PATRIOT NATIONAL BANCORP INC
Form 10KSB
March 28, 2003

U. S. SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10 - KSB

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

For the Fiscal Year Ended December 31, 2002

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

For the transition period from ____________________ to ____________________

Commission file number 000-29599

PATRIOT NATIONAL BANCORP, INC.
(Name of small business issuer in its charter)

| | |
|---|---|
| Connecticut<br>(State or other jurisdiction of incorporation or organization) | 06-1559137<br>(IRS Employer Identification Number) |
| 900 Bedford Street<br>Stamford, Connecticut<br>(Address of principal executive offices) | 06901<br>(Zip Code) |

Issuer's telephone number (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

Check whether the issuer (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 X No

Check if disclosure of delinquent filers in response to Item 405 of Regulation S-B 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-KSB or any amendment to this Form 10-KSB. [ ]

State issuer's revenue for its most recent fiscal year: $ 16,718,538

Aggregate market value of the voting stock held by nonaffiliates of the registrant as of February 28, 2003 based on the last sale price as reported on the NASDAQ Small Cap Market: $12,943,401.

Number of shares of the registrant's Common Stock, par value $2.00 per share, outstanding as of February 28, 2003: 2,400,725

Documents Incorporated by Reference

| | |
|---|---|
| Proxy Statement for 2003 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-KSB.) | Incorporated into Part III of this Form 10-KSB |

Transitional Small Business Disclosure Format (check one):

Yes _____ No X

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# PART I

## Item 1. Description of Business

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.

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. Except as specifically noted otherwise herein, the balance of the description of Bancorp's business is a description of the Bank's business.

The Bank was granted preliminary approval by the Comptroller of the Currency (the "OCC") on March 5, 1993 and received its charter and commenced operations as a national bank on August 31, 1994. The Bank opened branch offices in Greenwich and Old Greenwich, Connecticut on September 5, 1997 and October 12, 1999, respectively. On August 21, 2001 the Bank opened a branch office in Norwalk, Connecticut.

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 a division of the Bank. During 2002, Pinnacle had a significant impact on the business and results of operations of Bancorp.

The Bank conducts business at its main office located at 900 Bedford Street, Stamford, Connecticut and at branch offices located at 100 Mason Street, Greenwich, Connecticut, 184 Sound Beach Avenue, Old Greenwich, Connecticut, and 16 River Street, Norwalk, Connecticut. The Bank also operates mortgage origination offices at 71 Lewis Street, Greenwich, Connecticut and 20 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 and IRA's (Individual Retirement Accounts). 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 does not currently accept brokered deposits.

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 offers residential mortgages through its mortgage brokerage division Pinnacle Financial. Pinnacle solicits and processes conventional mortgage loan applications from consumers on behalf of permanent investors and originates loans for sale.

The Bank competes with all 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. 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 Bank does not offer trust services. If the Bank desires in the future to offer trust services, prior approval of the OCC will be required.

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 and Norwalk, Connecticut provide the majority of the Bank's deposits. The Bank has focused its attention on serving the segment 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 and north, the Town of Westport to the east, and Long Island Sound to the south.

The Bank's loan customers extend beyond Stamford, Greenwich and Norwalk to include the adjacent 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 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.



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 Town of Greenwich are presently served by approximately 115 branches of commercial banks and savings banks, most of which are offices of banks which have headquarters outside of the area or are subsidiaries of bank or financial holding companies whose headquarters are outside of Stamford, Greenwich or Norwalk. 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 and Norwalk, posing significant competition to the Bank for deposits and loans. Competition can also be expected from out-of-state financial institutions, which may establish or acquire offices in the Bank's service area and from other local financial institutions which may be formed in the future. Many of such 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. This increase in competition has caused banks and other financial service institutions to diversify their services and become more cost effective as a result of competition with one another and with new types of financial service companies, including non-bank competitors. The impact on Bancorp of federal legislation authorizing increased services by financial holding companies and interstate branching of banks has 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.

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 the Federal Reserve Board's view that a bank holding company should pay cash dividends only to the extent that 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 the bank holding company's 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 or 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.

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 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 nature and amount of collateral for certain loans a bank makes, 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.



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, including the 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. For example, 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 and Norwalk, 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.

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. The Bank has, however, registered the trademark "Patriot" and the corresponding logo with the State of Connecticut Trademark Office. Compliance by Bancorp and the Bank with federal, state and local provisions which have been enacted or adopted regulating or otherwise relating to the discharge of material into the environment is not expected to have a material effect upon the capital expenditures, earnings or competitive position of the Bancorp. As of December 31, 2002, the Bancorp had 69 full-time employees and nine part-time employees. None of the employees of the Bancorp is covered by a collective bargaining agreement.



## Item 2. Description of Properties

The Bank leases approximately 12,000 square feet of office space located at 900 Bedford Street, Stamford, Connecticut, which is used for its main office and as the corporate offices of Bancorp. Such space is adequate for Bancorp's and the Bank's current needs. The entire building is being leased by the Bank for a term of ten years, which commenced on September 1, 1994. Rent increases for the remainder of the term will be based on increases in the consumer price index. The Bank's lease also provides the Bank with a right of first refusal to purchase the building in the event the owner of the property receives an offer to purchase the building from a third party which it wishes to accept, on the same terms and conditions of such offer, subject to the terms of the lease. The Bank currently occupies approximately 90% of the space in the 900 Bedford Street building. The Bank has sublet the remaining space under a sublease having a maturity which coincides with the Bank's lease maturity. The business of the subtenant of the Bank is a law practice. See also, "Item 12. Certain

Relationships and Related Transactions."

The Bank has entered into an agreement for additional parking with a remaining term of two years at an annual rent of $18,000. See also, "Item 12. Certain Relationships and Related Transactions."

The Bank leases approximately 5,000 square feet of office space on the first floor located at 100 Mason Street, Greenwich, Connecticut. The lease has been extended for a five-year term commencing July 1, 2002 at an initial annual rent of $246,000, which rent will increase by approximately 3% each consecutive year. The lease provides for two additional five-year renewals at the Bank's option.

The Bank leases approximately 1,300 square feet of office space at 184 Sound Beach Avenue, Old Greenwich, Connecticut. The lease commenced on December 31, 1998 at an initial annual rent of $34,800, which rent has increased by approximately 10% in the third year and will increase by approximately 25% in the fourth year and will remain constant during the fifth year.

The Bank leases approximately 1,700 square feet of office space at 16 River Street, Norwalk, Connecticut. The lease commenced on January 1, 2001 with a five-year term at an initial annual rent of $27,648 with annual increases of approximately 2.4% through the fifth year of the lease.

The Bank leases approximately 1,200 square feet of office space at 20 Broad Hollow Road, Melville, New York. The lease commenced on April 1, 2002 at an initial annual rent of $23,400 with a three-year term, which rent will increase by approximately 5% each consecutive year. The lease provides for a three-year renewal after the initial term at the Bank's option.

The Bank leases approximately 1,250 square feet of office space at 365 Westport Avenue, Norwalk Connecticut for the purpose of establishing a second branch location in Norwalk; it is anticipated that this branch will open in the beginning of the second quarter of 2003. The lease commenced on January 1, 2003 with a five-year term at an annual rent of $36,240, which rent will increase based on increases in the Consumer Price Index. The lease provides for three five-year renewals after the initial term at the Bank's option.



The Bank leases approximately 3,032 square feet of office space at 845 High Ridge Road, Stamford Connecticut for the purpose of establishing a second Stamford office; it is anticipated that this branch will open at the end of the second quarter of 2003. The lease commences on April 1, 2003 at an annual rent of $100,056 for an initial term of ten years, which rent will increase by approximately 3% during the third year; during years four through ten, increases will be based on increases in the Consumer Price Index. The lease provides for a ten-year renewal after the initial term at the option of the Bank.

The Bank is in the process of finalizing negotiations for the lease of office space in Wilton, Connecticut for the purpose of establishing a branch office; it is anticipated that a Wilton location will open for business in the beginning of the third quarter of 2003.

All leased properties described above 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 2002, no matter was submitted to a vote of shareholders.



PART II

Item 5. Market for Common Equity and Related Shareholder Matters

Market Information

The Bancorp Common Stock is traded on the NASDAQ Small Cap Market under the Symbol "PNBK." On December 31, 2002, the last sale price for the Bancorp Common Stock on NASDAQ Small Cap Market was $9.40.

The following table sets forth the high and low sales price and dividends per share of the Bancorp Common Stock for the last two fiscal years for each quarter as reported on the NASDAQ Small Cap Market.

| 2002 | 2001 |
| --- | --- |

| Quarter Ended | Sales Price High | Sales Price Low | Cash Dividends Declared | Sales Price High | Sales Price Low | Cash Dividends Declared |
|---|---|---|---|---|---|---|
| March 31 | $ 8.50 | $ 8.10 | $ .020 | $ 10.00 | $ 7.50 | $ -- |
| June 30 | 8.50 | 8.00 | .025 | 9.65 | 7.70 | .020 |
| September 30 | 8.80 | 8.05 | .025 | 9.25 | 7.67 | .020 |
| December 31 | 10.66 | 8.30 | .025 | 8.64 | 7.70 | .020 |

## Holders

There were approximately 906 shareholders of record of Bancorp Common Stock as of December 31, 2002.

## Dividends

2001 marked the first year in which Bancorp paid a dividend on the Bancorp Common Stock; during the second quarter of 2002 the quarterly dividend was increased by 25%. 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, by the Bank 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.

## Recent Sales of Unregistered Securities

During the fourth quarter of 2002 Bancorp did not have any sales of unregistered securities.



## Securities Authorized for Issuance under Equity Compensation Plans

The following table presents information as of December 31, 2002 for equity compensation plans maintained by Bancorp.

Equity Compensation Plan Information

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| | Number of securities to be issued upon exercise of outstanding options, warrants and rights (a) | Weighted-average exercise price of outstanding options, warrants and rights (b) | re |
|---|---|---|---|
| Equity compensation plans approved by security holders ........ | 110,000 | $ 10.13 | |
| Equity compensation plans not approved by security holders ........ | -- | -- | |
| Total .................. | 110,000 | $ 10.13 | |

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Item 6. Management's Discussion and Analysis or Plan of Operation

Patriot National Bancorp, Inc
Financial Highlights

| | 2002 | 2001 | 2000 | 1999 | |
|---|---|---|---|---|---|
| Operating Data | | | | | |
| Interest and dividend income | $ 12,604,718 | $ 13,722,943 | $ 14,694,135 | $ 9,732,719 | $ 6,7 |
| Interest expense ........... | 4,764,693 | 6,866,960 | 8,017,615 | 4,739,921 | 3,0 |
| Net interest income ........ | 7,840,025 | 6,855,983 | 6,676,520 | 4,992,798 | 3,6 |
| Provision for loan losses .. | 468,000 | 250,000 | 325,900 | 553,000 | 1 |
| Noninterest income ......... | 4,113,820 | 3,509,955 | 2,685,296 | 1,221,329 | 3 |
| Noninterest expense ........ | 9,812,838 | 8,675,551 | 7,693,345 | 5,245,986 | 3,4 |
| Net income ................. | 1,052,007 | 876,387 | 767,171 | 348,641 | 6 |
| Basic income per share ..... | 0.44 | 0.37 | 0.34 | 0.17 | |
| Diluted income per share ... | 0.43 | 0.36 | 0.33 | 0.16 | |
| Dividends per share ........ | 0.095 | 0.060 | -- | -- | |
| Balance Sheet Data | | | | | |
| Cash and due from banks .... | 5,385,757 | 7,544,242 | 3,656,071 | 2,685,031 | 1,8 |
| Federal funds sold ......... | 3,000,000 | 12,700,000 | 29,500,000 | 18,900,000 | 27,7 |
| Short term investments ..... | 3,348,968 | 6,788,569 | -- | 10,976,264 | |
| Investment securities ...... | 61,720,716 | 35,816,880 | 34,073,832 | 33,003,494 | 13,5 |
| Loans, net ................. | 170,794,939 | 135,680,036 | 126,411,265 | 107,769,911 | 57,0 |

| | | | | | |
|---|---|---|---|---|---|
| Goodwill .................. | 930,091 | 930,091 | 1,054,027 | 1,177,948 | |
| Total assets .............. | 248,496,753 | 202,569,457 | 197,628,127 | 177,194,697 | 102,3 |
| Total deposits ............ | 217,911,260 | 183,263,939 | 179,666,098 | 162,746,354 | 89,3 |
| Total borrowings .......... | 10,292,675 | 839,280 | 945,270 | 888,687 | 6 |
| Total shareholders' equity . | 18,544,955 | 17,406,016 | 16,427,436 | 13,236,088 | 12,0 |

(a) Plan of Operation

Not applicable since Bancorp has 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

Several milestones were achieved during 2002 as Bancorp, for the third consecutive year, reported record earnings, which were $1,052,000 ($0.44 basic income per share and $0.43 diluted income per share) for 2002 compared to $876,000 ($0.37 basic income per share and $0.36 diluted income per share) for 2001. Total assets also ended the year at a record high of $248.5 million, an increase of $46.0 million from December 31, 2001.

The net interest margin for the year ended December 31, 2002 increased $984,000 or 14.4% to $7.8 million as compared to $6.9 million for the year ended December 31, 2001.

Total assets increased by 22.7% during the year as total loans increased from $135.7 million at December 31, 2001 to $170.8 million at December 31, 2002. The available for sale securities portfolio increased $25.9 million or 74.6% to $60.6 million from $34.7 million at December 31, 2001; $8.3 million of the increase resulted from a leveraging strategy in which purchases of mortgage backed securities were funded by securities sold under repurchase agreements and Federal Home Loan Bank advances. Construction and real estate loans increased by $38.0 million; while commercial and home equity loans decreased $1.6 million and $1.0 million, respectively. Loan growth was funded through growth in total deposits. Deposits increased $34.6 million to $217.9 million at December 31, 2002; interest bearing deposits increased $26.1 million, or 15.7%, and non-interest bearing deposits increased $8.6 million or 50.4%. Borrowings increased $9.5 million due to the leveraging strategy previously mentioned. Shareholders' equity increased $1.1 million due to the increase in retained earnings from net income net of dividend payments, and the increase in other comprehensive income from unrealized gains on the available for sale securities portfolio.

FINANCIAL CONDITION

Assets

Bancorp's total assets increased $45.9 million from $202.6 million at December 31, 2001 to $248.5 million at December 31, 2002. The growth in total assets was funded primarily by deposit and borrowings growth of $34.6 million and $9.5

million, respectively, as well as net income after dividend payments.



## Investments

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

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| U. S. Government Obligations ...... | $ -- | $ -- | $ 998,501 |
| U. S. Government Agency Obligations | 9,129,414 | -- | -- |
| Mortgage backed securities ........ | 38,461,159 | 10,243,418 | 14,191,090 |
| Corporate bonds .................. | 383,797 | 11,880,156 | 11,798,222 |
| Marketable equity securities ...... | 12,643,996 | 12,594,356 | 6,017,219 |
| Federal Reserve Bank stock ........ | 481,050 | 481,050 | 475,200 |
| Federal Home Loan Bank stock ...... | 621,300 | 617,900 | 593,600 |
| Total Investments ................ | $61,720,716 | $35,816,880 | $34,073,832 |

The available for sale portfolio increased $25.9 million to $60.6 million due to purchases of U. S. Government Agency Obligations and agency mortgage backed securities partially offset by the sale of $11.4 million of corporate bonds. A portion of the increase in the mortgage backed securities portfolio was funded through an increase in borrowings as a leveraging strategy. The Bank is a member of the Federal Home Loan Bank of Boston to provide additional sources of liquidity.

The following table presents the maturity distribution of available for sale investment securities at December 31, 2002 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 | |
|---|---|---|---|---|---|---|
| U. S. Government agency obligations .......... | $ -- | $ 8,019,920 | $ 1,004,606 | $-- | $ -- | $ |
| Mortgage backed securities . | -- | -- | -- | -- | 37,756,793 | |
| Corporate bonds ............ | 283,853 | -- | -- | -- | -- | |
| Marketable equity securities | -- | -- | -- | -- | 12,632,068 | |
| Total | $ 283,853 | $ 8,019,920 | $ 1,004,606 | $-- | $ 50,388,861 | $ |
| Weighted average yield | 6.26% | 4.39% | 5.00% | --% | 4.60% | |

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The following table presents a summary of investments for any issuer that exceeds 10% of shareholders' equity at December 31, 2002.

| | Amortized Cost | Fair Value |
|---|---|---|
| Available for sale securities: | | |
| Franklin U. S. Government Fund ................. | $ 2,032,068 | $ 2,043,996 |
| U.S. Government agency obligations ............. | 9,024,526 | 9,129,414 |
| U.S. Government agency mortgage backed securities | 37,756,793 | 38,461,159 |
| Short term investments: | | |
| Merrill Lynch Premier Institutional Fund ........ | 3,348,968 | 3,348,968 |

Loans

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

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| Real Estate | | | |
| Commercial .......... | $ 65,967,205 | $ 60,481,789 | $ 57,297,310 |
| Residential ......... | 27,012,024 | 7,501,504 | 5,041,776 |
| Construction ........ | 39,208,651 | 26,215,265 | 22,969,904 |
| Commercial ............. | 13,021,909 | 14,649,112 | 12,841,040 |
| Consumer installment .... | 1,757,321 | 1,231,672 | 1,652,587 |
| Consumer home equity .... | 26,812,092 | 27,770,723 | 28,468,453 |
| Total Loans ............ | 173,779,202 | 137,850,065 | 128,271,070 |
| Net deferred fees ....... | (611,809) | (275,575) | (214,988) |
| Allowance for loan losses | (2,372,454) | (1,894,454) | (1,644,817) |
| Loans, net ............. | $ 170,794,939 | $ 135,680,036 | $ 126,411,265 |

Bancorp's net loan portfolio increased $35.1 million from $135.7 million at December 31, 2001 to $170.8 million at December 31, 2002. Loan growth was funded through an increase in deposit accounts. At December 31, 2002, the net loan to deposit ratio was 78.4% and the net loan to asset ratio was 68.7%. At December 31, 2001, the net loan to deposit ratio was 74.0%, and the net loan to asset ratio was 67.0%.

During an historic environment of lower interest rates, loan activity remained moderate to strong and the volume of new loans exceeded principal reductions and payoffs.

## 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, 2002, 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 | $ 13,944 | $ 47,115 | $ 4,909 | $ 65,968 |
| Residential real estate | 2,782 | 1,537 | 22,693 | 27,012 |
| Construction loans .... | 20,376 | 18,833 | -- | 39,209 |
| Commercial loans ...... | 4,026 | 6,679 | 2,317 | 13,022 |
| Consumer installment .. | 1,547 | 210 | -- | 1,757 |
| Consumer home equity .. | 64 | 272 | 26,475 | 26,811 |
| Total ............ | $ 42,739 | $ 74,646 | $ 56,394 | $173,779 |
| Fixed rate loans ...... | $ 9,083 | $ 38,894 | $ 2,170 | $ 50,147 |
| Variable rate loans ... | 33,656 | 35,752 | 54,224 | 123,632 |
| Total ............ | $ 42,739 | $ 74,646 | $ 56,394 | $173,779 |

The following table presents loan concentrations at December 31, 2002:

| Category | Percentage | Dollars Outstanding |
|---|---|---|
| | | (thousands of dollars) |
| Construction ....................... | 22.6% | $39,209 |
| Commercial Retail .............. | 5.7% | 9,878 |
| Restaurant ......................... | 2.4% | 4,282 |
| Commercial Residential ............. | 2.4% | 4,241 |
| Limousine Service .................. | 1.6% | 2,761 |

## 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 portrayal of Bancorp's financial results and 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, a material estimate susceptible to significant change in the near-term, is established as losses are estimated to have occurred through a provision for loan losses charged against operations and is maintained at a level that management considers adequate to absorb losses in the loan portfolio. Management's judgment in determining the adequacy of the allowance is inherently subjective and is based on the evaluation of individual loans, the known and inherent risk characteristics and size of the loan portfolios, the 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 evaluations of specific loans and other relevant factors. The allowance for loan losses is maintained at a level that management believes is adequate to absorb probable losses on existing loans based on an evaluation of the collectibility of loans and prior loan loss experience. A risk rating system is utilized to measure the adequacy 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 one being the least risk and nine reflecting the most risk or a complete loss. Risk ratings are assigned by the originating loan officer or loan committee at the initiation of the transactions and are reviewed and changed, when necessary during the life of the loan. Loan loss reserve factors are 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. Loan quality control is continually monitored by management and reviewed by the board of directors and loan committee on a monthly basis, subject to oversight by the board of directors through its members who serve on the loan committee. 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.

Loans, including impaired loans, are charged against the allowance for loan losses when management believes that the uncollectibility of principal is confirmed. Any subsequent recoveries are credited to the allowance for loan losses when received. In connection with the determination of the allowance for loan losses, management obtains appraisals for significant properties, when considered necessary.

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.

Based upon this evaluation, management believes the allowance for loan losses of $2.4 million, at December 31, 2002, which represents 1.37% of gross loans outstanding, is adequate, under prevailing economic conditions, to absorb losses on existing loans. At December 31, 2001, the allowance for loan losses was $1.9 million or 1.38% of gross loans outstanding.

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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 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 an accrual status when it is no longer delinquent and collectibility of interest and principal is no longer in doubt.

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. Bancorp considers consumer installment loans to be pools of smaller balance homogeneous loans, which are collectively evaluated for impairment.

Analysis of Allowance for Loan Losses

| | 2002 | 2001 | 2000 | 1999 |
|---|---|---|---|---|
| | | (thousands of dollars) | | |
| Balance at beginning of period ...... | $ 1,894 | $ 1,645 | $ 1,360 | $ 785 |
| Charge-offs ........................ | -- | (2) | (44) | (19) |
| Recoveries ......................... | 10 | 1 | 3 | 41 |
| Net recoveries (charge-offs) ........ | 10 | (1) | (41) | 22 |
| Additions charged to operations ..... | 468 | 250 | 326 | 553 |
| Balance at end of period ........... | $ 2,372 | $ 1,894 | $ 1,645 | $ 1,360 |
| Ratio of net recoveries (charge-offs) during the period to average loans outstanding during the period ....... | 0.01% | (0.00%) | (0.03%) | 0.03% |

Allocation of the Allowance for Loan Losses

| | | |
|---|---|---|
| | | Percent of loans |
| Balance at end of each | Amounts (thousands of dollars) | category to total |

| Period applicable to | 2002 | 2001 | 2000 | 1999 | 1998 | 2002 | 2001 | 2000 |
|---|---|---|---|---|---|---|---|---|
| Real Estate: | | | | | | | | |
| Commercial ....... | $ 893 | $ 833 | $ 700 | $ 622 | $ 448 | 37.97% | 43.88% | 44.67% |
| Construction ..... | 726 | 348 | 270 | 154 | 78 | 22.56% | 19.02% | 17.91% |
| Residential ...... | 276 | 153 | 34 | 76 | 18 | 15.54% | 5.44% | 3.93% |
| Commercial ......... | 129 | 142 | 185 | 79 | 113 | 7.49% | 10.63% | 10.01% |
| Consumer installment | 11 | 14 | 12 | 12 | 16 | 1.01% | 0.89% | 1.29% |
| Consumer home equity | 283 | 296 | 312 | 267 | 112 | 15.43% | 20.14% | 22.19% |
| Unallocated ........ | 54 | 108 | 132 | 150 | -- | N/A | N/A | N/A |
| Total ............. | $2,372 | $1,894 | $1,645 | $1,360 | $ 785 | 100.00% | 100.00% | 100.00% |

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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.

| | 2002 | 2001 | 2000 | 1999 | 1998 |
|---|---|---|---|---|---|
| | | | (thousands of dollars) | | |
| Loans delinquent over 90 days still accruing ............ | $1,172 | $1,300 | $ 507 | $ 475 | $ 732 |
| Non-accruing loans .............. | 201 | 1,654 | 1,759 | 91 | 64 |
| | $1,373 | $2,954 | $2,266 | $ 566 | $ 796 |
| % of Total Loans ................ | 0.79% | 2.14% | 1.77% | 0.52% | 1.37% |
| % of Total Assets ............... | 0.56% | 1.46% | 1.15% | 0.32% | 0.78% |
| Additional income on non-accrual loans if recognized on an accrual basis .......................... | $ 67 | $ 159 | $ 115 | $ 9 | $ 5 |

There were no loans in either 2002 or 2001 considered as "troubled debt restructurings."

Potential Problem Loans

The $201,000 of non-accruing loans at December 31, 2002 are comprised of loans that are well collateralized and in process of collection.

At December 31, 2002, 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.

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| Non-interest bearing ................. | $ 25,519,809 | $ 16,961,636 | $ 16,899,057 |
| Interest bearing | | | |
| Time certificates, less than $100,000 | 57,202,908 | 53,081,137 | 71,240,470 |
| Time certificates, $100,000 or more . | 28,681,345 | 25,376,629 | 31,873,302 |
| Money market ....................... | 56,973,507 | 10,255,056 | 849,067 |
| Savings ............................ | 26,847,780 | 31,258,415 | 31,164,493 |
| NOW ................................ | 22,685,911 | 46,331,066 | 27,639,709 |
| Total interest bearing ............. | 192,391,451 | 166,302,303 | 162,767,041 |
| Total deposits ....................... | $217,911,260 | $183,263,939 | $179,666,098 |



Total deposits increased $34.6 million to $217.9 million at December 31, 2002. Non-interest bearing deposits increased $8.6 million to $25.5 million at December 31, 2002. Interest bearing deposits increased $26.1 million. Increases in money market fund products of $46.7 million, certificates of deposit and NOW accounts of $7.4 million and $1.6 million, respectively, were partially offset by decreases in Super NOW accounts, formerly priced at a premium interest rate, and Savings accounts of $23.7 million and $4.4 million, respectively, and attorney escrow accounts of $1.5 million. The outflow of funds from NOW and Savings accounts is due in part to a shift of funds into the premium money market fund products and longer term certificates of deposit. 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, 2002, the Bank's maturities of time deposits were:

| | $100,000 or greater | Less than $100,000 | Totals |
|---|---|---|---|
| (thousands of dollars) | | | |
| Three months or less .......... | $ 7,278 | $12,365 | $19,643 |
| Three to six months ........... | 2,976 | 10,821 | 13,797 |
| Six months to one year ........ | 2,781 | 10,877 | 13,658 |
| Over one year ................. | 15,646 | 23,140 | 38,786 |
| Total ........................ | $28,681 | $57,203 | $85,884 |

Borrowings

Borrowings increased $9.4 million net of principal repayments on capital leases and collateralized borrowings. $9.7 million in additional borrowing transactions were recorded as part of a leveraging strategy. Borrowings include short term borrowings under securities sold under repurchase agreements and Federal Home Loan Bank advances.

The following table sets forth the borrowing amounts along with the respective interest rates and maturities:

Securities sold under repurchase agreements:

| Amount | Maturity | Rate | Average amount outstanding |
|---|---|---|---|
| $2,900,000 | 05/21/2003 | 1.490% | $1,771,781 |
| 2,800,000 | 05/23/2003 | 2.690% | 1,710,685 |
| $5,700,000 | | 2.080% | $3,482,466 |

The amounts of short term borrowings outstanding at December 31, 2002 are representative of the amounts of short term borrowings outstanding at any month end during 2002.



Federal Home Loan Bank advances:

| Amount | Maturity | Rate | Average amount outstanding |
|---|---|---|---|
| $2,000,000 | 05/13/2005 | 4.480% | $1,284,788 |
| 2,000,000 | 05/14/2007 | 5.110% | 1,284,788 |
| $4,000,000 | | 4.795% | $2,569,576 |

Other

The decrease in accrued interest receivable is due to lower effective interest rates at December 31, 2002 as compared to those in effect at December 31, 2001.

The increase in accrued expenses and other liabilities is due primarily to increases in accruals for incentive compensation arrangements and higher accrual balances at year end for income taxes and dividends payable.



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 Shareholders' Equity

Interest Rates and Interest Differential and Rate Volume Variance Analysis
(thousands of dollars) (1)

| | 2002 | | | 2001 | | |
|---|---|---|---|---|---|---|
| | Average Balance | Interest Income/ Expense | Average Rate | Average Balance | Interest Income/ Expense | Average Rate |
| Interest earning assets: | | | | | | |
| Loans (2) .................. | $ 145,162 | $ 10,135 | 6.98% | $ 132,687 | $ 11,136 | 8.39% |
| Short term investments ...... | 7,443 | 138 | 1.85% | 3,306 | 86 | 2.60% |
| Investments (4) ............ | 51,572 | 2,177 | 4.22% | 36,025 | 2,024 | 5.62% |
| Federal funds sold .......... | 9,404 | 155 | 1.65% | 10,662 | 477 | 4.47% |
| Total interest earning assets | 213,581 | 12,605 | 5.90% | 182,680 | 13,723 | 7.51% |
| Cash and due from banks ..... | 5,961 | | | 4,772 | | |
| Premises and equipment, net . | 924 | | | 954 | | |
| Allowance for loan losses ... | (2,061) | | | (1,745) | | |
| Other ...................... | 4,088 | | | 3,178 | | |
| Total Assets ............... | $ 222,493 | | | $ 189,839 | | |
| Interest bearing liabilities: | | | | | | |
| Time certificates ........... | $ 79,691 | $ 2,827 | 3.55% | 81,042 | $ 4,177 | 5.15% |
| Savings accounts ............ | 30,191 | 563 | 1.86% | 33,170 | 929 | 2.80% |
| Money market accounts ....... | 37,394 | 786 | 2.10% | 3,539 | 101 | 2.85% |
| NOW accounts ................ | 17,140 | 118 | 0.69% | 13,330 | 168 | 1.26% |
| Super NOW accounts .......... | 12,588 | 204 | 1.62% | 23,950 | 1,398 | 5.84% |
| Securities sold under agreements to repurchase and other borrowings ..... | 3,482 | 79 | 2.27% | 3 | -- | -- |
| FHLB advances ............... | 2,570 | 125 | 4.86% | -- | -- | -- |
| Collateralized borrowings ... | 412 | 21 | 5.10% | 474 | 36 | 7.59% |
| Capital lease obligation .... | 300 | 42 | 14.00% | 415 | 58 | 13.98% |
| Total interest bearing liabilities ... | 183,768 | 4,765 | 2.59% | 155,923 | 6,867 | 4.40% |
| Demand deposits ............ | 19,522 | | | 15,800 | | |
| Accrued expenses and other liabilities ...... | 1,114 | | | 931 | | |
| Shareholders' equity ........ | 18,089 | | | 17,185 | | |
| Total liabilities and equity | $ 222,493 | | | $ 189,839 | | |
| Net interest income ......... | | $ 7,840 | | | $ 6,856 | |
| Interest margin ............. | | | 3.67% | | | 3.75% |
| Interest Spread ............. | | | 3.31% | | | 3.11% |

(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 gain or loss on available for sale securities.



RESULTS OF OPERATIONS

For the year ended December 31, 2002, Bancorp earned $1,052,000 ($0.44 basic income per share and $0.43 diluted income per share) an increase of 20.0% as compared to 2001 when Bancorp earned $876,000 ($0.37 basic income per share and $0.36 diluted income per share). Despite an increase in average earning assets, interest income decreased $1.1 million to $12.6 million in 2002 as compared to 2001 when interest income was $13.7 million. This decrease is due mainly to decreases in interest rates on variable rate loans and investments due to Federal Reserve Bank rate reductions throughout 2001 and in effect for all of 2002, as well as one rate reduction at the end of 2002; offset partially by an increase in loan volume and the size of the available for sales securities portfolio.

Noninterest income increased $604,000 or 17.2% to $4.1 million for 2002. A favorable interest rate environment for borrowers and an increase in the volume of loan refinancings resulted in an increase in mortgage brokerage and referral fees and loan processing fees of $297,000 as compared to the previous year. The sale of a non-accrual loan resulted in a gain of $249,000 for the year ended December 31, 2002 as compared to gains and origination fees from loans sold of $71,000 for the year ended December 31, 2001.

Interest expense decreased $2.1 million or 30.6% to $4.8 million in 2002 compared to $6.9 million in 2001. The decrease in interest expense is due to the general low interest rate environment partially offset by the increase in total deposits.

Noninterest expenses for 2002 totaled $9.8 million which represents an increase of $1.1 million or 13.1% over the prior year. The higher operating costs were primarily the result of increased bonus and sales and incentive compensation programs, as well as higher commissions paid to loan originators and the full year impact in 2002 of the Norwalk branch office which opened in August 2001.

The following are measurements of Bancorp's earnings in relation to assets, equity and earnings per share.

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| Return on average assets ............ | .47% | .46% | .42% |
| Return on average equity ............ | 5.82% | 5.10% | 5.20% |
| Dividend payout ratio ................ | 21.59% | 16.21% | -- |
| Average equity to average assets ..... | 8.13% | 9.05% | 8.12% |
| Basic income per share ............... | $ 0.44 | $ 0.37 | $ 0.34 |

| | | | |
|---|---|---|---|
| Diluted income per share ............ | $ 0.43 | $ 0.36 | $ 0.33 |

Interest income and expense

Bancorp's net interest margin increased $984,000 or 14.4%, to $7.8 million in 2002 from $6.9 million in 2001. Despite an increase in average earning assets of $30.9 million, or 16.9%, lower short term interest rates reduced Bancorp's interest income 8.2% from $13.7 million in



2001 to $12.6 million in 2002. Average loans outstanding increased $12.5 million led by growth in construction and real estate loans which reflects the strength of the local real estate market. An increase in average investments resulted in an increase in interest income on available for sale securities of $205,000 despite a reduction in the investment yield. Low short-term interest rates resulted in a decrease of 2.82% in the rate earned on Federal Funds Sold; this combined with a reduction of $1.3 million in average balances resulted in a decrease in interest on Federal Funds Sold of $322,000. Total average interest bearing liabilities increased by $27.8 million; average certificates of deposit decreased by $1.4 million; average Super NOW accounts decreased $11.4 million; average NOW accounts increased $3.8 million and average money market deposits increased $33.9 million. Interest expense decreased from $6.9 million in 2001 to $4.8 million in 2002. Interest expense on certificates of deposit decreased $1.4 million as a result of lower average outstanding balances and a decrease in the cost of funds for that portfolio from 5.15% in 2001 to 3.55% in 2002. Interest on Super NOW accounts decreased $1.2 million due to a decrease in the average outstanding balances of $11.4 million and a decrease in the interest rate paid on the product.

Noninterest income

Noninterest income increased $604,000 from $3.5 million in 2001 to $4.1 million in 2002. The increase is due primarily to the favorable interest rate environment for borrowers and an increase in the volume of residential mortgage loan refinancings which resulted in an increase of $297,000 in mortgage brokerage and loan processing fees. Included in the results for 2002 is a gain of $249,000 resulting from the sale of a non-accrual loan. Included in noninterest income for 2001 is a charge to earnings of $118,000 representing a write down made for the permanent impairment of a debt security due to the deterioration in the financial condition of the issuer; management has closely monitored the status and performance of the issuer. Subsequent to December 31, 2002 the issuer announced a tender offer at a price of 100.00% of par for the above notes under a comprehensive refinancing plan; during the first quarter of 2003 Bancorp received the proceeds from the tender offer.

Noninterest expenses

Noninterest expenses increased $1.1 million in 2002 from $8.7 million in 2001 to $9.8 million in 2002. Salaries and benefits increased $1.1 million due primarily to increases in performance related bonus and sales incentive compensation, as well as higher commissions and incentive compensation as a direct result of higher residential loan originations. Higher staffing levels and incentive compensation also impacted salaries, payroll taxes and health care costs. Occupancy and equipment expenses increased $69,000 from $935,000 in 2001 to $1,004,000 in 2002; this increase is due primarily to increases in maintenance and repairs as well as the costs associated with establishing the branch office in Norwalk, Connecticut which opened in August 2001 and was operational for a full year in 2002.

The provision for income taxes of $621,000 in 2002 and $564,000 for 2001 represents the tax expense recognized for both federal and state income tax. The effective tax rates for 2002 and 2001 are 37.1% and 39.2%, respectively. Fluctuations in effective tax rates are due to the cessation of the amortization of nondeductible goodwill for book purposes, as well as the



increase in dividend income from money market preferred instruments which are partially tax exempt.

Management believes that additional branch offices including the announced branches in Norwalk, Stamford and Wilton, Connecticut, if opened, 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.

Management regularly reviews loan and deposit rates and attempts to price Bancorp's products competitively. With the assistance of its investment advisors, 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.

LIQUIDITY

Bancorp's liquidity position was 29.1% and 30.5% at December 31, 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 balance sheets are considered liquid assets: cash and due from banks, federal funds sold, short-term investments, available-for-sale securities and held-to-maturity securities maturing in one year or less. 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 potential fluctuations in deposit accounts and loan demand and to meet other anticipated cash requirements.

CAPITAL

The following table illustrates the Bank's regulatory capital ratios:

| | December 31, 2002 | December 31, 2001 | December 31, 2000 |
|---|---|---|---|
| Leverage Capital .................... | 6.98% | 8.11% | 7.73% |
| Tier 1 Risk-Based Capital ........... | 9.11% | 9.57% | 10.01% |
| Total Risk-Based Capital ............ | 10.36% | 10.69% | 11.10% |

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 believes that it 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%. Bancorp's actual and required ratios are not substantially different from those shown above.

At the end of the first quarter of 2003, Bancorp created a statutory trust of which Bancorp will own 100% of the capital stock. The trust issued $8.0 million in preferred securities to investors, the proceeds of which were used to purchase junior subordinated debt from Bancorp. Bancorp



primarily invested the funds from the issuance of the debt in the Bank, which in turn will use the proceeds to fund general operations of the Bank. The securities will qualify for up to 25% of Bancorp's total Tier 1 Capital with the remainder qualifying as Tier 2 Capital.

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.

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. Customers may withdraw funds from their accounts at any time and deposit balances may therefore run off unexpectedly due to changing market conditions.

The exposure to interest rate risk is monitored by the Asset and Liability Management Committee ("ALCO") consisting of senior management personnel. ALCO reviews the interrelationships within the balance sheet to maximize net interest income within acceptable levels of risk. ALCO reports to the Board of Directors on a monthly basis regarding its activities.

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.

"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 or Plan 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 and the impact of 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 effect 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 the Bancorp's 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.

## Item 7. Financial Statements

The consolidated balance sheets of Bancorp as of December 31, 2002 and December 31, 2001 and the related consolidated statements of income, shareholders' equity and cash flows for the years ended December 31, 2002 and December 31, 2001, together with the report thereon of McGladrey & Pullen, LLP dated February 25, 2003, are included as part of this Form 10-KSB in the "Financial Report" following page 35 hereof.

## Item 8. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

Not applicable.

PART III

Item 9. Directors, Executive Officers, Promoters and Control Persons; Compliance with Section 16(a) of the Exchange Act

The information required by Items 401 and 405 of Regulation S-B is incorporated into this Form 10-KSB by reference to Bancorp's definitive proxy statement (the "Definitive Proxy Statement") for its 2003 Annual Meeting of Shareholders.

Item 10. Executive Compensation

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

Item 11. Security Ownership of Certain Beneficial Owners and Management

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

Item 12. Certain Relationships and Related Transactions

The information required by Item 404 of Regulation S-B is incorporated into this Form 10-KSB by reference to the Definitive Proxy Statement.

Item 13. Exhibits and Reports on Form 8-K

(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(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)).

| | |
|---|---|
| 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)). |



| Exhibit No. | Description |
|---|---|
| 10(a)(2) | Lease dated February 1, 1995 between 999 Bedford Street Corporation and the Bank (incorporated by reference to Exhibit 10(a)(3) to Bancorp's Current Report on Form 8-K dated December 1, 1999 (Commission File No. 000-29599)). |
| 10(a)(3) | Employment Agreement, dated as of October 23, 2000, as amended by a First Amendment, dated as of March 21, 2001, among the Bank, Bancorp and Charles F. Howell (incorporated by reference to Exhibit 10(a)(4) to Bancorp's Annual Report on Form 10-KSB for the year ended December 31, 2000 (Commission File No. 000-29599)). |
| 10(a)(4) | Second Amendment to Employment Agreement among Patriot National Bank, Bancorp and Charles F. Howell, dated May 9, 2002. |
| 10(a)(5) | Employment Agreement dated as of September 19, 2001 among Patriot National Bank, Bancorp and Robert F. O'Connell (incorporated by reference to Exhibit 10 to Bancorp's Quarterly Report on Form 10-QSB for the Quarter ended March 31, 2002 (Commission File No. 000-29599)). |
| 10(a)(6) | Change of Control Agreement, dated as of May 1, 2001 between Robert F. O'Connell and Patriot National Bank (incorporated by reference to Exhibit 10(a)(4) to Bancorp's Annual Report on Form 10-KSB for the year ended December 31, 2001 (Commission File No. 000-29599)). |
| 10(a)(7) | Employment Agreement dated as of January 1, 2003 between Patriot National Bank and Todd Brown. |
| 10(a)(8) | Employment Agreement dated as of January 1, 2003 between Patriot National Bank and Marcus Zavattaro. |
| 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)). |
| 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. |
| 99 | Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

(b) Reports on Form 8-K

Bancorp filed no reports on Form 8-K during the fourth quarter of 2002.

14. Controls and Procedures

Based on an evaluation of Bancorp's disclosure controls and procedures performed by Bancorp's Chief Executive Officer and its Chief Financial Officer within 90 days of the filing of 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 rules and forms issued by the Securities and Exchange Commission. 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 it principal executive officer or officers and its principal financial officer or officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

Since the date of the evaluation described above, there were no significant changes in Bancorp's internal controls or in other factors that could significantly affect these controls, and there were no corrective actions with regard to significant deficiencies and material weaknesses.

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 26, 2003

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 | March 28, 2003 |
| Angelo De Caro, Chairman, Chief Executive Officer and Director | Date |
| /s/ Robert F. O'Connell | March 28, 2003 |
| Robert F. O'Connell<br>Senior Executive Vice President,<br>Chief Financial Officer and Director | Date |
| /s/ Michael A. Capodanno | March 28, 2003 |
| Michael A. Capodanno<br>Vice President & Controller | Date |
| /s/ Fred A. DeCaro, Jr. | March 28, 2003 |
| Fred A. DeCaro, Jr.<br>Director | Date |
| /s/ John J. Ferguson | March 28, 2003 |
| John J. Ferguson<br>Director | Date |

Form 10 KSB - Signatures continued

| | |
|---|---|
| /s/ John A. Geoghegan | March 27, 2003 |
| John A. Geoghegan<br>Director | Date |
| /s/ L. Morris Glucksman | March 28, 2003 |
| L. Morris Glucksman<br>Director | Date |
| /s/ Charles F. Howell | March 28, 2003 |
| Charles F. Howell<br>Director | Date |
| /s/ Michael Intrieri | March 28, 2003 |
| Michael Intrieri<br>Director | Date |
| /s/ Richard Naclerio | March 28, 2003 |
| Richard Naclerio<br>Director | Date |
| /s/ Paul Settelmeyer | March 28, 2003 |
| Paul Settelmeyer<br>Director | Date |
| /s/ Philip Wolford | March 28, 2003 |
| Philip Wolford<br>Director | Date |



CERTIFICATION
BY CHIEF EXECUTIVE OFFICER
PURSUANT TO RULE 13A-14

I, Angelo De Caro, certify that:

1. I have reviewed this annual report on Form 10-KSB of Patriot National Bancorp, Inc;

2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

(a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiary, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;

(b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and

(c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the Audit Committee of the registrant's Board of Directors (or persons performing the equivalent functions):

(a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

(b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and



6. The registrants other certifying officer and I have indicated in this annual report whether there were any significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

/s/ Angelo De Caro
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Angelo De Caro,

Chairman and Chief Executive Officer
(Principal executive officer)

March 28, 2003



CERTIFICATION
BY CHIEF FINANCIAL OFFICER
PURSUANT TO RULE 13A-14

I, Robert F. O'Connell, certify that:

1. I have reviewed this annual report on Form 10-KSB of Patriot National Bancorp, Inc;

2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

(a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiary, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;

(b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and

(c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the Audit Committee of the registrant's Board of Directors (or persons performing the equivalent functions):

(a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

(b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and



6. The registrants other certifying officer and I have indicated in this annual report whether there were any significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

/s/ Robert F. O'Connell
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Robert F. O'Connell,
Senior Executive Vice President
(Principal financial officer)

March 28, 2003

PATRIOT NATIONAL BANCORP, INC.

FINANCIAL REPORT
December 31, 2002 and 2001

CONTENTS



McGLADREY & PULLEN
Certified Public Accountants

INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying consolidated balance sheets of Patriot National Bancorp, Inc. and Subsidiary (the "Company") as of December 31, 2002 and 2001, and the related consolidated statements of income, shareholders' equity and cash flows for the years then ended. 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 auditing standards generally accepted in the United States of America. 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, 2002 and 2001, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 11 to the financial statements, effective January 1, 2002, the Company changed its method of accounting for goodwill as prescribed in Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets."

/s/ McGLADREY & PULLEN, LLP

New Haven, Connecticut
February 25, 2003, except for Note 20
as to which the date is March 27, 2003

PATRIOT NATIONAL BANCORP, INC.

CONSOLIDATED BALANCE SHEETS
December 31, 2002 and 2001

| | 2002 | 200 |
|---|---|---|
| ASSETS | | |
| Cash and due from banks (Note 2) .................................. | $ 5,385,757 | $ 7,544 |
| Federal funds sold ................................................ | 3,000,000 | 12,700 |
| Short-term investment ............................................. | 3,348,968 | 6,788 |
| Cash and cash equivalents ......................................... | 11,734,725 | 27,032 |
| Available for sale securities (at fair value) (Note 3) ............. | 60,618,366 | 34,717 |
| Federal Reserve Bank stock ........................................ | 481,050 | 481 |

| | | |
|---|---|---|
| Federal Home Loan Bank stock (Note 8) | 621,300 | 617 |
| Loans receivable (net of allowance for loan losses: 2002 $2,372,454; 2001 $1,894,454) (Note 5) | 170,794,939 | 135,680 |
| Accrued interest receivable | 1,311,453 | 1,079 |
| Premises and equipment, net (Notes 6 and 9) | 789,197 | 1,102 |
| Deferred tax asset (Note 10) | 754,696 | 662 |
| Goodwill (Note 11) | 930,091 | 930 |
| Other assets | 460,936 | 265 |
| Total assets | $248,496,753 | $202,569 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Liabilities | | |
| Deposits (Note 7): | | |
| Noninterest bearing deposits | $ 25,519,809 | $ 16,961 |
| Interest bearing deposits | 192,391,451 | 166,302 |
| Total deposits | 217,911,260 | 183,263 |
| Securities sold under agreements to repurchase (Note 8) | 5,700,000 | |
| Federal Home Loan Bank borrowings (Note 8) | 4,000,000 | |
| Capital lease obligation (Note 9) | 243,231 | 364 |
| Collateralized borrowings | 349,444 | 474 |
| Accrued expenses and other liabilities | 1,747,863 | 1,060 |
| Total liabilities | 229,951,798 | 185,163 |
| Commitments and Contingencies (Notes 8, 9, 12 and 14) | | |
| Shareholders' equity (Notes 12 and 15) | | |
| Common stock, $2 par value: 5,333,333 shares authorized; shares issued and outstanding: 2002 2,400,525; 2001 2,400,525 | 4,801,050 | 4,801 |
| Additional paid-in capital | 11,484,649 | 11,484 |
| Retained earnings | 1,688,158 | 864 |
| Accumulated other comprehensive income - net unrealized gain on available for sale securities | 571,098 | 256 |
| Total shareholders' equity | 18,544,955 | 17,406 |
| Total liabilities and shareholders' equity | $248,496,753 | $202,569 |

See Notes to Consolidated Financial Statements.

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PATRIOT NATIONAL BANCORP, INC.

CONSOLIDATED STATEMENTS OF INCOME
Years Ended December 31, 2002 and 2001

| | 2002 | 2001 |
|---|---|---|

| | | |
|---|---|---|
| **Interest and Dividend Income** | | |
| Interest and fees on loans | $ 10,134,768 | $ 11,136 |
| Interest and dividends on investment securities | 2,315,412 | 2,110 |
| Interest on Federal funds sold | 154,538 | 476 |
| Total interest and dividend income | 12,604,718 | 13,722 |
| **Interest Expense** | | |
| Interest on deposits (Note 7) | 4,497,409 | 6,772 |
| Interest on securities sold under agreements to repurchase and other | 79,147 | |
| Interest on Federal Home Loan Bank borrowings | 124,489 | |
| Interest on capital lease obligation | 42,395 | 58 |
| Interest on collateralized borrowings | 21,253 | 36 |
| Total interest expense | 4,764,693 | 6,866 |
| Net interest income | 7,840,025 | 6,855 |
| Provision for Loan Losses (Note 5) | 468,000 | 250 |
| Net interest income after provision for loan losses | 7,372,025 | 6,605 |
| **Noninterest Income** | | |
| Mortgage brokerage referral fees | 2,936,735 | 2,667 |
| Loan origination and processing fees | 567,686 | 540 |
| Fees and service charges | 311,729 | 263 |
| Gains and origination fees from loans sold | 249,365 | 70 |
| Loss on impaired investment security (Note 3) | -- | (117 |
| Loss on sale of investment securities | (25,733) | |
| Other income | 74,038 | 85 |
| Total noninterest income | 4,113,820 | 3,509 |
| **Noninterest Expenses** | | |
| Salaries and benefits (Note 13) | 6,418,855 | 5,282 |
| Occupancy and equipment expense, net | 1,004,297 | 935 |
| Data processing and other outside services | 623,877 | 618 |
| Professional services | 302,000 | 322 |
| Advertising and promotional expenses | 265,845 | 251 |
| Forms, printing and supplies | 139,492 | 146 |
| Regulatory assessments | 98,636 | 90 |
| Directors' fees and expenses | 126,159 | 65 |
| Other operating expenses | 833,677 | 961 |
| Total noninterest expenses | 9,812,838 | 8,675 |
| Income before income taxes | 1,673,007 | 1,440 |
| Provision for Income Taxes (Note 10) | 621,000 | 564 |
| Net income | $ 1,052,007 | $ 876 |
| Basic income per share (Notes 11 and 12) | $ 0.44 | $ |

| | | |
|---|---|---|
| Diluted income per share (Notes 11 and 12) ................. | $ 0.43 | $ |
| Dividends per share ..................................... | $ 0.095 | $ 0 |

See Notes to Consolidated Financial Statements.

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PATRIOT NATIONAL BANCORP, INC.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
Years Ended December 31, 2002 and 2001

| | Number of Shares | Common Stock | Additional Paid-in Capital | Retained Earnings |
|---|---|---|---|---|
| Balance at January 1, 2001 ............ | 2,400,375 | $ 4,800,750 | $ 11,483,770 | $ 131,840 |
| Comprehensive income | | | | |
| Net income ........................... | -- | -- | -- | 876,387 |
| Unrealized holding gain on available for sale securities, net of taxes (Note 17) | -- | -- | -- | -- |
| Total comprehensive income ..... | | | | |
| Dividends ............................ | -- | -- | -- | (144,025) |
| Issuance of common stock .............. | 150 | 300 | 879 | |
| Balance at December 31, 2001 .......... | 2,400,525 | 4,801,050 | 11,484,649 | 864,202 |
| Comprehensive income | | | | |
| Net income ........................... | -- | -- | -- | 1,052,007 |
| Unrealized holding gain on available for sale securities, net of taxes (Note 17) | -- | -- | -- | -- |
| Total comprehensive income ..... | | | | |
| Dividends ............................ | -- | -- | -- | (228,051) |

| | | | | |
|---|---|---|---|---|
| Balance, December 31, 2002 ............ | 2,400,525 | $ 4,801,050 | $ 11,484,649 | $ 1,688,158 |

See Notes to Consolidated Financial Statements.

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PATRIOT NATIONAL BANCORP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ended December 31, 2002 and 2001

| | 2002 | |
|---|---|---|
| Cash Flows from Operating Activities | | |
| Net income ............................................................... | $ 1,052,007 | $ |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Amortization and accretion of net investment premiums and discounts, net | 138,158 | |
| Originations of loans held for sale | 208,000 | 2 |
| Proceeds from sales of loans held for sale ............................ | (208,000) | (2 |
| Gains on sales of loans .................................................. | (249,365) | |
| Provision for loan losses ................................................ | 468,000 | |
| Loss on impaired investment security .................................. | -- | |
| Loss on sales of investment securities ................................ | 25,733 | |
| Depreciation and amortization of premises and equipment ............... | 405,040 | |
| Loss on disposal of bank premises and equipment ....................... | -- | |
| Deferred income taxes .................................................... | (269,753) | |
| Amortization of goodwill ................................................. | -- | |
| Change in assets and liabilities: | | |
| Increase in deferred loan fees ........................................ | 336,234 | |
| (Increase) decrease in accrued interest receivable .................. | (232,003) | |
| Increase in other assets ............................................... | (195,471) | |
| Increase in accrued expenses and other liabilities .................. | 675,637 | |
| Net cash provided by operating activities ......................... | 2,154,217 | |
| Cash Flows from Investing Activities | | |
| Purchases of available for sale securities ............................ | (55,062,998) | ( |
| Proceeds from sales of available for sale securities ................. | 11,375,386 | |
| Proceeds from maturities of available for sale securities ............ | 7,000,000 | |
| Principal repayments on available for sale securities ................ | 11,115,621 | |
| Proceeds from maturities of held to maturity securities .............. | -- | |
| Purchase of Federal Reserve Bank stock ................................ | -- | |
| Purchase of Federal Home Loan Bank stock .............................. | (3,400) | |
| Proceeds from sale of loan receivable .................................. | 1,549,365 | |
| Net increase in loans .................................................... | (37,219,137) | |
| Purchases of premises and equipment .................................... | (91,809) | |
| Net cash used in investing activities ............................. | (61,336,972) | ( |

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PATRIOT NATIONAL BANCORP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS, Continued
Years Ended December 31, 2002 and 2001

| | 2002 | 2 |
|---|---|---|
| **Cash Flows from Financing Activities** | | |
| Net increase in demand, savings and money market deposits | $ 27,220,834 | $ 28, |
| Net increase (decrease) in time certificates of deposit | 7,426,487 | (24, |
| Increase in securities sold under repurchase agreements | 5,700,000 | |
| Increase in FHLB borrowings | 4,000,000 | |
| Principal payments on capital lease obligation | (121,605) | ( |
| Decrease in collateralized borrowings | (125,000) | |
| Proceeds from issuance of common stock | -- | |
| Dividends paid on common stock | (216,047) | |
| Net cash provided by financing activities | 43,884,669 | 3, |
| Net decrease in cash and cash equivalents | (15,298,086) | (6, |
| **Cash and cash equivalents** | | |
| Beginning | 27,032,811 | 33, |
| Ending | $ 11,734,725 | $ 27, |
| **Supplemental Disclosures of Cash Flow Information** | | |
| Cash paid for: | | |
| Interest | $ 4,782,645 | $ 6, |
| Income taxes | $ 808,809 | $ |
| **Supplemental Disclosure of Noncash Investing and Financing Activities** | | |
| Transfer of held to maturity securities to available for sale securities | $ -- | $ 11, |
| Unrealized holding gains on available for sale securities arising during the period | $ 492,336 | $ |
| Accrued dividends declared on common stock | $ 60,015 | $ |

See Notes to Consolidated Financial Statements.

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PATRIOT NATIONAL BANCORP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2002 and 2001

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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, two branch offices in Greenwich, Connecticut and one branch office in Norwalk, Connecticut. The Bank's customers are concentrated in Fairfield County, Connecticut and Westchester County, New York. The Bank also conducts mortgage brokerage operations in Connecticut and New York through its mortgage brokerage division, Pinnacle Financial.

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 (currently inactive); 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 revenues and expenses for the 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 valuation of deferred tax assets.

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

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.

PATRIOT NATIONAL BANCORP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued
December 31, 2002 and 2001

---

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 that management has the positive intent and ability to hold to maturity are classified as "held to maturity" and 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.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Declines in the fair value of held to maturity and available for sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. 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, taking into consideration all open positions. Gains and losses on sales of loans are recognized at 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.

Loans receivable

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

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





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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.

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.

Allowance for loan losses

The allowance for loan losses, a material estimate susceptible to significant change in the near-term, is established as losses are estimated to have occurred through a provision for losses charged against operations and is maintained at a level that management considers adequate to absorb losses in the loan portfolio. Management's judgment in determining the adequacy of the allowance is inherently subjective and is based on the evaluation of individual loans, the known and inherent risk characteristics and size of the loan portfolios, the 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 evaluations of specific loans and other relevant factors. Loans, including impaired loans, are charged against the allowance for loan losses when management believes that the uncollectibility of principal is confirmed. Any subsequent recoveries are credited to the allowance for loan losses when received. In connection with the determination of the allowance for loan losses, management obtains appraisals for significant properties, when considered necessary.

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

Management believes the allowance for loan losses is adequate. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in economic conditions. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses. Such agencies have the authority to require the Company to recognize additions to the allowance or charge-offs based on the agencies' judgments about information available to them at the time of their examination.

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 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.

Loan origination fees, net of 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 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, if any, 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 for purchased assets, and at the lower of fair value or the net present value of the minimum lease payments required over the term of the lease for assets under capital leases, 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 using the straight-line method over the estimated useful lives of the related assets which range from three to ten years. Amortization of premises under capital leases is charged to operations using the straight-line method over the life of the lease. 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

Goodwill represents the cost in excess of net assets of businesses acquired and was being amortized on a straight-line basis over ten years through December 31, 2001. Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142") was adopted January 1, 2002, and accordingly amortization of goodwill was discontinued and such goodwill is tested for impairment annually, or more frequently under prescribed conditions.

Collateralized borrowings

Collateralized borrowings represent the portion of loans transferred to other institutions under loan participation agreements. Such transfers were not recognized as sales due to recourse provisions and/or restrictions on the participant's right to transfer their portion of the loan.

### 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 dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. Potential common shares that may be issued by the 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. 123, Accounting for Stock-Based Compensation, encourages all entities to adopt a fair value based method of accounting for employee stock compensation plans, whereby compensation cost is measured at the grant date based on the value of the award and is recognized over the service period, which is usually the vesting period. However, it also allows an entity to continue to measure compensation cost for those plans using the intrinsic value based method of accounting prescribed by Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, whereby compensation cost is the excess, if any, of the quoted market price of the stock at the grant date (or other measurement date) over the amount an employee must pay to acquire the stock. Stock options issued under the Company's stock option plan, and stock warrants issued, have no intrinsic value at the grant date, and under Opinion No. 25 no compensation cost is recognized for them. During 2002, the Company adopted SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure, an Amendment of FASB Statement No. 123." The Company has elected to continue with the accounting methodology in Opinion No. 25 and, as a result, provides pro forma disclosures of net income and earnings per share and other disclosures, as if the fair value based method of accounting had been applied. There is no proforma disclosure required for 2002 and 2001.

Comprehensive income

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





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

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.

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.

Reclassifications

Certain 2001 financial statement amounts have been reclassified to conform with the 2002 presentations. Such reclassifications had no effect on 2001 net income.

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, 2002, the Bank was required to have cash and liquid assets of approximately $1,053,000 to meet these requirements. In addition, the Company is 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, 2002 and 2001 are as follows:

| 2002 | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses |
|---|---|---|---|
| U.S. Government agency obligations ........... | $ 9,024,526 | $ 104,888 | $ -- |
| Mortgage-backed securities .................... | 37,756,793 | 705,573 | (1,207) |
| Corporate bonds ............................... | 283,853 | 99,944 | -- |
| Marketable equity securities .................. | 12,632,068 | 11,928 | -- |
| | $ 59,697,240 | $ 922,333 | $ (1,207) |

| 2001 | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses |
|---|---|---|---|
| Mortgage-backed securities .................... | $ 9,981,222 | $ 262,196 | $ -- |
| Corporate bonds ............................... | 11,675,851 | 213,049 | (8,744) |
| Marketable equity securities .................. | 12,632,067 | -- | (37,711) |
| | $ 34,289,140 | $ 475,245 | $ (46,455) |





At December 31, 2002, available for sale securities with a carrying value of $8,368,347 were pledged to secure obligations under repurchase agreements and municipal deposits. There were no securities pledged at December 31, 2001.

The amortized cost and fair value of available for sale debt securities at December 31, 2002 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 .................... | $ 8,303,773 | $ 8,495,399 |
| 5-10 years ................... | 1,004,606 | 1,017,812 |
| Mortgage-backed securities ... | 37,756,793 | 38,461,159 |
| Total ........................... | $47,065,172 | $47,974,370 |

During 2002, proceeds from sales of available for sale securities were $11,375,386 and there were $25,733 in losses realized on those sales. During 2001, proceeds from sales of available for sale securities were $9,046,223 and there were no gains or losses realized on those sales. Also during 2001, due to the significant deterioration in the creditworthiness of the issuer, the Company recognized an impairment loss of $117,679 on an available for sale corporate bond, which loss was considered other than temporary. There were no such losses recognized during 2002.

Note 4. Held to Maturity Securities

During 2001, the Company transferred all of its held to maturity securities, which had a carrying value of $11,796,300, to the available for sale category. At the time of the transfer, the Company recognized an unrealized loss of $154,147 as an adjustment to other comprehensive income. The transfer of these securities was made based on a change in the Company's overall investment strategies and for liquidity purposes.

There were no sales of held to maturity securities during 2001.





Note 5.

Loans Receivable and Allowance for Loan Losses

A summary of the Company's loan portfolio at December 31, 2002 and 2001 is as follows:

| | 2002 | 2001 |
|---|---|---|
| Real estate: | | |
| Commercial ................................ | $ 65,967,205 | $ 60,481,789 |
| Residential ............................... | 27,012,024 | 7,501,504 |

| | | |
|---|---|---|
| Construction, net of undisbursed portion of $29,592,692 in 2002 and $7,183,318 in 2001 | 39,208,651 | 26,215,265 |
| Commercial .................................... | 13,021,909 | 14,649,112 |
| Consumer installment .......................... | 1,757,321 | 1,231,672 |
| Consumer home equity .......................... | 26,812,092 | 27,770,723 |
| Total loans ........................ | 173,779,202 | 137,850,065 |
| Net deferred loan fees ........................ | (611,809) | (275,575) |
| Allowance for loan losses ..................... | (2,372,454) | (1,894,454) |
| Loans receivable, net .............. | $ 170,794,939 | $ 135,680,036 |

The changes in the allowance for loan losses for the years ended December 31, 2002 and 2001 are as follows:

| | 2002 | 2001 |
|---|---|---|
| Balance, beginning of year .................. | $ 1,894,454 | $ 1,644,817 |
| Provision for loan losses ............... | 468,000 | 250,000 |
| Recoveries of loans previously charged-off | 10,000 | 1,412 |
| Loans charged-off ....................... | -- | (1,775) |
| Balance, end of year ........................ | $ 2,372,454 | $ 1,894,454 |

At December 31, 2002 and 2001, the unpaid principal balances of loans delinquent 90 days or more were $1,372,705 and $2,953,870, respectively, and the unpaid principal balances of loans placed on nonaccrual status were $200,957 and $1,653,946, respectively.





The following information relates to impaired loans as of and for the years ended December 31, 2002 and 2001:

| | 2002 | |
|---|---|---|
| Loans receivable for which there is a related allowance for credit losses ........................................................... | $ -- | $ |
| Loans receivable for which there is no related allowance for credit | | |

| | | |
|---|---|---|
| losses .......................................................... | $ 200,957 | |
| Allowance for credit losses related to impaired loans .................. | $ -- | $ |
| Average recorded investment in impaired loans .......................... | $ 903,634 | $ |

There was no interest income on impaired loans collected or recognized in 2002 and 2001. The Company has no commitments to lend additional funds to borrowers whose loans are impaired.

The Company's lending activities are conducted principally in the Fairfield County section of Connecticut and Westchester County section of 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 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.





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Note 6. Premises and Equipment

At December 31, 2002 and 2001, premises and equipment consisted of the following:

| | 2002 | 2001 |
|---|---|---|
| Premises under capital lease | $ 783,000 | $ 783,000 |
| Leasehold improvements | 880,169 | 831,814 |
| Furniture, equipment and software | 1,034,782 | 992,388 |
| | 2,697,951 | 2,607,202 |
| Less accumulated depreciation and amortization | (1,908,754) | (1,504,774) |
| | $ 789,197 | $ 1,102,428 |

For the years ended December 31, 2002 and 2001, depreciation and amortization expense related to premises and equipment totaled $405,040 and $357,706, respectively.

Note 7. Deposits

At December 31, 2002 and 2001, deposits consisted of the following:

| | 2002 | 2001 |
|---|---|---|
| Noninterest bearing | $ 25,519,809 | $ 16,961,636 |
| Interest bearing: | | |
| Time certificates, less than $100,000 | 57,202,908 | 53,081,137 |
| Time certificates, $100,000 or more | 28,681,345 | 25,376,629 |
| Money market | 56,973,507 | 10,255,056 |
| Savings | 26,847,780 | 31,258,415 |
| NOW | 22,685,911 | 46,331,066 |
| Total interest bearing | $192,391,451 | 166,302,303 |
| Total deposits | $217,911,260 | $183,263,939 |

Interest expense on certificates of deposit in denominations of $100,000 or more was $985,602 and $1,378,773 for the years ended December 31, 2002 and 2001, respectively.





Contractual maturities of time certificates of deposit as of December 31, 2002 are summarized below:

| | |
|---|---|
| Due within: | |
| 1 year | $47,098,521 |
| 1-2 years | 6,339,784 |

| | |
|---|---|
| 2-3 years | 8,222,490 |
| 3-4 years | 7,950,745 |
| 4-5 years | 16,272,713 |
| | $85,884,253 |

Note 8. Borrowings

Borrowings at December 31, 2002 consist of $5,700,000 of short-term borrowed funds under securities sold under agreements to repurchase, due in 2003, with interest rates ranging from 1.49% to 2.69%, and fixed rate Federal Home Loan Bank advances. Federal Home Loan bank advances in the following table are shown based on contractual maturity:

| | | |
|---|---|---|
| Due in: | | |
| 2005 | $ 2,000,000 | 4.48% |
| 2007 | 2,000,000 | 5.11% |
| | $ 4,000,000 | |

The Bank is a member of the Federal Home Loan Bank of Boston ("FHLB"). At December 31, 2002, 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, 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, 2002 and 2001, there were no advances outstanding under this line of credit.

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 FHLB at cost.

Note 9. Commitments and Contingencies

Capital lease

The Company leases the Bank's main office under a capital lease which expires in 2004. Premises under capital lease of $783,000 and related accumulated amortization of $652,500 and $574,200 as of December 31, 2002 and 2001, respectively, are included in premises and equipment.





The Company is obligated under the lease to pay executory costs including insurance, property taxes, maintenance and other related expenses.

At December 31, 2002, future minimum lease payments, by years and in the aggregate, under this capital lease are as follows:

| Years Ending December 31, | Amount |
|---|---|
| 2003 | $164,000 |
| 2004 | 109,333 |
| | 273,333 |
| Less amount representing interest | 30,102 |
| Present value of future minimum lease payments-capital lease obligation | $243,231 |

Operating leases

The Company subleases excess office space in its premises to a tenant under a noncancelable operating lease. Future minimum lease payments receivable for this lease by year, and in the aggregate, at December 31, 2002 are as follows:

| Years Ending December 31, | Amount |
|---|---|
| 2003 | $22,260 |
| 2004 | 16,695 |
| | $38,955 |

For the years ended December 31, 2002 and 2001, rental income under both cancelable and noncancelable leases totaled $22,260 and $29,060, respectively.

The Company also has noncancelable operating leases for certain of its branch offices and for its mortgage brokerage office in New York. 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.





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

| Years Ending December 31, | Amount |
|---|---|
| 2003 | $ 534,989 |
| 2004 | 494,341 |
| 2005 | 450,636 |
| 2006 | 412,328 |
| 2007 | 274,908 |
| Thereafter | 541,212 |
| | $2,708,414 |

Total rental expense charged to operations for cancelable and noncancelable operating leases was $423,343 and $407,865 for the years ended December 31, 2002 and 2001, respectively.

## Employment Agreements

### President's Agreement

In October 2000, the Company and the Bank entered into a three-year employment agreement (the "Agreement") with the Bank's President and Chief Executive Officer. The Agreement provides for, among other things, a stipulated base salary for the first year of the Agreement, annual increases at each anniversary, and a discretionary annual bonus to be determined by the Board of Directors. In addition, the Agreement provides that the Company will grant shares of the Company's common stock to the President on December 31, 2000, and annually thereafter through December 31, 2003. The number of shares to be granted is based on 30% of the President's stipulated base salary for the preceding annual employment period, as defined, and such shares granted will vest and be distributed to the President in four annual installments (with any balance distributed upon termination other than for cause). Compensation cost is being recognized over the term of the Agreement. Under certain circumstances defined in the Agreement, this stock grant may be settled in cash. The Agreement also provides 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 remains employed by the Bank. In the event that the Company does not have stock options available to grant at any of the stipulated dates, which was the case at December 31, 2000, 2001 and 2002, the President may then elect, on a future determination date, as defined, to receive cash compensation in the future equal to the difference between the value of the Company's stock at the time the options would have been granted, and the value of the Company's stock on the determination date. For the years ended December 31, 2002 and 2001, approximately $75,000 and $48,400, respectively, was charged to expense related to the stock and option compensation components of the Agreement.

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 stipulated base salary at the time of termination.

The Agreement also includes change of control provisions that entitles the President to a lump sum payment of two times the greater of the President's stipulated base salary at the time of the change in control; total cash compensation, as defined, for the year preceding the change in control; or the average total cash compensation, as defined, for the two years preceding the change in control.

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

Effective January 1, 2003, the Company entered into one-year employment agreements with two officers of the Pinnacle Financial division, which replaced contracts that expired on December 31, 2002. The agreements provide for, among other things, a minimum and maximum base salary and commission arrangement, as well as additional compensation based upon the achievement of certain other financial results, and for reimbursement of expenses incurred incidental to their duties as officers. The agreements terminate on December 31, 2003.

In 2001, the Company entered into a three-year employment agreement with its Chief Financial Officer. The agreement provides for, among other things, a stipulated base salary and discretionary bonuses as determined from time to time by the Board of Directors. The agreement terminates on September 19, 2004. In addition, certain officers of the Company have change of control agreements that entitle such officers to receive one year's compensation (as defined in the agreements) if a change of control (as defined in the agreements) occurs while such officers are full time officers of the Bank or within six months following termination of employment other than for cause (as defined in the agreements) or by reason of death or disability.

Stock Appreciation Rights Plan
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During 2001, the Company adopted the Patriot National Bancorp, Inc. 2001 Stock Appreciation Rights Plan (the "SAR Plan"). Under the terms of the SAR Plan, the Company may grant stock appreciation rights to officers of the Company that 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 vests 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 officers, and $2,600 and $3,600, respectively, was charged to operations under the SAR Plan for the years ended December 31, 2002 and 2001.

December 31, 2002 and 2001

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Legal Matters

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

Other

The Company expects to open three new branch offices in 2003. Prior to December 31, 2002, the Company entered into a noncancelable lease for one of these branches which expires in 2007; subsequent to December 31, 2002, the Company entered into a noncancelable lease for a second location.

Note 10. Income Taxes

The components of the income tax provision for the years ended December 31, 2002 and 2001 are as follows:

| | 2002 | 2001 |
|---|---|---|
| Current | | |
| Federal | $ 701,867 | $ 582,401 |
| State | 188,886 | 157,814 |
| Total | 890,753 | 740,215 |
| Deferred | | |
| Federal | (211,866) | (138,401) |
| State | (57,887) | (37,814) |
| Total | (269,753) | (176,215) |
| Provision for income taxes | $ 621,000 | $ 564,000 |

A reconciliation of the anticipated income tax provision (computed by applying the statutory Federal income tax rate to the income before income taxes) to the income tax provision as reported in the statements of income for the years ended December 31, 2002 and 2001 is as follows:

| | 2002 | 2001 |
|---|---|---|
| Provision for income taxes at statutory Federal rate | $ 568,800 | $ 489,700 |
| State taxes, net of Federal benefit | 86,800 | 75,300 |
| Dividends received deduction | (69,100) | (71,500) |
| Nondeductible expenses | 9,000 | 81,200 |
| Other | 25,500 | (10,700) |

| | | |
|---|---|---|
| Total provision for income taxes ........ | $ 621,000 | $ 564,000 |





At December 31, 2002 and 2001, the components of gross deferred tax assets and gross deferred tax liabilities are as follows:

| | 2002 | 2001 |
|---|---|---|
| Deferred tax assets: | | |
| Allowance for loan losses .... | $ 939,729 | $ 750,394 |
| Investment securities ........ | 46,613 | 46,613 |
| Asset under capital lease .... | 44,654 | 61,807 |
| Premises and equipment ....... | 159,637 | 75,931 |
| Accrued expenses ............ | 14,062 | 15,844 |
| Other ....................... | 15,938 | 23,103 |
| Gross deferred tax assets .. | 1,220,633 | 973,692 |
| Deferred tax liabilities: | | |
| Tax bad debt reserve ......... | 115,909 | 138,721 |
| Investment securities ........ | 350,028 | 172,675 |
| Gross deferred tax liabilities | 465,937 | 311,396 |
| Deferred tax asset, net | $ 754,696 | $ 662,296 |

## Note 11. Goodwill

The Company adopted the provisions of SFAS 142 effective January 1, 2002. As a result, effective January 1, 2002, goodwill is no longer amortized, and is evaluated for impairment under SFAS 142. Based on the Company's initial goodwill impairment test, goodwill was not impaired at the date of adoption of SFAS 142, and based on the Company's annual goodwill impairment test performed in October 2002, goodwill was not impaired for the year ended December 31, 2002. In addition, no goodwill was acquired during 2002.

In addition, the following represents the effect of adopting SFAS No. 142 on the Company's net income and earnings per share for the years ended December 31, 2002 and 2001:

| | 2002 | 2001 |
|---|---|---|
| Reported net income ........... | $ 1,052,007 | $ 876,387 |
| Add goodwill amortization ....... | -- | 123,936 |
| Adjusted net income ........... | $ 1,052,007 | $ 1,000,323 |
| Basic income per share | | |
| Reported net income per share | $ 0.44 | $ 0.37 |
| Goodwill amortization ....... | -- | 0.05 |
| Adjusted net income per share | $ 0.44 | $ 0.42 |
| Diluted income per share | | |
| Reported net income per share | $ 0.43 | $ 0.36 |
| Goodwill amortization ....... | -- | 0.05 |
| Adjusted net income per share | $ 0.43 | $ 0.41 |

Note 12. Shareholders' Equity

Income Per Share

The following is information about the computation of income per share for the years ended December 31, 2002 and 2001.

| | 2002 | | |
|---|---|---|---|
| | Net Income | Shares | Per Share Amount |
| Basic Income Per Share | | | |
| Income available to common shareholders | $1,052,007 | 2,400,525 | $ 0.44 |
| Effect of Dilutive Securities | | | |
| Warrants and stock options outstanding | -- | 26,789 | (0.01) |
| Diluted Income Per Share | | | |
| Income available to common shareholders plus assumed conversions ........... | $1,052,007 | 2,427,314 | $ 0.43 |

PATRIOT NATIONAL BANCORP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued
December 31, 2002 and 2001

| | 2001 | | |
|---|---|---|---|
| | Net Income | Shares | Per Share Amount |
| Basic Income Per Share | | | |
| Income available to common shareholders | $ 876,387 | 2,400,488 | $ 0.37 |
| Effect of Dilutive Securities | | | |
| Warrants and stock options outstanding | -- | 26,013 | (0.01) |
| Diluted Income Per Share | | | |
| Income available to common shareholders plus assumed conversions .......... | $ 876,387 | 2,426,501 | $ 0.36 |

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. These warrants are currently exercisable and expire on August 31, 2004. During 1998, the Bank issued warrants to certain other individuals involved in the organization of the Bank to purchase up to 28,680 shares of the Bank's common stock at $14 per share; these warrants expired on July 6, 2001, and none was exercised. The obligations related to all warrants issued by the Bank were assumed by the Company. The Company has reserved 91,166 shares of its common stock for issuance upon exercise of these warrants.

A summary of the status of the warrants at December 31, 2002 and 2001, and changes during the years ended on those dates, is as follows:

| | 2002 | | 2001 | |
|---|---|---|---|---|
| | Number of Shares | Weighted-Average Exercise Price | Number of Shares | W E |
| Outstanding at beginning of year | 91,166 | $ 6.00 | 119,846 | $ |
| Expired ...................... | -- | -- | (28,680) | |
| Exercised .................... | -- | -- | -- | |

| | | | |
|---|---|---|---|
| Outstanding at end of year ..... | 91,166 | 6.00 | 91,166 |
| Exercisable at end of year ..... | 91,166 | 6.00 | 91,166 |

The weighted average remaining contractual life for the warrants outstanding at December 31, 2002 is 1.7 years.

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PATRIOT NATIONAL BANCORP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued
December 31, 2002 and 2001

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 could have been 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 110,000 shares of common stock for issuance under the Plan. No additional options may be granted under the Plan.

A summary of the status of the stock options at December 31, 2002 and 2001 is as follows:

| | 2002 | | 2001 | |
|---|---|---|---|---|
| | Number of Shares | Weighted-Average Exercise Price | Number of Shares | Weighted Average Exercis Price |
| Outstanding at beginning of year | 110,000 | $ 10.13 | 110,000 | $ 10.1 |
| Granted ........................ | -- | | -- | |
| Outstanding at end of year ..... | 110,000 | 10.13 | 110,000 | 10.1 |
| Exercisable at end of year ..... | 110,000 | 10.13 | 110,000 | 10.1 |

The weighted-average remaining contractual life for the options outstanding at December 31, 2002 is 6.6 years.

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 contribution and Company contributions. The Company contributed approximately $34,000 and $25,000 to the 401(k) Plan in 2002 and 2001, 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 contract 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.

Financial instruments whose contract amounts represent credit risk are as follows at December 31, 2002 and 2001:

| | 2002 | 2001 |
|---|---|---|
| Commitments to extend credit: | | |
| Future loan commitments ....... | $32,714,416 | $ 5,142,789 |
| Unused lines of credit ........ | 25,127,648 | 16,221,043 |
| Undisbursed construction loans | 29,592,692 | 7,183,318 |
| Financial standby letters of credit | 635,500 | 144,000 |
| | $88,070,256 | $28,691,150 |

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. These financial instruments are recorded in the financial statements when they become payable.

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





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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 assets (as defined). Management believes, as of December 31, 2002, that the Company and the Bank meet all capital adequacy requirements to which it is 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 Bank's actual capital amounts and ratios at December 31, 2002 and 2001 were (dollars in thousands):

Ca

| | Actual | | For Capital Adequacy Purposes | | Pr Ac |
|---|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio | |
| **December 31, 2002:** | | | | | |
| Total Capital (to Risk Weighted Assets) | $19,340 | 10.36% | $14,934 | 8.00% | |
| Tier I Capital (to Risk Weighted Assets) | 17,001 | 9.11% | 7,465 | 4.00% | |
| Tier I Capital (to Average Assets) ..... | 17,001 | 6.98% | 9,743 | 4.00% | |

| | Actual | | For Capital Adequacy Purposes | | Ca Pr Ac |
|---|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio | |
| **December 31, 2001:** | | | | | |
| Total Capital (to Risk Weighted Assets) | $18,003 | 10.69% | $13,473 | 8.00% | |
| Tier I Capital (to Risk Weighted Assets) | 16,109 | 9.57% | 6,733 | 4.00% | |
| Tier I Capital (to Average Assets) .... | 16,109 | 8.11% | 7,945 | 4.00% | |

The Company is also considered to be well capitalized under the regulatory framework specified by the Federal Reserve Bank ("FRB"). The Company's actual and required ratios are not substantially different from those shown above.





## 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, 2002, the Bank had retained earnings of approximately $1,895,000, all of which 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 FRB 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 2002 and 2001 are as follows:

| | 2002 | 2001 |
|---|---|---|
| Balance, beginning of year .......... | $ 3,847,622 | $ 4,556,361 |
| Additional loans .................... | 4,043,876 | 832,941 |
| Repayments .......................... | (3,914,030) | (1,541,680) |
| Adjustment for former related parties | (429,702) | -- |
| Balance, end of year ................ | $ 3,547,766 | $ 3,847,622 |

Related party deposits aggregated approximately $4,002,000 and $7,161,000 as of December 31, 2002 and 2001, respectively.

The Company leases office space in its premises to a director of the Company under a five-year lease. Rental income under this lease was approximately $22,300 for each of the years ended December 31, 2002 and 2001. Also during 2001, the Company leased office space to a related individual under a month-to-month lease, and rental income under this lease was approximately $500 for the year ended December 31, 2001. In addition, the Company paid consulting fees of approximately $20,400 to this individual during the year ended December 31, 2001.

During 2002 and 2001, the Company paid legal fees of approximately $21,800 and $9,900, respectively, to an attorney who is a director of the Company.





During 2001, the Company leased parking space from a corporation, certain principals of which were related parties. Total rent paid to the corporation was $13,500 for the year ended December 31, 2001. During 2001, the corporation's asset was sold to individuals who are not related parties of the Company.

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:

| | 2002 | | |
|---|---|---|---|
| | Before-Tax Amount | Tax Expense | Net- Am |
| Unrealized holding gains arising during period | $ 466,603 | $(168,083) | $ 2 |
| Add: | | | |
| Reclassification adjustment for losses recognized in net income ............... | 25,733 | (9,270) | |
| Unrealized holding gain on available for sale securities, net of taxes ............... | $ 492,336 | $(177,353) | $ 3 |

| | 2001 | | |
|---|---|---|---|
| | Before-Tax Amount | Tax Expense | Net- Am |
| Unrealized holding gains arising during period | $ 138,360 | $ (55,707) | $ 8 |
| Add: | | | |
| Adjustment for unrealized losses of held to maturity securities transferred to available for sale securities .......... | 154,147 | (62,061) | 9 |
| Reclassification adjustment for losses recognized in net income ............... | 117,679 | (47,379) | 7 |
| Unrealized holding gain on available for sale securities, net of taxes ............... | $ 410,186 | $(165,147) | $ 24 |

PATRIOT NATIONAL BANCORP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued
December 31, 2002 and 2001

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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 statements of condition, 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, 2002 and 2001. The estimated fair value amounts for 2002 and 2001 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.

As of December 31, 2002 and 2001, the recorded book balances and estimated fair values of the Company's financial instruments were (in thousands):

| | 2002 | | 2001 | |
|---|---|---|---|---|
| | Recorded Book Balance | Fair Value | Recorded Book Balance | Fair Value |
| Financial Assets: | | | | |
| Cash and due from banks .......... | $ 5,386 | $ 5,386 | $ 7,544 | $ 7,544 |
| Federal funds sold ............... | 3,000 | 3,000 | 12,700 | 12,700 |
| Short-term investments ........... | 3,349 | 3,349 | 6,789 | 6,789 |
| Available for sale securities ..... | 60,618 | 60,618 | 34,718 | 34,718 |

| | | | | |
|---|---|---|---|---|
| Federal Reserve Bank stock ........ | 481 | 481 | 481 | 481 |
| Federal Home Loan Bank stock ...... | 621 | 621 | 618 | 618 |
| Loans receivable, net ............ | 170,795 | 174,693 | 135,680 | 138,541 |
| Accrued interest receivable ....... | 1,311 | 1,311 | 1,079 | 1,079 |

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PATRIOT NATIONAL BANCORP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued
December 31, 2002 and 2001

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| | 2002 | | 2001 | |
|---|---|---|---|---|
| | Recorded Book Balance | Fair Value | Recorded Book Balance | Fair |
| Financial Liabilities: | | | | |
| Demand deposits ............................ | $25,520 | $25,520 | $16,962 | $16, |
| Savings deposits ........................... | 26,848 | 26,848 | 31,258 | 31, |
| Money market deposits ...................... | 56,974 | 56,974 | 10,255 | 10, |
| NOW accounts ............................... | 22,686 | 22,686 | 46,331 | 46, |
| Time deposits .............................. | 85,884 | 88,470 | 78,458 | 79, |
| Securities sold under agreements to repurchase | 5,700 | 5,700 | -- | - |
| FHLB borrowings ............................ | 4,000 | 4,251 | -- | - |
| Collateralized borrowings .................. | 349 | 349 | 474 | |

Unrecognized financial instruments

Loan commitments on which the committed interest rate is less than the current market rate were insignificant at December 31, 2002 and 2001. The estimated fair value of fee income on letters of credit at December 31, 2002 and 2001 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.

Note 19. Segment Reporting

The Company has two reportable segments, the commercial bank and the mortgage broker. The commercial bank segment 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.

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PATRIOT NATIONAL BANCORP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued
December 31, 2002 and 2001

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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 the 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 as of and for the years ended December 31, 2002 and 2001 is as follows (in thousands):

| 2002 | Commercial Bank | Mortgage Broker | Consolidated Totals |
|---|---|---|---|
| Net interest income .... | $ 7,840 | $ -- | $ 7,840 |
| Noninterest income ...... | 496 | 3,618 | 4,114 |
| Noninterest expenses .... | 6,934 | 2,879 | 9,813 |
| Provision for loan losses | 468 | -- | 468 |
| Income before taxes ..... | 934 | 739 | 1,673 |
| Assets ................. | 247,459 | 1,038 | 248,497 |

| 2001 | Commercial Bank | Mortgage Broker | Consolidated Totals |
|---|---|---|---|

| | | | |
|---|---|---|---|
| Net interest income ..... | $ 6,856 | $ -- | $ 6,856 |
| Noninterest income ...... | 190 | 3,320 | 3,510 |
| Noninterest expenses .... | 6,056 | 2,620 | 8,676 |
| Provision for loan losses | 250 | -- | 250 |
| Income before taxes ..... | 740 | 700 | 1,440 |
| Assets .................. | 201,539 | 1,030 | 202,569 |

The accounting policies of the segments are the same as those described in the summary of significant accounting policies. Management allocates certain overhead expenses of the commercial bank to the mortgage broker segment, which allocations are based on a pre-determined monthly charge agreed to between the Company and the mortgage broker segment. Management evaluates the performance of each segment based on profit or loss from operations before income taxes. Intersegment revenues are accounted for at amounts that assume the revenues were between unrelated third parties at the current market prices at the time of the transactions.

The Company's reportable segments are strategic business units that offer different products and services. They are managed separately because each segment appeals to different markets and, accordingly, requires different technology and marketing strategies.





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The Company does not have operating segments other than those reported and the Company does not have a single external customer from which it derives 10% or more of its revenues and the Company operates in one geographical area.

Note 20. Subsequent Event

In the first quarter of 2003, the Company created a statutory trust of which the Company owns 100% of the capital stock. On March 27, 2003, the trust issued $8,000,000 in preferred securities to investors, the proceeds of which were used to purchase junior subordinated debt from the Company. The Company primarily invested the funds from the issuance of the debt in the Bank, which in turn will use the proceeds to fund general operations of the Bank. The securities will qualify for up to 25% of the Company's total Tier 1 Capital, with the remainder qualifying as Tier 2 Capital.

EXHIBIT INDEX

| 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(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)). |
| 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)(2) | Lease dated February 1, 1995 between 999 Bedford Street Corporation and the Bank (incorporated by reference to Exhibit 10(a)(3) to Bancorp's Current Report on Form 8-K dated December 1, 1999 (Commission File No. 000-29599)). |
| 10(a)(3) | Employment Agreement, dated as of October 23, 2000, as amended by a First Amendment, dated as of March 21, 2001, among the Bank, Bancorp and Charles F. Howell (incorporated by reference to Exhibit 10(a)(4) to Bancorp's Annual Report on Form 10-KSB for the year ended December 31, 2000 (Commission File No. 000-29599)). |
| 10(a)(4) | Second Amendment to Employment Agreement among Patriot National Bank, Bancorp and Charles F. Howell, dated May 9, 2002. |
| 10(a)(5) | Employment Agreement dated as of September 19, 2001 among Patriot National Bank, Bancorp and Robert F. O'Connell (incorporated by reference to Exhibit 10 to Bancorp's Quarterly Report on Form 10-QSB for the Quarter ended March 31, 2002 (Commission File No. 000-29599)). |

| | |
|---|---|
| 10(a)(6) | Change of Control Agreement, dated as of May 1, 2001 between Robert F. O'Connell and Patriot National Bank (incorporated by reference to Exhibit 10(a)(4) to Bancorp's Annual Report on Form 10-KSB for the year ended December 31, 2001 (Commission File No. 000-29599)). |
| 10(a)(7) | Employment Agreement dated as of January 1, 2003 between Patriot National Bank and Todd Brown. |
| 10(a)(8) | Employment Agreement dated as of January 1, 2003 between Patriot National Bank and Marcus Zavattaro. |
| 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)). |
| 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. |
| 99 | Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |