

SOUTHERN CONNECTICUT BANCORP INC  
Form 10QSB  
August 11, 2006

**U. S. SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

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**F O R M 10 - Q S B**

Quarterly Report Under Section 13 or 15(d) of the Securities Exchange Act of 1934

For the Quarterly Period Ended June 30, 2006

Transition Report Under Section 13 or 15(d) of the Exchange Act

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-49784

**SOUTHERN CONNECTICUT BANCORP, INC.**  
(Name of Small Business Issuer as Specified in Its Charter)

Connecticut  
(State or Other Jurisdiction of Incorporation  
or Organization)

06-1609692  
(I.R.S. Employer Identification Number)

215 Church Street  
New Haven, Connecticut 06510  
(Address of Principal Executive Offices)

(203) 782-1100  
(Issuer's Telephone Number)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that this 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 shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

The number of shares of the issuer's Common Stock, par value \$.01 per share, outstanding as of August 11, 2006: 2,938,869

Transitional Small Business Disclosure Format. Yes  No

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**SOUTHERN CONNECTICUT BANCORP, INC. AND SUBSIDIARY  
CONSOLIDATED BALANCE SHEETS**

**June 30, 2006 (unaudited) and December 31, 2005**

	2006	2005
<b>Assets</b>		
Cash and due from banks	\$ 1,713,920	\$ 966,732
Federal funds sold	10,760,000	9,579,000
Short-term investments	6,244,034	6,023,555
<b>Cash and cash equivalents</b>	<b>18,717,954</b>	<b>16,569,287</b>
Available for sale securities, at fair value	8,892,402	9,973,488
Federal Home Loan Bank Stock	66,100	60,000
Loans receivable (net of allowance for loan losses of \$939,220 in 2006 and \$778,051 in 2005)	63,996,039	55,881,508
Loans held for sale, at fair value	366,872	401,503
Accrued interest receivable	371,247	324,346
Premises and equipment, net	4,417,296	4,457,715
Other assets	1,035,990	906,387
<b>Total assets</b>	<b>\$ 97,863,900</b>	<b>\$ 88,574,234</b>
<b>Liabilities and Shareholders' Equity</b>		
<b>Liabilities</b>		
Deposits		
Noninterest bearing deposits	\$ 23,137,094	\$ 18,091,849
Interest bearing deposits	51,995,247	47,187,667
<b>Total deposits</b>	<b>75,132,341</b>	<b>65,279,516</b>
Repurchase agreements	820,075	1,363,368
Accrued expenses and other liabilities	659,219	445,295
Capital lease obligations	1,188,684	1,189,212
<b>Total liabilities</b>	<b>77,800,319</b>	<b>68,277,391</b>
Commitments and Contingencies	-	-
<b>Shareholders' Equity</b>		
Preferred stock, no par value; 500,000 shares authorized; none issued		
Common stock, par value \$.01; 5,000,000, shares authorized; shares issued and outstanding: 2006 2,938,869; 2005 2,937,525	29,389	29,375
Additional paid-in capital	24,093,167	24,083,638
Accumulated deficit	(3,641,091)	(3,477,576)
Accumulated other comprehensive loss – net unrealized loss on available for sale securities	(417,884)	(338,594)
<b>Total shareholders' equity</b>	<b>20,063,581</b>	<b>20,296,843</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 97,863,900</b>	<b>\$ 88,574,234</b>

See Notes to Consolidated Financial Statements.



**SOUTHERN CONNECTICUT BANCORP, INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**For the Three Months and Six Months Ended June 30, 2006 and 2005 (unaudited)**

	Three Months Ended		Six Months Ended	
	June		June	
	2006	2005	2006	2005
Interest Income				
Interest and fees on loans	\$ 1,388,549	\$ 1,087,627	\$ 2,658,689	\$ 2,084,574
Interest on securities	77,443	86,126	156,163	172,787
Interest on federal funds sold and short-term investments	175,983	99,487	319,479	188,810
<b>Total interest income</b>	<b>1,641,975</b>	<b>1,273,240</b>	<b>3,134,331</b>	<b>2,446,171</b>
Interest Expense				
Interest on deposits	449,984	202,891	816,413	393,519
Interest on capital lease obligations	43,640	43,228	87,181	86,375
Interest on repurchase agreements	4,315	2,879	7,612	5,659
<b>Total interest expense</b>	<b>497,939</b>	<b>248,998</b>	<b>911,206</b>	<b>485,553</b>
<b>Net interest income</b>	<b>1,144,036</b>	<b>1,024,242</b>	<b>2,223,125</b>	<b>1,960,618</b>
Provision for Loan Losses	162,507	93,409	104,475	110,409
<b>Net interest income after provision for loan losses</b>	<b>981,529</b>	<b>930,833</b>	<b>2,118,650</b>	<b>1,850,209</b>
Noninterest Income				
Service charges and fees	132,392	95,809	218,751	176,606
Gains and fees from sales and referrals of loans	24,734	28,809	61,300	42,081
Other noninterest income	41,579	36,923	103,064	71,718
<b>Total noninterest income</b>	<b>198,705</b>	<b>161,541</b>	<b>383,115</b>	<b>290,405</b>
Noninterest Expense				
Salaries and benefits	743,128	608,105	1,426,909	1,165,537
Occupancy and equipment	176,422	158,940	335,647	302,279
Professional services	155,545	188,493	257,213	282,633
Data processing and other outside services	92,470	85,239	173,443	161,721
Advertising and promotional expense	76,324	52,448	120,748	79,982
Forms, printing and supplies	32,126	26,270	64,428	43,544
Other operating expenses	146,627	133,349	286,892	280,955
<b>Total noninterest expense</b>	<b>1,422,642</b>	<b>1,252,844</b>	<b>2,665,280</b>	<b>2,316,651</b>
<b>Net loss</b>	<b>\$ (242,408)</b>	<b>\$ (160,470)</b>	<b>\$ (163,515)</b>	<b>\$ (176,037)</b>
Basic loss per Share	\$ (0.08)	\$ (0.05)	\$ (0.06)	\$ (0.06)

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Diluted loss per Share	\$	(0.08)	\$	(0.05)	\$	(0.06)	\$	(0.06)
Dividends per Share	\$	-	\$	-	\$	-	\$	-

See Notes to Consolidated Financial Statements.

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**SOUTHERN CONNECTICUT BANCORP, INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**  
**For the Six Months Ended June 30, 2006 and 2005 (unaudited)**

	<b>Number of Shares</b>	<b>Common Stock</b>	<b>Additional Paid-in Capital</b>	<b>Accumulated Deficit</b>	<b>Accumulated Other Comprehensive Loss</b>	<b>Total</b>
Balance December 31, 2004	2,797,711	\$ 27,977	\$ 24,085,612	\$ (3,199,126)	\$ (216,736)	\$ 20,697,727
Comprehensive Loss:						
Net Loss	-	-	-	(176,037)	-	(176,037)
Unrealized holding gains on available for sale securities	-	-	-	-	8,117	8,117
Total comprehensive loss						(167,920)
5% stock dividend	139,814	1,398	(1,398)	-	-	-
Fractional shares paid in cash	-	-	(576)	-	-	(576)
Balance June 30, 2005	2,937,525	\$ 29,375	\$ 24,083,638	\$ (3,375,163)	\$ (208,619)	\$ 20,529,231
<b>Balance December 31, 2005</b>	<b>2,937,525</b>	<b>\$ 29,375</b>	<b>\$ 24,083,638</b>	<b>\$ (3,477,576)</b>	<b>\$ (338,594)</b>	<b>\$ 20,296,843</b>
Comprehensive Loss:						
Net Loss	-	-	-	(163,515)	-	(163,515)
Unrealized holding loss on available for sale securities	-	-	-	-	(79,290)	(79,290)
Total comprehensive loss						(242,805)
Common Stock Issued	1,344	14	9,529			9,543
<b>Balance June 30, 2006</b>	<b>2,938,869</b>	<b>\$ 29,389</b>	<b>\$ 24,093,167</b>	<b>\$ (3,641,091)</b>	<b>\$ (417,884)</b>	<b>\$ 20,063,581</b>

See Notes to  
Consolidated  
Financial Statements.



**SOUTHERN CONNECTICUT BANCORP, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**For the Six Months Ended June 30, 2006 and 2005 (unaudited)**

<b>Cash Flows From Operations</b>	<b>2006</b>	<b>2005</b>
Net loss	\$ (163,515)	\$ (176,037)
Adjustments to reconcile net loss to net cash used in operating activities:		
Amortization and accretion of premiums and discounts on investments, net	(1,192)	(1,207)
Provision for loan losses	104,475	110,409
Loans originated for sale, net of principal payments received	(427,369)	(689,437)
Proceeds from sales of loans	462,000	140,250
Gains on sales of loans	(51,022)	(14,243)
Depreciation and amortization	176,813	150,700
Increase in cash surrender value of life insurance	(16,500)	(18,000)
Changes in assets and liabilities:		
Decrease in deferred loan fees	(15,892)	(12,081)
(Increase) decrease in accrued interest receivable	(46,901)	2,698
Increase in other assets	(113,103)	(35,768)
Increase in accrued expenses and other liabilities	223,467	148,124
<b>Net cash used in operating activities</b>	<b>131,261</b>	<b>(394,592)</b>
<b>Cash Flows From Investing Activities</b>		
Principal repayments on available for sale securities	2,988	176,942
Proceeds from maturities of available for sale securities	1,000,000	-
Purchases of Federal Home Loan Bank Stock	(6,100)	(12,900)
Net increase in loans receivable	(8,152,092)	(3,178,320)
Purchases of premises and equipment	(136,394)	(1,056,554)
<b>Net cash used in investing activities</b>	<b>(7,291,598)</b>	<b>(4,070,832)</b>
<b>Cash Flows From Financing Activities</b>		
Net increase in demand, savings and money market deposits	5,593,043	5,254,494
Net increase in certificates of deposit	4,259,782	840,542
Net decrease in repurchase agreements	(543,293)	(307,759)
Principal payments on capital lease obligations	(528)	(474)
Distribution in cash for fractional share of common stock	-	(576)
<b>Net cash provided by financing activities</b>	<b>9,309,004</b>	<b>5,786,227</b>
<b>Net increase in cash and cash equivalents</b>	<b>2,148,667</b>	<b>1,320,803</b>
<b>Cash and cash equivalents</b>		

Beginning		<b>16,569,287</b>		15,743,882
<b>Ending</b>	\$	<b>18,717,954</b>	\$	17,064,685

(continued)

**SOUTHERN CONNECTICUT BANCORP, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)**  
**For the Six Months Ended June 30, 2006 and 2005 (unaudited)**

	2006		2005
<b>Supplemental disclosures of cash flow information:</b>			
Cash paid during the period for:			
Interest	\$ 899,240	\$	475,002
Income taxes	\$ -	\$	-
<b>Supplemental disclosures of noncash investing activities:</b>			
Unrealized holding (losses) gains on available for sale securities arising during the period	\$ (79,290)	\$	8,117
Transfer of Loans Held for Sale to Loans Receivable	\$ (86,884)	\$	-
Accrued directors' fees paid in common stock	\$ 9,543	\$	-

See Notes to Consolidated Financial Statements.

**Southern Connecticut Bancorp, Inc.**  
**Notes to Consolidated Financial Statements**  
**(Unaudited)**

**Note 1. Nature of Operations**

Southern Connecticut Bancorp, Inc. (“Bancorp”) is a bank holding company headquartered in New Haven, Connecticut that was incorporated on November 8, 2000. Bancorp’s strategic objective is to serve as a bank holding company for a community-based commercial bank serving the greater New Haven and greater New London markets, as well as the approximately 62 miles of coastal towns and communities located between these two cities and extending to Rhode Island. Bancorp owns 100% of the capital stock of The Bank of Southern Connecticut (the “Bank”), a Connecticut-chartered bank with its headquarters in New Haven, Connecticut. The Bank operates through five offices, four of which are located in the greater New Haven area, including the main office in downtown New Haven, a branch in the Westville/Amity section of New Haven, a branch in Branford, Connecticut, a branch in North Haven, Connecticut, as well as a branch in New London, Connecticut. The New London branch, which opened March 6, 2006, is the headquarters of The Bank of Southeastern Connecticut, a division of The Bank of Southern Connecticut. The North Haven branch, which opened July 10, 2006, is the headquarters of The Bank of North Haven, a division of The Bank of Southern Connecticut. Bancorp owns a property in Clinton, Connecticut that is suitable for a branch location. A portion of the property has been rented. Management is considering opening a branch of The Bank of Southern Connecticut at that location at some point in the future. The Bank focuses on serving the banking needs of small to medium-sized businesses, professionals and professional corporations, and their owners and employees in the greater New Haven and greater New London markets. The Bank has been successful in winning business by offering a combination of competitive pricing for its services, quick decision making processes and a high level of personalized, “high touch” customer service.

**Note 2. Basis of Financial Statement Presentation**

The consolidated balance sheet at December 31, 2005 has been derived from the audited consolidated financial statements of Bancorp at that date, but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements.

The accompanying consolidated unaudited financial statements as of and for the three and six months ended June 30, 2006 and 2005 have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). Accordingly, certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted. The accompanying consolidated financial statements and notes thereto should be read in conjunction with the audited financial statements of Bancorp and notes thereto as of December 31, 2005, filed with the Securities and Exchange Commission on Form 10-KSB on March 22, 2006.

The accompanying unaudited consolidated financial information reflects, in the opinion of management, all adjustments, consisting of normal recurring accruals, necessary for a fair presentation of the interim periods presented. The results of operations for the three and six months ended June 30, 2006 are not necessarily indicative of the results of operations that may be expected for all of 2006.

**Note 3. Available for Sale Securities**

The amortized cost, gross unrealized gains, gross unrealized losses and approximate fair values of available for sale securities at June 30, 2006 and December 31, 2005 are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b><u>June 30, 2006</u></b>				
U.S. Government Sponsored Agency Obligations	\$ 9,198,905	\$ -	\$ (412,800)	\$ 8,786,105
Mortgage Backed Securities	111,381	-	(5,084)	106,297
	\$ 9,310,286	\$ -	\$ (417,884)	\$ 8,892,402
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b><u>December 31, 2005</u></b>				
U.S. Government Sponsored Agency Obligations	\$ 10,197,667	\$ -	\$ (337,415)	\$ 9,860,252
Mortgage Backed Securities	114,415	-	(1,179)	113,236
	\$ 10,312,082	\$ -	\$ (338,594)	\$ 9,973,488

At June 30, 2006, gross unrealized holding losses on available for sale securities totaled \$417,884. All such unrealized losses have existed for a period of twelve months or longer. Management does not believe that any of the unrealized losses as of June 30, 2006 are other than temporary, as they relate to debt and mortgage-backed securities issued by U.S. Government sponsored agencies resulting from changes in the interest rate environment. Bancorp has the intent and ability to hold these securities to maturity, if necessary, and expects to receive all contractual principal and interest related to these investments. As a result, management believes that these unrealized losses will not have a negative impact on future earnings or a permanent effect on capital.

At December 31, 2005, gross unrealized holding losses on available for sale securities totaled \$338,594. Of the securities with unrealized losses, the total unrealized losses on securities that existed for a period of twelve months or longer amounted to \$287,729.

**Note 4. Loans Receivable**

A summary of Bancorp's loan portfolio at June 30, 2006 and December 31, 2005 is as follows:

	<b>June 30, 2006</b>	December 31, 2005
Commercial loans secured by real estate	\$ 28,770,443	\$ 26,724,972
Commercial loans	29,911,568	25,852,655
Construction and land loans	4,413,471	2,573,809
Residential mortgage loans	152,691	155,909
Consumer home equity loans	818,671	750,114
Consumer installment loans	957,492	707,069
<b>Total loans</b>	<b>65,024,336</b>	<b>56,764,528</b>
Net deferred loan fees	(89,077)	(104,969)
Allowance for loan losses	(939,220)	(778,051)
<b>Loans receivable, net</b>	<b>\$ 63,996,039</b>	<b>\$ 55,881,508</b>

**Allowance for Loan Losses**

The following represents the activity in the allowance for loan losses for the six months ended June 30, 2006 and 2005:

	<b>For the Period Ended June 30,</b>	
	<b>2006</b>	2005
Balance at beginning of period	\$ 778,051	\$ 752,394
Charge-offs	(2,759)	(173,998)
Recoveries	59,453	750
Provision charged to operations	104,475	110,409
Balance at end of period	\$ 939,220	\$ 689,555
Net recoveries (charge-offs) to average loans	<b>0.09%</b>	<b>(0.33%)</b>

The following is a summary of non-accrual and past due loans:

	<b>June 30, 2006</b>	<b>December 31, 2005</b>
Loans delinquent over 90 days and still accruing	\$ -	\$ -
Non-accrual loans	302,038	578,826
<b>Total</b>	<b>\$ 302,038</b>	<b>\$ 578,826</b>
% of Total Loans	<b>0.47%</b>	1.02%
% of Total Assets	<b>0.31%</b>	0.65%
Ratio of allowance to nonperforming loans	<b>3.11</b>	1.34

**Note 5. Deposits**

At June 30, 2006 and December 31, 2005, deposits consisted of the following:

	<b>June 30, 2006</b>	December 31, 2005
Noninterest bearing deposits	\$ 23,137,094	\$ 18,091,849
Interest bearing deposits		
Checking	6,368,547	6,175,953
Money Market	27,355,587	27,001,393
Savings	2,691,246	2,690,236
Total checking, money market & savings	36,415,380	35,867,582
Time Certificates under \$100,000	7,619,063	4,498,286
Time Certificates of \$100,000 or more	7,960,804	6,821,799
Total time deposits	15,579,867	11,320,085
Total interest bearing deposits	51,995,247	47,187,667
Total deposits	\$ 75,132,341	\$ 65,279,516

**Note 6. Available Borrowings**

The Bank is a member of the Federal Home Loan Bank of Boston ("FHLB"). At June 30, 2006, the Bank had the ability to borrow from the FHLB based on a certain percentage of the value of the Bank's qualified collateral, as defined in the FHLB Statement of Products Policy, at the time of the borrowing. In accordance with an agreement with the FHLB, the qualified collateral must be free and clear of liens, pledges and encumbrances. There were no borrowings outstanding with the FHLB at June 30, 2006.

The Bank is required to maintain an investment in capital stock of the FHLB in an amount equal to a percentage of its outstanding mortgage loans and contracts secured by residential properties, including mortgage-backed securities. No ready market exists for FHLB stock and it has no quoted market value. For disclosure purposes, such stock is assumed to have a market value which is equal to cost since the Bank can redeem the stock with FHLB at cost.

**Note 7. Stock Dividend and Income (Loss) Per Share**

On April 12, 2005, Bancorp declared a 5% stock dividend to shareholders of record as of April 26, 2005. The stock dividend was distributed on May 9, 2005. Payment of this dividend resulted in the issuance of 139,814 additional common shares. Generally accepted accounting principals require such dividends to be recorded at fair value; however, when there is an accumulated deficit, the Securities and Exchange Commission ("SEC") advises that such stock dividends be accounted for by capitalizing the stock issued at par value only, through a reduction in additional paid-in capital. Fractional shares were payable in cash on an equivalent share basis of \$8.05.

Bancorp is required to present basic income (loss) per share and diluted income (loss) per share in its statements of operations. Basic per share amounts are computed by dividing net income (loss) by the weighted average number of common shares outstanding. Diluted per share amounts assume exercise of all potential common stock equivalents in weighted average shares outstanding, unless the effect is antidilutive. Bancorp is also required to provide a reconciliation of the numerator and denominator used in the computation of both basic and diluted income (loss) per share. The following is information about the computation of loss per share for the three and six month periods ended June 30, 2006 and 2005.



**Loss per Share****Three Months Ended  
June 30,**

	<b>Net Loss</b>	<b>2006 Weighted Average Shares</b>	<b>Amount Per Share</b>	<b>Net Loss</b>	<b>2005 Weighted Average Shares</b>	<b>Amount Per Share</b>
<b>Basic Loss Per Share</b>						
<b>Loss available to common shareholders</b>	\$ (242,408)	2,937,822	\$ (0.08)	\$ (160,470)	2,937,525	\$ (0.05)
<b>Effect of Dilutive Securities</b>						
<b>Warrants/Stock Options outstanding</b>	-	-	-	-	-	-
<b>Diluted Loss Per Share</b>						
<b>Loss available to common shareholders plus assumed conversions</b>	\$ (242,408)	2,937,822	\$ (0.08)	\$ (160,470)	2,937,525	\$ (0.05)

**Six Months Ended  
June 30,**

	<b>Net Loss</b>	<b>2006 Weighted Average Shares</b>	<b>Amount Per Share</b>	<b>Net Loss</b>	<b>2005 Weighted Average Shares</b>	<b>Amount Per Share</b>
<b>Basic Loss Per Share</b>						
<b>Loss available to common shareholders</b>	\$ (163,515)	2,937,822	\$ (0.06)	\$ (176,037)	2,937,525	\$ (0.06)
<b>Effect of Dilutive Securities</b>						
<b>Warrants/Stock Options outstanding</b>	-	-	-	-	-	-
<b>Diluted Loss Per Share</b>						
<b>Loss available to common shareholders plus assumed conversions</b>	\$ (163,515)	2,937,822	\$ (0.06)	\$ (176,037)	2,937,525	\$ (0.06)

For the three and six months ended June 30, 2006 and 2005, common stock equivalents have been excluded from the computation of the net loss per share because the inclusion of such equivalents is antidilutive.

**Note 8. Other Comprehensive Loss**

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



	<b>Six Months Ended June 30, 2006</b>		
	<b>Before-Tax Amount</b>	<b>Taxes</b>	<b>Net-of-Tax Amount</b>
<b>Unrealized holding losses arising during the period</b>	\$ (79,290)	\$ -	\$ (79,290)
<b>Reclassification adjustment for amounts recognized in net loss</b>	-	-	-
<b>Unrealized holding loss on available for sale securities</b>	\$ (79,290)	\$ -	\$ (79,290)

	<b>Six Months Ended June 30, 2005</b>		
	<b>Before-Tax Amount</b>	<b>Taxes</b>	<b>Net-of-Tax Amount</b>
Unrealized holding gains arising during the period	\$ 8,117	\$ -	\$ 8,117
Reclassification adjustment for losses recognized in net loss	-	-	-
Unrealized holding gain on available for sale securities	\$ 8,117	\$ -	\$ 8,117

There is no tax effect relating to other comprehensive income because there is a full valuation allowance recorded against the deferred tax asset.

### **Note 9. Share Based Compensation**

Bancorp has adopted three share-based plans, the 2001 Stock Option Plan (the "2001 Plan"), the 2002 Stock Option Plan (the "2002 Plan"), and the 2005 Stock Option and Award Plan (the "2005 Plan"), under which an aggregate of 582,914 shares of Bancorp's common stock are reserved for issuance of Bancorp's common stock, or upon the exercise of both incentive options and nonqualified options, granted under the share-based plans.

Under all three plans, the exercise price for each share covered by an option may not be less than the fair market value of a share of Bancorp's common stock on the date of grant. For incentive options granted to a person who owns more than 10% of the combined voting power of Bancorp or any subsidiary ("ten percent shareholder"), the exercise price cannot be less than 110% of the fair market value on the date of grant.

Options under all three plans have a term of ten years unless a shorter period is determined at the time of grant, except that incentive options granted to any ten percent shareholder will have a term of five years unless a shorter term is fixed. Under the 2001 and 2002 plans, unless otherwise fixed at the time of grant, 40% of the options become exercisable one year from the date of grant, and 30% of the options become exercisable at each of the second and third anniversaries from the date of grant. Under the 2005 plan, the vesting terms of the awards are determined at the date of grant. Dividends are not paid on unexercised options.

Upon adoption of the 2002 Option Plan in May 2002, Bancorp determined that no additional options will be granted under the 2001 Option Plan.



A summary of the status of stock options at June 30, 2006 and changes during the six months then ended is as follows:

		2006			
	Number of Shares	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Term		Aggregate Intrinsic Value
Outstanding at beginning of year	431,068	\$ 8.03			
Granted	45,400	7.45			
Exercised	-				
Forfeited	(2,862)	8.18			
Outstanding at end of period	473,606	7.92	7.6	\$	7,979
Vested or expected to vest at the end of period	473,606	\$ 7.92	7.6	\$	7,979
Exercisable at end of period	428,606	\$ 7.97	7.4	\$	7,979
Weighted-average fair value per option of options granted during the period	\$ 3.48				

The weighted-average fair value per option of options granted during the six month period ended June 30, 2005 was \$2.86.

The fair value of options issued in the six months ended June 30, 2006 was estimated at the grant date using the Black-Sholes option-pricing model with the following assumptions:

	2006	2005
Dividend rate	-	-
Risk free interest rate	5.11% to 5.18%	3.80% to 4.39%
Expected term (in years)	9 Years	8 Years
Weighted-average volatility	26%	20%
Expected volatility	26%	20%

A summary of the status of the Company's nonvested shares at June 30, 2006 and changes during the six months then ended is as follows:

	2006	
	Number of Shares	Weighted- Average Grant-Date Fair Value
Nonvested at beginning of year	-	\$ -
Granted	45,400	3.47

Vested	<b>(400)</b>	<b>2.53</b>
Forfeited	-	-
Outstanding at end of period	<b>45,000</b>	<b>3.48</b>

As of June 30, 2006, there was \$157,000 of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under the option plan. That cost is expected to be recognized over a weighted-average period of three years. No compensation cost was recognized during the three and six months ended June 30, 2006.

On December 22, 2005, the Compensation Committee of the Board of Directors approved the acceleration of all unvested options, outstanding as of December 31, 2005, granted under Bancorp's 2002 Stock Option Plan, held by 48 employees and directors. The decision to accelerate the vesting of all unvested options was made primarily to reduce compensation expense that would have been recognized in future periods once Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment," ("SFAS 123(R)") issued by the Financial Accounting Standards Board, became effective for reporting periods beginning after December 31, 2005. Pursuant to the acceleration of all unvested options, options to purchase 197,571 shares of Bancorp's common stock became immediately exercisable as of December 31, 2005. The exercise prices for such accelerated options range from \$6.90 to \$10.39 per share. As a result of accelerating the vesting of these options, approximately \$300,000 of compensation expense, before taxes, that would have been recorded in 2006 through 2008 under SFAS 123(R), was reflected as 2005 pro forma compensation expense in Note 1 of the audited financial statements of Bancorp and notes thereto as of December 31, 2005, filed with the Securities and Exchange Commission on Form 10-KSB on March 22, 2006. There was no impact to the 2005 financial statements resulting from this action.

Effective January 1, 2006, Bancorp adopted SFAS 123(R) utilizing the modified prospective transition approach. Prior to the adoption of SFAS 123(R), Bancorp accounted for stock option grants in accordance with APB Opinion No. 25, Accounting for Stock Issued to Employees (the intrinsic value method), and accordingly, recognized no compensation expense for stock option grants for the years ended December 31, 2005 or 2004. Because there were no unvested share-based awards at January 1, 2006, the adoption of this statement had no initial effect on Bancorp's financial statements. The impact of FAS 123(R) on Bancorp during 2006 and beyond will depend upon various factors, among them being Bancorp's future compensation strategy. The pro forma compensation costs presented in the table below and in prior filings for Bancorp have been calculated using a Black-Scholes option pricing model and may not be indicative of amounts which should be expected in future years. However, Bancorp anticipates using the Black-Scholes option-pricing model for future awards.

As of January 1, 2006, compensation of members of the Board of Directors is paid fifty percent in cash and fifty percent in stock, versus one hundred percent in options as done in prior years. The fair market value of the stock used to calculate the shares to be paid is the average of the closing price of the common stock on the first and the fifteenth day of the third month of the quarter, or the following business day. The total director fees to be paid in stock charged to noninterest expense for the three and six months ended June 30, 2006 was \$9,899 and \$19,739, respectively. During the quarter ended June 30, 2006, 1,344 shares of stock were issued in payment of prior director fees accrued.

Had compensation cost for issuance of such options and warrants been recognized based on the fair values of awards on the grant dates, in accordance with the method described in SFAS No. 123(R), reported net loss and per share amounts for 2005 would have been increased to the pro forma amounts shown below:

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For the six months ended June 30, 2005

	Six Months Ended June 30, 2005
Net loss as reported	\$ (176,037)
Add: total stock based employee compensation expense included in reported net loss	-
Deduct: total stock based employee compensation expense determined under fair value based method for all awards	(123,501)
Pro forma net loss	\$ (299,538)
Basic loss per share:	
As reported	\$ (0.06)
Pro forma	\$ (0.10)
Diluted loss per share:	
As reported	\$ (0.06)
Pro forma	\$ (0.10)

For the three months ended June 30, 2005

	Three Months Ended June 30, 2005
Net loss as reported	\$ (160,470)
Add: total stock based employee compensation expense included in reported net loss net of related tax effects	-
Deduct: total stock based employee compensation expense determined under fair value based method for all awards	(64,571)
Pro forma net loss	\$ (225,041)
Basic loss per share:	
As reported	\$ (0.05)
Pro forma	\$ (0.08)
Diluted loss per share:	
As reported	\$ (0.05)
Pro forma	\$ (0.08)

For the three and six months ended June 30, 2005, common stock equivalents have been excluded from the computation of the pro forma net loss per share because the inclusion of such equivalents is antidilutive.

Stock warrants

Bancorp adopted the 2001 Warrant Plan and the 2001 Supplemental Warrant Plan (the “Warrant Plans”), under which an aggregate of 77,184 shares of Bancorp’s common stock are reserved for issuance upon the exercise of warrants granted to non-employee directors of Bancorp and the Bank, and certain other individuals involved in the organization of the Bank.

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Warrants under the Warrant Plans have a term of ten years. Forty percent of the warrants became exercisable one year from the date of grant, and 30% of the warrants became exercisable at each of the second and third anniversaries from the date of grant.

A summary of the status of the warrants at June 30, 2006 and 2005, and changes during the three months then ended, is as follows.

	2006		2005	
	Number of Shares	Weighted- Average Exercise Price	Number of Shares	Weighted- Average Exercise Price
Outstanding at beginning of year	77,184	\$ 10.39	77,184	\$ 10.39
Granted	-		-	
Exercised	-		-	
Terminated	-		-	
Outstanding at end of period	77,184	10.39	77,184	10.39
Exercisable at end of period	77,184	\$ 10.39	77,184	\$ 10.39

#### Note 10. Business Developments

On March 6, 2006, Bancorp opened The Bank of Southeastern Connecticut, a division of The Bank of Southern Connecticut, headquartered in New London, Connecticut. On July 10, 2006, Bancorp opened The Bank of North Haven, a division of The Bank of Southern Connecticut, headquartered in North Haven, Connecticut. Both branches operate as full service banking offices. These openings have broadened Bancorp's market position and demonstrated enhanced capabilities for increasing total loans and deposits.

#### Note 11. Financial Instruments with Off-Balance-Sheet Risk

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

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

Financial instruments whose contract amounts represent credit risk are as follows at June 30, 2006 and December 31, 2005:

	<b>June 30, 2006</b>	December 31, 2005
Commitments to extend credit		
Future loan commitments	\$ 13,191,000	\$ 3,982,679
Unused lines of credit	15,683,197	8,561,405
Undisbursed construction loans	482,000	437,825
Financial standby letters of credit	3,143,188	1,908,888
	\$ 32,499,385	\$ 14,890,797

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

Standby letters of credit are written commitments issued by Bancorp to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. As of January 1, 2003, newly issued or modified guarantees that are not derivative contracts have been recorded on Bancorp's books at their fair value at inception. The liability related to guarantees recorded at June 30, 2006 and December 31, 2005 was not significant.

## **Item 2. Management's Discussion and Analysis or Plan of Operation**

The following discussion is intended to assist you in understanding the financial condition and results of operations of Bancorp. This discussion should be read in conjunction with the accompanying unaudited financial statements as of and for the three and six months ended June 30, 2006 and 2005, along with the audited financial statements as of and for the year ended December 31, 2005, included in Bancorp's Form 10-KSB filed with the Securities and Exchange Commission on March 22, 2006.

### **Summary**

As of June 30, 2006, Bancorp had \$97.9 million of total assets, \$64.0 million of net loans and \$75.1 million of total deposits. Total equity capital at June 30, 2006 was \$20.1 million, representing a Tier I Leverage Capital Ratio of 22.30%. Net interest margin for the three and six months ended June 30, 2006 was 5.35% and 5.08%, respectively, compared to 5.17% and 4.98% for the three and six months ended June 30, 2005, respectively. Bancorp had a net loss of \$242,408 (or basic and diluted loss per share of \$0.08) for the three months ended June 30, 2006, compared to a net loss of \$160,470 (or basic and diluted loss per share of \$0.05) for the three months ended June 30, 2005. Bancorp had a net loss of \$163,515 (or basic and diluted loss per share of \$0.06) for the six months ended June 30, 2006, compared to a net loss of \$176,037 (or basic and diluted loss per share of \$0.06) for the six months ended June 30, 2005. The results for the three and six months ended June 30, 2006 reflect the costs related to the opening of the two new branches.

## **Critical Accounting Policy**

In the ordinary course of business, Bancorp has made a number of estimates and assumptions relating to reporting results of operations and financial condition in preparing its financial statements in conformity with accounting principals generally accepted in the United States of America. Actual results could differ significantly from those estimates under different assumptions and conditions. Bancorp believes the following discussion addresses Bancorp's only critical accounting policy, which is the policy that is most important to the portrayal of Bancorp's financial condition and results of operations and requires management's most difficult, subjective and complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. Bancorp has reviewed this critical accounting policy and estimates with the audit committee of the Board of Directors. Refer to the discussion below under "Allowance for Loan Losses" and Note 1 to the audited financial statements as of and for the year ended December 31, 2005, included in Bancorp's Form 10-KSB filed with the Securities and Exchange Commission on March 22, 2006.

### *Allowance for Loan Losses*

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loans are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific, general, and unallocated components. The specific component relates to loans that are classified loss, doubtful, substandard or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component may be 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.

Based upon this evaluation, management believes the allowance for loan losses of \$939,000 which represents 1.43% of gross loans and 3.11 times nonaccrual loans at June 30, 2006 is adequate, under prevailing economic conditions, to absorb losses on existing loans. At December 31, 2005, the allowance for loan losses was \$778,000 representing 1.37% of gross loans outstanding and 1.34 times nonaccrual loans.

The accrual of interest income on loans is discontinued whenever reasonable doubt exists as to its collectibility and generally is discontinued when loans are past due 90 days as to either principal or interest, or are otherwise considered impaired. When the accrual of interest income is discontinued, all previously accrued and uncollected interest is reversed against interest income. The accrual of interest on loans past due 90 days or more may be continued if the loan is well secured, it is believed all principal and accrued interest income due on the loan will be realized, and the loan is in the process of collection. A non-accrual loan is restored to an accrual status when it is no longer delinquent and collectibility of interest and principal is no longer in doubt.

Management considers all non-accrual loans, other loans past due 90 days or more based on contractual terms, and restructured loans to be impaired. In most cases, loan payments that are past due less than 90 days and the related

loans are not considered to be impaired. The Bank considers consumer installment loans to be pools of smaller balance homogeneous loans, which are collectively evaluated for impairment.

## **Recent Accounting Changes**

Effective January 1, 2006, Bancorp adopted Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment," ("SFAS 123(R)") which requires the measurement and recognition of compensation expense for all share-base payment awards to employees and directors based on the grant-date fair value of the awards. Information regarding Bancorp's adoption of SFAS 123(R) and its effect upon the consolidated financial statements and the financial condition of Bancorp is provided in Note 9 to the consolidated financial statements of this Form 10-QSB.

## **Comparison of Financial Condition as of June 30, 2006 versus December 31, 2005**

### *General*

Bancorp's total assets were \$97.9 million at June 30, 2006, an increase of \$9.3 million (10.5%) from \$88.6 million in assets as of December 31, 2005, due to an increase in net loans of \$8.1 million (14.5%). Earning assets, comprised of federal funds sold, short-term investments, securities, and net loans, as of June 30, 2006 were \$91.3 million, an increase of \$8.6 million (10.4%) from \$82.7 million at December 31, 2005.

### *Investments*

Available for sale securities totaled \$8.9 million as of June 31, 2006, a decrease of \$1.1 million from December 31, 2005. The portfolio is invested in U.S. government sponsored agency and sponsored agency issued mortgage backed securities.

As of June 30, 2006, gross unrealized losses on the available for sale securities portfolio totaled \$417,884. Management believes that none of the unrealized losses on available for sale securities are other than temporary because all of the unrealized losses in Bancorp's investment portfolio are due to market interest rate changes related to debt and mortgage-backed securities issued by U.S. Government sponsored agencies, which Bancorp 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 Bancorp will receive all contractual principal and interest related to these investments.

### *Loans*

Net loans receivable increased \$8.1 million (14.5%) from \$55.9 million at December 31, 2005 to \$64.0 million at June 30, 2006. The increase in loans is due to commercial demand in the greater New Haven and New London, Connecticut markets. The increase in the loans receivable portfolio was funded primarily by increased deposits. The ratio of net loans receivable to deposits as of June 30, 2006 was 85%, within Bancorp's target ratio of net loans receivable to deposits of 80% to 90%. Bancorp's and the Bank's Boards of Directors may elect from time to time to review Bancorp's policy regarding this ratio.

***Allowance for Loan Losses and Non-Accrual, Past Due and Restructured Loans***

The following represents the activity in the allowance for loan losses for the six months ended June 30, 2006 and 2005:

	<b>For the Period Ended June 30,</b>	
	<b>2006</b>	<b>2005</b>
Balance at beginning of period	\$ 778,051	\$ 752,394
Charge-offs	(2,759)	(173,998)
Recoveries	59,453	750
Provision charged to operations	104,475	110,409
Balance at end of period	\$ 939,220	\$ 689,555
Net recoveries (charge-offs) to average loans	<b>0.09%</b>	<b>(0.33%)</b>
Allowance for loan losses to gross loans receivable	<b>1.44%</b>	1.29%

The following is a summary of non-accrual and past due loans:

	<b>June 30, 2006</b>	<b>December 31, 2005</b>
Loans delinquent over 90 days and still accruing	\$ -	\$ -
Non-accrual loans	302,038	578,826
Total	\$ 302,038	\$ 578,826
% of Total Loans	<b>0.47%</b>	1.02%
% of Total Assets	<b>0.31%</b>	0.65%
Ratio of allowance to nonperforming loans	<b>3.11</b>	1.34

***Potential Problem Loans***

At June 30, 2006, the Bank had no other loans, other than those disclosed in the table above, as to which management has significant doubts as to the ability of the borrower to comply with the present repayment terms.

*Deposits*

Deposits were \$75.1 million at June 30, 2006, an increase of \$9.8 million (15.0%) from \$65.3 million as of December 31, 2005. Interest bearing checking and money market accounts were \$33.7 million at June 30, 2006, an increase of \$.5 million (1.5%) from \$33.2 million as of December 31, 2005. Time certificates were \$15.6 million at June 30, 2006, an increase of \$4.3 million, or 38.1% from December 31, 2005. Savings accounts remained flat at \$2.7 million from December 31, 2005. Non-interest bearing checking accounts were \$23.1 million at June 30, 2006, an increase of \$5.0 million, or 27.6% from December 31, 2005. The increase in the total deposit portfolio reflects the ongoing marketing efforts of the Bank. The Bank does not have any brokered deposits.

	<b>June 30, 2006</b>	December 31, 2005
Noninterest bearing deposits	\$ 23,137,094	\$ 18,091,849
Interest bearing deposits		
Checking	6,368,547	6,175,953
Money Market	27,355,587	27,001,393
Savings	2,691,246	2,690,236
Total checking, money market & savings	36,415,380	35,867,582
Time Certificates under \$100,000	7,619,063	4,498,286
Time Certificates of \$100,000 or more	7,960,804	6,821,799
Total time deposits	15,579,867	11,320,085
Total interest bearing deposits	51,995,247	47,187,667
Total deposits	\$ 75,132,341	\$ 65,279,516

*Other*

Repurchase agreements were \$820,075 as of June 30, 2006, a decrease of \$543,293 from \$1,363,368 (39.8%) as of December 31, 2005, due to normal customer activity.

**Results of Operations - Comparison of Results for the Three and Six Months Ended June 30, 2006 and June 30, 2005***General*

Bancorp had a net loss of \$242,408 and \$163,515 for the three months and six months ended June 30, 2006, respectively, versus a net loss of \$160,470 and \$176,037 for the three and six months ended June 30, 2005, respectively. The results for the six months ended June 30, 2006 reflect the costs related to the opening of two new branches.

*Net Interest Income*

The principal source of revenue is net interest income. Bancorp's net interest income is dependent primarily upon the difference or spread between the average yield earned on loans receivable and securities and the average rate paid on deposits and borrowings, as well as the relative amounts of such assets and liabilities. Bancorp, like other banking institutions, is subject to interest rate risk to the degree that its interest-bearing liabilities mature or reprice at different times, or on a different basis, than its interest-earning assets.

For the three months ended June 30, 2006, net interest income was \$1.1 million versus \$1.0 million for the three months ended June 30, 2005, a \$100,000 or a 10% increase, as volume and rate increases related to interest earning assets slightly offset similar increases related to interest bearing liabilities. The net increase in average interest earnings asset was comprised of increases in average loans of \$7.4 million, decreases in short term investments of \$2.2 million, decreases in investments of \$2.0 million, and increases in federal funds of \$3.0 million. In addition, the yield on all interest earning assets increased due to general increases in market interest rates.



The cost of average interest bearing liabilities was 3.82% for the three months ended June 30, 2006 versus 2.17% for the three months ended June 30, 2005, an increase of 165 basis points, reflecting a general increase in market interest rates. The increase in the cost of interest bearing liabilities was due principally to an increase in rates paid on deposit accounts. The average rate on interest paid on money market and interest bearing checking deposits increased 201 basis points for the three months ended June 30, 2006 versus the three months ended June 30, 2005. Also, the Bank's average cost of funds for time deposits increased 129 basis points for the three months ended June 30, 2006 versus the three months ended June 30, 2005.

While the change in the mix of assets and increase in rates resulted in an increase in the average yield on earning assets for the three months ended June 30, 2006, this increase was more than offset by the increase in the cost of interest bearing liabilities. As a result, the interest spread decreased to 3.86% for three months ended June 30, 2006, a decrease of 39 basis points versus the three months ended June 30, 2005. Net interest margin increased to 5.35% for the three months ended June 30, 2006 from 5.17% for the three months ended June 30, 2005, an increase of 18 basis points which largely reflects the change in the mix of assets and increasing rates during 2006.

For the six months ended June 30, 2006, net interest income was \$2.2 million versus \$2.0 million for the six months ended June 30, 2005, a \$200,000 or 10% increase. This was primarily the result of volume increases on interest earning assets, which exceeded volume increases on interest bearing liabilities. The net increase in average interest earnings assets was comprised of increases in average loans of \$6.8 million, decreases in short term investments of \$2.3 million, decreases in investments of \$1.7 million, and increases in federal funds of \$1.1 million. In addition, the yield on all interest earning assets increased due to general increases in market interest rates.

The cost of average interest bearing liabilities was 3.67% for the six months ended June 30, 2006 versus 2.09% for the six months ended June 30, 2005, an increase of 158 basis points, reflecting a general increase in market interest rates. The increase in the cost of interest bearing liabilities was due principally to an increase in rates paid on deposit accounts. The average rate on interest paid on money market and interest bearing checking deposits increased 188 basis points for the six months ended June 30, 2006 versus the six months ended June 30, 2005. Also, the Bank's average cost of funds for time deposits increased 124 basis points for the six months ended June 30, 2006 versus the six months ended June 30, 2005.

While the change in the mix of assets and increase in rates resulted in an increase in the average yield on earning assets for the six months ended June 30, 2006, this increase was more than offset by the increase in the cost of interest bearing liabilities, due to the increased competition for deposits. As a result, the interest spread decreased to 3.91% for six months ended June 30, 2006, a decrease of 21 basis points versus the six months ended June 30, 2005. Net interest margin increased to 5.38% for the six months ended June 30, 2006 from 4.98% for the six months ended June 30, 2005, an increase of 40 basis points which largely reflects the change in the mix of assets and increasing rates during 2006.

#### *Average Balances, Yields, and Rates*

The following table presents average balance sheets (daily averages), interest income, interest expense, and the corresponding annualized rates on earning assets and rates paid on interest bearing liabilities for the three months ended June 30, 2006 and 2005.

**Distribution of Assets, Liabilities and Shareholders' Equity;  
Interest Rates and Interest Differential**

(Dollars in thousands)	Three months Ended June 30, 2006			Three months Ended June 30, 2005			Fluctuations in interest Income/Expense
	Average Balance	Interest Income/ Expense	Average Rate	Average Balance	Interest Income/ Expense	Average Rate	
<b>Interest earning assets</b>							
Loans (1)	\$ 61,875	\$ 1,389	9.00%	\$ 54,455	\$ 1,088	8.01%	\$ 301
Short-term investments	6,146	69	4.50%	8,255	60	2.92%	9
Investments	9,191	77	3.36%	11,232	86	3.07%	(9)
Federal funds sold	8,533	107	5.03%	5,535	39	2.83%	68
Total interest earning assets	85,745	1,642	7.68%	79,477	1,273	6.42%	369
Cash and due from banks	1,089			785			
Premises and equipment, net	4,401			3,304			
Allowance for loan losses	(799)			(734)			
Other	1,432			1,592			
Total assets	\$ 91,868			\$ 84,424			
<b>Interest bearing liabilities</b>							
Time certificates	\$ 15,285	155	4.07%	\$ 10,669	74	2.78%	81
Savings deposits	2,673	9	1.35%	3,560	11	1.24%	(2)
Money market / checking deposits	31,930	286	3.59%	29,922	118	1.58%	168
Capital lease obligations	1,189	44	14.84%	1,190	43	14.49%	1
Repurchase agreements	1,153	4	1.39%	770	3	1.56%	1
Total interest bearing liabilities	52,230	498	3.82%	46,111	249	2.17%	249
<b>Non-interest bearing</b>							
deposits	18,830			17,797			
Accrued expenses and other liabilities	507			330			
Shareholder's equity	20,301			20,186			
Total liabilities and equity	\$ 91,868			\$ 84,424			
Net interest income		\$ 1,144			\$ 1,024		\$ 120
Interest spread			3.86%			4.25%	
Interest margin			5.35%			5.17%	

(1) Includes nonaccruing loans.

*Average Balances, Yields, and Rates*

The following table presents average balance sheets (daily averages), interest income, interest expense, and the corresponding annualized rates on earning assets and rates paid on interest bearing liabilities for the six months ended June 30, 2006 and 2005.

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**Distribution of Assets, Liabilities and Shareholders' Equity;  
Interest Rates and Interest differential**

(Dollars in thousands)	Six Months Ended June 30, 2006			Six Months Ended June 30, 2005			
	Average Balance	Interest Income/ Expense	Average Rate	Average Balance	Interest Income/ Expense	Average Rate	Fluctuations in interest Income/Expense
Interest earning assets							
Loans (1)	\$ 59,761	\$ 2,659	8.97%	\$ 52,970	\$ 2,085	7.94%	\$ 574
Short-term investments	6,104	137	4.53%	8,354	102	2.46%	35
Investments	9,607	156	3.27%	11,286	173	3.09%	(17)
Federal funds sold	7,884	182	4.66%	6,823	87	2.57%	95
Total interest earning assets	<b>83,356</b>	<b>3,134</b>	<b>7.58%</b>	79,433	2,447	6.21%	687
Cash and due from banks	1,087			1,048			
Premises and equipment, net	4,417			3,682			
Allowance for loan losses	(790)			(746)			
Other	1,339			1,470			
Total assets	<b>\$ 89,409</b>			<b>\$ 84,887</b>			
Interest bearing liabilities							
Time certificates	\$ 14,340	276	3.88%	\$ 10,391	136	2.64%	140
Savings deposits	2,733	19	1.40%	3,686	24	1.31%	(5)
Money market / checking deposits	30,752	521	3.42%	30,693	234	1.54%	287
Capital lease obligations	1,189	87	14.76%	1,190	86	14.57%	1
Repurchase agreements	1,023	8	1.58%	892	6	1.36%	2
Total interest bearing liabilities	<b>50,037</b>	<b>911</b>	<b>3.67%</b>	46,852	486	2.09%	425
Non-interest bearing							
deposits	18,548			17,024			
Accrued expenses and other liabilities	484			316			
Shareholder's equity	20,340			20,695			
Total liabilities and equity	<b>\$ 89,409</b>			<b>\$ 84,887</b>			
Net interest income		<b>\$ 2,223</b>			<b>\$ 1,961</b>		<b>\$ 262</b>
Interest spread			<b>3.91%</b>			<b>4.12%</b>	
Interest margin			<b>5.38%</b>			<b>4.98%</b>	

(1) Includes nonaccruing loans.



*Changes in Assets and Liabilities and Fluctuations in Interest Rates*

The following table summarizes the variance in interest income and interest expense for the three months ended June 30, 2006 and 2005 resulting from changes in assets and liabilities and fluctuations in interest rates earned and paid. The changes in interest attributable to both rate and volume have been allocated to both rate and volume on a pro rata basis.

(Dollars in thousands)	<b>Three months Ended June 30, 2006 v. 2005</b>			
	<b>Increase Or (Decrease)</b>	<b>Due to Change in Average</b>		<b>Rate</b>
		<b>Volume</b>		
<b>Interest earning assets</b>				
Loans	\$ 301	\$ 158	\$	143
Short-term investments	9	(43)		52
Investments	(9)	(49)		40
Federal funds sold	68	28		40
Total interest earning assets	369	94		275
<b>Interest bearing liabilities</b>				
Time certificates	81	39		42
Savings deposits	(2)	(7)		5
Money market / checking deposits	168	8		160
Capital lease obligations	1	-		1
Repurchase agreements	1	3		(2)
Total interest bearing liabilities	249	43		206
<b>Net interest income</b>	<b>\$ 120</b>	<b>\$ 51</b>	<b>\$</b>	<b>69</b>

*Changes in Assets and Liabilities and Fluctuations in Interest Rates*

The following table summarizes the variance in interest income and interest expense for the six months ended June 30, 2006 and 2005 resulting from changes in assets and liabilities and fluctuations in interest rates earned and paid. The changes in interest attributable to both rate and volume have been allocated to both rate and volume on a pro rata basis.

(Dollars in thousands)	<b>Six months Ended June 30, 2006 v. 2005</b>		
	<b>Increase Or (Decrease)</b>	<b>Due to Change in Average</b>	
		<b>Volume</b>	<b>Rate</b>
<b>Interest earning assets</b>			
Loans	\$ 574	\$ 285	\$ 289
Short-term investments	35	(35)	70
Investments	(17)	(41)	24
Federal funds sold	95	15	80
Total interest earning assets	687	224	463
<b>Interest bearing liabilities</b>			
Time certificates	140	62	78
Savings deposits	(5)	(9)	4
Money market / checking deposits	287	-	287
Capital lease obligations	1	-	1
Repurchase agreements	2	1	1
Total interest bearing liabilities	425	54	371
<b>Net interest income</b>	<b>\$ 262</b>	<b>\$ 170</b>	<b>\$ 92</b>

*Provision for Loan Losses*

The \$162,507 provision for loan losses for the three months ended June 30, 2006 reflects the increase of the loans receivable portfolio during the quarter and portfolio seasoning. The provision for loan losses for the three months ended June 30, 2005 was \$93,409.

The \$104,475 provision for loan losses for the six months ended June 30, 2006 reflects both the increase of the loans receivable portfolio during the six month period, and the significant recovery of a \$58,032 loan that had previously been charged off. The provision for loan losses for the six months ended June 30, 2005 was \$110,409.

*Noninterest Income*

The \$37,164 increase in total noninterest income for the three months ended June 30, 2006 versus the three months ended June 30, 2005 is due to an increase of \$36,583 in service charges and fees derived from increases in deposit account balances, deposit account activity and deposit account charges.

The \$92,710 increase in total noninterest income for the six months ended June 30, 2006 versus the six months ended June 30, 2005 is due to \$51,000 in Small Business Administration ("SBA") guaranteed loan participation sales gains during the six months ended June 30, 2006 versus \$14,000 of such gains during the six months ended June 30, 2005. Through the Bank, Bancorp intends to continue to originate SBA guaranteed loans in the future and expects to continue to earn income from SBA loan participation sales and referrals. The Bank retains the servicing rights of the SBA loans, which generated \$37,000 in servicing income during the six months ended June 30, 2006 versus \$8,000 during the six months ended June 30, 2005. Noninterest income also reflects a \$14,000 prepayment penalty during the six months ended June 30, 2006. Separately, service charges and fees derived from deposits increased by \$42,000.

*Noninterest Expense*

Total noninterest expense was approximately \$1.4 million for the three months ended June 30, 2006 versus \$1.3 million for the three months ended June 30, 2005, an increase of \$100,000, or 8%. The primary factor contributing to the increase in non-interest expense was the opening of The Bank of North Haven, a division of The Bank of Southern Connecticut, which opened on July 10, 2006. During the three months ended June 30, 2006, additional staff was hired to support the new branch, extensive advertising took place to promote the new branch, and branch supplies were purchased.

Total noninterest expense was approximately \$2.7 million for the six months ended June 30, 2006 versus \$2.3 million for the six months ended June 30, 2005, an increase of \$400,000, or 17%. The primary factor contributing to the increase in noninterest expense was the opening of the two new branches, The Bank of Southeastern Connecticut and The Bank of North Haven, both of which are divisions of The Bank of Southern Connecticut. During the six months ended June 30, 2006, additional staff was hired to support the new branches, extensive advertising took place to promote the new branches, and branch supplies were purchased.

Salaries and benefits for the three months ended June 30, 2006, of \$743,128, increased \$135,023, or 22%, from the three months ended June 30, 2005. The increase is due to staff compensation and benefits increases in 2006 in comparison to the comparable period a year ago, primarily arising from the hiring of additional personnel for the North Haven branch.

Salaries and benefits for the six months ended June 30, 2006, of \$1,426,909, increased \$261,372, or 22%, from the six months ended June 30, 2005. The increase is due to staff compensation and benefits increases in 2006 in comparison to the comparable period a year ago, primarily arising from the hiring of additional personnel for the New London and North Haven branches.

Occupancy and equipment for the three months ended June 30, 2006, of \$176,422, increased \$17,482, or 11%, from the three months ended June 30, 2005, due primarily to the opening of the North Haven branch and the related depreciation of buildings, equipment and furniture, and property taxes.

Occupancy and equipment for the six months ended June 30, 2006, of \$335,647, increased \$33,368, or 11%, from the six months ended June 30, 2005, due primarily to the opening of the New London and North Haven branches and the related depreciation of buildings, equipment and furniture, and property taxes.

Professional fees for the three months ended June 30, 2006 of \$155,545, decreased \$32,948, or 18%, from the three months ended June 30, 2005, due primarily to the discontinued use of consultants now that the New London and North Haven branches are operational.

Professional fees for the six months ended June 30, 2006 of \$257,213, decreased \$25,420, or 9%, from the six months ended June 30, 2005, due primarily to the discontinued use of consultants now that the New London and North Haven branches are operational.

Data processing and other outside services for the three months ended June 30, 2006, increased \$7,231, or 9%, from the three months ended June 30, 2005, primarily due to the opening of the North Haven branch.

Data processing and other outside services for the six months ended June 30, 2006, increased \$11,722, or 7%, from the six months ended June 30, 2005, primarily due to the opening of the New London and North Haven branches.

Advertising and promotional expense for the three months ended June 30, 2006, increased \$23,876, or 46%, from the three months ended June 30, 2005, due to marketing initiatives, primarily related to the opening of the North Haven branch, and the promotion of the Bank's new online banking product.

Advertising and promotional expense for the six months ended June 30, 2006, increased \$40,766, or 51%, from the six months ended June 30, 2005, due to marketing initiatives, primarily related to the opening of the New London and North Haven branches, and the promotion of the Bank's new online banking product.

Forms, printing, and supplies expense for the three months ended June 30, 2006, increased by \$5,856, or 22%, from the three months ended June 30, 2005, primarily due to the printing of forms and the purchasing of supplies for the North Haven branch.

Forms, printing, and supplies expense for the six months ended June 30, 2006, increased by \$20,884, or 48%, from the six months ended June 30, 2005, primarily due to the printing of forms and the purchasing of supplies for the New London and North Haven branches.

### **Off-Balance Sheet Arrangements**

See Note 11 to the Financial Statements for information regarding Bancorp's off-balance sheet arrangements.

### **Liquidity**

Management believes that Bancorp's short-term assets have sufficient liquidity to cover potential fluctuations in deposit accounts and loan demand and to meet other anticipated operating cash requirements.

Bancorp's liquidity position as of June 30, 2006 and December 31, 2005 consisted of liquid assets totaling \$27.6 million and \$26.6 million, respectively. This represents 28.2% and 30.0% of total assets at June 30, 2006 and December 31, 2005, respectively. The liquidity ratio is defined as the percentage of liquid assets to total assets. The following categories of assets as described in the accompanying balance sheet are considered liquid assets: cash and due from banks, federal funds sold, short-term investments, and securities available for sale. Liquidity is a measure of Bancorp's ability to generate adequate cash to meet financial obligations. The principal cash requirements of a financial institution are to cover downward fluctuations in deposits and increases in its loan portfolio.

Management believes Bancorp's short-term assets provide sufficient liquidity to cover potential fluctuations in deposit accounts and loan demand and to meet other anticipated operating cash and investment requirements.

## Capital

The following Table illustrates Bancorp's regulatory capital ratios at:

	<b>June 30, 2006</b>	<b>December 31, 2005</b>
Tier 1 (Leverage) Capital to Average Assets	<b>22.30%</b>	24.17%
Tier 1 Capital to Risk-Weighted Assets	<b>26.18%</b>	29.17%
Total Capital to Risk-Weighted Assets	<b>27.41%</b>	30.30%

The following Table illustrates the Bank's regulatory capital ratios at:

	<b>June 30, 2006</b>	<b>December 31, 2005</b>
Tier 1 (Leverage) Capital to Average Assets	<b>18.00%</b>	20.38%
Tier 1 Capital to Risk-Weighted Assets	<b>21.31%</b>	23.96%
Total Capital to Risk-Weighted Assets	<b>22.57%</b>	25.17%

Capital adequacy is one of the most important factors used to determine the safety and soundness of individual banks and the banking system. Based on the above ratios, Bancorp is considered to be "well capitalized" under applicable regulations specified by the Federal Reserve. The Bank also is considered to be "well capitalized" under applicable regulations. To be considered "well capitalized" an institution must generally have a leverage capital ratio of at least 5%, a Tier 1 risk-based capital ratio of at least 6% and a total risk-based capital ratio of at least 10%. The Bank is one of the best-capitalized small community banks in New England.

## Market Risk

Market risk is defined as the sensitivity of income to fluctuations in interest rates, foreign exchange rates, equity prices, commodity prices and other market-driven rates or prices. Based upon the nature of Bancorp's business, market risk is primarily limited to interest rate risk, defined as the impact of changing interest rates on current and future earnings.

Bancorp's goal is to maximize long-term profitability, while minimizing its exposure to interest rate fluctuations. The first priority is to structure and price Bancorp's assets and liabilities to maintain an acceptable interest rate spread, while reducing the net effect of changes in interest rates. In order to reach an acceptable interest rate spread, Bancorp must generate loans and seek acceptable long-term investments to replace the lower yielding balances in Federal Funds sold and short-term investments. The focus also must be on maintaining a proper balance between the timing and volume of assets and liabilities re-pricing within the balance sheet. One method of achieving this balance is to

originate variable rate loans for the portfolio to offset the short-term re-pricing of the liabilities. In fact, a number of the interest bearing deposit products have no contractual maturity. Customers may withdraw funds from their accounts at any time and deposits balances may therefore run off unexpectedly due to changing market conditions.

The exposure to interest rate risk is monitored by Senior Management of the Bank and reported quarterly to the Asset and Liability Management Committee and the Board of Directors of the Bank and Bancorp. Management reviews the interrelationships within the balance sheet to maximize net interest income within acceptable levels of risk, while maintaining a conservative market risk posture.

### **Impact of Inflation and Changing Prices**

Bancorp's financial statements have been prepared in terms of historical dollars, without considering changes in relative purchasing power of money over time due to inflation. Unlike most industrial companies, virtually all of the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates have a more significant impact on a financial institution's performance than the effect of general levels of inflation. Interest rates do not necessarily move in the same direction or in the same magnitude as the prices of goods and services. Notwithstanding this fact, inflation can directly affect the value of loan collateral, in particular, real estate. Inflation, or disinflation, could significantly affect Bancorp's earnings in future periods.

### **"Safe Harbor" Statement Under Private Securities Litigation Reform Act of 1995**

Some of the statements under "Management's Discussion and Analysis of Financial Condition and Results of Operations," "Business" and elsewhere in this Report on Form 10-QSB may include forward-looking statements which reflect our current views with respect to future events and financial performance. Statements which include the words "expect," "intend," "plan," "believe," "project," "anticipate" and similar statements of a future or forward-looking nature identify forward-looking statements for purposes of the federal securities laws or otherwise. All forward-looking statements address matters that involve risks and uncertainties. Accordingly, there are or will be important factors that could cause actual results to differ materially from those indicated in these statements or that could adversely affect the holders of our common stock. These factors include, but are not limited to, (1) changes in prevailing interest rates which would affect the interest earned on Bancorp's interest earning assets and the interest paid on its interest bearing liabilities, (2) the timing of re-pricing of Bancorp's interest earning assets and interest bearing liabilities, (3) the effect of changes in governmental monetary policy, (4) the effect of changes in regulations applicable to Bancorp and the conduct of its business, (5) changes in competition among financial service companies, including possible further encroachment of non-banks on services traditionally provided by banks and the impact of recently enacted federal legislation, (6) the ability of competitors which are larger than Bancorp to provide products and services which are impractical for Bancorp to provide, (7) the volatility of quarterly earnings, due in part to the variation in the number, dollar volume and profit realized from SBA guaranteed loan participation sales in different quarters, (8) the effect of a loss of any executive officer, key personnel, or directors, (9) the effect of Bancorp's opening of branches and the receipt of regulatory approval to complete such actions, (10) concentration of Bancorp's business in southern Connecticut, (11) the concentration of Bancorp's loan portfolio in commercial loans to small-to-medium sized businesses, which may be impacted more severely than larger businesses during periods of economic weakness, (12) lack of seasoning in Bancorp's loan portfolio, which may increase the risk of future credit defaults, and (13) the effect of any decision by Bancorp to engage in any business not historically permitted to it. Other such factors may be described in other filings made by Bancorp with the SEC.

Although Bancorp believes that it offers the loan and deposit products, and has the resources needed for success, future revenues and interest spreads and yields cannot be reliably predicted. These trends may cause Bancorp to adjust its operations in the future. Because of the foregoing and other factors, recent trends should not be considered reliable indicators of future financial results or stock prices.

Any forward-looking statement speaks only as of the date on which such statement is made, and we undertake no obligation to publicly update or review any forward-looking statement, whether as a result of new information, future developments or otherwise.

### **Item 3. Controls and Procedures**

#### (a) Evaluation of Disclosure Controls and Procedures.

Based upon an evaluation of the effectiveness of Bancorp's disclosure controls and procedures performed by Bancorp's management, with the participation of Bancorp's Chief Executive Officer, its Chief Operating Officer, and its Chief Financial Officer as of the end of the period covered by this report, Bancorp's Chief Executive Officer, Chief Operating Officer and Chief Financial Officer concluded that Bancorp's disclosure controls and procedures have been effective.

As used herein, "disclosure controls and procedures" mean controls and other procedures of Bancorp that are designed to ensure that information required to be disclosed by Bancorp in the reports that it files or submits under the Securities Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by Bancorp in the reports that it files or submits under the Securities Exchange Act is accumulated and communicated to Bancorp's management, including its principal executive, and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.

#### (b) Changes in Internal Controls

There have not been any changes in Bancorp's internal controls over financial reporting that occurred during Bancorp's quarter ended June 30, 2006 that has materially affected, or is reasonably likely to affect Bancorp's internal control over financial reporting.

**PART II**  
**Other Information**

**Item 1. Legal Proceedings.**

Not applicable.

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

Not applicable.

**Item 3. Defaults Upon Senior Securities.**

Not applicable.

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

In connection with its Annual Meeting of Shareholders, held May 9, 2006 (the “Annual Meeting”), Bancorp solicited by proxy the vote of its shareholders on the following two items: (i) to elect three directors, each for a three-year term; who, along with the directors whose terms did not expire at the 2006 Annual Meeting constitute the full Board of Directors of Bancorp; and (ii) to ratify the appointment of McGladrey & Pullen, LLP as independent accountants for the year ending December 31, 2006.

The following table summarizes the voting for the Board of Directors, each of whom was elected by a plurality of the votes cast:

	<u>For</u>	<u>“Withhold Authority”</u>
Michael M. Ciaburri	2,863,350	28,636
Joshua H. Sandman, Ph.D.	2,862,115	29,871
James D. Wherry	2,859,596	32,390

The names of the other directors of Bancorp whose terms continued after the meeting are:

Carl R. Borrelli; Joseph V. Ciaburri; Elmer F. Laydon; Louis A. Lubrano; Juan Miguel Salas-Romer; and Alphonse F. Spadaro, Jr..

With respect to the ratification of the appointment of McGladrey & Pullen, LLP, as Bancorp’s independent accountants for the fiscal year ended December 31, 2006, the appointment was ratified by Bancorp’s shareholders with 2,866,637 voting “For” the ratification, and 23,226 voting “Against” the ratification.

**Item 5. Other Information.**

Not applicable.

**Item 6. Exhibits.**

(a) Exhibits



<u>No.</u>	<u>Description</u>
3(i)	Amended and Restated Certificate of Incorporation (incorporated by reference to Exhibit 3(i) to Bancorp's Quarterly Report on Form 10-QSB for the quarter ended June 30, 2002, as filed with the Securities and Exchange Commission on August 14, 2002)
3(ii)	By-Laws (incorporated by reference to Exhibit 3(ii) to Bancorp's Registration Statement on Form SB-2, as filed with the Securities and Exchange Commission on April 30, 2001 (No. 333-59824))
<u>31.1</u>	<u>Rule 13a-14(a)/15d-14(a) Certification by Chairman and Chief Executive Officer</u>
<u>31.2</u>	<u>Rule 13a-14(a)/15d-14(a) Certification by President and Chief Operating Officer</u>
<u>31.3</u>	<u>Rule 13a-14(a)/15d-14(a) Certification by Senior Vice President and Chief Financial Officer</u>
<u>32.1</u>	<u>Section 1350 Certification by Chairman and Chief Executive Officer</u>
<u>32.2</u>	<u>Section 1350 Certification by President and Chief Operating Officer</u>
<u>32.3</u>	<u>Section 1350 Certification by Senior Vice President and Chief Financial Officer</u>

**SIGNATURES**

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**SOUTHERN CONNECTICUT BANCORP, INC.**

By:	/s/ Joseph V. Ciaburri Name: Joseph V. Ciaburri Title: Chairman & Chief Executive Officer
Date: August 11, 2006	
By:	/s/ Michael M. Ciaburri Name: Michael M. Ciaburri Title: President & Chief Operating Officer
Date: August 11, 2006	
By:	/s/ Carlota I. Grate Name: Carlota I. Grate Title: Senior Vice President & Chief Financial Officer
Date: August 11, 2006	
By:	/s/ Anthony M. Avellani Name: Anthony M. Avellani Title: Vice President & Chief Accounting Officer
Date: August 11, 2006	

**Exhibit Index**

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