SI Financial Group, Inc.
Form 10-Q
August 14, 2007
Table of Contents

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 June 30, 2007

OR

¨ 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 August 3, 2007, there were 12,330,100 shares of the registrant s common stock outstanding.

Table of Contents

SI FINANCIAL GROUP, INC.

TABLE OF CONTENTS

		Page No.
PART I. FINANCIAL INFORMATION		
Item 1.	Consolidated Financial Statements of SI Financial Group, Inc. and Subsidiaries (unaudited):	
	Consolidated Balance Sheets at June 30, 2007 and December 31, 2006	1
	Consolidated Statements of Income for the three and six months ended June 30, 2007 and 2006	2
	Consolidated Statements of Changes in Stockholders Equity for the six months ended June 30, 2007	3
	Consolidated Statements of Cash Flows for the six months ended June 30, 2007 and 2006	4
	Notes to Consolidated Financial Statements	6
Item 2.	Management s Discussion and Analysis of Financial Condition and Results of Operations	15
Item 3.	Quantitative and Qualitative Disclosures about Market Risk	25
Item 4.	Controls and Procedures	27
PART II. OTHER INFORMATION		
Item 1.	Legal Proceedings	27
Item 1A.	Risk Factors	28
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	28
Item 3.	Defaults Upon Senior Securities	28
Item 4.	Submission of Matters to a Vote of Security Holders	28
Item 5.	Other Information	29
Item 6.	Exhibits	29
SIGNATURES		30

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 / Unaudited)

	June 30, 2007	December 31, 2006
ASSETS:		
Cash and due from banks:		
Noninterest-bearing	$ 17,140	$ 14,984
Interest-bearing	2,771	3,824
Federal funds sold	8,000	7,300
Total cash and cash equivalents	27,911	26,108
Available for sale securities, at fair value	120,740	119,508
Loans held for sale	774	135
Loans receivable (net of allowance for loan losses of $4,413 at June 30, 2007 and $4,365 at December 31, 2006)	574,214	574,111
Accrued interest receivable	3,540	3,824
Federal Home Loan Bank stock, at cost	6,660	6,660
Cash surrender value of bank-owned life insurance	8,260	8,116
Other real estate owned	953	
Premises and equipment, net	10,734	10,512
Goodwill and other intangibles	692	741
Deferred tax asset, net	3,428	3,361
Other assets	2,998	3,961
Total assets	$ 760,904	$ 757,037
LIABILITIES AND STOCKHOLDERS EQUITY:		
Liabilities:		
Deposits:		
Noninterest-bearing	$ 59,918	$ 55,703
Interest-bearing	492,725	482,973
Total deposits	552,643	538,676
Mortgagors and investors escrow accounts	3,262	3,246
Federal Home Loan Bank advances	108,793	111,956
Junior subordinated debt owed to unconsolidated trust	8,248	15,465
Accrued expenses and other liabilities	4,950	5,308
Total liabilities	677,896	674,651
Stockholders Equity:		
Preferred stock ($.01 par value; 1,000,000 shares authorized; none issued)		
	126	126

Common stock ($.01 par value; 75,000,000 shares authorized; 12,563,750 shares issued; 12,405,100 and 12,421,920 shares outstanding at June 30, 2007 and December 31, 2006, respectively)		
Additional paid-in capital	51,693	51,481
Unallocated common shares held by ESOP	(4,037)	(4,199)
Unearned restricted shares	(1,430)	(1,679)
Retained earnings	39,703	39,254
Accumulated other comprehensive loss	(1,254)	(1,011)
Treasury stock, at cost (158,650 shares at June 30, 2007 and 141,830 shares at December 31, 2006)	(1,793)	(1,586)
Total stockholders equity	83,008	82,386
Total liabilities and stockholders equity	$ 760,904	$ 757,037

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 June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Interest and dividend income:				
Loans, including fees	$ 9,136	$ 8,882	$ 18,050	$ 17,067
Securities:				
Taxable interest	1,366	1,336	2,721	2,539
Tax-exempt interest	4	7	8	13
Dividends	131	101	257	185
Other	87	63	162	115
Total interest and dividend income	10,724	10,389	21,198	19,919
Interest expense:				
Deposits	3,931	3,195	7,625	5,956
Federal Home Loan Bank advances	1,240	1,023	2,468	2,015
Subordinated debt	180	155	480	298
Total interest expense	5,351	4,373	10,573	8,269
Net interest income	5,373	6,016	10,625	11,650
Provision for loan losses	55	120	220	405
Net interest income after provision for loan losses	5,318	5,896	10,405	11,245
Noninterest income:				
Service fees	1,156	1,180	2,282	2,324
Wealth management fees	970	836	1,892	1,670
Increase in cash surrender value of bank-owned life insurance	72	69	144	137
Net gain (loss) on sale of securities		(112)	321	(112)
Net gain on sale of loans	34	11	65	35
Other	21	21	32	75
Total noninterest income	2,253	2,005	4,736	4,129
Noninterest expenses:				
Salaries and employee benefits	3,787	3,704	7,516	7,287
Occupancy and equipment	1,311	1,202	2,666	2,362
Computer and electronic banking services	631	632	1,269	1,259
Outside professional services	228	311	592	536
Marketing and advertising	237	204	409	357
Supplies and printing	150	140	276	264
Other	701	586	1,263	994
Total noninterest expenses	7,045	6,779	13,991	13,059

Income before income tax provision	526	1,122	1,150	2,315
Income tax provision	149	365	324	763
Net income	$ 377	$ 757	$ 826	$ 1,552
Net income per common share:				
Basic	$ 0.03	$ 0.06	$ 0.07	$ 0.13
Diluted	$ 0.03	$ 0.06	$ 0.07	$ 0.13

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 SIX MONTHS ENDED JUNE 30, 2007

(Dollars in Thousands, Except Share Amounts / Unaudited)

	Common Stock Shares	Common Stock Dollars	Additional Paid-in Capital	Unallocated Common Shares Held by ESOP	Unearned Restricted Shares	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total Stockholders Equity
Balance at December 31, 2006	**12,563,750**	**$ 126**	**$ 51,481**	**$ (4,199)**	**$ (1,679)**	**$ 39,254**	**$ (1,011)**	**$ (1,586)**	**$ 82,386**
Cash dividends declared ($0.08 per share)						(377)			(377)
Equity incentive plan shares earned			136		249				385
Allocation of ESOP shares			40	162					202
Vesting of restricted stock			36						36
Treasury shares purchased (16,820 shares)								(207)	(207)
Comprehensive income:									
Net income						826			826
Change in net unrealized losses on available for sale securities, net of reclassification adjustment and tax effects							(243)		(243)
Total comprehensive income									583
Balance at June 30, 2007	**12,563,750**	**$ 126**	**$ 51,693**	**$ (4,037)**	**$ (1,430)**	**$ 39,703**	**$ (1,254)**	**$ (1,793)**	**$ 83,008**

See accompanying notes to unaudited interim consolidated financial statements.

Table of Contents

SI FINANCIAL GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in Thousands / Unaudited)

	Six Months Ended June 30, 2007	2006
Cash flows from operating activities:		
Net income	$ 826	$ 1,552
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	220	405
Employee stock ownership plan expense	202	178
Equity incentive plan expense	385	382
Excess tax benefit from share-based payment arrangements	(36)	(13)
Accretion of investment premiums and discounts, net	(124)	(44)
Amortization of loan premiums and discounts, net	294	420
Depreciation and amortization of premises and equipment	1,058	827
Amortization of core deposit intangible	49	49
Amortization of deferred debt issuance costs	35	18
Amortization of mortgage servicing rights	45	37
Net (gain) loss on sale of securities	(321)	112
Deferred income tax benefit	58	61
Loans originated for sale	(6,290)	(4,582)
Proceeds from sale of loans held for sale	5,716	4,724
Net gain on sale of loans	(65)	(35)
Net loss on sale of bank premises and equipment		20
Loss on sale of other real estate owned		11
Increase in cash surrender value of bank-owned life insurance	(144)	(137)
Change in operating assets and liabilities:		
Accrued interest receivable	284	(372)
Other assets	916	(590)
Accrued expenses and other liabilities	(322)	202
Net cash provided by operating activities	2,786	3,225
Cash flows from investing activities:		
Purchases of available for sale securities	(15,718)	(17,647)
Proceeds from sales of available for sale securities	321	3,872
Proceeds from maturities of and principal repayments on available for sale securities	14,242	6,438
Net increase in loans	(1,570)	(39,414)
Purchases of Federal Home Loan Bank stock		(569)
Proceeds from sale of other real estate owned		314
Proceeds from sale of bank premises and equipment		242
Purchases of premises and equipment	(1,280)	(1,420)
Net cash used in investing activities	(4,005)	(48,184)
Cash flows from financing activities:		
Net increase in deposits	13,967	33,135
Net increase (decrease) in mortgagors and investors escrow accounts	16	(191)
Proceeds from Federal Home Loan Bank advances	24,198	77,075
Repayments of Federal Home Loan Bank advances	(27,361)	(70,339)
Repayments of other borrowings	(7,217)	

Cash dividends paid on common stock	(410)	(366)
Excess tax benefit from share-based payment arrangements	36	13
Treasury stock purchased	(207)	(1,438)
Net cash provided by financing activities	3,022	37,889

Table of Contents

SI FINANCIAL GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in Thousands / Unaudited)

	Six Months Ended June 30,	
	2007	**2006**
Net change in cash and cash equivalents	1,803	(7,070)
Cash and cash equivalents at beginning of period	26,108	25,946
Cash and cash equivalents at end of period	$ 27,911	$ 18,876
Supplemental cash flow information:		
Interest paid	$ 10,724	$ 8,241
Income taxes paid, net	777	551
Transfer of loans to other real estate owned	953	
Dividends declared	377	363

See accompanying notes to unaudited interim consolidated financial statements.

Table of Contents

SI FINANCIAL GROUP, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2007 AND 2006 AND DECEMBER 31, 2006

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. The Company does not conduct any business other than owning all of the stock of the Bank, paying the debt service obligations on its trust subsidiary and managing the proceeds it received from the stock offering in 2004.

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 June 30, 2007 and for the three and six months ended June 30, 2007 and 2006 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, 2006 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, 2007. 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 and six months ended June 30, 2007 are not necessarily indicative of the operating results for the twelve months ending December 31, 2007.

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. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses and the impairment of long-lived assets.

Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Financial Accounting Standards No. 157, *Fair Value Measurement* (SFAS 157) 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

Table of Contents

SI FINANCIAL GROUP, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2007 AND 2006 AND DECEMBER 31, 2006

beginning after November 15, 2007 and interim periods within those fiscal years. This Statement is not expected to have a material impact on the Company s consolidated financial statements.

In September 2006, the FASB ratified the Emerging Task Force (EITF) consensus on Issue No. 06-4, *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements* (EITF 06-4). This issue addresses accounting for split-dollar life insurance arrangements whereby the employer purchases a policy to insure the life of an employee, and separately enters into an agreement to split the policy benefits between the employer and the employee. This EITF states that an obligation arises as a result of a substantive agreement with an employee to provide future postretirement benefits. Under EITF 06-4, the obligation is not settled upon entering into an insurance arrangement. Since the obligation is not settled, a liability should be recognized in accordance with applicable authoritative guidance. EITF 06-4 is effective for fiscal years beginning after December 15, 2007. The Company is in the process of evaluating the potential impact of adopting EITF 06-4 on its consolidated financial statements.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159). This Statement provides companies with an option to report selected financial assets and liabilities at fair value. The Standard s objective is to reduce both the complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. SFAS 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. This Statement is effective as of the beginning of an entity s first fiscal year beginning after November 15, 2007. The Company is evaluating if it will elect the fair value option for reporting any of its eligible financial assets or liabilities.

Effective January 1, 2007, the Company adopted FASB 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 the servicing of financial assets. In accordance with this Statement, all separately recognized servicing rights must 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. The adoption of this Statement did not have a material impact on the Company s consolidated financial statements.

Effective January 1, 2007, the Company adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes,* (FIN 48) 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 adoption of this Interpretation did not have a material impact on the Company s consolidated financial statements. *See Note 10 Income Taxes for additional information.*

In June 2007, the FASB ratified the EITF consensus on Issue No. 06-11, *Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards* (EITF 06-11). This issue addresses questions concerning the accounting for income tax benefits related to the payment of dividends on nonvested equity awards. This EITF states that the realized income tax benefit from dividends or dividend equivalents paid to employees should be recorded as an increase in additional paid-in capital and included in the pool of excess tax benefits available to absorb tax deficiencies on share-based payment awards. EITF 06-11 should be applied prospectively to dividends declared in fiscal years beginning after September 15, 2007. The application of EITF 06-11 will not have a material impact on the Company s consolidated financial statements.

Table of Contents

SI FINANCIAL GROUP, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2007 AND 2006 AND DECEMBER 31, 2006

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 approximately 17,753 and 13,898 for the three and six months ended June 30, 2007, respectively, and 469,450 and 468,314 for the three and six months ended June 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.

	Three Months Ended June 30,		Six Months Ended June 30,	
(Dollars in Thousands, Except Share Amounts)	2007	2006	2007	2006
Net income	$ 377	$ 757	$ 826	$ 1,552
Weighted-average common shares outstanding:				
Basic	11,830,072	11,787,126	11,817,690	11,804,457
Effect of dilutive stock option and restricted stock awards	56,101	38,713	69,241	46,544
Diluted	11,886,173	11,825,839	11,886,931	11,851,001
Net income per common share:				
Basic	$ 0.03	$ 0.06	$ 0.07	$ 0.13
Diluted	$ 0.03	$ 0.06	$ 0.07	$ 0.13

NOTE 3. SECURITIES

The amortized cost and approximate fair values of investment securities at June 30, 2007 and December 31, 2006 are as follows:

June 30, 2007 *(Dollars in Thousands)*	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Debt securities:				
U.S. Government and agency obligations	$ 1,350	$ 12	$ (22)	$ 1,340
Government-sponsored enterprises	58,841	11	(854)	57,998
Mortgage-backed securities	54,538	12	(1,078)	53,472
Corporate debt securities	3,657	3	(10)	3,650
Obligations of state and political subdivisions	2,000	17		2,017
Tax-exempt securities	420			420

Foreign government securities	100		(1)	99
Total debt securities	120,906	55	(1,965)	118,996
Equity securities:				
Marketable equity securities	1,734	10		1,744
Total available for sale securities	$ 122,640	$ 65	$ (1,965)	$ 120,740

Table of Contents

SI FINANCIAL GROUP, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2007 AND 2006 AND DECEMBER 31, 2006

December 31, 2006 *(Dollars in Thousands)*	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Debt securities:				
U.S. Government and agency obligations	$ 1,596	$ 21	$ (15)	$ 1,602
Government-sponsored enterprises	66,190	64	(991)	65,263
Mortgage-backed securities	45,481	109	(775)	44,815
Corporate debt securities	3,917	5	(19)	3,903
Obligations of state and political subdivisions	2,000	24		2,024
Tax-exempt securities	420			420
Foreign government securities	100		(1)	99
Total debt securities	119,704	223	(1,801)	118,126
Equity securities:				
Marketable equity securities	1,336	46		1,382
Total available for sale securities	$ 121,040	$ 269	$ (1,801)	$ 119,508

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, except for certain longer-term residential mortgage loans that are sold in the secondary market. The Company sold $5.7 million of fixed-rate residential mortgage loans in the first half of 2007. At June 30, 2007 and December 31, 2006, loans held for sale were $774,000 and $135,000, respectively.

At June 30, 2007, the Company s loan portfolio, net, was $574.2 million, or 75.5% 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.

	June 30, 2007		December 31, 2006	
(Dollars in Thousands)	Amount	Percent of Total	Amount	Percent of Total
Real estate loans:				
Residential 1 to 4 family	$ 319,476	55.33%	$ 309,695	53.65%
Multi-family and commercial	120,114	20.80	118,600	20.55
Construction	45,075	7.81	44,647	7.73
Total real estate loans	484,665	83.94	472,942	81.93
Consumer loans:				
Home equity	17,582	3.05	18,489	3.20
Other	3,411	0.59	10,616	1.84
Total consumer loans	20,993	3.64	29,105	5.04

Commercial business loans	71,728	12.42	75,171	13.03
Total loans	577,386	100.00%	577,218	100.00%
Deferred loan origination costs, net of fees	1,241		1,258	
Allowance for loan losses	(4,413)		(4,365)	
Loans receivable, net	$ 574,214		$ 574,111	

Table of Contents

SI FINANCIAL GROUP, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2007 AND 2006 AND DECEMBER 31, 2006

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.

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 impaired loans. For such loans that are 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 and consideration that these loans, in the aggregate, represent an above-average credit risk and that more of these loans will prove to be uncollectible compared to loans in the general portfolio.

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 and six months ended June 30, 2007 and 2006.

	At or For the Three Months Ended June 30,		At or For the Six Months Ended June 30,	
(Dollars in Thousands)	**2007**	**2006**	**2007**	**2006**
Balance at beginning of period	$ 4,468	$ 3,954	$ 4,365	$ 3,671
Provision for loan losses	55	120	220	405
Loans charged-off	(210)		(294)	(5)
Recoveries of loans previously charged-off	100	1	122	4

Balance at end of period	$ 4,413	$ 4,075	$ 4,413	$ 4,075
Allowance for loan losses to total loans			0.76%	0.73%
Allowance for loan losses to nonperforming loans			134.58	1,997.55

Table of Contents

SI FINANCIAL GROUP, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2007 AND 2006 AND DECEMBER 31, 2006

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)	June 30, 2007	December 31, 2006
Nonaccrual loans:		
Real estate loans	$ 2,951	$ 392
Commercial business loans	310	71
Consumer loans	18	929
Total nonaccrual loans	3,279	1,392
Real estate owned, net	953	
Total nonperforming assets	4,232	1,392
Troubled debt restructurings	72	72
Total nonperforming assets and troubled debt restructurings	$ 4,304	$ 1,464
Total nonperforming loans to total loans	0.57%	0.24%
Total nonperforming loans to total assets	0.43	0.18
Total nonperforming assets and troubled debt restructurings to total assets	0.57	0.19

NOTE 5. DEPOSITS

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

(Dollars in Thousands)	June 30, 2007	December 31, 2006	Change
Noninterest-bearing demand deposits	$ 59,918	$ 55,703	$ 4,215
Interest-bearing accounts:			
NOW and money market accounts	132,578	126,567	6,011
Savings accounts	77,866	77,774	92
Certificates of deposit [1]	282,281	278,632	3,649
Total interest-bearing accounts	492,725	482,973	9,752
Total deposits	$ 552,643	$ 538,676	$ 13,967

(1) Includes brokered deposits of $7.1 million at June 30, 2007 and December 31, 2006.

Table of Contents

SI FINANCIAL GROUP, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2007 AND 2006 AND DECEMBER 31, 2006

NOTE 6. OTHER COMPREHENSIVE LOSS

Other comprehensive loss, which is comprised solely of the change in unrealized gains and losses on available for sale securities, net of taxes, for the six months ended June 30, 2007 and 2006 is as follows:

Six Months Ended June 30, 2007	Before Tax	Tax	Net of Tax
(Dollars in Thousands)	Amount	Effects	Amount
Unrealized holding losses on available for sale securities	$ (47)	$ 16	$ (31)
Reclassification adjustment for gains recognized in net income	(321)	109	(212)
Unrealized holding losses on available for sale securities, net of taxes	$ (368)	$ 125	$ (243)

Six Months Ended June 30, 2006	Before Tax	Tax	Net of Tax
(Dollars in Thousands)	Amount	Effects	Amount
Unrealized holding losses on available for sale securities	$ (1,119)	$ 381	$ (738)
Reclassification adjustment for losses recognized in net income	112	(39)	73
Unrealized holding losses on available for sale securities, net of taxes	$ (1,007)	$ 342	$ (665)

NOTE 7. EQUITY INCENTIVE PLAN

The 2005 Equity Incentive Plan (the Incentive Plan) allows the Company to 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. All restricted stock awards under the Company s Incentive Plan were granted in May 2005.

On June 14, 2007, the Company awarded 41,500 options to purchase the Company s common stock. Stock option awards were granted with an exercise price equal to the market price of the Company s stock at the date of grant. At June 30, 2007, a total of 106,623 stock options were available for future grants.

The weighted-average fair value of stock options granted on June 14, 2007, using the Black-Scholes option pricing model, was $3.84 per share. Assumptions used to determine the weighted-average fair value of the June 14, 2007 stock option grant were as follows:

Expected dividend yield	1.50%
Expected volatility	19.24
Risk-free interest rate:	4.38
Expected term (in years)	10.00

The expected volatility is based on the Company s historical volatility. The risk-free interest rate is based on the implied yields of U.S. Treasury zero-coupon issues for periods within the contractual life of the awards in effect at the time of the stock option grants. The expected term is based on the estimated life of the stock options. The dividend yield assumption is based on the Company s historical and expected dividend pay-outs.

Table of Contents

SI FINANCIAL GROUP, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2007 AND 2006 AND DECEMBER 31, 2006

In accordance with FASB s Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment (revised 2004),* the Company recognized share-based compensation expense related to the stock option and restricted stock awards for the three and six months ended June 30, 2007 of $193,000 and $385,000, respectively, and $191,000 and $382,000 for the three and six months ended June 30, 2006, respectively.

The following is a summary of activity for the Company s stock options for the six months ended June 30, 2007:

	Shares	Weighted-Average Exercise Price	Weighted-Average Grant Date Fair Value
Options outstanding at beginning of period	467,500	$ 10.13	$ 2.91
Options granted	41,500	12.51	3.84
Options forfeited/cancelled			
Options outstanding at end of period	509,000	$ 10.32	$ 2.98
Options exercisable at end of period	185,000	$ 10.11	$ 2.90

The following table summarizes information relating to stock options outstanding and exercisable at June 30, 2007:

Exercise Prices	Options Outstanding	Weighted-Average Remaining Contractual Life (in years)	Weighted-Average Exercise Price	Options Exercisable
$ 10.10	457,500	7.38	$ 10.10	183,000
11.39	10,000	8.15	11.39	2,000
12.51	41,500	9.46	12.51	
	509,000	7.57	$ 10.32	185,000

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 June 30, 2007 and December 31, 2006, the Bank met all capital adequacy requirements to which it was subject and the Bank is considered well capitalized under regulatory guidelines.

The following is a summary of the Bank s regulatory capital amounts and ratios as of June 30, 2007 and December 31, 2006.

June 30, 2007	**Actual**		**For Capital Adequacy Purposes**		**To Be Well Capitalized Under Prompt Corrective Action Provisions**	
(Dollars in Thousands)	**Amount**	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
Total Risk-based Capital Ratio	$ 70,724	15.91%	$ 35,562	8.00%	$ 44,453	10.00%
Tier I Risk-based Capital Ratio	66,971	15.06	17,788	4.00	26,682	6.00
Tier I Capital Ratio	66,971	9.01	29,732	4.00	37,165	5.00

Table of Contents

SI FINANCIAL GROUP, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2007 AND 2006 AND DECEMBER 31, 2006

December 31, 2006	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
(Dollars in Thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Risk-based Capital Ratio	$ 70,127	15.84%	$ 35,418	8.00%	$ 44,272	10.00%
Tier I Risk-based Capital Ratio	65,776	14.86	17,706	4.00	26,558	6.00
Tier I Capital Ratio	65,776	8.97	29,332	4.00	36,664	5.00

NOTE 9. REDEMPTION OF TRUST PREFERRED SECURITIES

On April 22, 2007, SI Capital Trust I, a subsidiary of the Company, redeemed all $7.2 million of its floating rate trust preferred securities. The redemption price for each of the trust preferred securities equaled the $1,000 liquidation amount per security, plus all accrued and unpaid distributions per security to the redemption date. All distributions accruing on the trust preferred securities ceased to accrue effective on the redemption date.

NOTE 10. INCOME TAXES

Effective January 1, 2007, the Company adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes.* FIN 48 provides guidance on financial statement recognition, measurement and disclosure of tax positions taken, or expected to be taken in the future, in the Company s tax returns. The initial adoption of FIN 48 had no impact on the Company s financial statements. The Company has no material uncertain tax positions as of June 30, 2007.

In accordance with the provisions of FIN 48, in future periods, the Company may record a liability for unrecognized tax benefits related to the recognition, derecognition or change in measurement of a tax position as a result of new tax positions, changes in management s judgment about the level of uncertainty of existing tax positions, expiration of open income tax returns due to the statutes of limitation, status of examinations and litigation and legislative activity.

The Company has elected to report future interest and penalties related to unrecognized tax benefits, if any, as income tax expense in the Company s Consolidated Statement of Income.

With limited exception, the Company is no longer subject to United States federal, state and local income tax examinations by the tax authorities for the years prior to 2003.

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 June 30, 2007 and December 31, 2006 and results of operations for the three and six months ended June 30, 2007 and 2006 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 2006 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, 7 and 8 in the Company s 2006 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. The indirect automobile loan portfolio was subsequently sold in June 2007, which resulted in a decrease in the allowance for loan losses. An unallocated component is maintained in the allowance to cover uncertainties that could affect management s estimate of probable losses. *Reference Note 4 for a more detailed discussion of the Allowance for Loan Losses.*

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

Table of Contents

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

On April 2, 2007, the Bank terminated its agreement to purchase a mortgage company based in Danbury, Connecticut.

On April 22, 2007, the Company redeemed $7.2 million of debentures with a portion of the proceeds from the $8.0 million trust preferred securities offering in September 2006.

The Company s Annual Meeting of Stockholders was held on May 9, 2007. Shareholders voted to re-elect two directors to a three-year term, elect one director to a one-year term and ratified the appointment of Wolf & Company, P.C. as the Company s independent registered public accounting firm for the year ended December 31, 2007. See Item 4. Submission of Matters to a Vote of Security Holders for additional details.

On June 20, 2007, the Company s Board of Directors declared a quarterly cash dividend of $0.04 per share, paid on July 27, 2007, to stockholders of record at the close of business on July 6, 2007. SI Bancorp, MHC, the Company s mutual holding company parent, waived receipt of its dividend.

On June 25, 2007, the Company sold its $5.2 million indirect automobile loan portfolio.

The Company repurchased 16,820 shares of common stock at an average cost of $12.30 per share during the three months ended June 30, 2007.

Comparison of Financial Condition at June 30, 2007 and December 31, 2006

Assets:

Summary. The Company s total assets increased $3.9 million, or 0.5%, to $760.9 million at June 30, 2007, as compared to $757.0 million at December 31, 2006, primarily due to increases in cash and cash equivalents of $1.8 million and available for sale securities of $1.2 million, other real estate owned of $953,000 and loans held for sale of $639,000, offset by decreases of $963,000 in other assets and $284,000 in accrued interest receivable. Available for sale securities increased as a result of purchases of predominately mortgage-backed securities with longer-term maturities. The decrease in other assets primarily resulted from the write-off of purchase-related transaction costs associated with the termination of the mortgage company purchase and the settlement of other receivables, offset by an increase in prepaid expenses associated with bank insurance premiums. Accrued interest receivable decreased as a result of commercial loan payments and the reversal of interest related to nonperforming loans and the indirect automobile loan portfolio.

Loans Receivable, Net. The Company s net loan portfolio increased $103,000. Loan originations declined for both the three and six months ended June 30, 2007 compared to the same periods of the prior year, as a result of a slowing of the local housing economy. For the first half of

2007, the Company sold $5.7 million of longer-term fixed-rate residential mortgage loans. The disposition of the indirect automobile portfolio further decreased net loans receivable $5.2 million during the second quarter of 2007. Additionally, a commercial real estate property with a net realizable value of $953,000 was transferred from loans receivable to other real estate owned in the second quarter of 2007. Changes in the loan portfolio consisted of the following:

Table of Contents

Residential Mortgage Loans. Despite mortgage loan sales, residential mortgage loans increased $9.8 million. Loan originations for residential mortgage loans decreased $17.3 million for the first half of 2007 compared to the same period in 2006.

Commercial Loans. Multi-family and commercial real estate increased $1.5 million, or 1.3%. However, commercial business loans declined $3.4 million, or 4.6%, for 2007, despite an increase in commercial business loan originations of $1.7 million, primarily due to loan repayments of purchased Small Business Administration and United States Department of Agriculture loans.

Consumer Loans. Consumer loans decreased $8.1 million during the first half of 2007, primarily the result of the disposition of the indirect automobile loan portfolio totaling $5.2 million.

The allowance for losses totaled $4.4 million, representing 0.76% of total loans, at June 30, 2007 and December 31, 2006. The ratio of the allowance for loan losses to total loans increased from 0.73% at June 30, 2006 to 0.76% at June 30, 2007. At June 30, 2007, nonperforming loans totaled $3.3 million compared to $204,000 at June 30, 2006. The increase was primarily attributable to two commercial construction loans totaling $2.4 million, of which $2.0 million was secured based on the fair values of the respective properties. Net loan charge-offs were $110,000 and $172,000 for the three and six months ended June 30, 2007, respectively, compared to net loan recoveries of $1,000 and net loan charge-offs of $1,000 for the three and six months ended June 30, 2006, respectively. Higher commercial mortgage loan charge-offs contributed to the increase in loan charge-offs for 2007.

Investment Activities. At June 30, 2007, the Company s investment portfolio, excluding Federal Home Loan Bank stock, consisted solely of available for sale securities of $120.7 million, or 15.9% of assets. At December 31, 2006, the Company s available for sale securities totaled $119.5 million, or 15.8% of assets. The increase in available for sale securities of $1.2 million, or 1.0%, was primarily due to purchases of predominately mortgage-backed securities.

Liabilities:

Summary. Total liabilities increased $3.2 million, or 0.5%, from December 31, 2006 to June 30, 2007 primarily as a result of net increases in deposits of $14.0 million, offset by decreases in subordinated debt of $7.2 million and net repayments of Federal Home Loan Bank advances of $3.2 million.

Deposits. Deposits increased $14.0 million, or 2.6%, to $552.6 million at June 30, 2007. Noninterest-bearing accounts increased $4.2 million related to higher balances in primarily business checking accounts. Interest-bearing deposits increased $9.8 million, or 2.0%, primarily due to increases in NOW and money market accounts and certificates of deposits of $6.0 million and $3.6 million, respectively. The Bank s new e.SI checking product contributed $8.6 million to the increase in NOW and money market accounts, which was partly offset by decreases in other deposit products, including savings accounts. Certificates of deposit increased $3.6 million, or 1.3%, as a result of promotional rates, competitive pricing and marketing efforts to capitalize on the consolidation of financial institutions within the Bank s market area.

Borrowings. Borrowings decreased $10.4 million from $127.4 million at December 31, 2006 to $117.0 million at June 30, 2007, resulting from the redemption of $7.2 million of debentures in April 2007 with a portion of the proceeds from the $8.2 million trust preferred securities offering in September 2006 and net repayments of Federal Home Loan Bank advances.

Equity:

Summary. Total stockholders equity increased $622,000 to $83.0 million at June 30, 2007. The increase in equity was primarily attributable to earnings of $826,000 and the amortization of equity awards of $385,000, offset by dividends declared of $377,000, an increase in net unrealized holding losses on available for sale securities aggregating $243,000 (net of taxes) and stock repurchases of 16,820 shares at a cost of $207,000.

Accumulated Other Comprehensive Loss. Accumulated other comprehensive loss is comprised solely of the changes in unrealized gains and losses on available for sale securities, net of taxes. Unrealized holding losses on available for sale securities, net of taxes, increased $243,000 to $1.3 million at June 30, 2007. Unrealized

Table of Contents

holding losses resulted from a decline in the market value of the debt securities portfolio, which was recognized in accumulated other comprehensive loss on the consolidated balance sheet and a component of comprehensive income on 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, all of 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.

	At or For the Three Months Ended June 30,					
	2007			2006		
(Dollars in Thousands)	Average Balance	Interest & Dividends	Average Yield/ Rate	Average Balance	Interest & Dividends	Average Yield/ Rate
ASSETS:						
Interest-earning assets:						
Loans [1][2]	$ 582,976	$ 9,136	6.29%	$ 545,772	$ 8,882	6.53%
Investment securities [3]	124,973	1,503	4.82	134,315	1,446	4.32
Other interest-earning assets	10,782	87	3.24	9,587	63	2.64
Total interest-earning assets	718,731	10,726	5.99	689,674	10,391	6.04
Noninterest-earning assets	38,489			37,087		
Total assets	$ 757,220			$ 726,761		
LIABILITIES AND EQUITY:						
Interest-bearing liabilities:						
Deposits:						
NOW and money market	$ 133,134	467	1.41	$ 125,447	236	0.75
Savings [4]	80,026	271	1.36	85,132	237	1.12
Certificates of deposit [5]	281,580	3,193	4.55	272,738	2,722	4.00
Total interest-bearing deposits	494,740	3,931	3.19	483,317	3,195	2.65
FHLB advances	108,289	1,240	4.59	98,236	1,023	4.18
Subordinated debt	9,993	180	7.22	7,217	155	8.61
Total interest-bearing liabilities	613,022	5,351	3.50	588,770	4,373	2.98
Noninterest-bearing liabilities	60,756			57,828		
Total liabilities	673,778			646,598		
Total stockholders equity	83,442			80,163		
Total liabilities and stockholders equity	$ 757,220			$ 726,761		

Net interest-earning assets	$ 105,709		$ 100,904	
Tax equivalent net interest income [3]		5,375		6,018
Tax equivalent interest rate spread [6]		2.49		3.06

Table of Contents

Tax equivalent net interest margin as a percentage of interest-earning assets [7]	3.00	3.50
Average of interest-earning assets to average interest-bearing liabilities	117.24	117.14
Less: Tax equivalent adjustment [3]	(2)	(2)
Net interest income per statements of income	$ 5,373	$ 6,016

(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.

	At or For the Six Months Ended June 30,					
	2007			2006		
(Dollars in Thousands)	Average Balance	Interest & Dividends	Average Yield/ Rate	Average Balance	Interest & Dividends	Average Yield/ Rate
ASSETS:						
Interest-earning assets:						
Loans [1][2]	$ 580,826	$ 18,050	6.27%	$ 537,895	$ 17,067	6.40%
Investment securities [3]	126,153	2,989	4.78	130,111	2,741	4.25
Other interest-earning assets	9,709	162	3.36	9,385	115	2.47
Total interest-earning assets	716,688	21,201	5.97	677,391	19,923	5.93
Noninterest-earning assets	38,048			38,127		
Total assets	$ 754,736			$ 715,518		
LIABILITIES AND EQUITY:						
Interest-bearing liabilities:						
Deposits:						
NOW and money market	$ 130,004	788	1.22	$ 124,082	445	0.72
Savings [4]	79,436	524	1.33	86,384	463	1.08
Certificates of deposit [5]	280,627	6,313	4.54	262,715	5,048	3.87
Total interest-bearing deposits	490,067	7,625	3.14	473,181	5,956	2.54
FHLB advances	109,343	2,468	4.55	98,026	2,015	4.15
Subordinated debt	12,714	480	7.61	7,217	298	8.33
Total interest-bearing liabilities	612,124	10,573	3.48	578,424	8,269	2.88
Noninterest-bearing liabilities	59,469			56,954		
Total liabilities	671,593			635,378		
Total stockholders equity	83,143			80,140		

Total liabilities and stockholders equity	$ 754,736	$ 715,518

Table of Contents

Net interest-earning assets	$ 104,564		$ 98,967	
Tax equivalent net interest income [3]	10,628		11,654	
Tax equivalent interest rate spread [6]		2.49		3.05
Tax equivalent net interest margin as a percentage of interest-earning assets [7]		2.99		3.47
Average of interest-earning assets to average interest-bearing liabilities		117.08		117.11
Less: Tax equivalent adjustment [3]	(3)		(4)	
Net interest income per statements of income	$ 10,625		$ 11,650	

(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.

***Rate/Volume Analysis*.** The following table sets forth the extent to which changes in interest rates and changes in volume of interest-earning assets and interest-bearing liabilities have on the Company s interest income and interest expense for the periods presented. The rate column shows the effects attributable to changes in rate (changes in rate multiplied by prior volume). The volume column shows the effects attributable to changes in volume (changes in volume multiplied by prior rate). The net column represents the sum of the rate and volume columns. For purposes of this table, changes attributable to both changes in rate and volume that cannot be segregated have been allocated proportionately based on the changes due to rate and the changes due to volume.

	Three Months Ended June 30, 2007 and 2006			**Six Months Ended June 30, 2007 and 2006**		
	Increase (Decrease) Due To			**Increase (Decrease) Due To**		
(Dollars in Thousands)	**Rate**	**Volume**	**Net**	**Rate**	**Volume**	**Net**
INTEREST-EARNING ASSETS:						
Interest and Dividend Income:						
Loans [1][2]	$ (1,621)	$ 1,875	$ 254	$ (924)	$ 1,907	$ 983
Investment securities [3]	378	(321)	57	362	(114)	248
Other interest-earning assets	16	8	24	43	4	47
Total interest-earning assets	(1,227)	1,562	335	(519)	1,797	1,278
INTEREST-BEARING LIABILITIES:						
Interest Expense:						
Deposits [4]	662	74	736	1,341	328	1,669
Federal Home Loan Bank advances	107	110	217	208	245	453
Subordinated debt	(134)	159	25	(74)	256	182
Total interest-bearing liabilities	635	343	978	1,475	829	2,304
CHANGE IN NET INTEREST INCOME [3]	$ (1,862)	$ 1,219	$ (643)	$ (1,994)	$ 968	$ (1,026)

20

Table of Contents

(1) Amount is net of deferred loan origination fees and costs. Average balances include nonaccrual loans and loans held for sale.
(2) Loans 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 and brokered deposits.

Results of Operations for the Three and Six Months Ended June 30, 2007 and 2006

General. The Company s results of operations depend primarily on net interest income, which is the difference between the interest and dividend income earned on the Company s interest-earning assets, such as loans and investments, and the interest expense on its interest-bearing liabilities, such as deposits and borrowings. The Company also generates noninterest income such as gains on securities and loan sales, fees from deposit and trust and investment management services, insurance commissions, increases in cash surrender value of bank-owned life insurance and other fees. The Company s noninterest expenses consist of salaries and employee benefits, occupancy and equipment, computer and electronic banking services, outside professional services, marketing and other general and administrative expenses. The Company s results of operations are also significantly affected by general economic and competitive conditions, particularly changes in market interest rates, governmental policies and actions of regulatory agencies.

Summary. The Company recorded net income of $377,000 for the three months ended June 30, 2007, a decrease of $380,000 compared to $757,000 for the three months ended June 30, 2006. The decrease was primarily attributable to a decrease of $643,000 in net interest income and an increase of $266,000 in noninterest expenses, offset by an increase of $248,000 in noninterest income and decreases in the provisions for income taxes and loan losses of $216,000 and $65,000, respectively.

Net income decreased $726,000 to $826,000 for the six months ended June 30, 2007 due to the decrease of $1.0 million in net interest income and an increase of $932,000 in noninterest expenses, offset by an increase of $607,000 in noninterest income and decreases in the provision for income taxes and loan losses of $439,000 and $185,000, respectively.

For both the three and six months ended June 30, 2007, net interest income declined in response to a higher cost of funds primarily related to interest paid on deposit accounts and the volume of interest-bearing liabilities, offset by an increase in the average balance of loans. Despite increases in interest income for the three and six months ended June 30, 2007, the net interest margin decreased 50 and 48 basis points, respectively, from the same period in 2006. The continual flattening of the yield curve and compression of the margins provides challenges for management in an effort to minimize the impact on net interest income.

Interest and Dividend Income. Total interest and dividend income increased $335,000, or 3.2%, for the second quarter of 2007. Average interest-earning assets increased $29.1 million to $718.7 million, primarily due to a higher volume of loans and, to a lesser extent, federal funds and other interest-bearing assets, offset by a decrease in average securities. Average loans increased $37.2 million and the rate earned on loans decreased 24 basis points to 6.29% for the second quarter of 2007 from 6.53% for the same period in 2006. Average securities declined $9.3 million, offset by an increase in yield from 4.32% to 4.82%.

For the six months ended June 30, 2007, interest and dividend income increased $1.3 million to $21.2 million due to a higher average balance of loans and an increase in the average yield on interest-earning assets from 5.93% to 5.97%. Average yields on securities increased 53 basis points from 4.25% to 4.78% for the first half of 2007 compared to the same period in 2006. For both the three and six months ended June 30, 2007, the average yield on loans was negatively impacted by the reversal of approximately $81,000 and $234,000, respectively, of interest income relating to loans placed on nonaccrual status during 2007.

Interest Expense. Interest expense increased $978,000, or 22.4%, to $5.4 million for the second quarter of 2007 compared to $4.4 million for the second quarter of 2006, primarily as a result of the rate paid on certificates of deposit and NOW and money market accounts and an increase in the average balance of interest-bearing

Table of Contents

liabilities. The yield on deposit accounts increased 54 basis points due to market interest rates, promotional rates and competitive pricing. Average deposits rose $11.4 million. The average balance on certificates of deposit increased $8.8 million and the average yield increased 55 basis points. Average Federal Home Loan Bank advances increased $10.1 million and the yield on Federal Home Loan Bank borrowings increased 41 basis points to 4.59%. The average volume of subordinated debt increased $2.8 million, while the rate paid on these borrowings decreased 139 basis points from 8.61% to 7.22%. Interest expense on subordinated debt borrowings is expected to decrease during the remainder of 2007 due to the redemption of $7.2 million of debentures during the second quarter of 2007.

For the six months ended June 30, 2007, interest expense increased $2.3 million as a result of increases in both the average yield from 2.88% to 3.48% and the average balance of interest-bearing liabilities from $578.4 million to $612.1 million. Higher interest expense for the first half of 2007 was primarily attributable to the 60 basis point increase in the average yield on deposit accounts and an increase of $33.7 million in the average balance of interest-bearing liabilities, with deposits and borrowings contributing $16.9 million and $16.8 million, respectively.

Provision for Loan Losses. The Company s provision for loan losses decreased $65,000 and $185,000 for the three and six months ended June 30, 2007. The first half of 2006 included an additional provision for loan losses of $150,000 related to the indirect automobile loan portfolio, due to the increased risk of loss associated with this type of consumer lending. The disposition of the indirect automobile portfolio in June 2007 favorably impacted the allowance for loan losses, resulting in a lower provision for loan losses for the period, offset by an increase in the provision for nonperforming loans and loan charge-offs. The Company continues to monitor the impact that rising interest rates will have on variable-rate borrowers ability to repay higher monthly interest payments.

Noninterest Income. The following table shows the components of noninterest income and the dollar and percentage changes for the periods presented.

	Three Months Ended June 30,				Six Months Ended June 30,			
			$	%			$	%
(Dollars in Thousands)	**2007**	**2006**	**Change**	**Change**	**2007**	**2006**	**Change**	**Change**
Service fees	$ 1,156	$ 1,180	$ (24)	(2.0)%	$ 2,282	$ 2,324	$ (42)	(1.8)%
Wealth management fees	970	836	134	16.0	1,892	1,670	222	13.3
Increase in cash surrender value of bank-owned life insurance	72	69	3	4.3	144	137	7	5.1
Net gain (loss) on sale of securities		(112)	112	(100.0)	321	(112)	433	(386.6)
Net gain on sale of loans	34	11	23	209.1	65	35	30	85.7
Other	21	21			32	75	(43)	(57.3)
Total noninterest income	$ 2,253	$ 2,005	$ 248	12.4%	$ 4,736	$ 4,129	$ 607	14.7%

Noninterest income was $2.3 million for the quarter ended June 30, 2007 compared to $2.0 million for the quarter ended June 30, 2006. Noninterest income was $4.7 million for the first half of 2007 compared to $4.1 million for the same period of 2006. Contributing to the increase in noninterest income for the three and six months ended June 30, 2007, were increases in net gains on the sale of available for sale securities of $112,000 and $433,000, respectively, and wealth management fees of $134,000 and $222,000, respectively. The increase of $433,000 on the sale of available for sale securities for the first half of 2007 included a gain of $321,000 from the sale of marketable equity securities during the first quarter and a net loss on the sale of government-sponsored enterprise securities of $112,000 during the second quarter of 2006. Wealth management fees were higher principally due to growth in the market value of assets under administration.

Table of Contents

Noninterest Expenses. The following table shows the components of noninterest expenses and the dollar and percentage changes for the periods presented.

	Three Months Ended June 30,				Six Months Ended June 30,			
(Dollars in Thousands)	2007	2006	$ Change	% Change	2007	2006	$ Change	% Change
Salaries and employee benefits	$ 3,787	$ 3,704	$ 83	2.2%	$ 7,516	$ 7,287	$ 229	3.1%
Occupancy and equipment	1,311	1,202	109	9.1	2,666	2,362	304	12.9
Computer and electronic banking services	631	632	(1)	(0.2)	1,269	1,259	10	0.8
Outside professional services	228	311	(83)	(26.7)	592	536	56	10.4
Marketing and advertising	237	204	33	16.2	409	357	52	14.6
Supplies and printing	150	140	10	7.1	276	264	12	4.5
Other	701	586	115	19.6	1,263	994	269	27.1
Total noninterest expenses	$ 7,045	$ 6,779	$ 266	3.9%	$ 13,991	$ 13,059	$ 932	7.1%

Noninterest expenses increased for both the three and six months ended June 30, 2007 compared to the same periods in 2006, primarily due to increased operating costs associated with the expansion of branch offices and other noninterest expenses. New branch offices resulted in higher occupancy and equipment expense relative to additional operating lease payments, depreciation expense and other occupancy-related expenses. Compensation costs were higher in 2007 due to increased staffing levels associated with new branch offices, offset by a reduction in performance-based compensation which included lower loan origination commissions resulting from a decline in new loan volume. An increase in the provision for credit losses for off-balance sheet commitments contributed to the increase in other noninterest expenses for 2007. Outside professional services expense was higher for the six months ended June 30, 2007 but lower in the second quarter of 2007 due to the termination of the agreement to purchase a mortgage company during the first quarter, resulting in a charge to operations for purchase-related transaction costs associated with the termination, offset by a reduction in other legal and auditing expenditures and the reimbursement of legal costs associated with the disposition of the indirect automobile portfolio in June 2007.

Income Tax Provision. For the three and six months ended June 30, 2007, the Company s income tax expense decreased $216,000 and $439,000, respectively. The effective tax rate for the three months ended June 30, 2007 and 2006 was 28.3% and 32.5%, respectively. The effective tax rate for the six months ended June 30, 2007 and 2006 was 28.2% and 33.0%, respectively.

Liquidity and Capital Resources

Liquidity is the ability to meet current and future financial obligations of a short-term nature. The Company s primary sources of funds consist of deposit inflows, loan repayments and sales, maturities and sales of investment securities and Federal Home Loan Bank and subordinated debt borrowings. While maturities and scheduled amortization of loans and securities are predictable sources of funds, deposit flows, mortgage prepayments and loan and security sales are greatly influenced by general interest rates, economic conditions and competition.

The Company s most liquid assets are cash and cash equivalents. The levels of these assets depend on the Company s operating, financing and investing activities during any given period. At June 30, 2007, cash and cash equivalents totaled $27.9 million, which included interest-bearing deposits and federal funds sold of $10.8 million.

Securities classified as available for sale, which provide additional sources of liquidity, totaled $120.7 million at June 30, 2007. In addition, at June 30, 2007, the Company had the ability to borrow $233.9 million from the Federal Home Loan Bank, which included overnight lines of credit of $10.0 million, before deducting outstanding advances. On that date, the Company had advances outstanding of $108.8 million and no overnight lines of credit advances outstanding. The Company believes that its most liquid assets combined with the available line from the Federal Home Loan Bank provide adequate liquidity to meet its current financial obligations.

Table of Contents

The Company s primary investing activities are the origination of loans and the purchase of securities. For the six months ended June 30, 2007, the Company originated $66.3 million of loans and purchased $15.7 million of securities, excluding Federal Home Loan Bank stock. For the twelve months ended December 31, 2006, the Company originated $168.7 million of loans and purchased $31.7 million of securities.

Financing activities consist primarily of activities in deposit accounts and Federal Home Loan Bank advances. Liquidity needed to fund asset growth has historically been provided through deposits, Federal Home Loan Bank borrowings, raising capital through the issuance of trust preferred securities and the initial public offering. The Company experienced a net increase in total deposits, including mortgagors and investors escrow accounts, of $14.0 million, $29.6 million and $51.8 million for the six months ended June 30, 2007 and for the years ended December 31, 2006 and 2005, respectively. Certificates of deposit due within one year of June 30, 2007 totaled $217.7 million, or 40.4%, of total deposits. Deposit flows are affected by the overall level of interest rates, products offered by the Company and its local competitors and other factors. The Company generally manages the pricing of its deposits to be competitive and to increase core deposits and commercial banking relationships. Occasionally, the Company offers promotional rates on certain deposit products to attract deposits. The Company believes, based on past experience, that a significant portion of the certificates of deposit maturing within one year will remain with the Company. The Company experienced a net decrease of $3.2 million in Federal Home Loan Bank advances for the six months ended June 30, 2007 as excess funds were used to pay down borrowings. The Company had net increases of $24.0 million and $15.3 million in Federal Home Loan Bank advances for the years ended December 31, 2006 and 2005, respectively. The Company redeemed $7.2 million of debentures during the second quarter of 2007. For the six months ended June 30, 2007, the Company repurchased 16,820 shares of common stock at a cost of $207,000. *Additional discussion about the Company s liquidity and capital resources is contained in Item 7 in the Company s 2006 Annual Report on Form 10-K. Reference the comparison of financial condition in this report for further details on the Company s capital resources.*

Payments Due Under Contractual Obligations

Information relating to payments due under contractual obligations is presented in the Company s Form 10-K for the year ended December 31, 2006. There were no material changes in the Company s payments due under contractual obligations between December 31, 2006 and June 30, 2007.

Off-Balance Sheet Arrangements

In the normal course of operations, the Company engages in a variety of financial transactions that, in accordance with accounting principles generally accepted in the United States of America, are not recorded in its financial statements. These transactions involve, to varying degrees, elements of credit, interest rate and liquidity risk. Such transactions are used primarily to manage customers requests for funding and take the form of loan commitments, lines of credit and letters of credit.

The contractual amount of commitments to extend credit represent the amount of potential accounting losses should the contract be fully drawn upon, the customer defaults and the value of any existing collateral becomes worthless. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. Financial instruments whose contract amounts represent credit risk at June 30, 2007 and December 31, 2006 are as follows:

	June 30,	December 31,
(Dollars in Thousands)	**2007**	**2006**
Commitments to extend credit: [1]		
Future loan commitments [2]	$ 17,905	$ 7,658
Undisbursed construction loans	22,917	27,010
Undisbursed home equity lines of credit	21,907	21,554
Undisbursed commercial lines of credit	13,288	12,070
Overdraft protection lines	1,471	1,424
Standby letters of credit [3]	1,228	1,178
Total commitments	$ 78,716	$ 70,894

Table of Contents

(1) 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 may require payment of a fee and generally have fixed expiration dates or other termination clauses.

(2) Includes fixed-rate loan commitments of $2.9 million at interest rates ranging from 5.250% to 7.880% and $2.6 million at interest rates ranging from 5.125% to 8.000% at June 30, 2007 and December 31, 2006, respectively.

(3) Standby letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party.

Outstanding commitments for the construction of two new branch facilities in the aggregate totaled approximately $1.1 million at June 30, 2007.

For the six months ended June 30, 2007, with the exception of the aforementioned commitments, the Company did not engage in any additional off-balance sheet transactions reasonably likely to have a material effect on the Company s financial condition, results of operations or cash flows. *See Notes 6 and 12 to the consolidated financial statements contained in the Company s 2006 Annual Report on Form 10-K.*

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Qualitative Aspects of Market Risk

The primary market risk factor affecting the financial condition and operating results of the Company is interest rate risk. Interest rate risk is the exposure of current and future earnings and capital arising from movements in interest rates. This risk is managed by periodic evaluation of the interest rate risk inherent in interest-earning assets and interest-bearing liabilities in an effort to minimize the adverse effects of changes in the interest rate environment. Deposit accounts typically react more quickly to changes in market interest rates than mortgage loans because of the shorter maturities of deposits. As a result, sharp increases in interest rates may decrease earnings while decreases in interest rates may increase earnings. To reduce the potential volatility of earnings, the Company has sought to improve the match between asset and liability maturities and rates, while maintaining an acceptable interest rate spread. Pursuant to this strategy, the Company originates adjustable-rate mortgage loans for retention in its loan portfolio. However, the ability to originate adjustable-rate loans depends, to a great extent, on market interest rates and borrowers preferences. As an alternative to adjustable-rate mortgage loans, the Company offers fixed-rate mortgage loans with maturities of fifteen years. This product enables the Company to compete in the fixed-rate mortgage market while maintaining a shorter maturity. Fixed-rate mortgage loans typically have an adverse effect on interest rate sensitivity compared to adjustable-rate loans. Accordingly, the Company has sold longer-term fixed-rate mortgage loans in the secondary market in an effort to manage interest rate risk. In recent years, the Company also has used investment securities with terms of three years or less, longer-term borrowings from the Federal Home Loan Bank and brokered deposits to help manage interest rate risk. The Company currently does not participate in hedging programs, interest rate swaps or other activities involving the use of derivative financial instruments.

The Company has an Asset/Liability Committee to communicate, coordinate and control all aspects involving asset and liability management. The Committee establishes and monitors the volume, maturities, pricing and mix of assets and funding sources with the objective of managing assets and funding sources to provide results that are consistent with liquidity, growth, risk limits and profitability goals.

Quantitative Aspects of Market Risk

The Company analyzes its interest rate sensitivity position to manage the risk associated with interest rate movements through the use of interest income simulation. The matching of assets and liabilities may be analyzed by examining the extent to which such assets and liabilities are interest rate sensitive. An asset or liability is said to be interest rate sensitive within a specific time period if it will mature or reprice within that time period. The Company s goal is to manage asset and liability positions to moderate the effect of interest rate fluctuations on net interest income.

Table of Contents

Income Simulation Analysis. Interest income simulations are completed quarterly and presented to the Company s Asset/Liability Committee. The simulations provide an estimate of the impact of changes in interest rates on net interest income under a range of assumptions. The numerous assumptions used in the simulation process are reviewed by the Asset/Liability Committee on a quarterly basis. Changes to these assumptions can significantly affect the results of the simulation. The simulation incorporates assumptions regarding the potential timing in the repricing of certain assets and liabilities when market rates change and the changes in spreads between different market rates. The simulation analysis incorporates management s current assessment of the risk that pricing margins will change adversely over time due to competition or other factors.

Simulation analysis is only an estimate of the Company s interest rate risk exposure at a particular point in time. The Company continually reviews the potential effect that changes in interest rates could have on the repayment of rate sensitive assets and funding requirements of rate sensitive liabilities.

The tables below set forth an approximation of the Company s exposure as a percentage of estimated net interest income for the next twelve and twenty-four-month periods using interest income simulation. The simulation uses projected repricing of assets and liabilities at June 30, 2007 and December 31, 2006 on the basis of contractual maturities, anticipated repayments and scheduled rate adjustments. Prepayment rates can have a significant impact on interest income simulation. Because of the Company s large percentage of loans and mortgage-backed securities, rising or falling interest rates have a significant impact on the prepayment speeds of its earning assets that in turn affect the rate sensitivity position. The prepayment rates on investment securities are assumed to fluctuate between 8% and 12% in a flat interest rate environment, between 6% and 9% in an increasing interest rate environment and between 13% and 44% in a decreasing interest rate environment, depending on the type of security. Loan prepayment rates are assumed to fluctuate between 6% and 15% in a flat interest rate environment, between 5% and 15% in a rising rate environment and between 6% and 30% in a falling rate environment, depending on the type of loan. As evidenced by these assumptions, when interest rates rise, prepayments tend to slow and when interest rates fall, prepayments tend to increase. The Company s asset sensitivity would be reduced if prepayments slow and vice versa. Because prospective effects of hypothetical interest rate changes are based on a number of assumptions, these computations should not be relied upon as indicative of actual results. While the Company believes such assumptions to be reasonable, there can be no assurance that assumed prepayment rates will approximate actual future mortgage-backed securities, collateralized mortgage obligations and loan repayment activity. Further, the computations do not reflect any actions that management may undertake in response to changes in interest rates. Management periodically reviews its rate assumptions based on existing and projected economic conditions.

The Company s management generally simulates changes to net interest income using three different interest rate scenarios. The first scenario anticipates the maximum foreseeable increase in rates over the next twelve months; management assumes this to be 200 basis points at June 30, 2007 and December 31, 2006. The second scenario anticipates management s view of the most likely change in interest rates over the next twelve months; management s current assumption is a 100 basis point increase in rates. The third scenario anticipates the maximum foreseeable decrease in rates over the next twelve months; management s assumption is 200 basis points. The basis point change in each of the three scenarios is assumed to occur evenly over both the twelve and twenty-four months presented. As of June 30, 2007 and December 31, 2006, the Company s estimated exposure as a percentage of estimated net interest income for the twelve-month and twenty-four-month periods is as follows:

	Percent Change in Estimated Net Interest Income Over	
June 30, 2007:	**12 Months**	**24 Months**
200 basis point increase in rates	(8.40)%	(11.56)%
100 basis point increase in rates	(3.36)	(5.22)
200 basis point decrease in rates	(0.32)	(5.13)

Table of Contents

December 31, 2006:	Percent Change in Estimated Net Interest Income Over 12 Months	24 Months
200 basis point increase in rates	(4.88)%	(9.69)%
100 basis point increase in rates	(1.98)	(3.67)
200 basis point decrease in rates	0.50	(0.87)

As of June 30, 2007, based on the scenarios above, net interest income would be adversely affected in both the twelve and twenty-four-month periods if interest rates rose by 100 and 200 basis points and if interest rates decreased 200 basis points. Using net interest income for the quarter ended June 30, 2007, for each percentage point change in net interest income, the effect on the Company s annual net income would be $142,000, assuming a 34% income tax rate.

As of December 31, 2006, based on the scenarios above, net interest income would be adversely affected in both the twelve and twenty-four-month periods if interest rates rose by 100 and 200 basis points or if interest rates decreased 200 basis points over the twenty-four-month period and favorably impacted by a 200 basis point decrease in rates over the twelve-month period. Using net interest income for the quarter ended December 31, 2006, for each percentage point change in net interest income, the effect on the Company s annual net income would be $141,000, assuming a 34% income tax rate.

For both the twelve-month and twenty-four-month periods, the effect on net interest income has declined in the event of a sudden and sustained increase in prevailing market interest rates of 100 and 200 basis points and a 200 basis point decrease in rates at June 30, 2007 compared to December 31, 2006. As a result, the Company s strategy is to better position the balance sheet for the anticipated economic slowdown by shortening the maturities on borrowings and certificates of deposit, while lengthening the durations of investment securities.

Item 4. Controls and Procedures.

The Company s management, including the Company s principal executive officer and principal financial officer, have evaluated the effectiveness of the Company s disclosure controls and procedures, as such term is defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended, (the Exchange Act). Based upon their evaluation, the principal executive officer and principal financial officer concluded that, as of the end of the period covered by this report, the Company s disclosure controls and procedures were effective for the purpose of ensuring that the information required to be disclosed in the reports that the Company files or submits under the Exchange Act with the Securities and Exchange Commission (1) is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms and (2) is accumulated and communicated to the Company s management, including its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

There has been no change in the Company s internal control over financial reporting identified in connection with the evaluation required by Rule 13(a)-15(e) that occurred during the Company s last fiscal quarter that has materially affected or is reasonably likely to materially affect, the Company s internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

The Company is not involved in any legal proceedings. Periodically, there have been various claims and lawsuits against the Bank, such as claims to enforce liens, condemnation proceedings on properties in which the Bank holds a security interest, claims involving the making and servicing of real property loans and other issues incident to the Bank s business. Management believes that these legal proceedings would not have a material adverse effect on the Company s financial condition, results of operations or cash flows.

Table of Contents

Item 1A. Risk Factors.

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in the Company s Annual Report on Form 10-K for the year ended December 31, 2006, which could materially and adversely affect the Company s business, financial condition or future results. The risks described in the Company s Annual Report on Form 10-K are not the only risks that the Company faces. Additional risks and uncertainties not currently known to the Company or that the Company currently deems to be immaterial also may materially adversely affect the Company s business, financial condition and/or operating results.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

The following table provides certain information with regard to shares repurchased by the Company in the second quarter of 2007.

Period	Total Number of Shares Purchased [1][2]	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet be Purchased Under the Plans or Programs
April 1, 2007 through April 30, 2007		$		486,170
May 1, 2007 through May 31, 2007	12,820	12.25	12,820	473,350
June 1, 2007 through June 30, 2007	4,000	12.45	4,000	469,350
Total	16,820	$ 12.30	16,820	469,350

(1) On November 23, 2005, the Company announced that the Board of Directors had approved a stock repurchase program authorizing the Company to repurchase up to 628,000 shares of the Company s common stock. The repurchase program will continue until it is completed or terminated by the Board of Directors.

(2) This table includes 12,820 shares withheld from employees to satisfy minimum tax withholding requirements upon the vesting of restricted stock awards.

Item 3. Defaults Upon Senior Securities.

None.

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

a. The Annual Meeting of Stockholders was held on May 9, 2007.

b. The items voted upon at the Annual Meeting and the votes for each proposal were as follows:

1. Election of directors for a three-year term, with the exception of Mr. Garvey who was elected for a one-year term.

Nominees	For	Withheld
Rheo A. Brouillard	11,592,348	75,482
Roger Engle	11,593,228	74,602
Michael R. Garvey	11,576,273	91,557

2. Ratification of the appointment of Wolf and Company, P.C. as the Company s independent registered public accounting firm for the fiscal year ending December 31, 2007.

For	Against	Abstain
11,599,601	47,477	18,782

Table of Contents

Item 5. Other Information.

None.

Item 6. Exhibits.

3.1	Charter of SI Financial Group, Inc. [(1)]
3.2	Bylaws of SI Financial Group, Inc. [(2)]
4.0	Specimen Stock Certificate of SI Financial Group, Inc. [(1)]
31.1	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer
31.2	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer
32.0	18 U.S.C. Section 1350 Certifications

(1) Incorporated by reference into this document from the Exhibits filed with the Securities and Exchange Commission on the Registration Statement on Form S-1, and any amendments thereto, Registration No. 333- 116381.

(2) Incorporated by reference into this document from the Exhibits filed with the Securities and Exchange Commission on the Form 10-K filed on March 29, 2007.

Table of Contents

SIGNATURES

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

SI FINANCIAL GROUP, INC.

Date: August 14, 2007

/s/ Rheo A. Brouillard
Rheo A. Brouillard
President and Chief Executive Officer
(principal executive officer)

Date: August 14, 2007

/s/ Brian J. Hull
Brian J. Hull
Executive Vice President, Treasurer and Chief Financial Officer
(principal financial and accounting officer)