

PATAPSCO BANCORP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements
June 30, 2007, 2006 and 2005

2004 Stock Incentive Plan

In October 2004, the shareholders' of the Company approved the 2004 Stock Incentive Plan. Under this plan, 90,000 shares of common stock are available for issuance under a variety of awards. An additional 40,146 shares were made available for issuance to settle past deferred compensation obligations. This new plan replaced the Director's retirement plan that became effective in September 1995. At the time of adoption, the directors had the option to reallocate their deferred compensation assets.

As of June 30, 2007, there are 53,850 deferred shares under this plan of which 12,906 are issued and outstanding. These deferred shares are allocated in lieu of cash compensation to Directors of the Company. Deferred shares are required to be distributed upon a Director leaving the Company or upon a change-in-control event. All these shares are included in shares outstanding for the purposes of computing earnings per share. Additionally, as of June 30, 2007 there are 14,453 non-vested shares outstanding under this plan:

Compensation expense recognized in connection with these plans during the years ended June 30, 2007, 2006 and 2005 was \$67,300, \$17,400 and \$80,700, respectively.

A summary of the status of the Company's non-vested shares as of and for the year ended June 30, 2007 is presented below:

| | Common Shares | Weighted Average Grant-Date Fair Value |
|---------------------------------------|---------------|--|
| Non-Vested as of June 30, 2006 | | |
| Awards Granted, November 2006 | 14,453 | \$13.71 |
| Vested | | |
| Non-vested at June 30, 2007 | 14,453 | \$13.71 |

As of June 30, 2007, there was \$148,000 of total unrecognized compensation costs related to non-vested share-based compensation. The cost is expected to be recognized over a weighted average period of 27 months. At grant date, vesting of the shares was "cliff" vesting at the end of either a two or three year period.

Stock Options

The company's 1996 Stock Options and Incentive Plan (plan) was approved by the stockholders at the 1996 annual meeting. The Plan provides for the granting of options to acquire common stock to directors and key employees. Option prices are equal or greater than the estimated fair market value of the common stock at the date of the grant. In October 1996 the Company granted options to purchase 137,862 shares at \$4.60 per share; On May 1, 2000, the Company granted options to purchase 18,981 shares at \$4.86 per share.

The Company's 2000 Stock Option and Incentive Plan was approved by the stockholders at the 2000 annual meeting. The Plan provides for the granting of options to acquire common stock to directors and key employees. Option prices are equal or greater than the estimated fair market value of the common stock at the date of the grant.

The Plan provides for one-fifth of the options granted to be exercisable on each of the first five anniversaries of the date of grant. Under this plan, in August 2001 the Company granted options to purchase 99,975 shares at \$6.29 per share.

The following table summarizes the status of and changes in the Company's stock option plans during the past three years.

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| | Options | Weighted Average Exercise Price | Options Exercisable | Weighted Average Exercise Price | Aggregate Intrinsic Value(OOo) |
|-----------------------------------|----------|---------------------------------|---------------------|---------------------------------|--------------------------------|
| Outstanding, June 30, 2004 | 197,898 | \$ 5.40 | 140,116 | \$ 5.40 | |
| Granted | | | | | |
| Exercised | (22,635) | 4.60 | | | |
| Cancelled | | | | | |
| Outstanding, June 30, 2005 | 175,263 | 5.40 | 139,723 | 5.51 | |
| Granted | | | | | |
| Exercised | (36,353) | 5.07 | | | |
| Cancelled | (415) | 6.29 | | | |
| Outstanding, June 30, 2006 | 138,495 | 5.62 | 122,877 | 5.51 | |
| Granted | | | | | |
| Exercised | (90,623) | 5.41 | | | |
| Cancelled | | | | | |
| Outstanding, June 30, 2007 | 47,872 | \$ 6.02 | 47,872 | \$ 6.02 | \$ 801 |

The following table summarizes information about stock options outstanding at **June 30, 2007**.

| Exercise Price | Number Outstanding | Remaining Contractual Life | Number Exercisable |
|----------------|--------------------|----------------------------|--------------------|
| 4.86 | 8,827 | 2.88 years | 8,827 |
| 6.29 | 39,045 | 4.15 years | 39,045 |
| | 47,872 | 3.92 years | 47,872 |

401(k) Retirement Savings Plan

The Company has a 401(k) Retirement Savings Plan. Employees may contribute a percentage of their salary subject to limitations established by the Internal Revenue Service. The **Company is obligated to contribute 3% of each employee's salary, whether or not the employee contributes their own money. All employees who have completed six months of service with the Company and are 21 years old are eligible to participate. The Company's contribution to this plan was \$91,000, \$73,000 and \$67,000 for the years ended June 30, 2007, 2006 and 2005, respectively. Additionally, since the ESOP is fully allocated, the Compensation Committee of the Board of Directors, has approved a discretionary profit sharing component to the 401K plan. The accrual for this component of the plan for the years ended June 30, 2007, 2006 and 2005 was \$113,000, \$108,000, and \$31,000, respectively.**

(12) Fair Value of Financial Instruments

Statement of Financial Accounting Standards No. 107, Disclosures about Fair Value of Financial Instruments (SFAS 107) requires the Company to disclose estimated fair values of certain on- and off-balance sheet financial instruments. Fair value estimates, methods, and assumptions are set forth below for the Company's financial instruments as of June 30, 2007 and 2006.

Fair value estimates are made at a specific point in time, based on relevant market information and information about financial instruments. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's **entire holdings of a particular financial instrument. Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect estimates.**

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The carrying amount and estimated fair value of financial instruments is summarized as follows at June 30:

| (In thousands) | 2007; | | 2006 | |
|---|-----------------|----------------|-----------------|----------------|
| | Carrying amount | Fair value | Carrying amount | Fair value |
| Assets: | | | | |
| Cash and interest-bearing deposits | \$5,215 | -\$5,215 | \$5,807 | \$5,807 |
| Federal funds sold | 2,255 | 2,255 | 2,381 | 2,381 |
| Time deposits at other financial institutions | | | 605 | 605 |
| Investment securities available for sale | 13,147 | 13,147 | 16,667 | 16,667 |
| Loans receivable, net | 220,239 | 217,376 | 190,589 | 186,882 |
| Investment securities required by law | 2,599 | 2,599 | 2,416 | 2,416 |
| Accrued interest receivable | 1,063 | 1,063 | 929 | 929 |
| Liabilities: | | | | |
| Deposits | 189,712 | 181,981 | 166,833 | 159,977 |
| Advance payments by borrowers for taxes, insurance and ground rents | 1,362 | 1,362 | 1,405 | 1,405 |
| Long-term debt | 43,800 | 43,032 | 40,050 | 39,044 |
| Accrued interest payable | 472 | 472 | 334 | 334 |
| Off balance sheet instruments: | | | | |
| Commitments to extend credit | | | | |

Cash and Due from Banks, Interest Bearing Deposits with Banks and Federal Funds Sold

The statement of financial condition carrying amounts for cash and due from banks, interest bearing deposits with banks and federal funds sold approximate the estimated fair values of such assets.

Time deposits at other financial institutions:

The fair value of these time deposits was calculated by discounting the scheduled cash flows at current market rates.

Securities

The fair value of securities is based on quoted market values.

Loans Receivable

Loans receivable were segmented into portfolios with similar financial characteristics. Loans were also segmented by type such as residential and nonresidential, construction and land, second mortgage loans, commercial, and consumer. Each 10M category was further segmented by fixed and adjustable rate interest terms. The fair value of loans was calculated by discounting anticipated cash flows based on weighted average contractual maturity, weighted average coupon and Current loan origination rates.

Accrued Interest Receivable

The carrying amount of accrued interest receivable approximates its fair value.

Securities required by Law.

The carrying amount of securities required by law approximates its fair value.

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Deposits

Under SFAS 107, the fair value of deposits with no stated maturity, such as non-interest bearing deposits, interest bearing NOW accounts and statement savings accounts, is equal to the carrying amounts. The fair value of certificates of deposit was based on the discounted value of contractual cash flows. The discount rate for certificates of deposit was estimated using the rate currently offered for deposits of similar remaining maturities.

Long-Term Debt

The fair value of long-term debt was based on the discounted value of contractual cash flows, using rates currently available.

Accrued Interest Payable

The carrying amount of accrued interest payable approximates its fair value.

Advance Payments by Borrowers for Taxes, Insurance and Ground Rents

The carrying amount of advance payments by borrowers for taxes, insurance and ground rents approximates its fair value.

Off-Balance Sheet Financial Instruments and Standby Letters of Credit

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business, including mortgage loan commitments, undisbursed lines of credit on commercial business loans and standby letters of credit. These instruments involve, to various degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated statements of financial condition. The fair values of such commitments are immaterial.

The disclosure of fair value amounts does not include the fair values of any intangibles, including core deposit intangibles. Core deposit intangibles represent the value attributable to total deposits based on an expected duration of customer relationships.

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(13) Condensed **Financial Information (Parent Company Only)**

Summarized financial information for the Company is as follows as of and for the years ended June 30:

(In thousands)

| Statements of Financial Condition | 2007 | 2006 |
|--|------------------|------------------|
| Cash | \$1,671 | \$ 2,834 |
| Investment securities | | 78 |
| Equity in net assets of the bank | 22,369 | 20,422 |
| Other assets | 251 | 271 |
| Total Assets | \$ 24,291 | \$ 23,605 |

| | | |
|--|------------------|------------------|
| Accrued expenses and other liabilities | 375 | 317 |
| Subordinated Debentures | 5,000 | 5,000 |
| Stockholders' equity | 18,916 | 18,288 |
| Total Liabilities & Stockholders Equity | \$ 24,291 | \$ 23,605 |

| | 2007 | 2006 | 2005 |
|---|--------------|--------------|--------------|
| Total Revenue | \$ 5 | \$ 10 | \$ 93 |
| Non-interest Expense | 11 | (2) | 28 |
| Loss before equity in net income of subsidiary and income taxes | (327) | (239) | (108) |
| Net income of subsidiary | 1,399 | 1,527 | 1,417 |
| Income before income tax provision | 1,072 | 1,288 | 1,309 |
| Income tax provision (benefit) | (113) | (100) | (37) |

PATAPSCO BANCORP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements
June 30, 2007, 2006 and 2005

(In thousands)

Statements of Cash Flows

| | 2007 | 2006 | 2005 |
|--|-----------------|----------------|---------------|
| Operating activities: | | | |
| Net income | \$ 1,185 | \$1,388 | \$ 1,346 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Equity in net income of subsidiary | (1,399) | (1,527) | (1,417) |
| Increase in other assets | (51) | (189) | - |
| Increase (decrease) in accrued expenses and other liabilities | 172 | 81 | (19) |
| Net cash used in operating activities | (93) | (247) | (90) |
| Investing activities: | | | |
| Purchase of investment securities | (20) | (10) | (7) |
| Proceeds from sale of investment security | 92 | - | - |
| Dividend received from subsidiary | - | - | 200 |
| Additional investment in subsidiary | (300) | - | - |
| | (228) | (10) | 193 |
| | 338 | 121 | 47 |
| | (690) | (23) | (105) |
| | (490) | (521) | (500) |
| Net cash provided by (used in) financing activities | (842) | 2,679 | (725) |
| | (1,163) | 2,422 | (622) |
| | 2,834 | 412 | 1,034 |
| Cash and cash equivalents, end of year | \$ 1,671 | \$2,834 | \$ 412 |

PATAPSCO BANCORP, INC. AND SUBSIDIARIES
 Notes to Consolidated Financial Statements
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(14) Quarterly **Financial Data**

A summary of selected consolidated quarterly financial data for the three years ended June 30, 2007, 2006 and 2005 is reported in the following table:

| <i>(In thousands, except per share data)</i> | First Quarter | Second Quarter | Third Quarter | Fourth Quarter |
|---|------------------|-------------------|------------------|-------------------|
| Interest income | \$ 3,838 | \$ 4,086 | \$ 4,207 | \$ 4,295 |
| Interest Expense | 1,633 | 1,868 | 1,967 | 2,035 |
| Net interest income | 2,205 | 2,218 | 2,240 | 2,260 |
| Provision for loan losses | 40 | 70 | 175 | 145 |
| Net Interest income after provision for loan losses | 2,165 | 2,148 | 2,065 | 2,115 |
| Noninterest income | 187 | 218 | 221 | 240 |
| Noninterest expense | 1,785 | 1,791 | 2,067 | 1,804 |
| Income before income taxes | 567 | 575 | 219 | 551 |
| Provision for income taxes | 211 | 216 | 78 | 222 |
| Net income | 356 | 359 | 141 | 329 |
| Basic net income per share | 0.19 | 0.19 | 0.07 | 0.17 |
| Diluted net income per share | 0.19 | 0.19 | 0.07 | 0.17 |
| 2006 | | | | |
| Interest income | \$ 3,046 | \$ 3,327 | \$ 3,498 | \$ 3,685 |
| Interest Expense | 1,025 | 1,141 | 1,315 | 1,468 |
| Net interest income | 2,021 | 2,186 | 2,183 | 2,217 |
| Provision for loan losses | 20 | 20 | - | 25 |
| Net Interest income after provision for loan losses | 2,001 | 2,167 | 2,183 | 2,192 |
| Noninterest income | 243 | 198 | 201 | 229 |
| Noninterest expense | 1,744 | 1,800 | 1,908 | 1,750 |
| Income before income taxes | 500 | 564 | 476 | 611 |
| Provision for income taxes | 187 | 213 | 175 | 248 |
| Net income | 313 | 351 | 301 | 423 |
| Basic net income per share | 0.18 | 0.21 | 0.17 | 0.23 |
| Diluted net income per share | 0.16 | 0.18 | 0.16 | 0.22 |
| 2005 | | | | |
| Interest income | \$ 2,965 | \$ 2,969 | \$ 2,977 | \$ 2,900 |
| Interest Expense | 937 | 941 | 945 | 931 |
| Net interest income | 2,028 | 2,028 | 2,032 | 1,969 |
| Provision for loan losses | 35 | 50 | 100 | 40 |
| Net Interest income after provision for loan losses | 1,993 | 1,978 | 1,932 | 1,929 |
| Noninterest income | 130 | 179 | 176 | 199 |
| Noninterest expense | 1,602 | 1,593 | 1,720 | 1,496 |
| Income before income taxes | 521 | 564 | 388 | 632 |
| Provision for income taxes | 187 | 204 | 141 | 227 |
| Net income | 334 | 360 | 247 | 405 |
| Basic net income per share | 0.20 | 0.22 | 0.14 | 0.25 |
| Diluted net income per share | 0.17 | 0.19 | 0.13 | 0.21 |



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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors
Patapsco Bancorp, Inc.
Dundalk, Maryland

We have audited the accompanying consolidated statements of financial condition of Patapsco Bancorp, Inc. and subsidiaries as of June 30, 2006 and 2005, and the related consolidated statements of income, stockholders' equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Patapsco Bancorp, Inc. and subsidiaries as of June 30, 2006 and 2005 and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Beard Miller Company LLP

Baltimore, Maryland
September 1, 2006

PATAPSCO BANCORP, INC. AND SUBSIDIARIES
Consolidated Statements of Financial Condition

June 30, 2006 and 2005

| <i>(dollars in thousands except for per share data)</i> | 2006 | 2005 |
|---|-------------------|-------------------|
| Assets | | |
| Cash on hand and due from banks | \$ 4,839 | \$ 5,270 |
| Interest bearing deposits in other financial institutions | 968 | 970 |
| Federal funds sold | 2,381 | 1,408 |
| Cash and Cash Equivalents | 8,188 | 7,648 |
| Time deposits at other financial institutions | 605 | 619 |
| Securities available for sale | 16,667 | 24,800 |
| Loans receivable, net of allowance for loan losses of \$1,000 and \$945, respectively | 190,589 | 161,094 |
| Investment securities required by law, at cost | 2,416 | 1,677 |
| Property and equipment, net | 2,175 | 1,585 |
| Goodwill and other intangible assets | 3,354 | 3,406 |
| Accrued interest and other assets | 4,076 | 3,875 |
| Total Assets | \$ 228,070 | \$ 204,704 |
| Liabilities and Stockholders' Equity | | |
| Deposits: | | |
| Non-interest bearing deposits | \$ 13,186 | \$ 12,072 |
| Interest bearing deposits | 153,647 | 152,248 |
| Total Deposits | 166,833 | 164,320 |
| Junior Subordinated debentures | 5,000 | |
| Long-Tenn Debt | 35,050 | 20,233 |
| Accrued expenses and other liabilities | 2,899 | 2,564 |
| Total liabilities | 209,782 | 187,117 |
| Temporary equity - ESOP shares subject to put option | 1,121 | 1,266 |
| Stockholders' equity | | |
| Preferred stock-Series A Non-cumulative Convertible Perpetual \$0.01 par value; authorized 1,000,000 shares with a liquidation preference of \$25 per share; 0 and 93,745 shares outstanding at June 30, 2006 and June 30, 2005, respectively | | 1 |
| Additional paid-in-capital | | 2,345 |
| Common stock \$0.01 par value; authorized 4,000,000 shares; issued and outstanding 1,813,925 shares at June 30, 2006 and 1,414,456 shares at June 30, 2005 | 18 | 14 |
| Additional paid-in capital | 6,950 | 4,332 |
| Deferred compensation contra | (78) | (78) |
| Obligation under deferred compensation | 395 | 440 |
| Retained earnings, SUBstantially restricted | 10,317 | 9,438 |
| Accumulated other comprehensive loss, net of taxes | (435) | (171) |
| Total Stockholders' Equity - Permanent | 17,167 | 16,321 |
| Total Stockholders' Equity - including Temporary Equity | 18,288 | 17,587 |
| Total Liabilities and Stockholders' Equity | \$228,070 | \$204,704 |

See accompanying notes to consolidated financial statements.

PATAPSCO BANCORP, INC. AND SUBSIDIARIES

Consolidated Statements of Income

Years Ended June 30, 2006 and 2005

| <i>(in thousands except for per share data)</i> | 2006 | 2005 |
|---|-----------------|-----------------|
| Interest income: | | |
| Loans receivable | \$12,501 | \$10,613 |
| Investment securities | 941 | 1,046 |
| Federal funds sold and other investments | 1)4 | 152 |
| Total interest income | 13,556 | 11,81) |
| Interest expense: | | |
| Deposits | 3,486 | 2,818 |
| Interest on Short-term debt | 140 | |
| Interest on Long term debt and junior subordinated debentures | 1,323 | 936 |
| Total interest expense | 4,949 | 3,754 |
| Net interest income | 8,607 | 8,057 |
| Provision for loan losses | 65 | 225 |
| Net interest income after provision for loan losses | 8,542 | 7,832 |
| Non-interest income: | | |
| Fees and service charges | 656 | 525 |
| Gain on sale of securities available for sale | 2 | |
| Gain on sale of office building | 64 | |
| Other | 149 | 159 |
| Total non-interest income | 871 | 684 |
| Non-interest expenses: | | |
| Compensation and employee benefits | 4,490 | 3,773 |
| Professional fees | 241 | 287 |
| Equipment expenses | 326 | 284 |
| Net occupancy costs | 552 | 306 |
| Advertising | 86 | 178 |
| Data processing | 285 | 244 |
| Amortization of core deposit intangible | 51 | 51 |
| Telephone, postage and delivery | 271 | 276 |
| Other | 900 | 1,012 |
| Total non-interest expenses | 7,202 | 6,41) |
| Income before income taxes | 2,211 | 2,105 |
| Income tax provision | 823 | 759 |
| Net income | 1,388 | 1,346 |
| Preferred dividends declared | 123 | 177 |
| Net income available to common stockholders | \$ 1,265 | \$ 1,169 |
| Basic earnings per share | \$ 0.80 | \$ 0.81 |
| Diluted earnings per share | \$ 0.72 | \$ 0.70 |
| Cash dividends declared per common share | \$ 0.25 | \$ 0.23 |

See accompanying notes to consolidated financial statements.