

SI Financial Group, Inc.
Form 10-Q
November 13, 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 September 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
(State or other jurisdiction of

incorporation or organization)

84-1655232
(I.R.S. Employer

Identification No.)

803 Main Street, Willimantic, Connecticut

06226

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(Address of principal executive offices)

(860) 423-4581

(Zip Code)

(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 ☒ 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 ☒

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

As of November 2, 2007, there were 12,191,100 shares of the registrant's common stock outstanding.

Table of Contents

SI FINANCIAL GROUP, INC.

TABLE OF CONTENTS

	Page No.
PART I. <u>FINANCIAL INFORMATION</u>	
Item 1. <u>Consolidated Financial Statements of SI Financial Group, Inc. and Subsidiaries (unaudited):</u>	1
<u>Consolidated Balance Sheets at September 30, 2007 and December 31, 2006</u>	1
<u>Consolidated Statements of Income for the three and nine months ended September 30, 2007 and 2006</u>	2
<u>Consolidated Statements of Changes in Stockholders' Equity for the nine months ended September 30, 2007</u>	3
<u>Consolidated Statements of Cash Flows for the nine months ended September 30, 2007 and 2006</u>	4
<u>Notes to Consolidated Financial Statements</u>	6
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	15
Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	26
Item 4. <u>Controls and Procedures</u>	28
PART II. <u>OTHER INFORMATION</u>	
Item 1. <u>Legal Proceedings</u>	29
Item 1A. <u>Risk Factors</u>	29
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	29
Item 3. <u>Defaults Upon Senior Securities</u>	29
Item 4. <u>Submission of Matters to a Vote of Security Holders</u>	29
Item 5. <u>Other Information</u>	29
Item 6. <u>Exhibits</u>	30
<u>SIGNATURES</u>	31

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)*

	September 30, 2007	December 31, 2006
ASSETS:		
Cash and due from banks:		
Noninterest-bearing	\$ 12,912	\$ 14,984
Interest-bearing	2,281	3,824
Federal funds sold	750	7,300
Total cash and cash equivalents	15,943	26,108
Available for sale securities, at fair value	126,453	119,508
Loans held for sale	524	135
Loans receivable (net of allowance for loan losses of \$4,934 at September 30, 2007 and \$4,365 at December 31, 2006)	584,537	574,111
Accrued interest receivable	3,450	3,824
Federal Home Loan Bank stock, at cost	7,001	6,660
Cash surrender value of bank-owned life insurance	8,335	8,116
Other real estate owned	850	
Premises and equipment, net	11,337	10,512
Goodwill and other intangibles	668	741
Deferred tax asset, net	3,012	3,361
Other assets	3,358	3,961
Total assets	\$ 765,468	\$ 757,037
LIABILITIES AND STOCKHOLDERS' EQUITY:		
Liabilities:		
Deposits:		
Noninterest-bearing	\$ 53,766	\$ 55,703
Interest-bearing	491,378	482,973
Total deposits	545,144	538,676
Mortgagors' and investors' escrow accounts	1,558	3,246
Federal Home Loan Bank advances	122,710	111,956
Junior subordinated debt owed to unconsolidated trust	8,248	15,465
Accrued expenses and other liabilities	5,427	5,308
Total liabilities	683,087	674,651
Stockholders' Equity:		
Preferred stock (\$.01 par value; 1,000,000 shares authorized; none issued)	126	126

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Common stock (\$.01 par value; 75,000,000 shares authorized; 12,563,750 shares issued; 12,236,100 and 12,421,920 shares outstanding at September 30, 2007 and December 31, 2006, respectively)

Additional paid-in capital	51,774	51,481
Unallocated common shares held by ESOP	(3,956)	(4,199)
Unearned restricted shares	(1,306)	(1,679)
Retained earnings	39,650	39,254
Accumulated other comprehensive loss	(348)	(1,011)
Treasury stock, at cost (327,650 shares at September 30, 2007 and 141,830 shares at December 31, 2006)	(3,559)	(1,586)
Total stockholders' equity	82,381	82,386
Total liabilities and stockholders' equity	\$ 765,468	\$ 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 September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Interest and dividend income:				
Loans, including fees	\$ 9,349	\$ 8,807	\$ 27,399	\$ 25,874
Securities:				
Taxable interest	1,435	1,359	4,156	3,898
Tax-exempt interest	4	7	12	20
Dividends	131	111	388	296
Other	73	24	235	139
Total interest and dividend income	10,992	10,308	32,190	30,227
Interest expense:				
Deposits	4,012	3,516	11,637	9,472
Federal Home Loan Bank advances	1,324	1,103	3,792	3,118
Subordinated debt	144	177	624	475
Total interest expense	5,480	4,796	16,053	13,065
Net interest income	5,512	5,512	16,137	17,162
Provision for loan losses	520	141	740	546
Net interest income after provision for loan losses	4,992	5,371	15,397	16,616
Noninterest income:				
Service fees	1,248	1,164	3,530	3,488
Wealth management fees	967	863	2,859	2,533
Increase in cash surrender value of bank-owned life insurance	75	67	219	204
Net gain (loss) on sale of securities	(215)	(172)	106	(284)
Net gain on sale of loans	40	37	105	72
Other	84	13	116	88
Total noninterest income	2,199	1,972	6,935	6,101
Noninterest expenses:				
Salaries and employee benefits	3,826	3,491	11,342	10,778
Occupancy and equipment	1,324	1,231	3,990	3,593
Computer and electronic banking services	661	662	1,930	1,921
Outside professional services	240	248	832	784
Marketing and advertising	178	234	587	591
Supplies and printing	117	131	393	395
Other	691	560	1,954	1,554
Total noninterest expenses	7,037	6,557	21,028	19,616
Income before income tax provision	154	786	1,304	3,101

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Income tax provision	26	229	350	992
Net income	\$ 128	\$ 557	\$ 954	\$ 2,109
Net income per common share:				
Basic	\$ 0.01	\$ 0.05	\$ 0.08	\$ 0.18
Diluted	\$ 0.01	\$ 0.05	\$ 0.08	\$ 0.18

See accompanying notes to unaudited interim consolidated financial statements.

Table of Contents**SI FINANCIAL GROUP, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY****FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2007***(Dollars in Thousands, Except Share Amounts / Unaudited)*

	Common Stock		Additional	Unallocated	Unearned	Retained	Accumulated	Treasury	Total
	Shares	Dollars	Paid-in	Common	Restricted	Earnings	Other	Stock	Stockholders
			Capital	Shares Held	Shares		Loss		Equity
				by ESOP					
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 (\$0.12 per share)						(558)			(558)
Equity incentive plan shares earned			212		373				585
Allocation of ESOP shares			45	243					288
Vesting of restricted stock			36						36
Treasury shares purchased (185,820 shares)								(1,973)	(1,973)
Comprehensive income:									
Net income						954			954
Change in net unrealized losses on available for sale securities, net of reclassification adjustment and tax effects							663		663
Total comprehensive income									1,617
Balance at September 30, 2007	12,563,750	\$ 126	\$ 51,774	\$ (3,956)	\$ (1,306)	\$ 39,650	\$ (348)	\$ (3,559)	\$ 82,381

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)*

	Nine Months Ended September 30,	
	2007	2006
Cash flows from operating activities:		
Net income	\$ 954	\$ 2,109
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	740	546
Employee stock ownership plan expense	288	270
Equity incentive plan expense	585	574
Excess tax benefit from share-based payment arrangements	(36)	(13)
Accretion of investment premiums and discounts, net	(181)	(83)
Amortization of loan premiums and discounts, net	450	704
Depreciation and amortization of premises and equipment	1,577	1,293
Amortization of core deposit intangible	73	73
Amortization of deferred debt issuance costs	35	44
Amortization of mortgage servicing rights	69	57
Net (gain) loss on sale of securities	(106)	284
Deferred income tax benefit	8	12
Loans originated for sale	(9,681)	(7,391)
Proceeds from sale of loans held for sale	9,397	7,570
Net gain on sale of loans	(105)	(72)
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	(219)	(205)
Change in operating assets and liabilities:		
Accrued interest receivable	374	(273)
Other assets	499	(1,077)
Accrued expenses and other liabilities	155	319
Net cash provided by operating activities	4,876	4,772
Cash flows from investing activities:		
Purchases of available for sale securities	(40,289)	(26,175)
Proceeds from sales of available for sale securities	17,551	12,284
Proceeds from maturities of and principal repayments on available for sale securities	17,083	12,068
Net increase in loans	(12,465)	(54,334)
Purchases of Federal Home Loan Bank stock	(341)	(569)
Proceeds from sale of other real estate owned		314
Proceeds from sale of bank premises and equipment		242
Purchases of premises and equipment	(2,402)	(2,963)
Other		(21)
Net cash used in investing activities	(20,863)	(59,154)
Cash flows from financing activities:		
Net increase in deposits	6,468	25,592
Net decrease in mortgagors' and investors' escrow accounts	(1,688)	(1,529)
Proceeds from Federal Home Loan Bank advances	59,593	152,240
Repayments of Federal Home Loan Bank advances	(48,839)	(134,334)

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(Repayments of) proceeds from subordinated debt borrowings	(7,217)	8,248
Cash dividends on common stock	(558)	(572)
Excess tax benefit from share-based payment arrangements	36	13
Treasury stock purchased	(1,973)	(1,438)
Net cash provided by financing activities	5,822	48,220

Table of Contents

SI FINANCIAL GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in Thousands / Unaudited)

	Nine Months Ended September 30,	
	2007	2006
Net change in cash and cash equivalents	(10,165)	(6,162)
Cash and cash equivalents at beginning of period	26,108	25,946
Cash and cash equivalents at end of period	\$ 15,943	\$ 19,784

Supplemental cash flow information:

Interest paid	\$ 16,063	\$ 12,720
Income taxes paid, net	977	1,102
Transfer of loans to other real estate owned	850	
Dividends paid	616	572

See accompanying notes to unaudited interim consolidated financial statements.

Table of Contents

SI FINANCIAL GROUP, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 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 twenty 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 offices. The Company's primary business activities consist of 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 September 30, 2007 and for the three and nine months ended September 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 nine months ended September 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, impairment of long-lived assets and the valuation of deferred tax 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 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.

Table of Contents

SI FINANCIAL GROUP, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2007 AND 2006 AND DECEMBER 31, 2006

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 Company will continue to amortize its servicing assets. 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 9 *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****SEPTEMBER 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 321,074 and 297,756 for the three and nine months ended September 30, 2007, respectively, and 467,653 and 468,092 for the three and nine months ended September 30, 2006, respectively. Treasury shares and unallocated common shares held by the ESOP are not included in the weighted-average number of common shares outstanding for purposes of calculating both basic and diluted net income per common share. ESOP shares are included in weighted-average shares outstanding for basic net income per common share as they are committed to be released. Unvested restricted shares are only included in dilutive net income per common share computations.

	Three Months		Nine Months	
	Ended September 30, 2007	2006	Ended September 30, 2007	2006
<i>(Dollars in Thousands, Except Share Amounts)</i>				
Net income	\$ 128	\$ 557	\$ 954	\$ 2,109
Weighted-average common shares outstanding:				
Basic	11,760,714	11,789,022	11,798,489	11,799,255
Effect of dilutive stock option and restricted stock awards	21,375	31,184	51,754	41,489
Diluted	11,782,089	11,820,206	11,850,243	11,840,744
Net income per common share:				
Basic	\$ 0.01	\$ 0.05	\$ 0.08	\$ 0.18
Diluted	\$ 0.01	\$ 0.05	\$ 0.08	\$ 0.18

Table of Contents**SI FINANCIAL GROUP, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****SEPTEMBER 30, 2007 AND 2006 AND DECEMBER 31, 2006****NOTE 3. SECURITIES**

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2007 <i>(Dollars in Thousands)</i>				
Debt securities:				
U.S. Government and agency obligations	\$ 1,228	\$ 5	\$ (23)	\$ 1,210
Government-sponsored enterprises	41,412	97	(154)	41,355
Mortgage-backed securities	76,437	271	(643)	76,065
Corporate debt securities	3,650		(12)	3,638
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	125,247	390	(833)	124,804
Equity securities:				
Marketable equity securities	1,734		(85)	1,649
Total available for sale securities	\$ 126,981	\$ 390	\$ (918)	\$ 126,453
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2006 <i>(Dollars in Thousands)</i>				
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

[Table of Contents](#)

SI FINANCIAL GROUP, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2007 AND 2006 AND DECEMBER 31, 2006

NOTE 4. LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES

At September 30, 2007, the Company's loan portfolio, net, was \$584.5 million, or 76.4% 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.

	September 30, 2007		December 31, 2006	
	Percent		Percent	
(Dollars in Thousands)	Amount	of Total	Amount	of Total
Real estate loans:				
Residential 1 to 4 family	\$ 327,254	55.64%	\$ 309,695	53.65%
Multi-family and commercial	124,799	21.22%	118,600	20.55
Construction	44,081	7.49%	44,647	7.73
Total real estate loans	496,134	84.35%	472,942	81.93
Consumer loans:				
Home equity	18,203	3.10%	18,489	3.20
Other	3,372	0.57%	10,616	1.84
Total consumer loans	21,575	3.67%	29,105	5.04
Commercial business loans	70,457	11.98%	75,171	13.03
Total loans	588,166	100.00%	577,218	100.00%
Deferred loan origination costs, net of fees	1,305		1,258	
Allowance for loan losses	(4,934)		(4,365)	
Loans receivable, net	\$ 584,537		\$ 574,111	

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 the remainder of the loan portfolio, which represents a general valuation allowance on the remainder of the loan portfolio, after excluding impaired loans, segregated by loan category and assigned allowance percentages based on historical loan 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.

Table of Contents**SI FINANCIAL GROUP, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****SEPTEMBER 30, 2007 AND 2006 AND DECEMBER 31, 2006**

The following table summarizes the activity in the allowance for loan losses at and for the three and nine months ended September 30, 2007 and 2006.

<i>(Dollars in Thousands)</i>	At or For the Three Months Ended September 30,		At or For the Nine Months Ended September 30,	
	2007	2006	2007	2006
Balance at beginning of period	\$ 4,413	\$ 4,075	\$ 4,365	\$ 3,671
Provision for loan losses	520	141	740	546
Loans charged-off	(127)	(32)	(421)	(37)
Recoveries of loans previously charged-off	128	3	250	7
Balance at end of period	\$ 4,934	\$ 4,187	\$ 4,934	\$ 4,187

NOTE 5. DEPOSITS

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

<i>(Dollars in Thousands)</i>	September 30, 2007	December 31, 2006	Change
Noninterest-bearing demand deposits	\$ 53,766	\$ 55,703	\$ (1,937)
Interest-bearing accounts:			
NOW and money market accounts	137,164	126,567	10,597
Savings accounts	70,969	77,774	(6,805)
Certificates of deposit ⁽¹⁾	283,245	278,632	4,613
Total interest-bearing accounts	491,378	482,973	8,405
Total deposits	\$ 545,144	\$ 538,676	\$ 6,468

⁽¹⁾ Includes brokered deposits of \$7.0 million and \$7.1 million at September 30, 2007 and December 31, 2006, respectively.

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 nine months ended September 30, 2007 and 2006 is as follows:

	Before Tax Amount	Tax Effects	Net of Tax Amount
Nine Months Ended September 30, 2007			

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(Dollars in Thousands)

Unrealized holding gains on available for sale securities	\$ 1,110	\$ (377)	\$ 733
Reclassification adjustment for gains recognized in net income	(106)	36	(70)
Unrealized holding gains on available for sale securities, net of taxes	\$ 1,004	\$ (341)	\$ 663

Table of Contents**SI FINANCIAL GROUP, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****SEPTEMBER 30, 2007 AND 2006 AND DECEMBER 31, 2006**

Nine Months Ended September 30, 2006 <i>(Dollars in Thousands)</i>	Before Tax Amount	Tax Effects	Net of Tax Amount
Unrealized holding gains on available for sale securities	\$ 488	\$ (166)	\$ 322
Reclassification adjustment for losses recognized in net income	284	(97)	187
Unrealized holding gains on available for sale securities, net of taxes	\$ 772	\$ (263)	\$ 509

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 September 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.

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 nine months ended September 30, 2007 of \$200,000 and \$585,000, respectively, and \$192,000 and \$574,000 for the three and nine months ended September 30, 2006, respectively.

Table of Contents**SI FINANCIAL GROUP, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****SEPTEMBER 30, 2007 AND 2006 AND DECEMBER 31, 2006**

The following is a summary of activity for the Company's stock options for the nine months ended September 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	\$ 2.99
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 September 30, 2007:

Exercise Prices	Options Outstanding	Weighted-Average		Options Exercisable
		Remaining Contractual Life (in years)	Weighted-Average Exercise Price	
\$10.10	457,500	7.63	\$ 10.10	183,000
11.39	10,000	8.40	11.39	2,000
12.51	41,500	9.71	12.51	
	509,000	7.82	\$ 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 September 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 September 30, 2007 and December 31, 2006.

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September 30, 2007 (Dollars in Thousands)	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Risk-based Capital Ratio	\$ 71,456	15.57%	\$ 36,715	8.00%	\$ 45,893	10.00%
Tier I Risk-based Capital Ratio	67,188	14.64	18,357	4.00	27,536	6.00
Tier I Capital Ratio	67,188	8.98	29,928	4.00	37,410	5.00

Table of Contents**SI FINANCIAL GROUP, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****SEPTEMBER 30, 2007 AND 2006 AND DECEMBER 31, 2006**

December 31, 2006 (Dollars in Thousands)	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total 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. 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 September 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 2004.

NOTE 10. SUBSEQUENT EVENT

On October 15, 2007, the Company announced that it has reached an agreement with Eastern Federal Bank to acquire the Eastern Federal Bank branch office located in Colchester, Connecticut. The purchase agreement includes the acquisition of certain fixed assets and the assumption of deposit liabilities and the branch lease agreement. The transaction is scheduled to be completed on or about November 30, 2007, subject to regulatory approval. This transaction is not expected to have a material impact on the financial condition of the Bank or the Company.

Table of Contents

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

The following analysis discusses changes in financial condition at September 30, 2007 and December 31, 2006 and results of operations for the three and nine months ended September 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 and in its other Securities and Exchange Commission reports. 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 loan adjusted for qualitative factors. 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 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.*

Deferred Income Taxes. The Company uses the asset and liability method of accounting for income taxes as prescribed in Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. If current available information raises doubt as to the realization of the deferred tax assets, a valuation allowance is established. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The Company exercises significant judgment in evaluating the amount and timing of recognition of the resulting tax liabilities and assets. These judgments require us to make projections of future taxable income. The judgments and estimates we make in determining our deferred tax assets, which are inherently subjective, are reviewed on a continual basis as regulatory and business factors change. Any reduction in estimated future taxable income may require us to record a valuation allowance against our deferred tax assets. A valuation allowance would result in additional income tax expense in the period, which would negatively affect earnings.

Table of Contents

Impairment of Long-Lived Assets. The Company is required to record certain assets it has acquired, including identifiable intangible assets such as core deposit intangibles, goodwill and certain liabilities that it assumed at fair value, which may involve making estimates based on third party valuations, such as appraisals, or internal valuations based on discounted cash flow analyses or other valuation techniques. Further, long-lived assets, including intangible assets and premises and equipment, that are held and used by the Company, are presumed to have a useful life. The determination of the useful lives of intangible assets is subjective, as is the appropriate amortization period for such intangible and long-lived assets. Additionally, long-lived assets are reviewed for impairment annually at a minimum or whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. If impairment is indicated by that review, the asset is written down to its estimated fair value through a charge to noninterest expenses. Testing for impairment is a subjective process, the application of which could result in different evaluations of impairment.

Impact of New Accounting Standards

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

Recent Developments and Initiatives

On August 27, 2007, the Bank opened its 20th branch in East Hampton, Connecticut.

On September 19, 2007, the Company's Board of Directors declared a quarterly cash dividend of \$0.04 per share, paid on October 26, 2007, to stockholders of record at the close of business on October 5, 2007. SI Bancorp, MHC, the Company's mutual holding company parent, waived receipt of its dividend.

The Company repurchased 169,000 shares of common stock at an average cost of \$10.45 per share during the three months ended September 30, 2007.

On October 15, 2007, the Bank entered into an agreement with Eastern Federal Bank to acquire its branch office located in Colchester, Connecticut.

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

Assets:

Summary. Assets increased \$8.4 million, or 1.1%, to \$765.5 million at September 30, 2007, as compared to \$757.0 million at December 31, 2006, primarily due to increases in net loans receivable of \$10.4 million and available for sale securities of \$6.9 million, other real estate owned of \$850,000 and premises and equipment of \$825,000, offset by decreases of \$10.2 million in cash and cash equivalents, and \$603,000 in other assets and \$374,000 in accrued interest receivable. The increase in net loans receivable included an increase in residential and commercial mortgage loans, offset by decreases in consumer loans, resulting from the disposition of the indirect automobile loan portfolio during the second quarter of 2007, and commercial business loans. Available for sale securities increased as a result of purchases of predominately mortgage-backed securities with longer-term maturities with proceeds from the sale of government-sponsored enterprise securities. Other real estate owned represents a commercial real estate property with a net realizable value of \$850,000. The increase in premises and equipment was primarily due to fixed assets associated with the Bank's new branch in East Hampton, Connecticut. Cash and cash equivalents decreased as excess funds were used to purchase mortgage-backed securities and to fund loan growth. 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 \$10.4 million. Loan originations declined for both the three and nine months ended September 30, 2007 compared to the same periods of the prior year, as a result of a slowing of the current real estate environment. For the first nine months of 2007, the Company sold \$9.3 million of longer-term fixed-rate residential mortgage loans. The disposition of the indirect automobile portfolio further decreased net loans receivable by \$5.2 million during the second quarter of 2007. Additionally, a commercial real estate property with a net realizable value of \$850,000 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:

Residential Mortgage Loans. Despite mortgage loan sales, residential mortgage loans increased \$17.6 million. Loan originations for residential mortgage loans decreased \$23.0 million for the first nine months of 2007 compared to the same period in 2006.

Table of Contents

Commercial Loans. Multi-family and commercial real estate increased \$6.2 million, or 5.2%. However, commercial business loans declined \$4.7 million, or 6.3%, for 2007, despite an increase in commercial business loan originations of \$1.4 million, primarily due to loan repayments of purchased Small Business Administration and United States Department of Agriculture loans.

Consumer Loans. Consumer loans decreased \$7.5 million during the first nine months of 2007, primarily the result of the disposition of the indirect automobile loan portfolio totaling \$5.2 million. Loan originations for consumer loans were down \$1.7 million for the nine months ended September 30, 2007 compared to the same period of 2006.

The allowance for loan losses totaled \$4.9 million at September 30, 2007. The ratio of the allowance for loan losses to total loans increased from 0.73% at September 30, 2006 to 0.84% at September 30, 2007. At September 30, 2007, nonperforming loans totaled \$3.4 million compared to \$903,000 at September 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, and \$721,000 in commercial business loans. For the three months ended September 30, 2007, net loan recoveries were \$1,000. Net loan charge-offs were \$171,000 for the nine months ended September 30, 2007. Net loan charge-offs were \$29,000 and \$30,000 for the three and nine months ended September 30, 2006, respectively. Higher loan charge-offs of commercial real estate loans and consumer loans related to the indirect automobile loan portfolio contributed to the increase in loan charge-offs for the nine months ended September 30, 2007.

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

<i>(Dollars in Thousands)</i>	September 30, 2007	December 31, 2006
Nonaccrual loans:		
Real estate loans	\$ 2,708	\$ 392
Commercial business loans	721	71
Consumer loans	12	929
Total nonaccrual loans	3,441	1,392
Real estate owned, net	850	
Total nonperforming assets	4,291	1,392
Troubled debt restructurings	71	72
Total nonperforming assets and troubled debt restructurings	\$ 4,362	\$ 1,464
 Total nonperforming loans to total loans	 0.58%	 0.24%
Total nonperforming loans to total assets	0.45%	0.18%
Total nonperforming assets and troubled debt restructurings to total assets	0.57%	0.19%

Investment Activities. At September 30, 2007, the Company's investment portfolio, excluding Federal Home Loan Bank stock, consisted solely of available for sale securities of \$126.5 million, or 16.5% 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 \$6.9 million, or 5.8%, was primarily due to purchases of predominately mortgage-backed securities. During 2007, the Company repositioned its balance sheet and invested the proceeds from the sale of marketable equity securities and government-sponsored enterprise securities into longer-term and higher-yielding mortgage-backed securities.

Table of Contents

Liabilities:

Summary. Total liabilities increased \$8.4 million, or 1.3%, from December 31, 2006 to September 30, 2007 primarily as a result of net increases in Federal Home Loan Bank advances of \$10.8 million and deposits of \$6.5 million, offset by a decrease in subordinated debt of \$7.2 million.

Deposits. Deposits increased \$6.5 million, or 1.2%, to \$545.1 million at September 30, 2007. Interest-bearing deposits increased \$8.4 million, or 1.7%, primarily due to increases in NOW and money market accounts and certificates of deposits of \$10.6 million and \$4.6 million, respectively. The Bank's new e.SI checking product contributed \$9.7 million to the increase in NOW and money market accounts. Certificates of deposit increased \$4.6 million, or 1.7%, 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. The increase in deposits was offset by decreases in savings accounts of \$6.8 million and noninterest-bearing accounts of \$1.9 million related to lower balances in primarily business checking accounts.

Borrowings. Borrowings increased \$3.5 million from \$127.4 million at December 31, 2006 to \$131.0 million at September 30, 2007, resulting from an increase of \$10.8 million in Federal Home Loan Bank advances, offset by the redemption of \$7.2 million of debentures in April 2007 with a portion of the proceeds from the \$8.0 million trust preferred securities offering in September 2006.

Equity:

Summary. Total stockholders' equity remained at \$82.4 million as of September 30, 2007, reflecting earnings of \$954,000, a decrease in net unrealized holding losses on available for sale securities aggregating \$663,000 (net of taxes) and the amortization of equity awards of \$585,000, offset by stock repurchases of 185,820 shares at a cost of \$2.0 million and declared dividends of \$558,000.

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, decreased \$663,000 to \$348,000 at September 30, 2007. Unrealized holding losses resulted from a decline in the market value of primarily 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.

Table of Contents

	At or For the Three Months Ended September 30, 2007			2006			Average
	Average Balance	Interest & Dividends	Average Yield/ Rate	Average Balance	Interest & Dividends		Yield/ Rate
<i>(Dollars in Thousands)</i>							
ASSETS:							
Interest-earning assets:							
Loans ⁽¹⁾⁽²⁾	\$ 584,554	\$ 9,349	6.35%	\$ 562,706	\$ 8,807		6.21%
Investment securities ⁽³⁾	131,352	1,571	4.75	131,484	1,479		4.46
Other interest-earning assets	6,688	73	4.33	3,730	24		2.55
Total interest-earning assets	722,594	10,993	6.04	697,920	10,310		5.86
Noninterest-earning assets	39,556			37,218			
Total assets	\$ 762,150			\$ 735,138			
LIABILITIES AND EQUITY:							
Interest-bearing liabilities:							
Deposits:							
NOW and money market	\$ 134,770	500	1.47	\$ 122,973	251		0.81
Savings ⁽⁴⁾	76,001	278	1.45	82,043	242		1.17
Certificates of deposit ⁽⁵⁾	282,879	3,234	4.54	280,121	3,023		4.28
Total interest-bearing deposits	493,650	4,012	3.22	485,137	3,516		2.88
FHLB advances	114,227	1,324	4.60	101,548	1,103		4.31
Subordinated debt	8,248	144	6.93	8,114	177		8.65
Total interest-bearing liabilities	616,125	5,480	3.53	594,799	4,796		3.20
Noninterest-bearing liabilities	63,204			59,797			
Total liabilities	679,329			654,596			
Total stockholders' equity	82,821			80,542			
Total liabilities and stockholders' equity	\$ 762,150			\$ 735,138			
Net interest-earning assets	\$ 106,469			\$ 103,121			
Tax equivalent net interest income ⁽³⁾		5,513			5,514		
Tax equivalent interest rate spread ⁽⁶⁾			2.51				2.66
Tax equivalent net interest margin as a percentage of interest-earning assets ⁽⁷⁾			3.03				3.13
Average of interest-earning assets to average interest-bearing liabilities			117.28				117.34
Less: Tax equivalent adjustment ⁽³⁾		(1)			(2)		
Net interest income per statements of income		\$ 5,512			\$ 5,512		

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

Table of Contents

	At or For the Nine Months Ended September 30, 2007			2006			Average
	Average Balance	Interest & Dividends	Average Yield/ Rate	Average Balance	Interest & Dividends	Average Yield/ Rate	
<i>(Dollars in Thousands)</i>							
ASSETS:							
Interest-earning assets:							
Loans ⁽¹⁾⁽²⁾	\$ 582,083	\$ 27,399	6.29%	\$ 546,256	\$ 25,874	6.33%	
Investment securities ⁽³⁾	127,905	4,560	4.77	130,575	4,221	4.32	
Other interest-earning assets	8,691	235	3.62	7,480	139	2.48	
Total interest-earning assets	718,679	32,194	5.99	684,311	30,234	5.91	
Noninterest-earning assets	38,555			37,819			
Total assets	\$ 757,234			\$ 722,130			
LIABILITIES AND EQUITY:							
Interest-bearing liabilities:							
Deposits:							
NOW and money market	\$ 131,611	1,287	1.31	\$ 123,708	697	0.75	
Savings ⁽⁴⁾	78,278	802	1.37	84,921	705	1.11	
Certificates of deposit ⁽⁵⁾	281,386	9,548	4.54	268,581	8,070	4.02	
Total interest-bearing deposits	491,275	11,637	3.17	477,210	9,472	2.65	
FHLB advances	110,989	3,792	4.57	99,213	3,118	4.20	
Subordinated debt	11,209	624	7.44	7,519	475	8.45	
Total interest-bearing liabilities	613,473	16,053	3.50	583,942	13,065	2.99	
Noninterest-bearing liabilities	60,727			57,912			
Total liabilities	674,200			641,854			
Total stockholders' equity	83,034			80,276			
Total liabilities and stockholders' equity	\$ 757,234			\$ 722,130			
Net interest-earning assets	\$ 105,206			\$ 100,369			
Tax equivalent net interest income ⁽³⁾		16,141			17,169		
Tax equivalent interest rate spread ⁽⁶⁾			2.49			2.92	
Tax equivalent net interest margin as a percentage of interest-earning assets ⁽⁷⁾			3.00			3.35	
Average of interest-earning assets to average interest-bearing liabilities			117.15			117.19	
Less: Tax equivalent adjustment ⁽³⁾							