PATRIOT NATIONAL BANCORP INC
Form 10QSB
August 14, 2002

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

# FORM 10-QSB

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

For the Quarter Ended June 30, 2002     Commission file number 000-29599

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

| | |
|---|---|
| Connecticut | 06-1559137 |
| (State of incorporation) | (I.R.S. Employer Identification Number) |

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

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

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

Common stock, $2.00 par value per share, 2,400,525 shares issued and outstanding as of the close of business July 31, 2002.

Transitional Small Business Disclosure Format (check one):Yes _____ No X

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## PART I - FINANCIAL INFORMATION

### Item 1. Consolidated Financial Statements

PATRIOT NATIONAL BANCORP, INC
CONSOLIDATED BALANCE SHEETS

| | June 30, 2002 (Unaudited) | Dec |
|---|---|---|
| ASSETS | | |
| Cash and due from banks | $ 10,960,941 | $ |
| Federal funds sold | 7,500,000 | 1 |
| Short term investments | 2,786,500 | |
| Cash and cash equivalents | 21,247,441 | 2 |
| Available for sale securities (at fair value) | 57,560,390 | 3 |
| Federal Reserve Bank stock | 481,050 | |
| Federal Home Loan Bank stock | 621,300 | |
| Loans receivable (net of allowance for loan losses: 2002 $2,062,454; 2001 $1,894,454) | 137,953,798 | 13 |
| Accrued interest receivable | 1,144,823 | |
| Premises and equipment, net | 945,157 | |
| Deferred tax asset, net | 618,774 | |
| Goodwill | 930,091 | |
| Other assets | 285,223 | |
| Total assets | $221,788,047 | $20 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Liabilities | | |
| Deposits: | | |
| Noninterest bearing deposits | $ 18,450,586 | $ 1 |
| Interest bearing deposits | 174,040,298 | 16 |
| Total deposits | 192,490,884 | 18 |
| Securities sold under agreements to repurchase | 5,700,000 | |
| Federal Home Loan Bank borrowings | 4,000,000 | |
| Capital lease obligation | 306,097 | |
| Collateralized borrowings | 399,444 | |
| Accrued expenses and other liabilities | 1,010,504 | |
| Total liabilities | 203,906,929 | 18 |
| Shareholders' equity | | |
| Common stock, $2 par value: 5,333,333 shares authorized; 2,400,525 shares issued and outstanding | 4,801,050 | |
| Additional paid-in capital | 11,484,649 | 1 |

| | | |
|---|---|---|
| Retained earnings ........................................... | 1,242,678 | |
| Accumulated other comprehensive income - net unrealized gain on available for sale securities, net of tax ......... | 352,741 | |
| Total shareholders' equity ........................... | 17,881,118 | 1 |
| Total liabilities and shareholders' equity ........... | $221,788,047 | $20 |

See accompanying notes to consolidated financial statements.



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

| | Three Months Ended June 30, | | Six |
|---|---|---|---|
| | 2002 | 2001 | 2002 |
| **Interest and Dividend Income** | | | |
| Interest and fees on loans ...................... | $ 2,438,451 | $ 2,826,483 | $ 4,823, |
| Interest and dividends on investment securities ....................... | 468,547 | 545,250 | 974, |
| Interest on federal funds sold ................. | 39,852 | 84,471 | 81, |
| Total interest and dividend income ........... | 2,946,850 | 3,456,204 | 5,879, |
| **Interest Expense** | | | |
| Interest on deposits ........................... | 1,081,217 | 1,685,381 | 2,228, |
| Interest on other borrowings ................... | 39,934 | -- | 40, |
| Interest on capital lease obligation ........... | 11,132 | 14,925 | 23, |
| Interest on collateralized borrowings .......... | 5,454 | 9,463 | 11, |
| Total interest expense ....................... | 1,137,737 | 1,709,769 | 2,303, |
| Net interest income .......................... | 1,809,113 | 1,746,435 | 3,575, |
| Provision for Loan Losses .......................... | 84,000 | 58,500 | 158, |
| Net interest income after provision for loan losses ................. | 1,725,113 | 1,687,935 | 3,417, |
| **Non-Interest Income** | | | |
| Mortgage brokerage referral fees ............... | 671,229 | 764,009 | 1,327, |
| Loan processing fees ........................... | 122,257 | 137,936 | 247, |
| Fees and service charges ....................... | 70,949 | 61,707 | 143, |
| Gains and origination fees from loans sold ...... | 249,365 | 24,510 | 249, |
| Loss on impaired investment security ........... | -- | (117,678) | - |
| Loss on sale of investment securities ........... | -- | -- | (31, |
| Other income ................................... | 18,965 | 2,155 | 40, |
| Total non-interest income .................... | 1,132,765 | 872,639 | 1,976, |
| 7Non-Interest Expenses | | | |
| Salaries and benefits .......................... | 1,502,206 | 1,344,595 | 2,910, |

| | | | |
|---|---|---|---|
| Occupancy and equipment expenses, net .......... | 242,816 | 232,482 | 504, |
| Data processing and other outside services ...... | 143,246 | 160,492 | 313, |
| Professional services ......................... | 105,790 | 85,498 | 176, |
| Advertising and promotional expenses ........... | 98,442 | 70,078 | 155, |
| Forms, printing and supplies ................... | 41,925 | 39,090 | 78, |
| Regulatory assessments ........................ | 24,324 | 22,889 | 48, |
| Directors' fees and expenses ................... | 50,900 | 17,000 | 75, |
| Other operating expenses ...................... | 197,511 | 259,554 | 369, |
| Total non-interest expenses ................. | 2,407,160 | 2,231,678 | 4,633, |
| Income before income taxes .................. | 450,718 | 328,896 | 760, |
| Provision for Income Taxes ....................... | 163,000 | 120,751 | 274, |
| Net income .................................. | $ 287,718 | $ 208,145 | $ 86, |
| Basic income per share ...................... | $ 0.120 | $ 0.090 | $ 0. |
| Diluted income per share .................... | $ 0.120 | $ 0.090 | $ 0. |
| Dividends per share ......................... | $ 0.025 | $ 0.020 | $ 0. |

See accompanying notes to consolidated financial statements



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

| | Three Months Ended June 30, | | Six |
|---|---|---|---|
| | 2002 | 2001 | 2002 |
| Net income .................................. | $ 287,718 | $ 208,145 | $ 486, |
| Unrealized holding gains (losses) on securities: | | | |
| Unrealized holding gains (losses) arising during the period, net of taxes ............ | 249,073 | (37,503) | 96, |
| Comprehensive income ....................... | $ 536,791 | $ 170,642 | $ 583, |

See accompanying notes to consolidated financial statements.

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

| | Six Months En June 30, 2002 |
|---|---|
| **Cash Flows from Operating Activities** | |
| Net income | $ 486,500 |
| Adjustments to reconcile net income to net cash provided by operating activities: | |
| Amortization and accretion of investment premiums and discounts, net | (9,737) |
| Originations of loans held for sale | (208,000) |
| Proceeds from sales of loans held for sale | 208,000 |
| Gain on sale of loans | (249,365) |
| Provision for loan losses | 158,000 |
| Loss on impaired investment security | -- |
| Loss on sale of investment securities | 31,275 |
| Depreciation and amortization | 213,885 |
| Changes in assets and liabilities: | |
| Increase in deferred loan fees | 164,343 |
| (Increase) decrease in accrued interest receivable | (65,373) |
| Increase in other assets | (19,757) |
| (Decrease) increase in accrued expenses and other liabilities | (61,722) |
| Net cash provided by operating activities | 648,049 |
| **Cash Flows from Investing Activities** | |
| Purchases of available for sale securities | (37,015,836) |
| Proceeds from sales of available for sale securities | 10,369,844 |
| Principal repayments on available for sale securities | 2,922,141 |
| Proceeds from maturities of available for sale securities | 1,000,000 |
| Proceeds from maturities of held to maturity securities | -- |
| Purchase of Federal Reserve Bank Stock | -- |
| Purchase of Federal Home Loan Bank Stock | (3,400) |
| Net increase in loans | (3,896,104) |
| Proceeds from sale of loan receivable | 1,549,365 |
| Purchases of bank premises and equipment | (56,614) |
| Net cash used in investing activities | (25,130,604) |
| **Cash Flows from Financing Activities** | |
| Net increase in demand, savings and money market deposits | 13,434,970 |
| Net decrease in time certificates of deposits | (4,208,025) |
| Increase in FHLB borrowings | 4,000,000 |
| Increase in securities sold under agreements to repurchase | 5,700,000 |
| Principal payments on capital lease obligation | (58,739) |
| Decrease in collateralized borrowings | (75,000) |
| Dividends paid on common stock | (96,021) |
| Proceeds from issuance of common stock | -- |
| Net cash provided by financing activities | 18,697,185 |
| Net decrease in cash and cash equivalents | (5,785,370) |

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

| | Six Months En June 30, 2002 | |
|---|---|---|
| Cash and cash equivalents | | |
| Beginning | 27,032,811 | |
| Ending | $ 21,247,441 | |
| Supplemental Disclosures of Cash Flow Information | | |
| Cash paid for: | | |
| Interest | $ 2,317,295 | $ |
| Income Taxes | $ 347,146 | $ |
| Supplemental disclosure of noncash investing and financing activities: | | |
| Transfer of held to maturity securities to available for sale securities | $ -- | $ |
| Unrealized holding gain on available for sale securities arising during the period | $ 140,147 | $ |
| Dividends declared on common stock | $ 60,013 | $ |

See accompanying notes to consolidated financial statements.

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Notes to Consolidated Financial Statements

(1) The Consolidated Balance Sheet at December 31, 2001 has been derived from the audited financial statements of Patriot National Bancorp, Inc. ("Bancorp") at that date, but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements.

(2) The accompanying unaudited financial statements and related notes have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in

accordance with accounting principles generally accepted in the United States of America have been omitted. The accompanying consolidated financial statements and related notes should be read in conjunction with the audited financial statements of Bancorp and notes thereto for the year ended December 31, 2001.

The information furnished reflects, in the opinion of management, all adjustments, consisting of normal recurring accruals, necessary for a fair presentation of the results of the interim periods presented. The results of operations for the three and six months ended June 30, 2002 are not necessarily indicative of the results of operations that may be expected for all of 2002.

(3) Bancorp is required to present basic income per share and diluted income per share in its income statements. Basic income per share amounts are computed by dividing net income by the weighted average number of common shares outstanding. Diluted income per share assumes exercise of all potential common stock in weighted average shares outstanding, unless the effect is antidilutive. Bancorp is also required to provide a reconciliation of the numerator and denominator used in the computation of both basic and diluted income per share. The following is information about the computation of income per share for the three and six months ended June 30, 2002 and 2001.

Quarter ended June 30, 2002

| | Net Income | Shares | Amount |
|---|---|---|---|
| Basic Income Per Share | | | |
| Income available to common shareholders | $ 287,718 | 2,400,525 | $ 0.12 |
| Effect of Dilutive Securities | | | |
| Warrants/Stock Options outstanding | - | 25,398 | - |
| Diluted Income Per Share | | | |
| Income available to common shareholders plus assumed conversions | $ 287,718 | 2,425,923 | $ 0.12 |



Quarter ended June 30, 2001

| | Net Income | Shares | Amount |
|---|---|---|---|
| Basic Income Per Share | | | |
| Income available to common shareholders | $ 208,145 | 2,400,525 | $ 0.09 |
| Effect of Dilutive Securities | | | |
| Warrants/Stock Options outstanding | - | 24,621 | - |
| Diluted Income Per Share | | | |
| Income available to common shareholders plus assumed conversions | $ 208,145 | 2,425,146 | 0.09 |

Six months ended June 30, 2002

| | Net Income | Shares | Amount |
|---|---|---|---|
| Basic Income Per Share | | | |
| Income available to common shareholders | $ 486,500 | 2,400,525 | $ 0.20 |
| Effect of Dilutive Securities | | | |
| Warrants/Stock Options outstanding | - | 25,114 | - |

| | Net Income | Shares | Amount |
|---|---|---|---|
| Diluted Income Per Share | | | |
| Income available to common shareholders plus assumed conversions | $ 486,500 | 2,425,639 | $ 0.20 |

Six months ended June 30, 2001

| | Net Income | Shares | Amount |
|---|---|---|---|
| Basic Income Per Share | | | |
| Income available to common shareholders | $ 515,722 | 2,400,450 | $ 0.21 |
| Effect of Dilutive Securities | | | |
| Warrants/Stock Options outstanding | - | 27,112 | - |
| Diluted Income Per Share | | | |
| Income available to common shareholders plus assumed conversions | $ 515,722 | 2,427,562 | $ 0.21 |

(4) Bancorp has two reportable segments, the commercial bank and the mortgage broker. The commercial bank 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 commercial bank segment also attracts deposits from both consumer and commercial customers, and invests such deposits in loans, investments and working capital. The commercial bank's revenues are generated primarily from net interest income from its lending, investment and deposit activities.

The mortgage broker solicits and processes conventional mortgage loan applications from consumers on behalf of permanent investors and originates loans for sale. Revenues are generated from loan brokerage and application processing fees received from permanent investors and gains and origination fees from loans sold.



Information about reportable segments and a reconciliation of such information to the consolidated financial statements for the three and six months ended June 30, 2002 and 2001 is as follows (in thousands):

Quarter ended June 30, 2002

| | Bank | Mortgage Broker | Consolidated Totals |
|---|---|---|---|
| Net interest income ..... | $ 1,809 | $ -- | $ 1,809 |
| Non-interest income ..... | 317 | 816 | 1,133 |
| Non-interest expense .... | 1,774 | 633 | 2,407 |
| Provision for loan losses | 84 | -- | 84 |
| Income before taxes ..... | 268 | 183 | 451 |
| Assets .................. | 220,791 | 997 | 221,788 |

Quarter ended June 30, 2001

Mortgage Consolidated

| | Bank | Broker | Totals |
|---|---|---|---|
| Net interest income ..... | $ 1,746 | $ -- | $ 1,746 |
| Non-interest income ..... | (74) | 947 | 873 |
| Non-interest expense .... | 1,553 | 679 | 2,232 |
| Provision for loan losses | 58 | -- | 58 |
| Income before taxes ..... | 61 | 268 | 329 |
| Assets .................. | 182,576 | 1,152 | 183,728 |

Six months ended June 30, 2002

| | Bank | Mortgage Broker | Consolidated Totals |
|---|---|---|---|
| Net interest income ..... | $ 3,576 | $ -- | $ 3,576 |
| Non-interest income ..... | 357 | 1,620 | 1,977 |
| Non-interest expense .... | 3,364 | 1,270 | 4,634 |
| Provision for loan losses | 158 | -- | 158 |
| Income before taxes ..... | 411 | 350 | 761 |
| Assets .................. | 220,791 | 997 | 221,788 |

Six months ended June 30, 2001

| | Bank | Mortgage Broker | Consolidated Totals |
|---|---|---|---|
| Net interest income ..... | $ 3,494 | $ -- | $ 3,494 |
| Non-interest income ..... | 11 | 1,559 | 1,570 |
| Non-interest expense .... | 2,922 | 1,210 | 4,132 |
| Provision for loan losses | 102 | -- | 102 |
| Income before taxes ..... | 481 | 349 | 830 |
| Assets .................. | 182,576 | 1,152 | 183,728 |

(5) Certain 2001 amounts have been reclassified to conform with the 2002 presentation. Such reclassifications had no effect on net income.



(6) In June 2001, the Financial Accounting Standards Board issued SFAS No. 142 "Goodwill and Other Intangible Assets." SFAS No. 142 no longer permits the amortization of goodwill and indefinite-lived intangible assets. Instead, these assets must be reviewed annually (or more frequently under prescribed conditions) for impairment in accordance with this statement. This impairment test uses a fair value approach rather than the undiscounted cash flows approach previously required by SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of." The goodwill impairment test under SFAS No. 142 requires a two-step approach, which is performed at the reporting unit level, as defined in SFAS No. 142. Step one identifies potential impairments by comparing the fair value of the reporting unit to its carrying amount. Step two, which is only performed if there is a potential impairment, compares the carrying amount of the reporting unit's goodwill to its implied value, as defined in SFAS No. 142. If the carrying amount of the reporting unit's goodwill exceeds the implied value of that goodwill, an impairment loss is recognized in an amount

equal to that excess.

Bancorpadopted the provisions of SFAS No. 142 effective January 1, 2002 and, as a result, goodwill is no longer amortized, and is evaluated for impairment under SFAS No. 142. Based on Bancorp's initial goodwill impairment test, no impairment losses have been recognized related to goodwill upon the adoption of SFAS No. 142. Bancorp will perform the required annual impairment reviews as of October 31 of each year. In addition, the following represents the effect of adopting SFAS No. 142 on Bancorp's net income and earnings per share for all periods presented.

| | Three Months Ended June 30, 2002 | Three Months Ended June 30, 2001 | Six Months Ended June 30, 2002 | Six Months Ended June 30, 2001 |
|---|---|---|---|---|
| Reported net income ......... | $ 287,718 | $ 208,145 | $ 486,500 | $ 515,722 |
| Add goodwill amortization.... | -- | 31,003 | -- | 61,930 |
| Adjusted net income ......... | $ 287,718 | $ 239,148 | $ 486,500 | $ 577,652 |
| Basic earnings per share | | | | |
| Reported net income ....... | $ 0.12 | $ 0.09 | $ 0.20 | $ 0.21 |
| Goodwill amortization ..... | -- | 0.01 | -- | 0.03 |
| Adjusted net income ....... | $ 0.12 | $ 0.10 | $ 0.20 | $ 0.24 |
| Diluted earnings per share | | | | |
| Reported net income ....... | $ 0.12 | $ 0.09 | $ 0.20 | $ 0.21 |
| Goodwill amortization ..... | -- | 0.01 | -- | 0.03 |
| Adjusted net income ...... | $ 0.12 | $ 0.10 | $ 0.20 | $ 0.24 |



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

| | Three Months Ended June 30, 2002 Before Tax Amount | Tax Effect | Net of Tax Amount | Six Months En June 30, 20 Before Tax Amount | Tax Effect |
|---|---|---|---|---|---|
| Unrealized holding gain arising during the period ....... | $ 395,375 | $(146,302) | $ 249,073 | $ 108,872 | $ (33,810 |

| | | | | | |
|---|---|---|---|---|---|
| Reclassification adjustment for losses recognized in income.. | -- | -- | -- | 31,275 | (9,711 |
| Unrealized holding gain on available for sale securities, net of taxes .................... | $ 395,375 | $(146,302) | $ 249,073 | $ 140,147 | $ (43,521 |

| | Three Months Ended June 30, 2002 | | | Six Months En June 30, 20 | |
|---|---|---|---|---|---|
| | Before Tax Amount | Tax Effect | Net of Tax Amount | Before Tax Amount | Tax Effect |
| Unrealized holding loss arising during the period ....... | $(334,614) | $ 134,725 | $(199,889) | $(119,617) | $ 48,142 |
| Adjustment for unrealized losses of held to maturity securities transferred to available for sale securities ... | 154,147 | (62,061) | 92,086 | 154,147 | (62,039 |
| Reclassification adjustment for losses recognized in income ..... | 117,679 | (47,379) | 70,300 | 117,679 | (47,362 |
| Unrealized holding (loss) gain on available for sale securities, net of taxes .................... | $ (62,788) | $ 25,285 | $ (37,503) | $ 152,209 | $ (61,259 |

(8) During the six months ended June 30, 2002 the Bank entered into the following borrowing transactions:

| | Amount | Rate | Maturity |
|---|---|---|---|
| Securities sold under agreements to repurchase: | | | |
| | $2,900,000 | 1.92% | 08/23/2002 |
| | $2,800,000 | 2.69% | 05/23/2003 |
| Federal Home Loan Bank Advances: | | | |
| | $2,000,000 | 4.48% | 05/13/2005 |
| | $2,000,000 | 5.11% | 05/14/2004 |

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Item 2. Management's Discussion and Analysis or Plan of Operation

(a) Plan of Operation

Not applicable since Bancorp had revenues from operations in each of the last two fiscal years.

(b) Management's Discussion and Analysis of Financial Condition and Results of Operations

SUMMARY

Bancorp had net income of $288,000 ($0.12 basic income per share and $0.12 diluted income per share) for the quarter ended June 30, 2002, compared to net income of $208,000 ($0.09 basic income per share and $0.09 diluted income per share) for the quarter ended June 30, 2001. For the six-month period ended June 30, 2002, net income was $487,000 as compared to $516,000 for the same period last year.

Total assets increased $19.2 million from $202.6 million at December 31, 2001 to $221.8 million at June 30, 2002. Cash and cash equivalents decreased $5.8 million to $21.2 million at June 30, 2002 from $27.0 million at December 31, 2001. The available for sale securities portfolio increased $22.9 million to $57.6 million at June 30, 2002 from $34.7 million at December 31, 2001. The net loan portfolio increased $2.3 million from $135.7 million at December 31, 2001 to $138.0 million at June 30, 2002. Deposits increased $9.2 million to $192.5 million at June 30, 2002 from $183.3 million at December 31, 2001. Total shareholders' equity increased $0.5 million to $17.9 million at June 30, 2002 from $17.4 million at December 31, 2001.

FINANCIAL CONDITION

Assets
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Bancorp's total assets increased $19.2 million from $202.6 million at December 31, 2001 to $221.8 million at June 30, 2002. Cash and cash equivalents decreased $5.8 million to $21.2 million at June 30, 2002. Cash and due from banks increased $3.4 million, federal funds sold decreased $5.2 million and short term investments decreased $4.0 million. This net decrease along with the increase in deposits and borrowings funded the increases in available for sale securities and loans. Available for sale securities increased $22.8 million; $9.7 million of this increase represents an interest rate leveraging strategy which was funded by Federal Home Loan Bank borrowings and securities sold under agreements to repurchase.

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Loans
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Bancorp's net loan portfolio increased $2.3 million from $135.7 million at December 31, 2001 to $138.0 million at June 30, 2002. Increases in commercial real estate loans and residential loans of $2.8 million and $4.4 million, respectively, were partially offset by decreases in commercial loans of $2.9 million, construction loans of $1.2 million, home equity loans of $0.6 million and consumer loans of $0.2 million. At June 30, 2002, the net loan to deposit ratio was 71.7% and the net loan to total assets ratio was 62.2%. At December

31, 2001, the net loan to deposit ratio was 74.0% and the net loan to total assets was 67.0%. Based on loan applications in process and Bancorp's hiring of additional loan officers, management anticipates moderate loan demand during the second half of 2002.

## Allowance for Loan Losses

The provision for loan losses is a charge against income and an addition to the allowance for loan losses. Management's judgement in determining the adequacy of the allowance is based on an evaluation of individual loans, the risk characteristics and size of the loan portfolio, an assessment of current economic and real estate market conditions, estimates of the current value of underlying collateral, past loan loss experience, review of regulatory authority examination reports and other relevant factors.

Based upon this evaluation, management believes the allowance for loan losses of $2.1 million at June 30, 2002, which represents 1.48% of gross loans outstanding, is adequate, under prevailing economic conditions, to absorb losses on existing loans which may become uncollectible. At December 31, 2001, the allowance for loan losses was $1.9 million or 1.38% of gross loans outstanding.

Analysis of Allowance for Loan Losses

| | June 30, | |
|---|---|---|
| (Thousands of dollars) | 2002 | 2001 |
| Balance at beginning of period | $1,894 | $1,645 |
| Charge-offs | 0 | (2) |
| Recoveries | 10 | 1 |
| Net recoveries (charge-offs) | 10 | (1) |
| Provision charged to operations | 158 | 102 |
| Balance at end of period | $2,062 | $1,746 |
| Ratio of net recoveries (charge-offs) during the period to average loans outstanding during the period. | 0.01% | 0.00% |



## Non-Accrual, Past Due and Restructured Loans

The following table presents non-accruing and past due loans:

| (Thousands of dollars) | June 30, 2002 | December 31, 2001 |
|---|---|---|
| Loans delinquent over 90 days still accruing | $ 60 | $1,300 |
| Non-accruing loans | 354 | 1,654 |
| Total | $ 414 | $2,954 |

| | | |
|---|---|---|
| % of Total Loans | 0.30% | 2.14% |
| % of Total Assets | 0.19% | 1.46% |

The decrease in non-accruing loans is due to the sale of a $1.3 million residential real estate loan for which the bank realized a gain of $249,000.

Potential Problem Loans

At June 30 2002, Bancorp had no loans other than those disclosed in the table above, as to which management has significant doubts as to the ability of the borrower to comply with the present repayment terms.

Deposits

Total deposits increased $9.2 million from $183.3 million at December 31, 2001 to $192.5 million at June 30, 2002. Non-interest bearing deposits increased $1.5 million due to higher levels of both commercial and personal demand deposit accounts. Interest bearing deposits increased $7.7 million. NOW and Money market fund accounts increased $3.4 million and $27.5 million, respectively. The increase in Money market fund deposits is due to competitive pricing; much of this increase was funded by funds shifted from other accounts. Super NOW accounts, formerly priced at a premium rate, decreased $18.1 million; certificates of deposit decreased $4.2 million and savings accounts decreased $0.9 million; some of these decreases were transfers that resulted in the increase in the money market fund product.

RESULTS OF OPERATIONS

Interest and dividend income and expense

Bancorp's interest and dividend income decreased 14.7% or $509,000 for the quarter ended June 30, 2002 from the comparable period in 2001. The decrease in interest income is due to a much lower interest rate environment this quarter as compared to the same period last year. For the six months ended June 30, 2002, interest and dividend income was $5.9 million which represents a decrease of $1.3 million compared to interest and

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dividend income of $7.2 million for the same period last year. The decrease in interest income for the six months ended June 30, 2002 is also due to the lower interest rate environment.

Bancorp's interest expense decreased 33.5% or $572,000 for the quarter ended June 30, 2002 compared to the same period in 2001. The decrease in interest expense is due to the lower interest rate environment cited earlier. For the six months ended June 30, 2002, interest expense decreased $1.4 million or 37.8% to $2.3 million as compared to $3.7 million for the six months ended June 30, 2001. The decrease in interest expense for the six months ended June 30, 2002 is also due to the lower interest rate environment. Included in interest expense for the three and six months ended June 30, 2002 is $40,000 due to FHLB Advances and securities sold under agreements to repurchase transactions entered into during the six months ended June 30, 2002.

Non-interest income

Non-interest income increased 29.8% or $260,000 to $1.1 million for the quarter ended June 30, 2002 as compared to $873,000 for the comparable period last year. Included in the results for the quarter ended June 30, 2002 is a gain of $249,000 from the sale of a nonperforming loan. The continued favorable interest rate environment for borrowers has resulted in the maintenance of historical high mortgage brokerage and referral fees, however, not as high as last year when interest rates were dramatically declining. Mortgage broker referral fees decreased 12.1% or $93,000 to $671,000 for the quarter ended June 30, 2002 as compared to $764,000 for the same period last year. Included in non-interest income for the three months ended June 30, 2001 was a charge of $118,000 representing a write down provision made for the permanent impairment of a debt security due to a deterioration in the financial condition of the issuer; management continues to monitor the status and performance of the issuer.

For the six months ended June 30, 2002, non-interest income increased $406,000 or 25.9% to $2.0 million as compared to $1.6 million for the same period last year. Mortgage broker and referral fees increased $102,000 or 8.3% to $1.3 million for the six months ended June 30, 2002 from $1.2 million for the six months ended June 30, 2001 due to the continued favorable interest rate environment for borrowers. Included in non-interest income for the six months ended June 30, 2002 is a gain of $249,000 from the sale of a loan cited earlier. Fees and service charges increased 14.0%, or $18,000, to $144,000 for the six months ended June 30, 2002, from $126,000 for the six months ended June 30, 2001; this increase is the result of increases in account and transaction volumes. Included in non-interest income for the six months ended June 30, 2001 was a charge of $118,000 representing a write down provision made for the permanent impairment of a debt security.

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## Non-interest expenses

Non-interest expenses increased 7.9% or $175,000 to $2.4 million for the quarter ended June 30, 2002 from $2.2 million for the quarter ended June 30, 2001. Salaries and benefits expense increased 11.7%, or $158,000, to $1.5 million for the quarter ended June 30, 2002 from $1.3 million for the quarter ended June 30, 2001, due primarily to staffing additions made during the second half of 2001 for the Norwalk Office and compensation adjustments made during the fourth quarter of 2001. Occupancy and equipment expense, net increased 4.4% or $10,000 to $243,000 for the quarter ended June 30, 2002 from $232,000 for the quarter ended June 30, 2001; this increase is a result of increases in depreciation of leasehold improvements as well as furniture and equipment due primarily to the Norwalk Branch Office which opened in August 2001. Advertising and promotional expenses increased 40.1% or $28,000 to $98,000 for the quarter ended June 30, 2002 from $70,000 for the comparable period last year due to an increased level of promotional campaigns. Directors' fees increased $34,000 from $17,000 for the quarter ended June 30, 2001 to $51,000 for the quarter ended June 30, 2002 due to compensation based payments made to directors upon the attainment of certain years of service and not standing for reelection, per meeting fee increases and an increase in the number of committee meetings. Other operating expenses decreased $62,000 or 23.9% to $198,000 for the quarter ended June 30, 2002 from $260,000 for the quarter ended June 30, 2001; $31,000 of this decrease is due to the cessation of the amortization of goodwill as required by SFAS No. 142.

For the six months ended June 30, 2002, non-interest expenses increased $502,000 or 12.2% to $4.6 million from $4.1 million for the same period last year for similar reasons previously cited. Increases in salary and benefits of $461,000, occupancy and equipment, net of $56,000, directors fees of $44,000, advertising and promotional expenses of $29,000 and data processing and other outside services of $26,000 were partially offset by decreases in other operating expenses of $112,000. Included in the decrease in other non-interest expense is $62,000 due to the cessation of the amortization of goodwill as required by SFAS No. 142.

Bancorp has received regulatory approval to establish an additional branch location which will result in additional capital expenditures as well as an increase in salaries and benefits and occupancy and equipment expenses. Management anticipates that the new branch will open either late in 2002 or early in 2003.

## Income Taxes

Bancorp recorded income tax expense of $163,000 for the quarter ended June 30, 2002 as compared to $121,000 for the quarter ended June 30, 2001. For the six months ended June 30, 2002, income tax expense was $274,000 as compared to $315,000 for the same period last year. These changes are related primarily to the changes in pre-tax income.



The effective tax rates for the quarters ended June 30, 2002 and June 30, 2001 were 36.2% and 36.7%, respectively; the effective tax rates for the six months ended June 30, 2002 and June 30, 2001 were 36.0% and 37.9%, respectively.

## LIQUIDITY

Bancorp's liquidity ratio was 35.5% and 24.6% at June 30, 2002 and 2001, 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 consolidated balance sheets are considered liquid assets: cash and due from banks, federal funds sold, short term investments and available for sale securities. Liquidity is a measure of Bancorp's ability to generate adequate cash to meet financial obligations. The principal cash requirements of a financial institution are to cover downward fluctuations in deposit accounts and increases in its loan portfolio. Management believes Bancorp's short-term assets have sufficient liquidity to cover loan demand, potential fluctuations in deposit accounts, the costs related to opening new branch offices and to meet other anticipated cash requirements.

## CAPITAL

The following table illustrates the Bancorp's regulatory capital ratios at June 30, 2002 and December 31, 2001 respectively:

| | June 30, 2002 | December 31, 2001 |
|---|---|---|
| Leverage Capital | 7.94% | 8.11% |
| Tier 1 Risk-based Capital | 10.40% | 9.57% |
| Total Risk-based Capital | 11.65% | 10.69% |

Capital adequacy is one of the most important factors used to determine the safety and soundness of individual banks and the banking system. Based on the above ratios, the Bank is considered to be "well capitalized" at June 30, 2002 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%. Bancorp is also considered to be "well capitalized" under the regulatory framework specified by the Federal Reserve Bank. Bancorp's actual and required ratios are not substantially different from those shown above.

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IMPACT OF INFLATION AND CHANGING PRICES

Bancorp's consolidated financial statements have been prepared in terms of historical dollars, without considering changes in the relative purchasing power of money over time due to inflation. Unlike most industrial companies, virtually all of the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates have a more significant impact on a financial institution's performance than the general levels of inflation. Interest rates do not necessarily move in the same direction or 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.

"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 this "Management's Discussion and Analysis of Financial Condition and Results of Operation," may be forward looking and subject to a variety of risks and uncertainties. These factors include, but are not limited to, (1) changes in prevailing interest rates which would affect the interest earned on Bancorp's interest earning assets and the interest paid on its interest bearing liabilities, (2) the timing of repricing of Bancorp's interest earning assets and interest bearing liabilities, (3) the effect of changes in governmental monetary policy, (4) the effect of changes in regulations applicable to Bancorp and the conduct of its business, (5) changes in competition among financial service companies, including possible further encroachment of non-banks on services traditionally provided by banks and the impact of recently enacted federal legislation, (6) the ability of competitors which are larger than Bancorp to provide products and services which it is impracticable for Bancorp to provide, (7) the effects of Bancorp's opening of branches, and (8) the effect of any decision by Bancorp to engage in any business not historically permitted to it. Other such factors may be described in Bancorp's future filings with the SEC.

PART II - OTHER INFORMATION.

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

(a) The Annual Meeting of Shareholders (the "Annual Meeting") of Patriot National Bancorp, Inc was held on June 18, 2002.

(b) Not applicable pursuant to Instruction 3 to Item 4 of Part II of Form10-QSB.

(c) The following is a brief description of the matters voted upon at the Annual

Meeting and the number of votes cast for, against or withheld as well as the number of abstentions to each such matter:

(i) The election of eleven directors for the ensuing year:

| | For | Withheld Authority to Vote For |
|---|---|---|
| Angelo De Caro | 21,282,151 | 1,209,791 |
| Fred A. DeCaro, Jr. | 21,282,151 | 935,077 |
| John J. Ferguson | 21,282,140 | 1,209,901 |
| John A. Geoghegan | 21,282,140 | 1,209,901 |
| L. Morris Glucksman | 21,282,140 | 1,214,807 |
| Charles F. Howell | 21,282,151 | 1,209,791 |
| Michael Intrieri | 21,282,140 | 1,567,280 |
| Richard Naclerio | 21,282,140 | 1,209,901 |
| Robert F. O'Connell | 21,282,151 | 1,209,791 |
| Paul C. Settelmeyer | 21,282,151 | 1,209,901 |
| Philip W. Wolford | 21,282,140 | 1,212,871 |

(ii) The consideration of a proposal to ratify the appointment of McGladrey & Pullen as independent auditors for Bancorp for the year ending December 31, 2002.

| For | Against | Abstain |
|---|---|---|
| 2,013,812 | 29,200 | 2,555 |

(d) Not applicable.

Item 6. Exhibits and Reports on Form 8-K

(a) No. Description

| No. | Description |
|---|---|
| 99 | Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

(b) The issuer filed no reports on Form 8-K during the second quarter of 2002.



SIGNATURES

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

PATRIOT NATIONAL BANCORP, INC.

(Registrant)

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

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

August 14, 2002