, depreciation and amortization expense related to premises and equipment totaled \$644,472, \$604,399, and \$536,029, respectively.

**Note 6. Other Real Estate Operations**

Other real estate owned of \$834,341 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. A summary of other real estate operations for the year ended December 31, 2006 is as follows:

Rental income from other real estate owned	\$ 20,458
Less expenses of holding other real estate owned	743
Income from other real estate operations	\$ 19,715

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**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued****December 31, 2006 and 2005****Note 7. Deposits**

At December 31, 2006 and 2005, deposits consisted of the following:

	2006	2005
Noninterest bearing	\$ 56,679,836	\$ 48,797,389
Interest bearing:		
Time certificates, less than \$100,000	248,414,014	168,565,756
Time certificates, \$100,000 or more	162,546,807	98,440,248
Money market	40,935,628	57,798,772
Savings	25,993,452	20,089,889
NOW	26,881,927	25,383,234
Total interest bearing	504,771,828	370,277,899
<b>Total deposits</b>	<b>\$ 561,451,664</b>	<b>\$ 419,075,288</b>

Interest expense on certificates of deposit in denominations of \$100,000 or more was \$5,693,596, \$3,023,519 and \$1,883,047 for the years ended December 31, 2006, 2005 and 2004, respectively.

Contractual maturities of time certificates of deposit as of December 31, 2006 are summarized below:

Due within:	
1 year	\$ 327,238,523
1-2 years	46,660,435
2-3 years	17,382,871
3-4 years	16,737,157
4-5 years	2,941,835
	\$ 410,960,821

**Note 8. Borrowings****Federal Home Loan Bank borrowings**

The Bank is a member of the Federal Home Loan Bank of Boston ("FHLB"). At December 31, 2006, the Bank has the ability to borrow from the FHLB based on a certain percentage of the value of the Bank's qualified collateral, as defined in the FHLB Statement of Products Policy, comprised mainly of mortgage-backed securities delivered under collateral safekeeping to the FHLB, and a blanket lien on qualifying mortgage loans, at the time of the borrowing. In accordance with an agreement with the FHLB, the qualified collateral must be free and clear of liens, pledges and encumbrances. In addition, the Company has a \$2,000,000 available line of credit with the FHLB. At December 31, 2006 and 2005, there were no advances outstanding under this line of credit. At December 31, 2006, other outstanding advances from the FHLB aggregated \$8,000,000 at interest rates ranging from 2.96% to 5.24% and at

**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued**

**December 31, 2006 and 2005**

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December 31, 2005, other outstanding advances aggregated \$9,000,000 at interest rates ranging from 2.49% to 5.11%.

The Bank is required to maintain an investment in capital stock of the FHLB in an amount equal to a percentage of its outstanding mortgage loans and contracts secured by residential properties, including mortgage-backed securities. No ready market exists for FHLB stock and it has no quoted market value. For disclosure purposes, such stock is assumed to have a market value which is equal to cost since the Bank can redeem the stock with the FHLB at cost.

Repurchase agreements

At December 31, 2006 and 2005, the Company had available borrowings under repurchase agreements of \$10,000,000 and had no amounts outstanding at those dates.

Junior subordinated debt owed to unconsolidated trust

During 2003, the Company formed the Trust of which 100% of the Trust's common securities are owned by the Company. The Trust has no independent assets, and exists for the sole purpose of issuing trust securities and investing the proceeds thereof in an equivalent amount of junior subordinated debentures issued by the Company.

The Trust issued \$8,000,000 of trust preferred securities in 2003. Pursuant to FIN 46R, issued in December 2003, the Company deconsolidated the Trust at December 31, 2003. The Company's investment in the Trust of \$248,000 is included in other assets. The overall effect on the financial position and operating results of the Company as a result of the deconsolidation was not material.

Trust preferred securities currently qualify for up to 25% of the Company's Tier I Capital, with the excess qualifying as Tier 2 Capital. On March 1, 2005, the Federal Reserve Board of Governors, which is the banking regulator for the Holding Company, approved final rules that allow for the continued inclusion of outstanding and prospective issuances of trust preferred securities in regulatory capital, subject to new, more strict limitations. The Company has until March 31, 2009 to meet the new limitations. Management does not believe these final rules will have a significant impact on the Company.

The subordinated debentures are unsecured obligations of the Company and are subordinate and junior in right of payment to all present and future senior indebtedness of the Company. The Company has entered into a guarantee, which together with its obligations under the subordinated debentures and the declaration of trust governing the Trust, including its obligations to pay costs, expenses, debts and liabilities, other than trust securities, provides a full and unconditional guarantee of amounts on the capital securities. The subordinated debentures, which bear interest at the three month LIBOR plus 3.15% (8.516% at December 31, 2006), mature on March 26, 2033 and can be redeemed at the Company's option in 2008.

**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued****December 31, 2006 and 2005**

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The duration of the Trust is 30 years with early redemption at par at the Company's option in 2008, or earlier in the event of certain regulatory or tax changes. The trust securities also bear interest at the three month LIBOR plus 3.15%.

Other borrowings

At December 31, 2006 and 2005, the Company had available borrowings under federal funds or letters of credit from its correspondent bank of \$3,000,000 and had no amounts outstanding at those dates.

Maturity of borrowings

The contractual maturities of the Company's borrowings at December 31, 2006, by year, are as follows:

	Fixed Rate	Floating Rate	Total
2007	\$8,000,000	\$ -	\$8,000,000
2008	-	-	-
2009	-	-	-
2010	-	-	-
2011	-	-	-
Thereafter	-	8,248,000	8,248,000
Total borrowings	\$8,000,000	\$8,248,000	\$16,248,000

**Note 9. Commitments and Contingencies**Operating leases

The Company has non-cancelable operating leases for its main office, branch and mortgage brokerage offices. Under these lease agreements, the Company is required to pay certain executory costs such as insurance and property taxes. The Company also leases parking space under a noncancelable operating lease agreement and certain equipment under cancelable and noncancelable arrangements.

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**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued****December 31, 2006 and 2005**

Future minimum rental commitments under the terms of these leases, by year and in the aggregate, are as follows:

Years Ending December 31,	Amount
2007	\$ 1,884,072
2008	1,702,223
2009	1,642,460
2010	1,641,027
2011	1,522,680
Thereafter	6,240,279
	\$ 14,632,741

Total rental expense charged to operations for cancelable and noncancelable operating leases was \$1,677,824, \$1,194,499 and \$876,132 for the years ended December 31, 2006, 2005 and 2004, respectively. The Company subleases excess space at three locations. Income from subleases included in noninterest expense was \$57,403, \$73,545 and \$28,326 for the years ended December 31, 2006, 2005 and 2004, respectively.

Employment Agreements*President's Agreement*

Effective January 1, 2007, after the expiration of a previous employment agreement the Company and the Bank entered into a new employment agreement (the "Agreement") with the Bank's President and Chief Executive Officer that expires on December 31, 2009. The Agreement provides for, among other things, a stipulated base salary for each of the three years covered by the Agreement and a discretionary annual bonus to be determined by the Board of Directors.

In the event of the early termination of the Agreement for cause (as defined in the agreement) or because of his death or disability, all unvested restricted stock awards and options will be forfeited. The President was issued stock appreciation rights and restricted share rights under an earlier employment contract and may participate in future option grants if made by the Company. In the event the President's employment terminates for any other reason, including termination following a change in control (as defined in the agreement), all stock rights and options, if any, will vest immediately.

In the event of the early termination of the Agreement for any reason other than cause, the Company would be obligated to compensate the President in one lump sum payment, an amount equal to the higher of the aggregate salary payments that would be made to the President under the remaining term of the Agreement, or eighteen months of the President's base salary at the time of termination.

**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued**

**December 31, 2006 and 2005**

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The Company and the Bank have also entered into a change of control agreement with the President that entitles the President to a lump sum payment of two and one half times the greater of the President's base salary at the time or total compensation for the most recently completed fiscal year at the time of the change in control. This agreement is substantially similar to those described below for other executive officers.

The provisions of the early termination clause apply only to termination of the Agreement prior to a change of control. Termination of the Agreement following a change of control shall be governed by the change of control provisions.

*Other Employment Agreements*

In November 2003, the Company entered into an employment agreement with its Chief Financial Officer that expires on December 31, 2007. The agreement provides for, among other things, a stipulated base salary and annual discretionary bonuses as determined by the Board of Directors. In addition, the Chief Financial Officer has a change of control agreement that entitles the Chief Financial Officer to a lump sum payment of two and one half times the greater of the Chief Financial Officer's base salary at the time or total compensation for the most recently completed fiscal year.

Effective January 1, 2007, the Company entered into a one-year employment agreement with an officer of the Bank who serves as Executive Vice President of the Bank, Sales Manager of Retail Brokerage, which replaced a contract that expired on December 31, 2006. The agreement provides for, among other things, a minimum base salary and commission arrangement, as well as additional compensation based upon the revenue generated by direct reports, and for reimbursement of expenses incurred incidental to duties as an officer. The agreement terminates on December 31, 2007.

In addition, three other executive officers of the Company have change of control agreements that entitle such officers to receive two or two and one half times the greater of the officer's base salary at the time or total compensation for the most recently completed fiscal year if a change of control occurs while such officers are full time officers of the Company or within six months following termination of employment other than for cause or by reason of death or disability.

Legal Matters

The Company is involved in various legal proceedings which have arisen in the normal course of business. Management believes that the resolution of these matters will not have a material effect on the Company's financial condition or results of operations.

## PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued

December 31, 2006 and 2005

Other

The Company has received regulatory approval to open six new branch offices. The Company entered into non-cancelable leases for four of these locations.

**Note 10. Income Taxes**

The components of the income tax provision for the years ended December 31, 2006, 2005 and 2004 are as follows:

	2006	2005	2004
Current			
Federal	\$ 1,408,384	\$ 1,211,403	\$ 554,723
State	356,958	308,430	179,489
<b>Total</b>	<b>1,765,342</b>	<b>1,519,833</b>	<b>734,212</b>
Deferred			
Federal	(402,384)	(454,457)	(81,723)
State	(95,958)	(108,376)	(19,489)
<b>Total</b>	<b>(498,342)</b>	<b>(562,833)</b>	<b>(101,212)</b>
<b>Provision for income taxes</b>	<b>\$ 1,267,000</b>	<b>\$ 957,000</b>	<b>\$ 633,000</b>

A reconciliation of the anticipated income tax provision (computed by applying the statutory Federal income tax rate of 34% to the income before income taxes) to the income tax provision as reported in the statements of income for the years ended December 31, 2006, 2005 and 2004 is as follows:

	2006	2005	2004
Provision for income taxes at statutory Federal rate	\$ 1,251,900	\$ 803,600	\$ 530,200
State taxes, net of Federal benefit	200,100	117,000	96,500
Dividends received deduction	(77,500)	(68,500)	(52,300)
Nondeductible expenses	56,300	38,600	16,800
(Under) over accrual of income tax provision	(159,489)	86,800	900
Other	(4,311)	(20,500)	40,900
<b>Total provision for income taxes</b>	<b>\$ 1,267,000</b>	<b>\$ 957,000</b>	<b>\$ 633,000</b>

## PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued

December 31, 2006 and 2005

At December 31, 2006 and 2005, the components of gross deferred tax assets and gross deferred tax liabilities are as follows:

	2006	2005
Deferred tax assets:		
Allowance for loan losses	\$ 2,193,055	\$ 1,787,157
Nonaccrual interest	55,015	-
Investment securities	417,363	676,738
Premises and equipment	302,847	272,370
Accrued expenses	28,382	17,138
Other	-	6,989
Gross deferred tax assets	2,996,662	2,760,392
Deferred tax liabilities:		
Tax bad debt recapture	63,746	70,827
Other	18,354	13,970
Gross deferred tax liabilities	82,100	84,797
<b>Deferred tax asset, net</b>	<b>\$ 2,914,562</b>	<b>\$ 2,675,595</b>

The allocation of the deferred tax provision (benefit) involving items charged to current year income and items charged directly to equity for the years ended December 31, 2006, 2005 and 2004 are as follows:

	2006	2005	2004
Deferred tax provision (benefit) allocated to equity	\$ 259,375	\$ (435,721)	\$ (51,705)
Deferred tax provision (benefit) allocated to operations	(498,342)	(562,833)	(101,212)
<b>Total deferred tax benefit</b>	<b>\$ (238,967)</b>	<b>\$ (998,554)</b>	<b>\$ (152,917)</b>

**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued****December 31, 2006 and 2005****Note 11. Goodwill and other intangible assets**

On November 17, 2006, the Company acquired the assets and assumed deposit liabilities of a branch office from bcpbank, N.A. In consideration for the assumption of approximately \$3,146,000 in deposit liabilities, the Company received approximately \$2,586,000 in cash and other assets. The Company accounted for this branch acquisition as a business combination and recorded the acquired tangible and identifiable intangible assets and liabilities at fair value with the remainder recorded as goodwill. In connection with this purchase, the Company has recorded \$435,400 in goodwill and a core deposit intangible of \$124,600. The core deposit intangible is being amortized over the estimated life of the related deposits of eight years using the straight line method. The net book value of the Company's goodwill and core deposit intangibles at December 31, 2006 and 2005 is as follows:

	2006	2005
Goodwill	\$ 1,365,491	\$ 930,091
Core deposit intangible	124,600	
Less accumulated amortization	2,440	
	122,160	-
<b>Total goodwill and other intangible assets</b>	<b>\$ 1,487,651</b>	<b>\$ 930,091</b>

Amortization expense for the year ended December 31, 2006 was \$2,440. Expected future amortization expenses is as follows:

Years Ending December 31,	Amount
2007	\$ 18,574
2008	17,684
2009	16,793
2010	15,903
2011	15,012
Thereafter	38,194
	<b>\$ 122,160</b>

Based on the Company's annual impairment tests goodwill and the core deposit intangible were not impaired for the years ended December 31, 2006, 2005 and 2004.

**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued**

**December 31, 2006 and 2005**

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**Note 12. Shareholders' Equity**

Common stock

On September 26, 2006, the Company commenced an offering of up to 1,320,000 shares of its common stock, at \$22.00 per share through an underwritten public offering. In addition, the Company granted the underwriter an option to purchase up to 180,000 additional shares of common stock at the public offering price, less the underwriting discount, to cover over-allotments. The common stock offering was completed on September 29, 2006 with the issuance of 1,500,000 shares of common stock resulting in an increase in common stock and additional paid in capital of \$30,665,966 after deducting total stock issuance costs of \$2,334,034 which were charged to additional paid-in capital.

In addition, during 2006, 8,000 options were exercised resulting in proceeds to the Company of \$80,880 and 845 shares were issued to directors in payment of directors' fees of \$24,927.

On August 4, 2005, the Company commenced an offering of up to 705,883 shares of its common stock, at \$17.00 per share, to existing shareholders, whereby each shareholder was granted the right to purchase one share of stock for every six shares owned as of August 1, 2005. In addition, each shareholder was granted an oversubscription privilege to purchase up to two additional shares for each share owned from stock not subscribed by existing shareholders under the initial rights described above. The Company also entered into standby purchase agreements pursuant to which the standby purchasers agreed to acquire up to 529,412 shares at \$17.00 per share. The common stock offering was completed on September 21, 2005 resulting in an increase in common stock and additional paid in capital of \$10,965,881 after deducting total stock issuance costs of \$1,034,130 which were charged to additional paid-in capital. The Company received subscriptions for a total of 705,883 shares; existing shareholders purchased \$6.3 million or 368,687 shares; standby investors purchased \$5.7 million or 337,196 shares.

In addition, during 2005, 37,000 options were exercised resulting in proceeds to the Company of \$375,436 and 1,375 shares were issued to directors in payment of directors' fees of \$26,250.

During 2004, 77,784 warrants issued to certain of the Bank's original organizers and certain other individuals were exercised resulting in proceeds to the Company of \$466,704.

## PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued

December 31, 2006 and 2005

Income Per Share

The following tables present information about the computation of basic and diluted income per share for the years ended December 31, 2006, 2005 and 2004.

	Net Income	2006 Shares	Per Share Amount
<b>Basic Income Per Share</b>			
Income available to common shareholders	\$ 2,415,155	3,621,250	\$ 0.67
<b>Effect of Dilutive Securities</b>			
Stock options outstanding	-	41,897	(0.01)
<b>Diluted Income Per Share</b>			
Income available to common shareholders plus assumed conversions	\$ 2,415,155	3,663,147	\$ 0.66
	Net Income	2005 Shares	Per Share Amount
<b>Basic Income Per Share</b>			
Income available to common shareholders	\$ 1,406,626	2,696,676	\$ 0.52
<b>Effect of Dilutive Securities</b>			
Stock options outstanding	-	42,042	(0.01)
<b>Diluted Income Per Share</b>			
Income available to common shareholders plus assumed conversions	\$ 1,406,626	2,738,718	\$ 0.51

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**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued****December 31, 2006 and 2005**

	Net	2004	Per Share
	Income	Shares	Amount
<b>Basic Income Per Share</b>			
Income available to common shareholders	\$ 926,397	2,449,679	\$ 0.38
<b>Effect of Dilutive Securities</b>			
Warrants and stock options outstanding	-	53,012	(0.01)
<b>Diluted Income Per Share</b>			
Income available to common shareholders plus assumed conversions	\$ 926,397	2,502,691	\$ 0.37

Stock warrants

The Bank issued warrants to certain of the Bank's original organizing group and certain other individuals to purchase up to 95,000 shares of the Bank's common stock at the original public offering price of \$6 per share. The obligations related to all warrants issued by the Bank were assumed by the Company. During 2004, all unexercised warrants expired.

A summary of the status of the warrants at December 31, 2004, and changes during the year ended on that date, is as follows:

	<b>2004</b>	
	<b>Number of Shares</b>	<b>Weighted-Average Exercise Price</b>
Outstanding at beginning of year	<b>83,484</b>	<b>\$ 6.00</b>
Expired	<b>5,700</b>	<b>6.00</b>
Exercised	<b>77,784</b>	<b>6.00</b>
Outstanding at end of year	-	
Exercisable at end of year	-	

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 grant. Such options were immediately exercisable and expire if unexercised ten years after the date of grant. The Company has reserved 65,000 shares of common stock for issuance under the Plan. No additional options may be granted under the Plan.



## PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued

December 31, 2006 and 2005

A summary of the status of the stock options at December 31, 2006, 2005 and 2004 is as follows:

	2006		2005		2004	
	Number of Shares	Weighted-Average Exercise Price	Number of Shares	Weighted-Average Exercise Price	Number of Shares	Weighted-Average Exercise Price
Outstanding at beginning of year	73,000	\$ 10.13	110,000	\$ 10.13	110,000	\$ 10.13
Exercised	8,000	10.11	37,000	10.15	-	-
Outstanding at end of year	65,000	10.13	73,000	10.13	110,000	10.13
Exercisable at end of year	65,000	10.13	73,000	10.13	110,000	10.13

The intrinsic value of options outstanding and exercisable at December 31, 2006 and 2005 was \$977,795 and \$733,577, respectively. The intrinsic value of options exercised during the twelve months ended December 31, 2006 and 2005 were \$149,275 and \$313,037, respectively. There are no pro forma disclosures required for the twelve months ended December 31, 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 weighted-average remaining contractual life for the options outstanding at December 31, 2006 is 2.7 years.

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

#### President's Agreement

Included under the terms of an employment agreement, which expired on October 23, 2003 (the "Agreement") between the Company and the President, was a provision for the Company to grant shares of the Company's common stock, if available, or its cash equivalent, if not, to the President on December 31, 2000, and annually thereafter through December 31, 2003. The number of shares to be granted was based on 30% of the President's base salary for the preceding annual employment period. Compensation cost for grants through 2002 were recognized over the period ending with the expiration date of the Agreement and compensation cost for the 2003 grant was recognized over the term of the most recently expired contract. This stock grant has been settled in cash each year from 2001 through 2006 and the remaining 1,135 shares are anticipated to settle in cash when fully distributed at the end of 2007. The expense charged to operations related to this component of the Agreement for the twelve months ended December 31, 2006, 2005 and 2004 was \$51,951, \$46,247 and \$77,085, respectively.



**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued**

**December 31, 2006 and 2005**

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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 2002, and on December 31, 2003, if the President remained employed by the Bank. In the event that the Company did not have stock options available to grant at any of the stipulated 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 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 President has the equivalent of 15,000 options remaining under this section of the Agreement. The expense charged to operations related to the option component of the Agreement for the twelve months ended December 31, 2006, 2005 and 2004 was \$114,998, \$114,338 and \$198,665, respectively.

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 officers to receive, in cash or Company common stock, the appreciation in the value of the Company's common stock from the date of grant. Each award vested at the rate of 20% per year from the date of grant. Any unexercised rights will expire ten years from the date of grant. During 2001, the Company granted a total of 18,000 stock appreciation rights to three Company executive officers, and \$89,880, \$67,932 and \$99,216, respectively, was charged to operations under the SAR Plan for the years ended December 31, 2006, 2005 and 2004. At December 31, 2006 there are 12,000 unexercised rights under this plan.

Rights Agreement

On April 15, 2004, the Board of Directors of the Company declared, effective as of April 19, 2004, a dividend distribution of one Right for each outstanding share of common stock of the Company. The dividend was payable on April 29, 2004 to the stockholders of record as of the close of business on that date. Each Right entitles the registered holder to purchase from the Company 8.152 shares of the Company's common stock, at a price of \$60.00, or \$7.36 per share subject to adjustment. The description and terms of the Rights are set forth in a Rights Agreement, dated as of April 19, 2004 between the Company and Registrar and Transfer Company.

The Rights are not exercisable until the earliest of (i) the tenth business day after a public announcement that a person or group of affiliated or associated persons acquired, or obtained the right to acquire, beneficial ownership of 15% or more of the outstanding shares of the Company's common stock (an Acquiring Person); (ii) the tenth business day (or such later day as may be determined by action of the Board of Directors of the Company prior to such time as any person becomes an Acquiring Person) after the date of the commencement of a tender or exchange offer by any person (other than the Company) if, upon consummation such person would be an Acquiring Person; and (iii) the tenth business day (or such later day as may be determined by action of the Board of Directors of the Company prior to such time as

**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued**

**December 31, 2006 and 2005**

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any person becomes an Acquiring Person) after the filing by any Person (other than the Company) of a registration statement under the Securities Act of 1933, as amended, with respect to a contemplated exchange offer to acquire (when added to any shares as to which such person is the beneficial owner immediately prior to such filing) beneficial ownership of 15% or more of the issued and outstanding shares of the Company's common stock.

The Rights will expire on April 19, 2014, unless earlier redeemed or exchanged by the Company.

**Note 13. 401(k) Savings Plan**

The Company offers employees participation in the Patriot National Bank 401(k) Savings Plan (the "401(k) Plan") under Section 401(k) of the Internal Revenue Code. The 401(k) Plan covers substantially all employees who have completed six months of service, are 21 years of age and who elect to participate. Under the terms of the 401(k) Plan, participants can contribute up to the maximum amount allowed, subject to Federal limitations. The Company may make discretionary matching contributions to the 401(k) Plan. Participants are immediately vested in their contributions and fully vested in Company contributions after two years. The Company contributed approximately \$147,000, \$140,000 and \$127,000 to the 401(k) Plan in 2006, 2005 and 2004, respectively.

**Note 14. Financial Instruments With Off-Balance-Sheet Risk**

In the normal course of business, the Company 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 the Company 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 upon; the customer default; and the value of any existing collateral become worthless. The Company 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 the Company controls the credit risk of these financial instruments through credit approvals, credit limits, monitoring procedures and the receipt of collateral as deemed necessary.

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**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued****December 31, 2006 and 2005**

Financial instruments whose contract amounts represent credit risk are as follows at December 31, 2006 and 2005:

	2006	2005
Commitments to extend credit:		
Future loan commitments	\$ 54,134,247	\$ 55,364,491
Unused lines of credit	43,900,007	37,819,135
Undisbursed construction loans	97,977,899	40,398,941
Financial standby letters of credit	264,483	216,000
	<b>\$ 196,276,636</b>	<b>\$ 133,798,567</b>

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 the Company 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 the Company 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. As of January 1, 2003, newly issued or modified guarantees that are not derivative contracts have been recorded on the Company's consolidated balance sheet at their fair value at inception. No liability related to guarantees was required to be recorded at December 31, 2006 and 2005.

**Note 15. Regulatory Matters**

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

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital (as defined) to average

## PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued

December 31, 2006 and 2005

assets (as defined). Management believes, as of December 31, 2006, that the Company and the Bank meet all capital adequacy requirements to which they are subject.

The most recent notification from the Office of the Comptroller of the Currency categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier I risk-based, and Tier-I leverage ratios as set forth in the table. There are no conditions or events since then that management believes have changed the Bank's category.

The Company's and the Bank's actual capital amounts and ratios at December 31, 2006 and 2005 were (dollars in thousands):

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>2006</b>						
<b>The Company:</b>						
Total Capital (to Risk Weighted Assets)	\$ 77,107	15.34%	\$ 40,212	8.00%	N/A	N/A
Tier I Capital (to Risk Weighted Assets)	71,477	14.22%	20,106	4.00%	N/A	N/A
Tier I Capital (Average Assets)	71,477	11.63%	24,584	4.00%	N/A	N/A
<b>The Bank:</b>						
Total Capital (to Risk Weighted Assets)	\$ 75,499	15.02%	\$ 40,213	8.00%	\$ 50,266	10.00%
Tier I Capital (to Risk Weighted Assets)	69,869	13.90%	20,106	4.00%	30,159	6.00%
Tier I Capital (to Average Assets)	69,869	11.37%	24,580	4.00%	30,725	5.00%
<b>2005</b>						

**The Company:**

Total Capital (to Risk Weighted Assets)	\$ 43,870	12.70%	\$ 27,635	8.00%	\$ N/A	N/A
Tier I Capital (to Risk Weighted Assets)	39,549	11.45%	13,816	4.00%	N/A	N/A
Tier I Capital (Average Assets)	39,549	8.56%	18,481	4.00%	N/A	N/A

**The Bank:**

Total Capital (to Risk Weighted Assets)	\$ 43,180	12.52%	\$ 27,591	8.00%	\$ 34,489	10.00%
Tier I Capital (to Risk Weighted Assets)	38,865	11.27%	13,794	4.00%	20,691	6.00%
Tier I Capital (to Average Assets)	38,865	8.42%	18,463	4.00%	23,079	5.00%

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**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued****December 31, 2006 and 2005**Restrictions on dividends, loans and advances

The Company's ability to pay dividends is dependent on the Bank's ability to pay dividends to the Company. However, certain restrictions exist regarding the ability of the Bank to transfer funds to the Company in the form of cash dividends, loans or advances. The approval of the Comptroller of the Currency is required to pay dividends in excess of the Bank's earnings retained in the current year plus retained net earnings for the preceding two years. As of December 31, 2006, the Bank had retained earnings of approximately \$7,634,000, of which \$4,157,000 is available for distribution to the Company as dividends without prior regulatory approval. The Bank is also prohibited from paying dividends that would reduce its capital ratios below minimum regulatory requirements, and the Federal Reserve Bank may impose further dividend restrictions on the Company.

Loans or advances to the Company by the Bank are limited to 10% of the Bank's capital stock and surplus on a secured basis.

**Note 16. Related Party Transactions**

In the normal course of business, the Company grants loans to executive officers, directors and members of their immediate families, as defined, and to entities in which these individuals have more than a 10% equity ownership. Such loans are transacted at terms, including interest rates, similar to those available to unrelated customers.

Changes in loans outstanding to such related parties during 2006 and 2005 are as follows:

	2006	2005
Balance, beginning of year	\$ 153,394	\$ 198,586
Additional loans	4,612	341,394
Repayments	(106,825)	(386,586)
Balance, end of year	\$ 51,181	\$ 153,394

Related party deposits aggregated approximately \$7,300,000 and \$5,700,000 as of December 31, 2006 and 2005, respectively.

The Company leases office space to a director of the Company under two leases. Rental income under these leases was approximately \$28,300 for the years ended December 31, 2006, 2005 and 2004, respectively.

During 2006, 2005 and 2004, the Company paid legal fees of approximately \$6,200, \$18,600 and \$20,900, respectively, to an attorney who is a director of the Company.

## PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued

December 31, 2006 and 2005

## Note 17. 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:

	2006		
	Before-Tax Amount	Tax Effect	Net-of-Tax Amount
Unrealized holding gains arising during period	\$ 682,562	\$ (259,375)	\$ 423,187
Add reclassification adjustment for gains recognized in net income	-	-	-
Unrealized holding gain on available for sale securities, net of taxes	\$ 682,562	\$ (259,375)	\$ 423,187
	2005		
	Before-Tax Amount	Tax Effect	Net-of-Tax Amount
Unrealized holding losses arising during period	\$(1,146,631)	\$ 435,721	\$ (710,910)
Add reclassification adjustment for gains recognized in net income	-	-	-
Unrealized holding loss on available for sale securities, net of taxes	\$(1,146,631)	\$ 435,721	\$ (710,910)
	2004		
	Before-Tax Amount	Tax Effect	Net-of-Tax Amount
Unrealized holding losses arising during period	\$ (136,065)	\$ 51,705	\$ (84,360)
Add reclassification adjustment for gains recognized in net income	-	-	-

Unrealized holding loss on available for sale

securities, net of taxes	\$ (136,065)	\$ 51,705	\$ (84,360)
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**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued**

**December 31, 2006 and 2005**

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**Note 18. Fair Value of Financial Instruments and Interest Rate Risk**

SFAS No. 107, "Disclosures About Fair Value of Financial Instruments" ("Statement No. 107"), requires disclosure of fair value information about financial instruments, whether or not recognized in the balance sheet, for which it is practicable to estimate that value. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rates and estimates of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparisons to independent markets and, in many cases, could not be realized in immediate settlement of the instrument. Statement No. 107 excludes certain financial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company.

Management uses its best judgment in estimating the fair value of the Company's financial instruments; however, there are inherent weaknesses in any estimation technique. Therefore, for substantially all financial instruments, the fair value estimates presented herein are not necessarily indicative of the amounts the Company could have realized in a sales transaction at December 31, 2006 and 2005. The estimated fair value amounts for 2006 and 2005 have been measured as of their respective year-ends, and have not been reevaluated or updated for purposes of these consolidated financial statements subsequent to those respective dates. As such, the fair values of these financial instruments subsequent to the respective reporting dates may be different from the amounts reported at each year-end.

The information presented should not be interpreted as an estimate of the fair value of the entire Company since a fair value calculation is only required for a limited portion of the Company's assets and liabilities. Due to the wide range of valuation techniques and the degree of subjectivity used in making the estimate, comparisons between the Company's disclosures and those of other bank holding companies may not be meaningful.

## PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued

December 31, 2006 and 2005

As of December 31, 2006 and 2005, the recorded book balances and estimated fair values of the Company's financial instruments were (in thousands):

	2006		2005	
	Recorded Book Balance	Fair Value	Recorded Book Balance	Fair Value
<b>Financial Assets:</b>				
Cash and noninterest bearing deposits due from banks	\$ 3,865	\$ 3,865	\$ 7,181	\$ 7,181
Interest bearing deposits due from banks	3	3	40	40
Federal funds sold	27,000	27,000	6,500	6,500
Short-term investments	24,606	24,606	2,247	2,247
Available for sale securities	67,093	67,093	78,672	78,672
Federal Reserve Bank stock	1,912	1,912	1,022	1,022
Federal Home Loan Bank stock	1,217	1,217	1,297	1,297
Loans receivable, net	506,884	474,079	364,244	353,231
Accrued interest receivable	3,542	3,542	2,445	2,445
<b>Financial Liabilities:</b>				
Demand deposits	\$ 56,680	\$ 56,680	\$ 48,797	\$ 48,797
Savings deposits	25,993	25,993	20,090	20,090
Money market deposits	40,936	40,936	57,799	57,799
NOW accounts	26,882	26,882	25,383	25,383
Time deposits	410,961	413,951	267,006	268,643
FHLB borrowings	8,000	7,981	9,000	8,967
Subordinated debt	8,248	8,248	8,248	8,248
Accrued interest payable	182	182	45	45

Unrecognized financial instruments

Loan commitments on which the committed interest rate is less than the current market rate were insignificant at December 31, 2006 and 2005. The estimated fair value of fee income on letters of credit at December 31, 2006 and 2005 was insignificant.

The Company assumes interest rate risk (the risk that general interest rate levels will change) as a result of its normal operations. As a result, the fair values of the Company's financial instruments will change when interest rate levels change and that change may be either favorable or unfavorable to the Company. Management attempts to match maturities of assets and liabilities to the extent believed necessary to minimize interest rate risk. However, borrowers with fixed rate obligations are less likely to prepay in a rising rate environment and more likely to prepay in a falling rate environment. Conversely, depositors who are receiving fixed rates are more likely to withdraw funds before

maturity in a rising rate environment and less likely to do so in a falling rate environment. Management monitors rates and maturities of assets and liabilities and attempts to minimize interest rate risk by adjusting terms of new loans and deposits and by investing in securities with terms that mitigate the Company's overall interest rate risk.

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**PATRIOT NATIONAL BANCORP, INC. AND SUBSIDIARY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued**

**December 31, 2006 and 2005**

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**Note 19. Segment Reporting**

The Company 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. The Company 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.

The Company's loan and deposit customers are primarily residents and businesses located in the Connecticut communities in which the Company 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. The Company also makes loans from its Melville (Long Island), New York loan production office.

The Company'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. The Company 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, the Company 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.