PATRIOT NATIONAL BANCORP INC
Form 10-Q
November 09, 2009

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

FORM 10-Q

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

For the Quarter Ended September 30, 2009 Commission file number 000-29599

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

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

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

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

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

Yes X No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company in Rule 12b-2 of the Exchange Act:

Large Accelerated Filer ____ Accelerated Filer __X__ Non-Accelerated Filer Smaller Reporting Company____

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

Yes ___ No X

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

Common stock, $2.00 par value per share, 4,762,727 shares outstanding as of the close of business October 31, 2009.

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PART I - FINANCIAL INFORMATION

Item 1: Consolidated Financial Statements

PATRIOT NATIONAL BANCORP, INC.
CONSOLIDATED BALANCE SHEETS

	September 30, 2009 (Unaudited)	December 31, 2008
ASSETS		
Cash and due from banks:		
Noninterest bearing deposits and cash	$ 2,469,273	$ 3,045,708
Interest bearing deposits	150,522,285	1,240,525
Federal funds sold	-	20,000,000
Short term investments	203,376	316,518
Cash and cash equivalents	153,194,934	24,602,751
Available for sale securities (at fair value)	31,917,772	51,979,677
Federal Reserve Bank stock	1,914,700	1,913,200
Federal Home Loan Bank stock	4,508,300	4,508,300
Loans receivable (net of allowance for loan losses: 2009 $17,651,755; 2008 $16,247,070)	702,307,916	788,568,687
Accrued interest and dividends receivable	3,486,111	4,556,755
Premises and equipment, net	6,999,528	7,948,501
Deferred tax asset, net	-	8,680,075
Intangible assets	73,305	85,896
Cash surrender value of life insurance	19,694,365	19,135,105
Other real estate owned	7,715,600	-
Other assets	5,625,248	1,380,031
Total assets	$ 937,437,779	$ 913,358,978
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities		
Deposits:		
Noninterest bearing deposits	$ 48,053,616	$ 50,194,400
Interest bearing deposits	780,999,316	734,626,951
Total deposits	829,052,932	784,821,351
Repurchase agreements	7,000,000	7,000,000
Federal Home Loan Bank borrowings	50,000,000	50,000,000
Junior subordinated debt owed to unconsolidated trust	8,248,000	8,248,000
Accrued expenses and other liabilities	3,482,453	4,515,483
Total liabilities	897,783,385	854,584,834
Shareholders' equity		
Preferred stock: 1,000,000 shares authorized; no shares issued	-	-
Common stock, $2 par value: 60,000,000 shares authorized; shares issued 2009 4,774,432; outstanding 4,762,727; shares issued 2008		

4,755,114; outstanding 4,743,409		9,548,864		9,510,228
Additional paid in capital		49,651,534		49,634,337
Accumulated deficit		(19,790,260)		(119,886)
Less Treasury stock at cost: 11,705 shares		(160,025)		(160,025)
Accumulated other comprehensive income(loss) - net unrealized				
gain (loss) on available for sale securities, net of taxes		404,281		(90,510)
Total shareholders' equity		39,654,394		58,774,144
Total liabilities and shareholders' equity	$	937,437,779	$	913,358,978

See accompanying notes to consolidated financial statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Interest and Dividend Income				
Interest and fees on loans	$ 9,558,338	$ 12,685,086	$ 31,948,530	$ 39,782,456
Interest and dividends on investment securities	339,927	758,192	1,261,099	2,379,517
Interest on interest bearing deposits in banks	78,862	1,584	98,254	7,855
Interest on federal funds sold	6,805	28,303	34,246	125,550
Total interest and dividend income	9,983,932	13,473,165	33,342,129	42,295,378
Interest Expense				
Interest on deposits	5,400,341	5,585,521	17,649,135	20,020,142
Interest on Federal Home Loan Bank borrowings	428,183	583,203	1,270,527	1,265,176
Interest on subordinated debt	77,645	123,767	259,904	401,664
Interest on other borrowings	77,772	77,772	230,780	231,625
Total interest expense	5,983,941	6,370,263	19,410,346	21,918,607
Net interest income	3,999,991	7,102,902	13,931,783	20,376,771
Provision for Loan Losses	1,453,000	3,000,000	9,009,000	4,545,000
Net interest income after provision for loan losses	2,546,991	4,102,902	4,922,783	15,831,771
Noninterest Income				
Mortgage brokerage referral fees	34,070	56,110	116,252	206,670
Loan origination & processing fees	48,772	75,881	172,676	247,004
Fees and service charges	257,306	245,766	751,704	750,664
Loss on impaired investment security	-	(1,050,000)	-	(1,050,000)
Gain on sale of investment securities	-	-	434,333	-
Earnings on cash surrender value of life insurance	179,240	237,235	559,260	726,968
Other income	98,319	131,444	272,734	329,882
Total noninterest income (loss)	617,707	(303,564)	2,306,959	1,211,188
Noninterest Expenses				

Salaries and benefits	2,946,743	3,006,518	8,863,928	9,670,358
Occupancy and equipment expense, net	1,374,719	1,356,155	4,088,569	3,841,503
Data processing and other outside services	721,175	250,344	2,050,215	1,338,257
Professional services	637,629	247,493	1,787,534	700,638
Advertising and promotional expenses	91,157	189,669	161,914	618,839
Loan administration and processing expenses	138,991	77,217	408,210	197,533
Regulatory assessments	663,365	191,103	1,865,092	554,909
Other real estate operations	134,646	-	134,646	-
Other noninterest expenses	826,921	677,921	1,928,100	1,666,807
Total noninterest expenses	7,535,346	5,996,420	21,288,208	18,588,844
Loss before income taxes	(4,370,648)	(2,197,082)	(14,058,466)	(1,545,885)
Provision (Benefit) for Income Taxes	9,565,000	(288,000)	5,611,000	(183,000)
Net loss	$ (13,935,648)	$ (1,909,082)	$ (19,669,466)	$ (1,362,885)
Basic (loss) per share	$ (2.93)	$ (0.40)	$ (4.14)	$ (0.29)
Diluted (loss) per share	$ (2.93)	$ (0.40)	$ (4.14)	$ (0.29)
Dividends per share	$ -	$ 0.045	$ -	$ 0.135

See accompanying notes to consolidated financial statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Net loss	$ (13,935,648)	$ (1,909,082)	$ (19,669,466)	$ (1,362,885)
Unrealized holding gains on securities:				
Unrealized holding gains arising during the period, net of taxes	94,558	69,425	494,791	152,240
Comprehensive loss	$ (13,841,090)	$ (1,839,657)	$ (19,174,675)	$ (1,210,645)

See accompanying notes to consolidated financial statements.
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PATRIOT NATIONAL BANCORP, INC
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(Unaudited)

	Number of Shares	Common Stock	Additional Paid-In Capital	Retained Earnings (Accumulated Deficit)	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total
Nine months ended September 30, 2008							
Balance at December 31, 2007	4,746,844	$ 9,493,688	$ 49,549,119	$ 7,846,060	$ -	$ (53,500)	$ 66,835,367
Comprehensive income							
Net loss	-	-	-	(1,362,885)	-	-	(1,362,885)
Unrealized holding gain on available for sale securities, net of taxes	-	-	-	-		152,240	152,240
Total comprehensive loss							(1,210,645)
Issuance of common stock							
Stock options exercised	5,000	10,000	40,550				50,550
Stock issued to directors	3,270	6,540	43,392				49,932
							100,482
Treasury Strock							
Stock purchased under buyback					(138,235)		(138,235)
Dividends	-	-	-	(640,887)		-	(640,887)
Balance, September 30, 2008	4,755,114	$ 9,510,228	$ 49,633,061	$ 5,842,288	$ (138,235)	$ 98,740	$ 64,946,082
Nine months ended September 30, 2009							
Balance at December 31,	4,743,409	$ 9,510,228	$ 49,634,337	$ (119,886)	$ (160,025)	$ (90,510)	$ 58,774,144

2008							
Comprehensive loss							
Net loss	-	-	-	(19,669,466)	-	-	(19,669,466)
Unrealized holding gain on available							
for sale securities, net of taxes	-	-	-	-	-	494,791	494,791
Total comprehensive loss							(19,174,675)
Issuance of common stock							
Stock issued to directors	19,318	38,636	17,197	-	-	-	55,833
Dividends	-	-	-	(908)	-	-	(908)
Balance, September 30, 2009	4,762,727	$ 9,548,864	$ 49,651,534	$ (19,790,260)	$ (160,025)	$ 404,281	$ 39,654,394

See accompanying notes to consolidated financial statements.

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

	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
Cash Flows from Operating Activities:		
Net loss	$ (19,669,466)	$ (1,362,885)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Amortization and accretion of investment premiums and discounts, net	101,743	114,453
Provision for loan losses	9,009,000	4,545,000
Loss on impaired investment security	-	1,050,000
Gain on sale of investment securities	(434,333)	-
Amortization of core deposit intangible	12,591	13,266
Earnings on cash surrender value of life insurance	(559,260)	(726,968)
Depreciation and amortization	1,242,948	1,197,200
Loss on disposal of bank premises and equipment	156	46
Payment of fees to directors in common stock	55,833	49,932
Deferred income taxes	8,624,602	(1,474,368)
Changes in assets and liabilities:		
Decrease in deferred loan fees	(679,708)	(553,329)
Decrease (increase) in accrued interest and dividends receivable	1,070,644	(115,410)
Increase in other assets	(4,245,217)	(427,277)
Decrease in accrued expenses and other liabilities	(1,067,361)	(1,923,735)
Net cash (used in) provided by operating activities	(6,537,828)	385,925
Cash Flows from Investing Activities:		
Purchases of available for sale securities	(14,524,178)	(18,366,036)
Proceeds from sales of available for sale securities	19,852,541	-
Principal repayments on available for sale securities	4,864,181	19,688,086
Proceeds from calls and redemptions of available for sale securities	11,000,000	9,000,000
Purchases of Federal Reserve Bank Stock	(1,500)	(1,500)
Purchases of Federal Home Loan Bank Stock	-	(1,852,200)
Net decrease (increase) in loans	70,215,878	(108,699,558)
Purchase of bank premises and equipment	(294,131)	(994,195)
Net cash provided by (used in) investing activities	91,112,791	(101,225,403)
Cash Flows from Financing Activities:		
Net increase in demand, savings and money market deposits	55,477,476	36,398,254
Net (decrease) increase in time certificates of deposits	(11,245,895)	23,145,738
Net proceeds from FHLB borrowings	-	41,500,000
Proceeds from issuance of common stock	-	50,550

Payments under stock buyback program	-	(138,235)
Dividends paid on common stock	(214,361)	(641,422)
Net cash provided by financing activities	44,017,220	100,314,885
Net increase (decrease) in cash and cash equivalents	128,592,183	(524,593)

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

	Nine Months Ended September 30, 2009	2008
Cash and Cash Equivalents:		
Beginning	24,602,751	14,011,914
Ending	$ 153,194,934	$ 13,487,321
Supplemental Disclosures of Cash Flow Information		
Cash paid for:		
Interest	$ 19,313,572	$ 21,741,157
Income taxes	$ 1,379,195	$ 1,231,245
Supplemental disclosures of noncash investing and financing activities:		
Unrealized holding gain on available for sale securities arising during the period	$ 798,048	$ 245,548
Transfer of loans to other real estate owned	$ 7,715,600	$ -
Dividends declared on common stock	$ -	$ 213,073

See accompanying notes to consolidated financial statements.
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PATRIOT NATIONAL BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Note 1: Basis of Financial Statement Presentation

The Consolidated Balance Sheet at December 31, 2008 has been derived from the audited financial statements of Patriot National Bancorp, Inc. ("Bancorp") at that date, but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements.

The accompanying unaudited financial statements and related notes have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted. The accompanying consolidated financial statements and related notes should be read in conjunction with the audited financial statements of Bancorp and notes thereto for the year ended December 31, 2008.

The information furnished reflects, in the opinion of management, all normal recurring adjustments necessary for a fair presentation of the results for the interim periods presented. The results of operations for the three and nine months ended September 30, 2009 are not necessarily indicative of the results of operations that may be expected for the remainder of 2009.

Certain 2008 amounts have been reclassified to conform to the 2009 presentation. Such reclassifications had no effect on net income.

In May 2009, the FASB issued a new standard entitled Subsequent Events. This standard provides guidance on principles and requirements for subsequent events. The guidance sets forth: 1) the period after the balance sheet date during which the management of a reporting entity shall evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements; 2) the circumstances under which an entity shall recognize events or transactions occurring after the balance sheet date in its financial statements; and 3) the disclosures that an entity shall make about events or transactions that occurred after the balance sheet date. Two types of subsequent events require consideration by management: (a) recognized subsequent events; and (b) non-recognized subsequent events. Recognized subsequent events consist of those events or transactions that provide additional evidence with respect to conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Non-recognized subsequent events consist of those events that provide evidence with respect to conditions that did not exist at the date of the balance sheet, but arose subsequent to that date. This statement is effective for interim or annual financial periods ending after June 15, 2009. Bancorp has evaluated subsequent events through the date of November 9, 2009. No material subsequent events occurred since September 30, 2009 that required recognition or disclosure in these financial statements.

Note 2: Investment Securities

The amortized cost, gross unrealized gains, gross unrealized losses and fair values of available-for-sale securities at September 30, 2009 and December 31, 2008 are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2009:				
U. S. Government Agency bonds	$ 5,178,165	$ -	$ (28,165)	$ 5,150,000
U. S. Government Agency and sponsored agency mortgage-backed securities	23,204,701	203,798	(43,481)	23,365,018
Money market preferred equity securities	2,882,840	519,914	-	3,402,754
Total Available-for-Sale Securities	$ 31,265,706	$ 723,712	$ (71,646)	$ 31,917,772
December 31, 2008:				
U. S. Government sponsored agency obligations	$ 10,000,000	$ 102,248	$ -	$ 10,102,248
U. S. Government Agency and sponsored agency mortgage-backed securities	38,246,799	231,766	(479,996)	37,998,569
Money market preferred equity securities	3,878,860	-	-	3,878,860
Total Available-for-Sale Securities	$ 52,125,659	$ 334,014	$ (479,996)	$ 51,979,677

The following table presents the gross unrealized loss and fair value of the Company's available-for-sale securities, aggregated by the length of time the individual securities have been in a continuous loss position, at September 30, 2009 and December 31, 2008:

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
September 30, 2009:						
U. S. Government Agency bonds	$5,150,000	$(28,165)	$-	$-	$5,150,000	$(28,165)
Mortgage-backed securities	4,547,486	(22,932)	2,075,074	(20,548)	6,622,560	(43,481)
Totals	$9,697,486	$(51,097)	$2,075,074	$(20,548)	$11,772,560	$(71,646)
December 31, 2008:						
Mortgage-backed securities	$14,593,894	$(317,703)	$5,527,631	$(162,293)	$20,121,525	$(479,996)

At September 30, 2009, gross unrealized holding gains and gross unrealized holding losses on available-for-sale securities totaled $723,712 and $71,646, respectively. Of the securities with unrealized losses, there are four U. S. Government Agency and sponsored agency mortgage-backed securities that have unrealized losses for a period in excess of twelve months, with a combined current unrealized loss of $20,548.

At September 30, 2009, fourteen securities had unrealized losses with aggregate depreciation of 0.7% from the amortized cost. There were no securities with unrealized losses greater than 5% of amortized cost. At December 31, 2008, thirty-two securities had unrealized losses with aggregate depreciation of 2.3% from the amortized cost. There was one security with unrealized losses greater than 5% of amortized cost.

Management does not believe that any of the unrealized losses related to U.S. Government Agency bonds and mortgage-backed securities issued by U.S. Government Agencies and sponsored agencies are other-than-temporary since they are the result of changes in the interest rate environment. Bancorp has both the intent and the ability to hold these securities until maturity, if necessary, and intends to hold these securities until fair value recovery.

The amortized cost and fair value of available for sale debt securities at September 30, 2009 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
September 30, 2009:		
Maturity:		
> 5 years	$ 5,178,165	$ 5,150,000
Mortgage-backed securities	23,204,701	23,365,018
Total	$ 28,382,866	$ 28,515,018

Note 3: Allowance for Loan Losses and Impaired Loans

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

	Three months ended September 30,		Nine months ended September 30,	
(Thousands of dollars)	2009	2008	2009	2008
Balance at beginning of period	$ 16,564,668	$ 7,217,619	$ 16,247,070	$ 5,672,619
Provision for loan losses	1,453,000	3,000,000	9,009,000	4,545,000
Charge-offs	(474,913)	(716,225)	(7,786,345)	(716,225)
Recoveries	109,000	754	182,030	754
Balance at end of period	$ 17,651,755	$ 9,502,148	$ 17,651,755	$ 9,502,148

At September 30, 2009 and December 31, 2008, the unpaid balances of loans delinquent 90 days or more and still accruing were $4.6 million and $337,000, respectively. These loans have matured and are either in the process of being renewed or awaiting payoff in full.

The unpaid principal balances of loans on nonaccrual status and considered impaired were $137.9 million at September 30, 2009 and $80.2 million at December 31, 2008. If nonaccrual loans had been performing in accordance with their original terms, Bancorp would have recorded approximately $2.2 million of additional income during the quarter ended September 30, 2009 and $1.2 million during the quarter ended September 30, 2008. If nonaccrual loans had been performing in accordance with their original terms, Bancorp would have recorded approximately $5.0 million of additional income for the nine months ended September 30, 2009 and $1.3 million during the nine months ended September 30, 2008.

The following information relates to impaired loans at September 30, 2009 and December 31, 2008:

	September 30, 2009	December 31, 2008
Impaired loans receivable for which there is a related allowance for credit losses	$ 48,979,155	$ 42,535,777
Impaired loans receivable for which there is no related allowance for credit losses	$ 88,949,520	$ 37,620,136
Allowance for credit losses related to impaired loans	$ 6,730,503	$ 4,211,954

For the three months ended September 30, 2009 and 2008, the interest income collected and recognized on impaired loans was $327,000 and $22,000, respectively. For the nine months ended September 30, 2009 and 2008, the interest income collected and recognized on impaired loans was $624,000 and $85,000, respectively.

At September 30, 2009, there were 10 loans totaling $15.1 million that were considered "troubled debt restructurings," all of which are included in non-accrual loans, as compared to December 31, 2008 when there were 11 loans totaling $16.7 million, of which $12.4 million were included in non-accrual loans.

Note 4: Income (loss) per share

Bancorp is required to present basic income (loss) per share and diluted income (loss) per share in its consolidated statements of operations. Basic income per share amounts are computed by dividing net income (loss) by the weighted average number of common shares outstanding. Diluted income (loss) per share reflects additional common shares that would have been outstanding if potentially dilutive common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. Potential common shares that may be issued by Bancorp relate to outstanding stock options and are determined using the treasury stock method. Bancorp is also required to provide a reconciliation of the numerator and denominator used in the computation of both basic and diluted loss per share.

The following is information about the computation of loss per share for the three and nine months ended September 30, 2009 and 2008. For the three and nine months ended September 30, 2009 and 2008, because net losses were incurred, any dilutive common shares are not included in the calculations of loss per share because they would be antidilutive.

Three months ended September 30, 2009

		Net Loss	Shares		Amount
Basic and Diluted Loss Per Share					
Loss attributable to common shareholders	$	(13,935,648)	4,762,727	$	(2.93)

Three months ended September 30, 2008

		Net Loss	Shares		Amount
Basic Loss Per Share					
Loss attributable to common shareholders	$	(1,909,082)	4,749,534	$	(0.40)

Nine months ended September 30, 2009

		Net Loss	Shares		Amount
Basic and Diluted Loss Per Share					
Loss attributable to common shareholders	$	(19,669,466)	4,750,768	$	(4.14)

Nine months ended September 30, 2008

		Net Loss	Shares		Amount
Basic Loss Per Share					
Loss attributable to common shareholders	$	(1,362,885)	4,750,584	$	(0.29)

Note 5: Other Comprehensive Income (Loss)

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

	Three Months Ended September 30, 2009			Nine Months Ended September 30, 2009		
	Before Tax Amount	Tax Effect	Net of Tax Amount	Before Tax Amount	Tax Effect	Net of Tax Amount
Unrealized holding gains arising during the period	$ 152,512	$ (57,954)	$ 94,558	$ 1,232,381	$ (468,304)	$ 764,077
Reclassification adjustment for gains recognized in income	-	-	-	(434,333)	165,047	(269,286)
Unrealized holding gains (losses) on available for sale securities, net of taxes	$ 152,512	$ (57,954)	$ 94,558	$ 798,048	$ (303,257)	$ 494,791

	Three Months Ended September 30, 2008			Nine Months Ended September 30, 2008		
	Before Tax Amount	Tax Effect	Net of Tax Amount	Before Tax Amount	Tax Effect	Net of Tax Amount
Unrealized holding losses arising during the period	$ (938,024)	$ 361,449	$ (576,575)	$ (804,452)	$ 310,692	$ (493,760)
Reclassification adjustment for losses recognized in income	1,050,000	(404,000)	646,000	1,050,000	(404,000)	646,000
Unrealized holding gains on available for sale securities, net of taxes	$ 111,976	$ (42,551)	$ 69,425	$ 245,548	$ (93,308)	$ 152,240

Note 6: Financial Instruments with Off-Balance Sheet Risk

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

The contractual amounts of commitments to extend credit and standby letters of credit represent the amounts of potential accounting loss should the contracts be fully drawn upon, the customers default and the values of any existing collateral become worthless. Bancorp uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments and evaluates each customer's creditworthiness on a case-by-case basis. Management believes that Bancorp controls the credit risk of these financial instruments through credit approvals, credit limits, monitoring procedures and the receipt of collateral as deemed necessary.

Financial instruments whose contractual amounts represent credit risk are as follows at September 30, 2009:

Commitments to extend credit:		
Future loan commitments	$	8,078,229
Unused lines of credit		37,595,049
Undisbursed construction loans		30,711,543
Financial standby letters of credit		1,231,600
	$	77,616,421

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

Standby letters of credit are written commitments issued by Bancorp to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Newly issued or modified guarantees that are not derivative contracts are recorded on Bancorp's consolidated balance sheet at the fair value at inception. No liability related to guarantees was required to be recorded at September 30, 2009.

Note 7: Income Taxes

The determination of the amount of deferred income tax assets which are more likely than not to be realized is primarily dependent on projections of future earnings, which are subject to uncertainty and estimates that may change given economic conditions and other factors. A valuation allowance related to deferred tax assets is required when it is considered more likely than not that all or part of the benefit related to such assets will not be realized. Management has reviewed the deferred tax position of Bancorp at September 30, 2009. The deferred tax position has been affected by several significant transactions in the past three years. These transactions included continued provision for loan losses, the increasing levels of non-accrual loans and other-than-temporary impairment write-offs of certain investments. As a result, Bancorp is in a cumulative net loss position at September 30, 2009, and under the applicable accounting guidance, can no longer support the deferred tax asset based on future profit projections, and accordingly has established a full valuation allowance totaling $12.2 million against its net deferred tax asset at September 30, 2009, of which $11.4 million was recorded in the quarter ended September 30, 2009. The valuation allowance will be analyzed quarterly for changes affecting the deferred tax asset. Once Bancorp generates taxable income on a sustained basis, management's conclusion regarding the need for a deferred tax asset valuation allowance could change, resulting in the reversal of all or a portion of the deferred tax asset valuation allowance.

The following table is a summary of Bancorp's deferred tax asset at the dates shown:

		September 30, 2009		December 31, 2008
Deferred Tax Asset	$	12,204,000	$	9,504,075
Valuation Allowance		(12,204,000)		(824,000)
Net Deferred Tax Asset	$	-	$	8,680,075

Bancorp recorded an income tax provision of $9.6 million for the quarter ended September 30, 2009 as compared to an income tax benefit of $288,000 for the quarter ended September 30, 2008. The effective tax rates for the three months ended September 30, 2009 and September 30, 2008 were 219% and 13%, respectively. The change in effective tax rates is primarily due to the recording of the valuation allowance described above.

For the nine months ended September 30, 2009, Bancorp recorded an income tax provision of $5.6 million as compared to an income tax benefit of $183,000 for the nine months ended September 30, 2008. The effective tax rates for the nine months ended September 30, 2009 and September 30, 2008 were 40% and 12%, respectively, and the change in effective tax rate is for the reason cited above.

Note 8: Fair Value of Financial Instruments and Interest Rate Risk

Effective January 1, 2008, Bancorp adopted the provisions of a standard issued by the Financial Accounting Standards Board (FASB) entitled "Fair Value Measurements," for financial assets and financial liabilities. Effective January 1, 2009, Bancorp adopted a staff position entitled "Effective Date of FASB Statement No. 157," for non-financial assets and non-financial liabilities. These standards define fair value, establish a framework for measuring fair value in generally accepted accounting principles and expand disclosures about fair value measurements.

The standard defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets and liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are (i) independent, (ii) knowledgeable, (iii) able to transact and (iv) willing to transact.

The standard requires the use of valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities. The income approach uses valuation techniques to convert future amounts, such as cash flows or earnings, to a single present amount on a discounted basis. The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (replacement cost). Valuation techniques should be consistently applied. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. In that regard, the standard establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

o Level 1 Inputs - Unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

o Level 2 Inputs - Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (such as interest rates, volatilities, prepayment speeds, credit risks, etc.) or inputs that are derived principally from or corroborated by market data by correlation or other means.

o Level 3 Inputs - Unobservable inputs for determining the fair values of assets or liabilities that reflect an entity's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

In general, fair value is based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon internally developed models that primarily use, as inputs, observable market-based parameters. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments may include amounts to reflect counterparty credit quality, Bancorp creditworthiness, among other things, as well as unobservable parameters. Any such valuation adjustments are applied consistently over time. Bancorp's valuation methodologies may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. While management believes Bancorp's valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

A description of the valuation methodologies used for assets and liabilities recorded at fair value, and for estimating fair value for financial instruments only disclosed at fair value is set forth below.

Cash and due from banks, federal funds sold, short-term investments and accrued interest receivable and payable: The carrying amount is a reasonable estimate of fair value.

Available-for-Sale Securities: These financial instruments are recorded at fair value in the financial statements. Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. If quoted prices are not available, then fair values are estimated by using pricing models (i.e., matrix pricing) or quoted prices of securities with similar characteristics and are classified within Level 2 of the valuation hierarchy. Examples of such instruments include government agency and sponsored agency bonds and mortgage-backed securities. Level 3 securities are instruments for which significant unobservable input are utilized.

Loans: For variable rate loans, which reprice frequently and have no significant change in credit risk, carrying values are a reasonable estimate of fair values, adjusted for credit losses inherent in the portfolios. The fair value of fixed rate loans is estimated by discounting the future cash flows using the period end rates, estimated by using local market data, at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities, adjusted for credit losses inherent in the portfolios. Bancorp does not record loans at fair value on a recurring basis. However, from time to time, nonrecurring fair value adjustments to collateral-dependent impaired loans are recorded to reflect partial write-downs based on the observable market price or current appraised value of collateral.

Other Real Estate Owned: The fair values of Bancorp's other real estate owned properties ("OREO") are based on the estimated current property valuations less estimated disposition costs. When the fair value is based on current observable appraised values, OREO is classified within Level 2. Bancorp classifies the OREO within Level 3 when unobservable adjustments are made to appraised values. Bancorp does not record other real estate owned at fair value on a recurring basis.

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, estimated using local market data, to a schedule of aggregated expected maturities on such deposits. Bancorp does not record deposits at fair value on a recurring basis.

Short-term borrowings: The carrying amounts of borrowings under short-term repurchase agreements and other short-term borrowings maturing within 90 days approximate their fair values. Bancorp does not record short-term borrowings at fair value on a recurring basis.

Junior Subordinated Debt: Junior subordinated debt reprices quarterly and as a result the carrying amount is considered a reasonable estimate of fair value.

Federal Home Loan Bank Borrowings: The fair value of the advances is estimated using a discounted cash flow calculation that applies current Federal Home Loan Bank interest rates for advances of similar maturity to a schedule of maturities of such advances. Bancorp does not record these borrowings at fair value on a recurring basis.

Other Borrowings: The fair values of longer term borrowings and fixed rate repurchase agreements are estimated using a discounted cash flow calculation that applies current interest rates for transactions of similar maturity to a schedule of maturities of such transactions. Bancorp does not record these borrowings at fair value on a recurring basis.

Off-balance sheet instruments: Fair values for Bancorp's off-balance-sheet instruments (lending commitments) 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. Bancorp does not record its off-balance-sheet instruments at fair value on a recurring basis.

The following table summarizes financial assets measured at fair value on a recurring basis as of September 30, 2009 and December 31, 2008, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

September 30, 2009	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance as of September 30, 2009
Securities available for sale	$ -	$ 31,917,772	$ -	$ 31,917,772

December 31, 2008	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance as of December 31, 2008
Securities available for sale	$ -	$ 51,979,677	$ -	$ 51,979,677

Certain financial assets and financial liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment).

The following table reflects financial assets measured at fair value on a non-recurring basis as of September 30, 2009 and December 31, 2008, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

September 30, 2009	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance as of September 30, 2009
Impaired Loans (1)	$ -	$ -	$ 125,528,450	$ 125,528,450

December 31, 2008	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance as of December 31, 2008
Impaired Loans (1)	$ -	$ -	$ 57,233,190	$ 57,233,190

(1) Represents carrying value for which adjustments are based on the appraised value of the collateral.

Bancorp has no non-financial assets or non-financial liabilities measured at fair value on a recurring basis as of September 30, 2009.

The following table summarizes non-financial assets measured at fair value on a non-recurring basis as of September 30, 2009, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance as of September 30, 2009
Other real estate owned	$ -	$ -	$ 7,715,600	$ 7,715,600

Generally accepted accounting principles require disclosure of fair value information about financial instruments, whether or not recognized in the statement of financial condition, for which it is practicable to estimate that value. Certain financial instruments are excluded from the disclosure requirements and, accordingly, the aggregate fair value amounts presented do not represent the underlying value of Bancorp.

The estimated fair value amounts have been measured as of September 30, 2009 and December 31, 2008 and have not been reevaluated or updated for purposes of these financial statements subsequent to those respective dates. As such, the estimated fair values of these financial instruments subsequent to the respective reporting dates may be different than amounts reported on those dates.

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

The following is a summary of the recorded book balances and estimated fair values of Bancorp's financial instruments at September 30, 2009 and December 31, 2008 (in thousands):

	September 30, 2009		December 31, 2008	
	Recorded Book Balance	Fair Value	Recorded Book Balance	Fair Value
Financial Assets:				
Cash and noninterest bearing balances due from banks	$2,469	$2,469	$3,046	$3,046
Interest-bearing deposits due from banks	150,522	150,522	1,241	1,241
Federal funds sold	-	-	20,000	20,000
Short-term investments	203	203	317	317
Available-for-sale securities	31,918	31,918	51,980	51,980
Federal Reserve Bank stock	1,915	1,915	1,913	1,913
Federal Home Loan Bank stock	4,508	4,508	4,508	4,508
Loans receivable, net	702,308	696,084	788,569	795,938
Accrued interest receivable	3,486	3,486	4,557	4,557
Financial Liabilities:				
Demand deposits	$48,054	$48,054	$50,194	$50,194
Savings deposits	64,324	64,324	46,040	46,040
Money market deposits	106,451	106,451	68,242	68,242
Negotiable orders of withdrawal	20,670	20,670	19,545	19,545
Time deposits	589,555	594,946	600,801	601,357
FHLB Borrowings	50,000	50,725	50,000	50,106
Repurchase agreements	7,000	7,791	7,000	8,365
Subordinated debentures	8,248	8,248	8,248	8,248
Accrued interest payable	590	590	493	493

Bancorp 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 Bancorp's financial instruments will change when interest rate levels change and that change may be either favorable or unfavorable to Bancorp. 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 Bancorp's overall interest rate risk.

Off-balance sheet instruments

Loan commitments on which the committed interest rate is less than the current market rate were insignificant at September 30, 2009 and December 31, 2008. The estimated fair value of fee income on letters of credit at September 30, 2009 and December 31, 2008 was insignificant.

Note 9: Contingencies

On October 9, 2009, a complaint captioned PNBK Holdings LLC v. Patriot National Bancorp, Inc. and Patriot National Bank was filed in the United States District Court, Southern District of New York. PNBK Holdings LLC is a newly formed Delaware entity created to be an investment vehicle for an investor group led by Michael A. Carrazza (collectively, “Carrazza”).

Earlier in 2009, Carrazza expressed interest in acquiring a controlling interest in Bancorp. In late July 2009, Bancorp entered into a preliminary Letter of Intent with Carrazza which would result in additional capital of up to $50 million representing a substantial, controlling interest in Bancorp. The parties and Carrazza entered into extensive negotiations to memorialize the investment in the form of a definitive Securities Purchase Agreement (“SPA”). On the evening of September 30, 2009 and before executing a SPA with Carrazza, Bancorp received an unsolicited written offer from another investment group to acquire a controlling interest in Bancorp. This unsolicited offer was at a considerably higher price than the Carrazza offer, again for up to $50 million of additional capital in return for a significant, controlling interest. The next day, October 1, 2009, the Board of Directors held a special meeting and consulted with its outside counsel and advisors to consider the unsolicited offer and to discuss the Carrazza proposal. The Board of Directors determined in its fiduciary capacity that it should further analyze and evaluate the unsolicited offer.

The Carrazza lawsuit demands, among other things, that the court make a declaratory judgment that the parties entered into a binding and enforceable SPA. Further, the lawsuit alleges that the Bank breached the SPA, by among other things: (a) improperly attempting to rescind the SPA after allegedly receiving a competing offer after the parties reached their agreement; (b) denying the existence of the SPA; (c) failing and refusing the deliver an executed copy of the SPA; (d) failing and refusing to permit PNBK Holdings access to information necessary for its work toward closing the transaction; and (e) violating the Exclusivity Provision in the SPA by entertaining competing proposals and inquiries concerning an acquisition of the Bank.

The Carrazza lawsuit seeks (a) a judgment declaring the parties entered into a binding and enforceable SPA; (b) an order for specific performance allowing PNBK Holdings to enforce the SPA and requiring the Bank to abide by the terms of the SPA; (c) a judgment in favor of PNBK Holdings awarding PNBK Holdings all of its compensatory damages in an amount to be determined at trial but presently calculated by PNBK Holdings to be not less than

$15,100,000; (d) to the extent of PNBK Holdings' entitlement thereto under applicable law, a judgment providing for PNBK Holdings to recoup all of its costs and attorneys' fees in prosecuting the action; and (e) a preliminary injunction enjoining the Bank from violating the Exclusivity Provision in the SPA and requiring the Bank to immediately disclose to PNBK Holdings all information and documents concerning any competing proposal or inquiries for a controlling investment in the Bank.