UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the Quarterly Period Ended September 30, 2006

¨ **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: 0-50801

SI FINANCIAL GROUP, INC.

(Exact name of registrant as specified in its charter)

United States	**84-1655232**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
803 Main Street, Willimantic, Connecticut	**06226**
(Address of principal executive offices)	**(Zip Code)**

(860) 423-4581

(Registrant s telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 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 or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

As of October 27, 2006, there were 12,421,920 shares of the registrant s common stock outstanding.

Table of Contents

SI FINANCIAL GROUP, INC.

TABLE OF CONTENTS

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

SI FINANCIAL GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Dollars in Thousands, Except Share Amounts)

	September 30, 2006 *(Unaudited)*	December 31, 2005
ASSETS:		
Cash and due from banks:		
Noninterest-bearing	$ 13,022	$ 16,317
Interest-bearing	6,762	6,829
Federal funds sold		2,800
Total cash and cash equivalents	19,784	25,946
Available for sale securities, at fair value	122,413	120,019
Loans held for sale		107
Loans receivable (net of allowance for loan losses of $4.2 million at September 30, 2006 and $3.7 million at December 31, 2005)	566,859	513,775
Accrued interest receivable	3,572	3,299
Federal Home Loan Bank stock, at cost	6,207	5,638
Cash surrender value of bank-owned life insurance	8,042	7,837
Other real estate owned		325
Premises and equipment, net	10,246	8,838
Goodwill and other intangibles	765	817
Deferred tax asset, net	2,529	2,804
Other assets	3,508	2,463
TOTAL ASSETS	$ 743,925	$ 691,868
LIABILITIES AND STOCKHOLDERS EQUITY:		
Liabilities:		
Deposits:		
Noninterest-bearing	$ 54,017	$ 51,996
Interest-bearing	480,872	457,301
Total deposits	534,889	509,297
Mortgagors and investors escrow accounts	1,456	2,985
Federal Home Loan Bank advances	105,835	87,929
Junior subordinated debt owed to unconsolidated trust	15,465	7,217
Accrued expenses and other liabilities	4,750	4,397
TOTAL LIABILITIES	662,395	611,825
Commitments and contingencies		
Stockholders Equity:		
Preferred stock ($.01 par value; 1,000,000 shares authorized; none issued or outstanding)		

Common stock ($.01 par value; 75,000,000 shares authorized; 12,563,750 shares issued; 12,421,920 outstanding at September 30, 2006 and 12,551,186 shares outstanding at December 31, 2005)	126	126
Additional paid-in capital	51,397	51,155
Unallocated common shares held by ESOP	(4,279)	(4,521)
Unearned restricted shares	(1,803)	(2,176)
Retained earnings	38,775	37,216
Accumulated other comprehensive loss	(1,100)	(1,609)
Treasury stock, at cost (141,830 shares at September 30, 2006 and 12,564 shares at December 31, 2005)	(1,586)	(148)
TOTAL STOCKHOLDERS EQUITY	81,530	80,043
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 743,925	$ 691,868

See accompanying notes to unaudited interim consolidated financial statements.

Table of Contents

SI FINANCIAL GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(Dollars in Thousands, Except Share Amounts / Unaudited)

	Three Months Ended September 30, 2006	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2006	Nine Months Ended September 30, 2005
Interest and dividend income:				
Loans, including fees	$ 8,807	$ 7,382	$ 25,874	$ 20,808
Investment securities:				
Taxable interest	1,359	1,185	3,898	3,567
Tax-exempt interest	7	5	20	16
Dividends	111	62	296	169
Other	24	77	139	235
TOTAL INTEREST AND DIVIDEND INCOME	10,308	8,711	30,227	24,795
Interest expense:				
Deposits	3,516	2,237	9,472	6,057
Federal Home Loan Bank advances	1,103	842	3,118	2,211
Subordinated debt	177	127	475	354
TOTAL INTEREST EXPENSE	4,796	3,206	13,065	8,622
NET INTEREST INCOME BEFORE PROVISION FOR LOAN LOSSES	5,512	5,505	17,162	16,173
Provision for loan losses	141	75	546	310
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	5,371	5,430	16,616	15,863
Noninterest income:				
Service fees	1,164	1,094	3,488	3,102
Wealth management fees	863	233	2,533	745
Increase in cash surrender value of bank-owned life insurance	67	69	204	206
Net (loss) gain on sale of securities	(172)	24	(284)	59
Net gain on sale of loans	37	26	72	173
Other	13	(21)	88	96
TOTAL NONINTEREST INCOME	1,972	1,425	6,101	4,381
Noninterest expenses:				
Salaries and employee benefits	3,491	3,269	10,778	9,142
Occupancy and equipment	1,231	929	3,593	2,726
Computer and electronic banking services	662	436	1,921	1,322
Outside professional services	248	247	784	907
Marketing and advertising	234	202	591	517
Supplies and printing	131	83	395	346
Other	560	472	1,554	1,483
TOTAL NONINTEREST EXPENSES	6,557	5,638	19,616	16,443

INCOME BEFORE INCOME TAX PROVISION		786		1,217		3,101		3,801
Income tax provision		229		405		992		1,242
NET INCOME	$	557	$	812	$	2,109	$	2,559

See accompanying notes to unaudited interim consolidated financial statements.

Table of Contents

SI FINANCIAL GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME Concluded

(Dollars in Thousands, Except Share Amounts / Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
NET INCOME PER COMMON SHARE:				
Basic	$ 0.05	$ 0.07	$ 0.18	$ 0.21
Diluted	$ 0.05	$ 0.07	$ 0.18	$ 0.21
WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING:				
Basic	11,789,022	12,026,119	11,799,255	12,064,016
Diluted	11,820,206	12,146,514	11,840,744	12,101,886

See accompanying notes to unaudited interim consolidated financial statements.

Table of Contents

SI FINANCIAL GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2006 AND 2005

(Dollars in Thousands, Except Share Amounts / Unaudited)

	Common Stock		Additional	Unallocated Common	Unearned		Accumulated Other		Total
			Paid-in	Shares Held	Restricted	Retained	Comprehensive	Treasury	Stockholders
	Shares	Dollars	Capital	by ESOP	Shares	Earnings	Loss	Stock	Equity
BALANCE AT DECEMBER 31, 2004	12,563,750	$ 126	$ 50,947	$ (4,844)	$ -	$ 34,870	$ (290)	$ -	$ 80,809
Cash dividends declared ($0.09 per share)						(475)			(475)
Restricted stock activity			1,113		(2,487)	(265)			(1,639)
Equity incentive plan shares earned			99		186				285
Comprehensive income:									
Net income						2,559			2,559
Change in net unrealized losses on available for sale securities, net of reclassification adjustment and tax effects							(1,057)		(1,057)
Total comprehensive income									1,502
BALANCE AT SEPTEMBER 30, 2005	**12,563,750**	**$ 126**	**$ 52,159**	**$ (4,844)**	**$ (2,301)**	**$ 36,689**	**$ (1,347)**	**$**	**$ 80,482**
BALANCE AT DECEMBER 31, 2005	**12,563,750**	**$ 126**	**$ 51,155**	**$ (4,521)**	**$ (2,176)**	**$ 37,216**	**$ (1,609)**	**$ (148)**	**$ 80,043**
Cash dividends declared ($0.12 per share)						(550)			(550)
Equity incentive plan shares earned			201		373				574
Allocation of ESOP shares			28	242					270
Vesting of restricted stock			13						13
Treasury shares purchased (129,266 shares)								(1,438)	(1,438)
Comprehensive income:									
Net income						2,109			2,109
Change in net unrealized gains on available for sale securities, net of reclassification adjustment and tax effects							509		509
Total comprehensive income									2,618
BALANCE AT SEPTEMBER 30, 2006	**12,563,750**	**$ 126**	**$ 51,397**	**$ (4,279)**	**$ (1,803)**	**$ 38,775**	**$ (1,100)**	**$ (1,586)**	**$ 81,530**

See accompanying notes to unaudited interim consolidated financial statements.

4

Table of Contents

SI FINANCIAL GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in Thousands / Unaudited)

	Nine Months Ended September 30, 2006	Nine Months Ended September 30, 2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 2,109	$ 2,559
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	546	310
Employee stock ownership plan expense	270	270
Equity incentive plan expense	574	285
Excess tax benefit from share-based payment arrangements	(13)	
Amortization (accretion) of investment premiums and discounts, net	(83)	49
Amortization of loan premiums and discounts, net	704	181
Depreciation and amortization of premises and equipment	1,293	972
Amortization of core deposit intangible	73	73
Amortization of deferred debt issuance costs	44	26
Amortization of mortgage servicing rights	57	46
Net loss (gain) on sale of securities	284	(59)
Deferred income tax provision (benefit)	12	(73)
Loans originated for sale	(7,391)	(6,186)
Proceeds from sale of loans held for sale	7,570	6,247
Net gain on sale of loans	(72)	(173)
Net loss (gain) on sale of bank premises and equipment	20	(31)
Loss on sale of other real estate owned	11	
Increase in cash surrender value of bank-owned life insurance	(205)	(206)
Change in operating assets and liabilities:		
Accrued interest receivable	(273)	(399)
Other assets	(1,077)	(795)
Accrued expenses and other liabilities	319	289
NET CASH PROVIDED BY OPERATING ACTIVITIES	4,772	3,385
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of available for sale securities	(26,175)	(18,819)
Proceeds from sales of available for sale securities	12,284	159
Proceeds from maturities of and principal repayments on available for sale securities	12,068	20,427
Net increase in loans	(54,334)	(74,068)
Purchases of Federal Home Loan Bank stock	(569)	(1,325)
Proceeds from the sale of loans held for investment		27,660
Proceeds from sale of other real estate owned	314	
Proceeds from sale of bank premises and equipment	242	485
Purchases of premises and equipment	(2,963)	(3,234)
Other	(21)	
NET CASH USED IN INVESTING ACTIVITIES	(59,154)	(48,715)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in deposits	25,592	28,546
Net decrease in mortgagors and investors escrow accounts	(1,529)	(1,323)
Proceeds from Federal Home Loan Bank advances	152,240	42,827

Repayments of Federal Home Loan Bank advances	(134,334)	(24,373)
Proceeds from subordinated debt borrowings	8,248	
Cash dividends paid on common stock	(572)	(317)
Purchase of common stock for equity incentive plan		(1,639)

Table of Contents

SI FINANCIAL GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in Thousands / Unaudited)

	Nine Months Ended September 30, 2006	Nine Months Ended September 30, 2005
Excess tax benefit from share-based payment arrangements	13	
Treasury stock purchased	(1,438)	
NET CASH PROVIDED BY FINANCING ACTIVITIES	48,220	43,721
NET CHANGE IN CASH AND CASH EQUIVALENTS	(6,162)	(1,609)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	25,946	30,775
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 19,784	$ 29,166
SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid	$ 12,720	$ 8,467
Income taxes paid, net	$ 1,102	$ 1,402
Transfer of loans to other real estate owned	$	$ 350
Dividends declared	$ 550	$ 475

See accompanying notes to unaudited interim consolidated financial statements.

Table of Contents

SI FINANCIAL GROUP, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2006 AND 2005 AND DECEMBER 31, 2005

NOTE 1. NATURE OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Business

SI Financial Group, Inc. (the Company) is the holding company for Savings Institute Bank and Trust Company (the Bank). Established in 1842, the Bank is a community-oriented financial institution headquartered in Willimantic, Connecticut. The Bank provides a variety of financial services to individuals, businesses and municipalities through its nineteen offices in eastern Connecticut. The primary products include savings, checking and certificate of deposit accounts, residential and commercial mortgage loans, commercial business loans and consumer loans. In addition, wealth management services, which include trust, financial planning, life insurance and investment services, are offered to individuals and businesses through the Bank s Connecticut offices. Trust operations in Vermont provide third-party trust outsourcing services to other community banks located throughout the country. SI Bancorp, MHC, the Company s mutual holding company parent, does not conduct any business other than owning a majority of the common stock of SI Financial Group, Inc.

On November 15, 2005, the Company acquired certain assets of two trust services businesses, Private Trust Services and Bank Trust Services (SI Trust Servicing), from the former Circle Trust Company headquartered in Darien, Connecticut. SI Trust Servicing, located in Rutland, Vermont, is a third-party provider of trust outsourcing services for other financial institutions. The acquisition was accounted for as an asset purchase transaction with total cash consideration funded through internal sources. The purchase price was allocated to the net assets acquired with the excess purchase price resulting in goodwill.

On August 31, 2006, the Company formed a new subsidiary, SI Capital Trust II (the Trust), and issued $8.0 million of trust-preferred securities through a pooled trust-preferred securities offering. The Company owns all of the common securities of the Trust, which has no independent assets or operations. The Trust was formed for the sole purpose of issuing trust-preferred securities and investing the proceeds in an equivalent amount of junior subordinated debentures issued by the Company.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, Savings Institute Bank and Trust Company, and the Bank s wholly-owned subsidiaries, 803 Financial Corp., SI Mortgage Company and SI Realty Company, Inc. All significant intercompany accounts and transactions have been eliminated.

Basis of Financial Statement Presentation

The interim consolidated financial statements and related notes have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information, with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X of the Securities and Exchange Commission and generally accepted practices within the banking industry. Accordingly, certain information and footnote disclosures required by accounting principles generally accepted in the United States of America for complete financial statements have been omitted. Information in the accompanying interim consolidated financial statements and notes to the financial statements of the Company as of September 30, 2006 and for the three months and nine months ended September 30, 2006 and 2005 is unaudited. These unaudited interim consolidated financial statements and related notes should be read in conjunction with the audited financial statements of the Company and the accompanying notes for the year ended December 31, 2005 contained in the Company s Form 10-K.

Interim financial statements are subject to possible adjustment in connection with the annual audit of the Company for the year ending December 31, 2006. In the opinion of management, the accompanying unaudited interim consolidated financial statements reflect all of the adjustments (consisting only of normal and recurring in nature) necessary for a fair presentation of the financial condition, results of operations and cash flows as of and for the period covered herein. The results of operations for the three months and nine months ended September 30, 2006 are not necessarily indicative of the operating results for the twelve months ending December 31, 2006.

7

Table of Contents

SI FINANCIAL GROUP, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2006 AND 2005 AND DECEMBER 31, 2005

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 date of the statement of financial condition and reported amounts of revenues and expenses for the periods presented. Actual results could differ from those estimates. A material estimate that is particularly susceptible to significant change in the near term relates to the determination of the allowance for loan losses and the impairment of long-lived assets.

Recent Accounting Pronouncements

In March 2006, the Financial Accounting Standards Board (FASB) issued Financial Accounting Standards No. 156, *Accounting for Servicing of Financial Assets*, which amends Financial Accounting Standards No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities,* with respect to the accounting for servicing of financial assets. This Statement requires that all separately recognized servicing rights be initially measured at fair value, if practicable. For each class of separately recognized servicing assets and liabilities, this Statement permits an entity to choose either of the following subsequent measurement methods: (1) amortize servicing assets or liabilities in proportion to and over the period of estimated net servicing income or net servicing loss; or (2) report servicing assets or liabilities at fair value at each reporting date and report changes in fair value in earnings in the period in which the changes occur. This Statement also requires additional disclosures for all separately recognized servicing rights and is effective for new transactions occurring and for subsequent measurement at the beginning of an entity s first fiscal year that begins after September 15, 2006. This Statement is not expected to have a material impact on the Company s consolidated financial statements.

In June 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes,* which is an interpretation of FASB Statement No. 109, *Accounting for Income Taxes.* This Interpretation clarifies the accounting for uncertainty in income taxes recognized in a Company s financial statements, prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position in the tax return and provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosures and transition. The effective date of this Interpretation is for fiscal years beginning after December 15, 2006. The Company does not expect this Interpretation to have a material impact on the Company s consolidated financial statements.

In September 2006, the FASB issued Financial Accounting Standards No. 157, *Fair Value Measurement*, which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands the disclosures about fair value measurement. This Statement was developed to provide guidance for consistency and comparability in fair value measurements and disclosures and applies under other accounting pronouncements that require or permit fair value measurements. This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years.

In September 2006, the FASB issued Financial Accounting Standards No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106 and 132(R).* This Statement improves financial reporting by requiring employers to recognize the overfunded or underfunded status of a defined benefit postretirement plan as a asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income or a business entity or changes in unrestricted net assets of a not-for-profit organization. An employer with publicly traded equity securities is required to initially recognize the funded status of a defined benefit postretirement plan and to provide the required disclosures as of the end of the fiscal year ending after December 15, 2006. The Company is currently in the process of determining the impact this Statement will have on the Company s consolidated financial statements.

In September 2006, the Securities and Exchange Commission (the SEC) issued Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* (SAB 108). This Bulletin provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. The SEC staff believes that registrants should quantify errors using both a balance sheet and an income statement approach and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative

Table of Contents

SI FINANCIAL GROUP, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2006 AND 2005 AND DECEMBER 31, 2005

and qualitative factors are considered, is material. SAB 108 is effective for years ending on or after November 15, 2006. The Company does not anticipate that the application of SAB 108 will have a material impact on the Company s consolidated financial statements.

NOTE 2. EARNINGS PER SHARE

Basic net income per common share is calculated by dividing the net income available to common stockholders by the weighted-average number of common shares outstanding during the period. Diluted net income per common share is computed in a manner similar to basic net income per common share except that the weighted-average number of common shares outstanding is increased to include the incremental common shares (as computed using the treasury stock method) that would have been outstanding if all potentially dilutive common stock equivalents were issued during the period. The Company s common stock equivalents relate solely to stock option and restricted stock awards. Anti-dilutive shares are common stock equivalents with weighted-average exercise prices in excess of the weighted-average market value for the periods presented. The Company had anti-dilutive common shares outstanding of 467,653 and 468,092 for the three months and nine months ended September 30, 2006, respectively. Treasury shares and unallocated common shares held by the ESOP are not included in the weighted-average number of common shares outstanding for purposes of calculating both basic and diluted net income per common share. Unvested restricted shares are only included in dilutive net income per common share computations.

(Dollars in Thousands, Except Share Amounts)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Net income	$ 557	$ 812	$ 2,109	$ 2,559
Weighted-average common shares outstanding:				
Basic	11,789,022	12,026,119	11,799,255	12,064,016
Effect of dilutive stock option and restricted stock awards	31,184	120,395	41,489	37,870
Diluted	11,820,206	12,146,514	11,840,744	12,101,886
Net income per common share:				
Basic	$ 0.05	$ 0.07	$ 0.18	$ 0.21
Diluted	$ 0.05	$ 0.07	$ 0.18	$ 0.21

Table of Contents

SI FINANCIAL GROUP, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2006 AND 2005 AND DECEMBER 31, 2005

NOTE 3. SECURITIES

The amortized cost and approximate fair values of investment securities at September 30, 2006 and December 31, 2005 are as follows:

September 30, 2006

(Dollars in Thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
AVAILABLE FOR SALE SECURITIES:				
Debt securities:				
U.S. Government and agency obligations	$ 3,787	$ 23	$ (29)	$ 3,781
Government-sponsored enterprises	64,750	76	(1,067)	63,759
Mortgage-backed securities	47,609	123	(853)	46,879
Corporate debt securities	4,519	7	(21)	4,505
Obligations of state and political subdivisions	1,499	30		1,529
Tax-exempt securities	490			490
Foreign government securities	100		(1)	99
Total debt securities	122,754	259	(1,971)	121,042
Equity securities:				
Marketable equity securities	1,325	46		1,371
TOTAL AVAILABLE FOR SALE SECURITIES	$ 124,079	$ 305	$ (1,971)	$ 122,413

December 31, 2005

(Dollars in Thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
AVAILABLE FOR SALE SECURITIES:				
Debt securities:				
U.S. Government and agency obligations	$ 4,820	$ 58	$ (65)	$ 4,813
Government-sponsored enterprises	73,135		(1,645)	71,490
Mortgage-backed securities	37,346	28	(836)	36,538
Corporate debt securities	4,537	3	(12)	4,528
Obligations of state and political subdivisions	1,499	47		1,546
Tax-exempt securities	490			490
Foreign government securities	75		(1)	74
Total debt securities	121,902	136	(2,559)	119,479
Equity securities:				
Marketable equity securities	555		(15)	540

TOTAL AVAILABLE FOR SALE SECURITIES	$	122,457	$	136	$	(2,574)	$ 120,019

NOTE 4. LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES

Loan Portfolio. The Company s loan portfolio consists primarily of one- to four-family residential mortgage loans, multi-family and commercial real estate loans and commercial business loans. To a lesser extent, the Company s loan portfolio includes construction and consumer loans. The Company historically and currently originates loans primarily for investment purposes. However, the Company sold $7.6 million of fixed-rate residential mortgage loans in the first nine months of 2006. At September 30, 2006 and December 31, 2005, loans held for sale were $0 and $107,000, respectively.

Table of Contents

SI FINANCIAL GROUP, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2006 AND 2005 AND DECEMBER 31, 2005

At September 30, 2006, the Company s loan portfolio, net, was $566.9 million, or 76.2% of assets. The following table summarizes the composition of the loan portfolio in dollar amounts and as a percentage of the respective portfolio at the dates indicated.

(Dollars in Thousands)	September 30, 2006		December 31, 2005	
	Amount	Percent of Total	Amount	Percent of Total
Real estate loans:				
Residential 1 to 4 family	$ 302,900	53.16%	$ 266,739	51.66%
Multi-family and commercial	114,523	20.10	100,926	19.54
Construction	43,734	7.67	47,325	9.16
Total real estate loans	461,157	80.93	414,990	80.36
Consumer loans:				
Home equity	19,890	3.49	20,562	3.98
Other	11,618	2.04	3,294	0.64
Total consumer loans	31,508	5.53	23,856	4.62
Commercial business loans	77,172	13.54	77,552	15.02
TOTAL LOANS	569,837	100.00%	516,398	100.00%
Deferred loan origination costs, net of fees	1,209		1,048	
Allowance for loan losses	(4,187)		(3,671)	
LOANS RECEIVABLE, NET	$ 566,859		$ 513,775	

Allowance for Loan Losses. The allowance for loan losses, a material estimate which could change significantly in the near-term, is established through a provision for loan losses charged to earnings to account for losses that are inherent in the loan portfolio and estimated to occur, and is maintained at a level that management considers adequate to absorb losses in the loan portfolio. Loans are charged against the allowance for loan losses when management believes that the uncollectibility of the principal balance is confirmed. Subsequent recoveries, if any, are credited to the allowance for loan losses when received. The Company evaluates the allowance for loan losses on a monthly basis.

Management s judgment in determining the adequacy of the allowance is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. The allowance for loan losses is evaluated on a monthly basis by management and is based on the evaluation of the known and inherent risk characteristics and size and composition of the loan portfolio, the assessment of current economic and real estate market conditions, adverse situations that may affect the borrower s ability to repay, estimated value of any underlying collateral, historical loan loss experience, regulatory examination and evaluations of loans and other relevant factors.

The methodology for assessing the appropriateness of the allowance for loan losses consists of the following key elements:

Specific allowances for identified problem loans, including loans that are classified as doubtful, substandard or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan.

General valuation allowance on certain identified problem loans which include classified loans on the Managed Asset Report that do not have an individual allowance. These loans are segregated by loan category and assigned allowance percentages based on the inherent losses associated with each type of lending.

Table of Contents

SI FINANCIAL GROUP, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2006 AND 2005 AND DECEMBER 31, 2005

General valuation allowance on the remainder of the loan portfolio, which covers nonclassified loans and is based on historical loss experience adjusted for qualitative factors.

Unallocated component is maintained to cover uncertainties that could affect management s estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

The following table summarizes the activity in the allowance for loan losses at and for the three months and the nine months ended September 30, 2006 and 2005.

(Dollars in Thousands)	At or For the Three Months Ended September 30,		At or For the Nine Months Ended September 30,	
	2006	2005	2006	2005
BALANCE AT BEGINNING OF PERIOD	$ 4,075	$ 3,510	$ 3,671	$ 3,200
Provision for loan losses	141	75	546	310
Loans charged-off	(32)	(24)	(37)	(27)
Recoveries of loans previously charged-off	3	8	7	86
BALANCE AT END OF PERIOD	$ 4,187	$ 3,569	$ 4,187	$ 3,569
Allowance for loan losses to total loans			0.73%	0.72%
Allowance for loan losses to nonperforming loans			463.68	1,450.81

Nonperforming Assets and Restructured Loans. The following table provides information with respect to nonperforming assets and troubled debt restructurings as of the dates indicated.

(Dollars in Thousands)	September 30, 2006	December 31, 2005
Nonaccrual loans:		
Real estate loans	$ 174	$ 224
Consumer loans	729	16
TOTAL NONACCRUAL LOANS	903	240
Real estate owned, net		325
TOTAL NONPERFORMING ASSETS	903	565
Troubled debt restructurings	73	74
TOTAL NONPERFORMING ASSETS AND TROUBLED DEBT RESTRUCTURINGS	$ 976	$ 639

Total nonperforming loans to total loans	0.16%	0.05%
Total nonperforming loans to total assets	0.12	0.03
Total nonperforming assets and troubled debt restructurings to total assets	0.13	0.09

In addition to the loans disclosed in the above table, at September 30, 2006, the Company identified loans totaling $6.5 million in which the borrowers had possible credit problems that caused management to have doubts about the ability of the borrowers to comply with the present loan repayment terms and that may result in the future

12

SI FINANCIAL GROUP, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2006 AND 2005 AND DECEMBER 31, 2005

inclusion of such loans in the above table. The aforementioned loans have been classified as substandard based on the Company s internal asset classification system, which the Company uses to monitor and evaluate the credit risk inherent in its loan portfolio.

NOTE 5. DEPOSITS

The following table sets forth the deposit balances, by type, at the dates indicated.

(Dollars in Thousands)

	September 30, 2006	December 31, 2005	Change
Noninterest-bearing demand deposits	$ 54,017	$ 51,996	$ 2,021
Interest-bearing accounts:			
NOW and money market accounts	121,290	125,156	(3,866)
Savings accounts	78,897	87,894	(8,997)
Certificates of deposit [1]	280,685	244,251	36,434
Total interest-bearing accounts	480,872	457,301	23,571
TOTAL DEPOSITS	$ 534,889	$ 509,297	$ 25,592

[1] Includes brokered deposits of $7.0 million and $5.0 million at September 30, 2006 and December 31, 2005, respectively.

NOTE 6. 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, net of taxes, for the nine months ended September 30, 2006 and 2005 is as follows:

Nine Months Ended September 30, 2006

(Dollars in Thousands)

	Before Tax Amount	Tax Effects	Net of Tax Amount
Unrealized holding gains arising during the period	$ 488	$ (166)	$ 322
Reclassification adjustment for losses recognized in net income	284	(97)	187
UNREALIZED HOLDING GAINS ON AVAILABLE FOR SALE SECURITIES, NET OF TAXES	$ 772	$ (263)	$ 509

Nine Months Ended September 30, 2005

(Dollars in Thousands)

	Before Tax	Tax	Net of Tax

	Amount	Effects	Amount
Unrealized holding losses arising during the period	$ (1,543)	$ 525	$ (1,018)
Reclassification adjustment for gains recognized in net income	(59)	20	(39)
UNREALIZED HOLDING LOSSES ON AVAILABLE FOR SALE SECURITIES, NET OF TAXES	$ (1,602)	$ 545	$ (1,057)

Table of Contents

SI FINANCIAL GROUP, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2006 AND 2005 AND DECEMBER 31, 2005

NOTE 7. EQUITY INCENTIVE PLAN

Under the SI Financial Group, Inc. 2005 Equity Incentive Plan (the Incentive Plan), the Company may grant up to 615,623 stock options and 246,249 shares of restricted stock to its employees, officers, directors and directors emeritus. Both incentive stock options and non-statutory stock options may be granted under the plan. Stock option and restricted stock awards vest at 20% per year beginning on the first anniversary of the date of grant. *See additional details relating to the Incentive Plan in Note 11 of the consolidated financial statements in the Company s 2005 Annual Report on Form 10-K.*

Effective for the quarter ended June 30, 2005, the Company adopted the provisions of FASB s Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation* (SFAS 123(R)) for recognizing the cost of employee services received in share-based payment arrangements. In accordance with SFAS 123(R), the Company records share-based compensation expense related to outstanding stock option and restricted stock awards based upon the fair value at the date of grant over the vesting period of such awards on a straight-line basis. The fair value of the restricted stock awards, which is equal to the market price at the date of grant, was recorded as unearned restricted shares. The fair value of each stock option award is estimated on the date of grant using the Black-Scholes option pricing model, which included several assumptions such as volatility, expected dividends, expected term and risk-free rate for each stock option award. For the three months and nine months ended September 30, 2006, the Company recorded share-based compensation expense of $192,000 and $574,000, respectively, and $189,000 and $285,000, respectively, for the three months and nine months ended September 30, 2005.

For the nine months ended September 30, 2006, the Company granted 10,000 stock options at a fair value of $3.64 per share. Using the Black-Scholes option pricing model, the following assumptions were used to determine the weighted-average fair value of stock options granted:

Dividend yield:	1.50%
Expected volatility:	20.02%
Risk-free rate:	4.57%
Expected life in years:	10 years

The following table summarizes the total aggregate stock option activity for the period January 1, 2006 through September 30, 2006:

	Shares	Weighted-Average Exercise Price	Weighted-Average Grant Date Fair Value
OUTSTANDING AT JANUARY 1, 2006	463,500	$ 10.10	$ 2.89
Granted	10,000	11.39	3.64
Forfeited	(6,000)	10.10	2.89
OUTSTANDING AT SEPTEMBER 30, 2006	467,500	10.13	2.91

NOTE 8. REGULATORY CAPITAL

The Bank is subject to various regulatory capital requirements administered by the Office of Thrift Supervision, including a risk-based capital measure. The risk-based capital guidelines include both a definition of capital and a framework for calculating risk-weighted assets by assigning balance sheet assets and off-balance sheet items to broad risk categories. As a savings and loan holding company regulated by the Office of Thrift Supervision, the Company is not subject to any separate regulatory capital requirements.

At September 30, 2006 and December 31, 2005, the Bank met all capital adequacy requirements to which it was subject and the Bank is considered well capitalized under regulatory guidelines.

Table of Contents

SI FINANCIAL GROUP, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2006 AND 2005 AND DECEMBER 31, 2005

The following is a summary of the Bank s regulatory capital amounts and ratios as of September 30, 2006 and December 31, 2005.

September 30, 2006

(Dollars in Thousands)	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Capital to Risk Weighted Assets	$ 69,213	15.92%	$ 34,780	8.00%	$ 43,476	10.00%
Tier I Capital to Risk Weighted Assets	65,102	14.98	17,384	4.00	26,076	6.00
Tier I Capital to Total Assets	65,102	9.00	28,934	4.00	36,168	5.00

December 31, 2005

(Dollars in Thousands)	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Capital to Risk Weighted Assets	$ 66,274	16.79%	$ 31,578	8.00%	$ 39,472	10.00%
Tier I Capital to Risk Weighted Assets	62,612	15.87	15,781	4.00	23,672	6.00
Tier I Capital to Total Assets	62,612	9.31	26,901	4.00	33,626	5.00

NOTE 9. DEFINITIVE AGREEMENT SIGNED TO BUY MORTGAGE COMPANY

On September 5, 2006, the Company announced that the Bank had signed a definitive agreement to purchase Fairfield Financial Mortgage Group, Inc. (FFMG). FFMG has branch offices in Texas, Massachusetts, New Hampshire, New Jersey, New York and Pennsylvania and is also a licensed mortgage banker in South Carolina, Florida, Georgia, Michigan, Rhode Island, Maryland, Delaware and California. The transaction is expected to be completed in the first quarter of 2007, subject to all necessary regulatory approvals.

NOTE 10. TRUST-PREFERRED SECURITIES OFFERING

On August 31, 2006, the Company formed a new subsidiary, SI Capital Trust II, a statutory trust formed under the laws of Delaware and issued $8.0 million of trust-preferred securities through a pooled trust-preferred securities offering. The Company owns all of the common securities of the Trust, which has no independent assets or operations. The Trust was formed for the sole purpose of issuing trust-preferred securities and investing the proceeds in an equivalent amount of junior subordinated debentures issued by the Company. The junior subordinated debentures are unsecured obligations of the Company and are subordinate and junior in right of payment to all present and future senior indebtedness of the Company. The junior subordinated debentures, which bear interest at three-month LIBOR plus 1.70%, mature in 30 years and can be redeemed at the Company s option on or after September 15, 2011, subject to regulatory approval.

Table of Contents

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

The following analysis discusses changes in financial condition at September 30, 2006 and December 31, 2005 and results of operations for the three months and nine months ended September 30, 2006 and 2005 and should be read in conjunction with the Company s consolidated financial statements and notes thereto, appearing in Part I, Item I of this document, as well as with Management s Discussion and Analysis included in the Company s 2005 Annual Report on Form 10-K.

Forward-Looking Statements

This report contains forward-looking statements that are based on assumptions and may describe future plans, strategies and expectations of the Company. These forward-looking statements are generally identified by the use of the words *believe, expect, intend, anticipate, estimate, project* or similar expressions. The Company s ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Factors that could have a material adverse effect on the operations of the Company and its subsidiaries include, but are not limited to, changes in interest rates, national and regional economic conditions, legislative and regulatory changes, monetary and fiscal policies of the United States government, including policies of the United States Treasury and the Federal Reserve Board, the quality and composition of the loan or investment portfolios, demand for loan products, deposit flows, competition, demand for financial services in the Company s market area, changes in real estate market values in the Company s market area and changes in relevant accounting principles and guidelines. Additional factors that may affect the Company s results are discussed in this document under Item 1A Risk Factors and in the Company s Form 10-K under Item 1A Risk Factors. These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. Except as required by applicable law or regulation, the Company does not undertake, and specifically disclaims any obligation, to release publicly the result of any revisions that may be made to any forward-looking statements to reflect events or circumstances after the date of the statements or to reflect the occurrence of anticipated or unanticipated events.

Critical Accounting Policies

The Company considers accounting policies involving significant judgments and assumptions by management that have, or could have, a material impact on the carrying value of certain assets or on income to be critical accounting policies. The Company considers the allowance for loan losses and the impairment of long-lived assets to be its critical accounting policies. *Additional information about the Company s accounting policies is included in Notes 1 and 4 of the consolidated financial statements in Part I, Item 1 of this document and Items 1 and 8 in the Company s 2005 Annual Report on Form 10-K.*

Allowance for Loan Losses. Determining the amount of allowance for loan losses necessarily involves a high degree of judgment. Management reviews the level of the allowance on a monthly basis and establishes the provision for loan losses based on the size and the composition of the loan portfolio, delinquency levels, loss experience, economic conditions, and other factors related to the collectibility of the loan portfolio. The level of the allowance for loan losses fluctuates primarily due to changes in the size and composition of the loan portfolio and in the level of nonperforming loans, classified assets and charge-offs. A portion of the allowance is established by segregating the loans by loan category and assigning allocation percentages based on historical loss experience and delinquency trends. The applied loss factors are re-evaluated at least annually to ensure their relevance in the current real estate environment. Accordingly, increases in the size of the loan portfolio and the increased emphasis on commercial real estate and commercial business loans, which carry a higher degree of risk of default and, thus, a higher allocation percentage, increases the allowance. To a lesser extent, the purchase of indirect automobile loans during 2006 increased the allowance for loan losses due to the higher risk of loss associated with this type of consumer lending. An unallocated component is maintained in the allowance to cover uncertainties that could affect management s estimate of probable losses.

Table of Contents

Impairment of Long-Lived Assets. The Company is required to record certain assets it has acquired, including identifiable intangible assets such as core deposit intangibles, goodwill and certain liabilities that it assumed at fair value, which may involve making estimates based on third party valuations, such as appraisals, or internal valuations based on discounted cash flow analyses or other valuation techniques. Further, long-lived assets, including intangible assets and premises and equipment, that are held and used by the Company, are presumed to have a useful life. The determination of the useful lives of intangible assets is subjective, as is the appropriate amortization period for such intangible and long-lived assets. Additionally, long-lived assets are reviewed for impairment annually at a minimum or whenever events or changes in circumstances indicate that the carrying amount of the 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 expenses. Testing for impairment is a subjective process, the application of which could result in different evaluations of impairment.

Impact of New Accounting Standards

Refer to Note 1 to the consolidated financial statements in this report for a detailed discussion of new accounting pronouncements.

Recent Developments and Initiatives

The Bank opened its 19th branch office in Gales Ferry, Connecticut on August 14, 2006.

The Bank signed a definitive agreement to purchase a mortgage company based in Danbury, Connecticut, and with branch offices in Texas, Massachusetts, New Hampshire, New Jersey, New York and Pennsylvania.

The Savings Institute Bank and Trust Company Employees Caring and Giving Program awarded grants to ten local charitable organizations. The Caring and Giving Program continues to make quarterly grants since its inception in 1998.

The Company s Board of Directors declared a quarterly cash dividend of $0.04 per share, paid on October 27, 2006, to stockholders of record at the close of business on October 6, 2006.

The Company raised $8.0 million through a pooled trust-preferred securities offering. The trust-preferred securities were issued by a newly-established subsidiary, SI Capital Trust II.

Bauer Financial, the nation s leading independent bank rating firm, announced that Savings Institute Bank & Trust Company achieved its highest 5-Star superior rating for its financial strength and stability for seven consecutive quarters.

Comparison of Financial Condition at September 30, 2006 and December 31, 2005

Assets:

Summary. The Company s total assets increased $52.1 million, or 7.5%, to $743.9 million at September 30, 2006, as compared to $691.9 million at December 31, 2005, primarily due to increases in net loans receivable of $53.1 million, available for sale securities of $2.4 million, premises and equipment of $1.4 million, other assets of $1.0 million and Federal Home Loan Bank stock of $569,000, offset by a $6.2 million decrease in cash and cash equivalents. Other assets increased primarily due to other investments and receivables. Federal Home Loan Bank stock increased to $6.2 million at September 30, 2006 to support a higher level of Federal Home Loan Bank borrowings. The decrease in cash and cash equivalents resulted as excess funds were used to fund loans and purchase investment securities.

Loans Receivable, Net. The Company s net loan portfolio increased 10.3% to $566.9 million as a result of strong loan originations and the purchase of $10.3 million in consumer loans, offset by loan sales of $7.6 million of fixed-rate residential mortgage loans during the first nine months of 2006. The sale of loans is expected to mitigate the Company s exposure to interest rate risk while improving liquidity. Loan originations increased 1.2% for the nine months ended September 30, 2006, compared to the same period in 2005. The level of loan closings were impacted by several factors, including promotional and sales activities, competitive pricing initiatives and a relatively stable housing market and local economy. Changes in the loan portfolio consisted of the following:

Residential Mortgage Loans. Despite mortgage loan sales, residential mortgage loans increased $36.2 million, or 13.6%. Loan originations for residential mortgage loans increased 6.1% to $81.4 million for the first nine months of 2006 compared to the same period in 2005.

Commercial Loans. Multi-family and commercial real estate and commercial business loans increased $13.2 million, or 7.4%. Despite the Company s continued emphasis on the commercial loan market, commercial mortgage and business loan originations were relatively flat for 2006 compared to 2005.

Consumer Loans. The increase of $7.7 million, or 32.1%, reflects the purchase of $10.3 million of indirect automobile loans during the first quarter of 2006. Although automobile loans typically involve a higher degree of credit risk, they generally provide a higher rate of return and were therefore, purchased with the intention of supplementing the Company s interest income during this period of lower net interest margins. Consumer loan originations were down 23.3% in 2006 partly due to a decrease in home equity lines of credit as a result of the variable-rate nature of the product and rising market interest rates.

The allowance for losses totaled $4.2 million, representing 0.73% of total loans, at September 30, 2006, compared to $3.7 million, or 0.71% of total loans, at December 31, 2005. The increase in the allowance reflects increases in the commercial and consumer loan portfolios, which carry a higher risk of default compared to residential mortgage loans. Centrix Financial, LLC (Centrix), the organization with which the Company contracted to service the Company s indirect automobile loan portfolio, filed Chapter 11 bankruptcy during the third quarter of 2006. As a result, the Company increased its provision for loan losses 0.5% for anticipated loan charge-offs on its indirect automobile loan portfolio. Although Centrix continues to operate, their ability to service the remaining $7.4 million loan portfolio is currently being assessed by the Company s management.

Investment Activities. At September 30, 2006, the Company s investment portfolio, excluding Federal Home Loan Bank stock, consisted solely of available for sale securities of $122.4 million, or 16.5% of assets. At December 31, 2005, the Company s available for sale securities totaled $120.0 million, or 17.3% of assets. The increase in available for sale securities of $2.4 million, or 2.0%, was primarily due to net purchases of mortgage-backed securities. Proceeds from the sale of primarily government-sponsored enterprise securities, which were in an unrealized loss position, were reinvested into higher yielding mortgage-backed securities during the second and third quarters of 2006.

Liabilities:

Summary. Total liabilities increased $50.6 million, or 8.3%, from December 31, 2005 to September 30, 2006 primarily as a result of net increases in deposits of $25.6 million, increases in Federal Home Loan Bank advances of $17.9 million and proceeds from subordinated debt of $8.2 million.

***Borrowings*.** Increases in Federal Home Loan Bank advances of 20.4% to $105.8 million at September 30, 2006 represented short-term fixed-rate advances with terms of three months to three years used to fund loan growth and to manage interest rate risk. In September 2006, a newly-formed subsidiary of the company, SI Capital Trust II, issued $8.0 million of trust-preferred securities through a pooled trust-preferred securities offering. The proceeds were invested in an equivalent amount of junior subordinated debentures issued by the Company that mature in 30 years or may be redeemed in whole or in part on or after September 15, 2011.

Deposits. Deposits, including mortgagors and investors escrow accounts, increased $24.1 million, or 4.7%, to $536.3 million at September 30, 2006. Noninterest-bearing accounts increased $2.0 million related to higher balances in primarily business checking accounts. Interest-bearing deposits increased $23.6 million, or 5.2%, primarily due to increases in certificates of deposits. Certificates of deposit increased $36.4 million, or 14.9%, as a result of branch expansion, promotional rates, competitive pricing and marketing efforts to capitalize on the consolidation of financial institutions within the Bank s market area. Savings accounts decreased $9.0 million

Table of Contents

mainly due to a reduction in passbook savings and money market accounts. Additionally, brokered deposits increased $2.0 million in 2006.

Equity:

Summary. Total stockholders equity increased $1.5 million to $81.5 million at September 30, 2006. The increase in equity was primarily attributable to retained earnings of $2.1 million, a decrease in net unrealized holding losses on available for sale securities aggregating $509,000 (net of taxes), offset by stock repurchases of 129,266 shares at a cost of $1.4 million and dividends declared of $550,000.

Net Unrealized Losses on Available for Sale Securities. Unrealized holding losses on available for sale securities, net of taxes, decreased $509,000 to $1.1 million for the nine months ended September 30, 2006. Unrealized holding losses resulted primarily from a decline in the market value of the debt securities portfolio, which was recognized in accumulated other comprehensive income (loss) on the consolidated balance sheet and the consolidated statement of changes in stockholders equity. Management believes that none of the unrealized losses on these securities are other than temporary because substantially all of the unrealized losses relate to government-sponsored enterprises and mortgage-backed securities issued by the U.S. Treasury, government-sponsored enterprises or private issuers that maintain investment grade ratings, which the Company has both the intent and the ability to hold until maturity or until the fair value fully recovers. In addition, management considers the issuers of the securities to be financially sound and believes the Company will receive all contractual principal and interest related to these investments.

Average Balance Sheet and Analysis of Net Interest and Dividend Income

Average Balance Sheet. The following table presents information regarding the average balances of assets and liabilities, the total dollar amounts of interest and dividend income from average interest-earning assets, the total dollar amounts of interest expense on average interest-bearing liabilities and the resulting average yields and costs. The yields and costs for the periods indicated are derived by dividing income or expense by the average balances of assets or liabilities, respectively, for the periods presented. For purposes of this table, average balances have been calculated using average daily balances.

Table of Contents

(Dollars in Thousands)	At or For the Three Months Ended September 30, 2006			2005		
	Average Balance	Interest & Dividends	Average Yield/ Rate	Average Balance	Interest & Dividends	Average Yield/ Rate
ASSETS:						
Interest-earning assets:						
Loans [1][2]	$ 562,706	$ 8,807	6.21%	$ 483,944	$ 7,382	6.05%
Investment securities [3]	131,484	1,479	4.46	127,894	1,254	3.89
Other interest-earning assets	3,730	24	2.55	11,324	77	2.70
Total interest-earning assets	697,920	10,310	5.86	623,162	8,713	5.55
Noninterest-earning assets	37,218			39,644		
Total assets	$ 735,138			$ 662,806		
LIABILITIES AND EQUITY:						
Interest-bearing liabilities:						
Deposits:						
NOW and money market	$ 122,973	251	0.81	$ 124,692	212	0.67
Savings [4]	82,043	242	1.17	92,098	221	0.95
Certificates of deposit [5]	280,121	3,023	4.28	217,373	1,804	3.29
Total interest-bearing deposits	485,137	3,516	2.88	434,163	2,237	2.04
FHLB advances	101,548	1,103	4.31	85,223	842	3.92
Subordinated debt	8,114	177	8.65	7,217	127	6.98
Total interest-bearing liabilities	594,799	4,796	3.20	526,603	3,206	2.42
Noninterest-bearing liabilities	59,797			54,713		
Total liabilities	654,596			581,316		
Total stockholders equity	80,542			81,490		
Total liabilities and stockholders equity	$ 735,138			$ 662,806		
Net interest-earning assets	$ 103,121			$ 96,559		
Tax equivalent net interest income [3]		5,514			5,507	
Tax equivalent interest rate spread [6]			2.66			3.13
Tax equivalent net interest margin as a percentage of interest-earning assets [7]			3.13			3.51
Average of interest-earning assets to average interest-bearing liabilities			117.34			118.34
Less: Tax equivalent adjustment [3]		(2)			(2)	
NET INTEREST INCOME PER STATEMENTS OF INCOME		$ 5,512			$ 5,505	

(1) Amount is net of deferred loan origination fees and costs. Average balances include nonaccrual loans and loans held for sale.
(2) Loan fees are included in interest income and are insignificant.
(3) Investment securities income and net interest income are presented on a tax equivalent basis using a tax rate of 34%. The tax equivalent adjustment is deducted from tax equivalent net interest income to agree to the amount reported in the statements of income.
(4) Includes mortgagors and investors escrow accounts.
(5) Includes brokered deposits.
(6) Tax equivalent net interest rate spread represents the difference between the weighted-average tax equivalent yield on interest-earning assets and the weighted-average cost of interest-bearing liabilities.
(7) Tax equivalent net interest margin represents tax equivalent net interest income divided by average interest-earning assets.

Table of Contents

(Dollars in Thousands)	At or For the Nine Months Ended September 30, 2006 Average Balance	Interest & Dividends	Average Yield/ Rate	2005 Average Balance	Interest & Dividends	Average Yield/ Rate
ASSETS:						
Interest-earning assets:						
Loans [1][2]	$ 546,256	$ 25,874	6.33%	$ 461,508	$ 20,808	6.03%
Investment securities [3]	130,575	4,221	4.32	128,520	3,758	3.91
Other interest-earning assets	7,480	139	2.48	11,975	235	2.62
Total interest-earning assets	684,311	30,234	5.91	602,003	24,801	5.51
Noninterest-earning assets	37,819			39,707		
Total assets	$ 722,130			$		