

NORTHEAST BANCORP /ME/  
Form 10-Q  
April 30, 2012  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

**Quarterly report pursuant to Section 13 or 15 (d) of  
the Securities Exchange Act of 1934**

For the quarterly period ended March 31, 2012

Commission File Number: 1-14588

**Northeast Bancorp**

(Exact name of registrant as specified in its charter)

Maine  
(State or other jurisdiction of

01-0425066  
(I.R.S. Employer

Edgar Filing: NORTHEAST BANCORP /ME/ - Form 10-Q

incorporation or organization)

Identification No.)

500 Canal Street, Lewiston, Maine  
(Address of Principal executive offices)

04240  
(Zip Code)

(207) 786-3245

Registrant's telephone number, including area code

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subjected to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of "accelerated filer", "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller Reporting Company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. As of April 27, 2012, the registrant had outstanding 3,312,173 shares of voting common stock, \$1.00 par value per share and 195,351 shares of non-voting common stock, \$1.00 par value per share.

**Table of Contents**

|                 |  |           |
|-----------------|--|-----------|
| <b>Part I.</b>  | <b><u>Financial Information</u></b>  | <b>3</b>  |
| Item 1.         | <b><u>Financial Statements (unaudited)</u></b>   | <b>3</b>  |
|                 | <b><u>Consolidated Balance Sheets March 31, 2012 and June 30, 2011</u></b>   | <b>3</b>  |
|                 | <b><u>Consolidated Statements of Income Three and Nine Months Ended March 31, 2012 Three Months Ended March 31, 2011 93 Days Ended March 31, 2011 181 Days Ended December 28, 2010</u></b>               | <b>4</b>  |
|                 | <b><u>Consolidated Statements of Comprehensive Income Three and Nine Months Ended March 31, 2012 Three Months Ended March 31, 2011 93 Days Ended March 31, 2011 181 Days Ended December 28, 2010</u></b> | <b>6</b>  |
|                 | <b><u>Consolidated Statements of Changes in Stockholders' Equity Nine Months Ended March 31, 2012 93 Days Ended March 31, 2011 181 Days Ended December 28, 2010</u></b>                                  | <b>7</b>  |
|                 | <b><u>Consolidated Statements of Cash Flows Nine Months Ended March 31, 2012 93 Days Ended March 31, 2011 181 Days Ended December 28, 2010</u></b>   | <b>8</b>  |
|                 | <b><u>Notes to Consolidated Financial Statements</u></b>   | <b>9</b>  |
| Item 2.         | <b><u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u></b>  | <b>31</b> |
| Item 3.         | <b><u>Quantitative and Qualitative Disclosure about Market Risk</u></b>  | <b>51</b> |
| Item 4.         | <b><u>Controls and Procedures</u></b>  | <b>51</b> |
| <b>Part II.</b> | <b><u>Other Information</u></b>  | <b>51</b> |
| Item 1.         | <b><u>Legal Proceedings</u></b>  | <b>51</b> |
| Item 1A.        | <b><u>Risk Factors</u></b>   | <b>51</b> |
| Item 2.         | <b><u>Unregistered Sales of Equity Securities and Use of Proceeds</u></b>  | <b>51</b> |
| Item 3.         | <b><u>Defaults Upon Senior Securities</u></b>  | <b>51</b> |
| Item 4.         | <b><u>Mine Safety Disclosures</u></b>  | <b>51</b> |
| Item 5.         | <b><u>Other Information</u></b>  | <b>51</b> |
| Item 6.         | <b><u>Exhibits</u></b>   | <b>51</b> |

**Table of Contents**

## PART 1 FINANCIAL INFORMATION

## Item 1. Financial Statements (Unaudited)

**NORTHEAST BANCORP AND SUBSIDIARY****CONSOLIDATED BALANCE SHEETS****(Unaudited)**

(Dollars in thousands, except share and per share data)

|  | March 31, 2012 | June 30, 2011 |
|--|----------------|---------------|
| <b>Assets</b>  |                |               |
| Cash and due from banks                                    | \$ 2,609       | \$ 3,227      |
| Short-term investments                                     | 62,271         | 80,704        |
| Total cash and cash equivalents                            | 64,880         | 83,931        |
| Available-for-sale securities, at fair value               | 136,730        | 148,962       |
| Loans held for sale  | 6,354          | 5,176         |
| Loans  | 345,777        | 309,913       |
| Less: Allowance for loan losses                            | 748            | 437           |
| Loans, net   | 345,029        | 309,476       |
| Premises and equipment, net                                | 8,918          | 8,271         |
| Repossessed collateral, net                                | 915            | 690           |
| Accrued interest receivable                                | 1,659          | 1,244         |
| Federal Home Loan Bank stock, at cost                      | 4,602          | 4,889         |
| Federal Reserve Bank stock, at cost                        | 871            | 871           |
| Intangible assets, net                                     | 4,749          | 13,133        |
| Bank owned life insurance                                  | 14,171         | 13,794        |
| Other assets   | 6,074          | 5,956         |
| Total assets   | \$ 594,952     | \$ 596,393    |
| <b>Liabilities and Stockholders Equity</b>                 |                |               |
| <b>Liabilities</b>   |                |               |
| <b>Deposits</b>  |                |               |
| Demand   | \$ 41,613      | \$ 48,215     |
| Savings and interest checking                              | 88,860         | 89,804        |
| Money market   | 45,589         | 48,695        |
| Time deposits  | 227,673        | 214,404       |
| Total deposits   | 403,735        | 401,118       |
| Federal Home Loan Bank advances                            | 43,567         | 43,922        |
| Structured repurchase agreements                           | 66,636         | 68,008        |
| Short-term borrowings                                      | 1,836          | 2,515         |
| Junior subordinated debentures issued to affiliated trusts | 8,066          | 7,957         |
| Capital lease obligation                                   | 1,953          | 2,075         |
| Other borrowings   | 0              | 2,229         |
| Other liabilities  | 4,289          | 3,615         |

Edgar Filing: NORTHEAST BANCORP /ME/ - Form 10-Q

|  |               |               |
|--|---------------|---------------|
| Total liabilities  | 530,082       | 531,439       |
| <b>Commitments and contingencies</b>   |               |               |
| <b>Stockholders' equity</b>  |               |               |
| Preferred stock, \$1.00 par value, 1,000,000 shares authorized; 4,227 shares issued and outstanding at March 31, 2012 and June 30, 2011; liquidation preference of \$1,000 per share | 4             | 4             |
| Voting common stock, \$1.00 par value, 13,500,000 shares authorized; 3,312,173 issued and outstanding at March 31, 2012 and June 30, 2011  | 3,312         | 3,312         |
| Non-voting common stock, \$1.00 par value, 1,500,000 shares authorized 195,351 issued and outstanding at March 31, 2012 and June 30, 2011  | 195           | 195           |
| Warrants to purchase common stock  | 406           | 406           |
| Additional paid-in capital   | 50,129        | 49,700        |
| Unearned restricted stock  | (136)         | (163)         |
| Retained earnings  | 11,601        | 11,726        |
| Accumulated other comprehensive loss   | (641)         | (226)         |
| <b>Total stockholders' equity</b>  | <b>64,870</b> | <b>64,954</b> |
| Total liabilities and stockholders' equity   | \$ 594,952    | \$ 596,393    |

*The accompanying notes are an integral part of these unaudited consolidated financial statements.*

**Table of Contents****NORTHEAST BANCORP AND SUBSIDIARY****CONSOLIDATED STATEMENTS OF INCOME**

(Unaudited)

(Dollars in thousands, except share and per share data)

|  | Successor Company (1)                   |   |   |                                 | Predecessor Company<br>(2)                |
|--|---|---|---|---------------------------------|---|
|  | Three Months Ended<br>March 31,<br>2012 | Three Months Ended<br>March 31,<br>2012 | Three Months Ended<br>March 31,<br>2011 | 93 Days Ended<br>March 31, 2011 | 181 Days<br>Ended<br>December 28,<br>2010 |
| <b>Interest and dividend income:</b>                                     |   |   |   |                                 |   |
| Interest on loans  | \$ 5,870                                | \$ 16,881                               | \$ 5,649                                | \$ 5,845                        | \$ 11,210                                 |
| Interest and dividends on available-for-sale securities                  | 422                                     | 1,602                                   | 910                                     | 954                             | 3,111                                     |
| Dividends on regulatory stock  | 15                                      | 48                                      | 12                                      | 13                              | 18  |
| Other interest and dividend income                                       | 45                                      | 128                                     | 33                                      | 34                              | 39  |
| <b>Total interest and dividend income</b>                                | <b>6,352</b>                            | <b>18,659</b>                           | <b>6,604</b>                            | <b>6,846</b>                    | <b>14,378</b>                             |
| <b>Interest expense:</b>   |   |   |   |                                 |   |
| Deposits   | 875                                     | 2,548                                   | 774                                     | 816                             | 2,796                                     |
| Federal Home Loan Bank advances  | 256                                     | 772                                     | 284                                     | 299                             | 918                                       |
| Structured repurchase agreements   | 247                                     | 744                                     | 249                                     | 272                             | 1,392                                     |
| Short-term borrowings  | 7                                       | 15                                      | 60                                      | 67                              | 376                                       |
| Junior subordinated debentures issued to affiliated trusts               | 188                                     | 556                                     | 174                                     | 180                             | 340                                       |
| Obligation under capital lease agreements                                | 25                                      | 76                                      | 26                                      | 28                              | 55  |
| <b>Total interest expense</b>  | <b>1,598</b>                            | <b>4,711</b>                            | <b>1,567</b>                            | <b>1,662</b>                    | <b>5,877</b>                              |
| <b>Net interest and dividend income before provision for loan losses</b> | <b>4,754</b>                            | <b>13,948</b>                           | <b>5,037</b>                            | <b>5,184</b>                    | <b>8,501</b>                              |
| Provision for loan losses  | 100                                     | 634                                     | 49                                      | 49                              | 912                                       |
| <b>Net interest and dividend income after provision for loan losses</b>  | <b>4,654</b>                            | <b>13,314</b>                           | <b>4,988</b>                            | <b>5,135</b>                    | <b>7,589</b>                              |
| <b>Noninterest income:</b>   |   |   |   |                                 |   |
| Fees for other services to customers                                     | 326                                     | 1,036                                   | 310                                     | 323                             | 698                                       |
| Net securities gains   | 731                                     | 1,111                                   | 47                                      | 47                              | 17  |
| Gain on sales of loans held for sale                                     | 634                                     | 2,060                                   | 490                                     | 539                             | 1,867                                     |
| Gain (loss) on sales of portfolio loans                                  | 219                                     | 422                                     | (195)                                   | (195)                           | 0   |
| Investment commissions   | 720                                     | 2,111                                   | 709                                     | 734                             | 1,174                                     |
| Bank-owned life insurance income   | 124                                     | 377                                     | 126                                     | 131                             | 250                                       |
| Bargain purchase gain  | 0                                       | 0                                       | 296                                     | 15,216                          | 0   |
| Other noninterest income   | 13                                      | 120                                     | 144                                     | 152                             | 225                                       |
| <b>Total noninterest income</b>  | <b>2,767</b>                            | <b>7,237</b>                            | <b>1,927</b>                            | <b>16,947</b>                   | <b>4,231</b>                              |

Edgar Filing: NORTHEAST BANCORP /ME/ - Form 10-Q

Noninterest expense:

|                                 |       |        |       |        |       |
|---------------------------------|-------|--------|-------|--------|-------|
| Salaries and employee benefits  | 4,093 | 11,539 | 3,958 | 4,097  | 4,949 |
| Occupancy and equipment expense | 970   | 2,735  | 773   | 795    | 1,352 |
| Professional fees               | 539   | 1,231  | 374   | 383    | 509   |
| Data processing fees            | 260   | 823    | 274   | 283    | 521   |
| Marketing expense               | 142   | 487    | 216   | 220    | 230   |
| FDIC insurance premiums         | 125   | 364    | 170   | 175    | 346   |
| Intangible asset amortization   | 262   | 935    | 306   | 306    | 0     |
| Merger expense                  | 0     | 0      | 132   | 3,182  | 94    |
| Other noninterest expense       | 861   | 2,668  | 893   | 997    | 1,454 |
| Total noninterest expense       | 7,252 | 20,782 | 7,096 | 10,438 | 9,455 |

|  |     |       |       |        |       |
|--|-----|-------|-------|--------|-------|
| Income (loss) from continuing operations before income tax expense (benefit) | 169 | (231) | (181) | 11,644 | 2,365 |
| Income tax expense (benefit)   | 15  | (209) | (217) | (233)  | 698   |

|  |        |         |       |           |          |
|--|--------|---------|-------|-----------|----------|
| Net income (loss) from continuing operations | \$ 154 | \$ (22) | \$ 36 | \$ 11,877 | \$ 1,667 |
|--|--------|---------|-------|-----------|----------|

**Table of Contents****NORTHEAST BANCORP AND SUBSIDIARY****CONSOLIDATED STATEMENTS OF INCOME**

(Unaudited)

(Dollars in thousands, except share and per share data)

(Continued)

|  | Successor Company (1)                   |                                     |                                      |                                 | Predecessor Company (2)                |  |
|--|---|-------------------------------------|--------------------------------------|---------------------------------|--|--|
|  | Three Months Ended<br>March 31,<br>2012 | Nine Months Ended<br>March 31, 2012 | Three Months Ended<br>March 31, 2011 | 93 Days Ended<br>March 31, 2011 | 181 Days Ended<br>December 28,<br>2010 |  |
| <b>Discontinued operations:</b>                |   |                                     |                                      |                                 |  |  |
| Income from discontinued operations            | \$ 0                                    | \$ 186                              | \$ 184                               | \$ 176                          | \$ 94                                  |  |
| Gain on sale of discontinued operations        | 22                                      | 1,551                               | 0                                    | 0                               | 105                                    |  |
| Income tax expense                             | 8                                       | 600                                 | 64                                   | 62                              | 70                                     |  |
| <b>Net income from discontinued operations</b> | <b>14</b>                               | <b>1,137</b>                        | <b>120</b>                           | <b>114</b>                      | <b>129</b>                             |  |
| <br>   |   |                                     |                                      |                                 |  |  |
| Net income                                     | \$ 168                                  | \$ 1,115                            | \$ 156                               | \$ 11,991                       | \$ 1,796                               |  |
| <br>   |   |                                     |                                      |                                 |  |  |
| Net income available to common stockholders    | \$ 70                                   | \$ 821                              | \$ 58                                | \$ 11,891                       | \$ 1,677                               |  |
| <br>   |   |                                     |                                      |                                 |  |  |
| <b>Weighted-average shares outstanding:</b>    |   |                                     |                                      |                                 |  |  |
| Basic  | 3,494,498                               | 3,494,498                           | 3,492,498                            | 3,492,498                       | 2,330,197                              |  |
| Diluted  | 3,512,273                               | 3,494,498                           | 3,559,873                            | 3,560,278                       | 2,354,385                              |  |
| <br>   |   |                                     |                                      |                                 |  |  |
| <b>Earnings per common share:</b>              |   |                                     |                                      |                                 |  |  |
| <b>Basic:</b>                                  |   |                                     |                                      |                                 |  |  |
| Income (loss) from continuing operations       | \$ 0.02                                 | \$ (0.09)                           | \$ (0.01)                            | \$ 3.36                         | \$ 0.66                                |  |
| Income from discontinued operations            | 0.00                                    | 0.32                                | 0.03                                 | 0.03                            | 0.06                                   |  |
| <b>Net income</b>                              | <b>\$ 0.02</b>                          | <b>\$ 0.23</b>                      | <b>\$ 0.02</b>                       | <b>\$ 3.39</b>                  | <b>\$ 0.72</b>                         |  |
| <br>   |   |                                     |                                      |                                 |  |  |
| <b>Diluted:</b>                                |   |                                     |                                      |                                 |  |  |
| Income (loss) from continuing operations       | \$ 0.02                                 | \$ (0.09)                           | \$ (0.01)                            | \$ 3.30                         | \$ 0.66                                |  |
| Income from discontinued operations            | 0.00                                    | 0.32                                | 0.03                                 | 0.03                            | 0.05                                   |  |
| <b>Net income</b>                              | <b>\$ 0.02</b>                          | <b>\$ 0.23</b>                      | <b>\$ 0.02</b>                       | <b>\$ 3.33</b>                  | <b>\$ 0.71</b>                         |  |

(1) Successor Company means Northeast Bancorp and its subsidiary after the closing of the merger with FHB Formation LLC on December 29, 2010.



Edgar Filing: NORTHEAST BANCORP /ME/ - Form 10-Q

(2) Predecessor Company means Northeast Bancorp and its subsidiary before the closing of the merger with FHB Formation LLC on December 29, 2010.

*The accompanying notes are an integral part of these unaudited consolidated financial statements.*

**Table of Contents****NORTHEAST BANCORP AND SUBSIDIARY****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

(Unaudited)

(Dollars in thousands)

|  | Successor Company (1)                   |   |   | Predecessor Company (2)         |   |
|--|---|---|---|---------------------------------|---|
|  | Three Months Ended<br>March 31,<br>2012 | Three Months Ended<br>March 31,<br>2012 | Three Months Ended<br>March 31,<br>2011 | 93 Days Ended<br>March 31, 2011 | 181 Days<br>Ended<br>December 28,<br>2010 |
| Net income   | \$ 168                                  | \$ 1,115                                | \$ 156                                  | \$ 11,991                       | \$ 1,796                                  |
| Other comprehensive income, net of tax:                              |   |   |   |                                 |   |
| Unrealized (loss) gain on available-for-sale securities, net         | (936)                                   | (288)                                   | (222)                                   | (34)                            | (1,863)                                   |
| Unrealized (loss) gain on purchased interest rate caps and swap, net | (5)                                     | (127)                                   | 66                                      | 66                              | (10)                                      |
| Total other comprehensive (loss) income                              | (941)                                   | (415)                                   | (156)                                   | 32                              | (1,873)                                   |
| Comprehensive (loss) income  | \$ (773)                                | \$ 700                                  | \$ 0                                    | \$ 12,023                       | \$ (77)                                   |

(1) Successor Company means Northeast Bancorp and its subsidiary after the closing of the merger with FHB Formation LLC on December 29, 2010.

(2) Predecessor Company means Northeast Bancorp and its subsidiary before the closing of the merger with FHB Formation LLC on December 29, 2010.

*The accompanying notes are an integral part of these unaudited consolidated financial statements.*

**Table of Contents****NORTHEAST BANCORP AND SUBSIDIARY**

## Consolidated Statements of Changes in Stockholders' Equity

Periods Ended March 31, 2012, March 31, 2011 and December 28, 2010

(Unaudited)

(Dollars in thousands, except share and per share data)

|  | Preferred Stock<br>Shares | Preferred Stock<br>Amount | Common Stock<br>Shares | Common Stock<br>Amount | Warrants<br>to Purchase<br>Common Stock | Additional<br>Paid-in Capital | Unearned<br>Restricted<br>Stock | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income (Loss) | Total<br>Stockholders<br>Equity |
|--|---------------------------|---------------------------|------------------------|------------------------|---|-------------------------------|---------------------------------|----------------------|--|---------------------------------|
| <b>Predecessor Company (2)</b>                     |                           |                           |                        |                        |   |                               |                                 |                      |  |                                 |
| Balance at June 30, 2010                           | 4,227                     | \$ 4                      | 2,323,832              | \$ 2,324               | \$ 133                                  | \$ 6,761                      | \$ 0                            | \$ 37,338            | \$ 4,346   | \$ 50,906                       |
| Net income for 181 days ended<br>December 28, 2010 | 0                         | 0                         | 0                      | 0                      | 0                                       | 0                             | 0                               | 1,796                | 0  | 1,796                           |
| Other comprehensive loss, net of<br>tax            | 0                         | 0                         | 0                      | 0                      | 0                                       | 0                             | 0                               | 0                    | (1,873)  | (1,873)                         |
| Dividends on preferred stock                       | 0                         | 0                         | 0                      | 0                      | 0                                       | 0                             | 0                               | (106)                | 0  | (106)                           |
| Dividends on common stock at<br>\$0.18 per share   | 0                         | 0                         | 0                      | 0                      | 0                                       | 0                             | 0                               | (419)                | 0  | (419)                           |
| Stock options exercised                            | 0                         | 0                         | 7,500                  | 8                      | 0                                       | 54                            | 0                               | 0                    | 0  | 62                              |
| Accretion of preferred stock                       | 0                         | 0                         | 0                      | 0                      | 0                                       | 16                            | 0                               | (16)                 | 0  | 0                               |
| <b>Balance at December 28, 2010</b>                | <b>4,227</b>              | <b>\$ 4</b>               | <b>2,331,332</b>       | <b>\$ 2,332</b>        | <b>\$ 133</b>                           | <b>\$ 6,831</b>               | <b>\$ 0</b>                     | <b>\$ 38,593</b>     | <b>\$ 2,473</b>  | <b>\$ 50,366</b>                |
| <b>Successor Company (1)</b>                       |                           |                           |                        |                        |   |                               |                                 |                      |  |                                 |
| Balance at December 29, 2010                       | 4,227                     | \$ 4                      | 2,331,332              | \$ 2,332               | \$ 406                                  | \$ 33,685                     | \$ 0                            | \$ 0                 | \$ 0   | \$ 36,427                       |
| Net income for the 93 days ended<br>March 31, 2011 | 0                         | 0                         | 0                      | 0                      | 0                                       | 0                             | 0                               | 11,991               | 0  | 11,991                          |
| Other comprehensive income, net<br>of tax          | 0                         | 0                         | 0                      | 0                      | 0                                       | 0                             | 0                               | 0                    | 32   | 32                              |
| Dividends on preferred stock                       | 0                         | 0                         | 0                      | 0                      | 0                                       | 0                             | 0                               | (53)                 | 0  | (53)                            |
| Dividends on common stock at<br>\$0.09 per share   | 0                         | 0                         | 0                      | 0                      | 0                                       | 0                             | 0                               | (314)                | 0  | (314)                           |
| Restricted stock award                             | 0                         | 0                         | 13,026                 | 13                     | 0                                       | 168                           | (181)                           | 0                    | 0  | 0                               |
| Voting common stock issued                         | 0                         | 0                         | 965,815                | 965                    | 0                                       | 12,489                        | 0                               | 0                    | 0  | 13,454                          |
| Non-voting common stock issued                     | 0                         | 0                         | 195,351                | 195                    | 0                                       | 2,526                         | 0                               | 0                    | 0  | 2,721                           |
| Stock-based compensation                           | 0                         | 0                         | 0                      | 0                      | 0                                       | 96                            | 9                               | 0                    | 0  | 105                             |
| Accretion of preferred stock                       | 0                         | 0                         | 0                      | 0                      | 0                                       | 45                            | 0                               | (45)                 | 0  | 0                               |
| Modification of stock appreciation<br>rights       | 0                         | 0                         | 0                      | 0                      | 0                                       | 526                           | 0                               | 0                    | 0  | 526                             |
| <b>Balance at March 31, 2011</b>                   | <b>4,227</b>              | <b>\$ 4</b>               | <b>3,505,524</b>       | <b>\$ 3,505</b>        | <b>\$ 406</b>                           | <b>\$ 49,535</b>              | <b>\$ (172)</b>                 | <b>\$ 11,579</b>     | <b>\$ 32</b>   | <b>\$ 64,889</b>                |
| <b>Successor Company (1)</b>                       |                           |                           |                        |                        |   |                               |                                 |                      |  |                                 |
| Balance at June 30, 2011                           | 4,227                     | \$ 4                      | 3,507,524              | \$ 3,507               | \$ 406                                  | \$ 49,700                     | \$ (163)                        | \$ 11,726            | \$ (226)   | \$ 64,954                       |
| Net income   | 0                         | 0                         | 0                      | 0                      | 0                                       | 0                             | 0                               | 1,115                | 0  | 1,115                           |
| Other comprehensive loss, net of<br>tax            | 0                         | 0                         | 0                      | 0                      | 0                                       | 0                             | 0                               | 0                    | (415)  | (415)                           |

Edgar Filing: NORTHEAST BANCORP /ME/ - Form 10-Q

|                              |       |      |           |          |        |           |          |           |          |           |
|------------------------------|-------|------|-----------|----------|--------|-----------|----------|-----------|----------|-----------|
| Dividends on preferred stock | 0     | 0    | 0         | 0        | 0      | 0         | 0        | (159)     | 0        | (159)     |
| Dividends on common stock at |       |      |           |          |        |           |          |           |          |           |
| \$0.27 per share             | 0     | 0    | 0         | 0        | 0      | 0         | 0        | (946)     | 0        | (946)     |
| Stock-based compensation     | 0     | 0    | 0         | 0        | 0      | 294       | 27       | 0         | 0        | 321       |
| Accretion of preferred stock | 0     | 0    | 0         | 0        | 0      | 135       | 0        | (135)     | 0        | 0         |
| Balance at March 31, 2012    | 4,227 | \$ 4 | 3,507,524 | \$ 3,507 | \$ 406 | \$ 50,129 | \$ (136) | \$ 11,601 | \$ (641) | \$ 64,870 |

- (1) Successor Company means Northeast Bancorp and its subsidiary after the closing of the merger with FHB Formation LLC on December 29, 2010.
- (2) Predecessor Company means Northeast Bancorp and its subsidiary before the closing of the merger with FHB Formation LLC on December 29, 2010.

*The accompanying notes are an integral part of these unaudited consolidated financial statements.*

**Table of Contents****NORTHEAST BANCORP AND SUBSIDIARY**

## Consolidated Statements of Cash Flows

(Unaudited)

(Dollars in thousands)

|   | Successor Company (1)                  |                                 | Predecessor<br>Company (2)          |
|---|--|---------------------------------|-------------------------------------|
|   | Nine Months Ended<br>March 31,<br>2012 | 93 Days Ended<br>March 31, 2011 | 181 Days Ended<br>December 28, 2010 |
| <b>Cash flows from operating activities:</b>  |  |                                 |                                     |
| Net income  | \$ 1,115                               | \$ 11,991                       | \$ 1,796                            |
| Adjustments to reconcile net income to net cash (used in) provided by operating activities: |  |                                 |                                     |
| Provision for loan losses   | 634                                    | 49                              | 912                                 |
| (Gain) loss on sale or impairment of repossessed collateral, net                            | (19)                                   | 55                              | 91                                  |
| Accretion of fair value adjustments on loans, net   | (1,559)                                | (396)                           | 0                                   |
| Accretion of fair value adjustments on deposits, net  | (1,001)                                | (466)                           | 0                                   |
| Accretion of fair value adjustments on borrowings, net                                      | (1,621)                                | (553)                           | 0                                   |
| Originations of loans held for sale   | (93,879)                               | (29,812)                        | (87,971)                            |
| Net proceeds from sales of loans held for sale  | 94,761                                 | 29,826                          | 96,239                              |
| Gain on sales of loans held for sale  | (2,060)                                | (539)                           | (1,867)                             |
| (Gain) loss on sales of portfolio loans   | (422)                                  | 195                             | 0                                   |
| Amortization of intangible assets   | 1,004                                  | 444                             | 344                                 |
| Bank-owned life insurance income, net   | (377)                                  | (131)                           | (250)                               |
| Depreciation of premises and equipment  | 907                                    | 281                             | 520                                 |
| Gain on sale of premises and equipment  | (2)                                    | (4)                             | (6)                                 |
| Net gain on sale of available-for-sale securities   | (1,111)                                | (47)                            | (17)                                |
| Deferred income tax benefit   | 0                                      | 0                               | (313)                               |
| Stock-based compensation  | 321                                    | 105                             | 0                                   |
| Gain on sale of assets of insurance division  | (1,580)                                | 0                               | (104)                               |
| Amortization of securities, net   | 1,239                                  | 301                             | 89                                  |
| Bargain purchase gain   | 0                                      | (15,216)                        | 0                                   |
| Changes in other assets and liabilities:  |  |                                 |                                     |
| Interest receivable   | (415)                                  | 585                             | 121                                 |
| Decrease in prepaid FDIC assessment   | 438                                    | 159                             | 120                                 |
| Other assets and liabilities  | (697)                                  | (750)                           | 33                                  |
| <b>Net cash (used in) provided by operating activities</b>                                  | <b>(4,324)</b>                         | <b>(3,923)</b>                  | <b>9,737</b>                        |
| <b>Cash flows from investing activities:</b>  |  |                                 |                                     |
| Proceeds from sales of available-for-sale securities  | 179,045                                | 64,588                          | 173                                 |
| Purchases of available-for-sale securities  | (185,991)                              | (51,029)                        | (19,001)                            |
| Proceeds from maturities and principal payments on available-for-sale securities            | 18,615                                 | 10,706                          | 26,806                              |
| Loan purchases  | (59,849)                               | 0                               | 0                                   |
| Loan originations and principal collections, net  | 22,363                                 | 11,256                          | 14,292                              |
| Proceeds from sales of portfolio loans  | 2,405                                  | 36,729                          | 0                                   |
| Purchases of premises and equipment   | (1,841)                                | (463)                           | (503)                               |
| Proceeds from sales of premises and equipment   | 124                                    | 16                              | 36                                  |
| Proceeds from sales of repossessed collateral   | 669                                    | 184                             | 217                                 |

Edgar Filing: NORTHEAST BANCORP /ME/ - Form 10-Q

|   |           |            |           |
|---|-----------|------------|-----------|
| Proceeds from redemption of regulatory stock                                | 287       | 0          | 0         |
| Proceeds from sale of assets of insurance division                          | 9,863     | 0          | 147       |
| Net cash (used in) provided by investing activities                         | (14,310)  | 71,987     | 22,167    |
| <b>Cash flows from financing activities:</b>                                |           |            |           |
| Net increase (decrease) in deposits   | 3,618     | 24,588     | (9,580)   |
| Net (decrease) increase in short-term borrowings                            | (679)     | (49,264)   | 16,875    |
| Dividends paid on preferred stock   | (159)     | (53)       | (106)     |
| Dividends paid on common stock  | (946)     | (314)      | (419)     |
| Issuance of common stock  | 0         | 16,175     | 62        |
| Repayment of other borrowings   | (2,129)   | 0          | (496)     |
| Repayment of Federal Home Loan Bank advances                                | 0         | (8,000)    | 0         |
| Repayment of capital lease obligation                                       | (122)     | (39)       | (77)      |
| Net cash (used in) provided by financing activities                         | (417)     | (16,907)   | 6,259     |
| Net (decrease) increase in cash and cash equivalents                        | (19,051)  | 51,157     | 38,163    |
| Cash and cash equivalents, beginning of period                              | 83,931    | 58,598     | 20,435    |
| Cash and cash equivalents, end of period                                    | \$ 64,880 | \$ 109,755 | \$ 58,598 |
| <b>Supplemental schedule of cash flow information:</b>                      |           |            |           |
| Interest paid   | \$ 7,334  | \$ 2,971   | \$ 5,800  |
| Income taxes paid, net  | 307       | 28         | 846       |
| <b>Supplemental schedule of noncash investing and financing activities:</b> |           |            |           |
| Transfers from loans to acquired assets                                     | \$ 919    | \$ 27      | \$ 124    |
| Transfers from acquired assets to loans                                     | 44        | 0          | 143       |

- (1) Successor Company means Northeast Bancorp and its subsidiary after the closing of the merger with FHB Formation LLC on December 29, 2010.
- (2) Predecessor Company means Northeast Bancorp and its subsidiary before the closing of the merger with FHB Formation LLC on December 29, 2010.

*The accompanying notes are an integral part of these unaudited consolidated financial statements.*

**Table of Contents****NORTHEAST BANCORP AND SUBSIDIARY****Notes to Unaudited Consolidated Financial Statements****March 31, 2012****1. Basis of Presentation**

The accompanying unaudited condensed and consolidated interim financial statements include the accounts of Northeast Bancorp ( Northeast or the Company ) and its wholly-owned subsidiary, Northeast Bank (the Bank ). These financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ( GAAP ) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, the accompanying consolidated financial statements contain all adjustments (consisting principally of normal recurring accruals) considered necessary for a fair presentation of the Company s financial position at March 31, 2012; the results of operations for the three- and nine-month periods ended March 31, 2012, the three-month period ended March 31, 2011, the 93 days ended March 31, 2011, and the 181 days ended December 28, 2010; the changes in stockholders equity for the nine-month period ended March 31, 2012, the 93 days ended March 31, 2011, and the 181 days ended December 28, 2010; the cash flows for the nine-month period ended March 31, 2012, the 93 days ended March 31, 2011, and the 181 days ended December 28, 2010. Operating results for the three- and nine-month periods ended March 31, 2012 are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2012 ( Fiscal 2012 ). For further information, refer to the audited consolidated financial statements and notes thereto for the fiscal year ended June 30, 2011 ( Fiscal 2011 ) included in the Company s Annual Report on Form 10-K for the fiscal year ended June 30, 2011, as amended, filed with the Securities and Exchange Commission on March 19, 2012.

**2. Merger Transaction**

On December 29, 2010, the merger of the Company and FHB Formation LLC, a Delaware limited liability company ( FHB ), was consummated. As a result of the merger, the surviving company received a capital contribution of \$16.2 million (in addition to the approximately \$13.1 million in cash consideration paid to former shareholders), and the former members of FHB collectively acquired approximately 60% of the Company s outstanding common stock. The Company has applied the acquisition method of accounting, as described in ASC 805, *Business Combinations* ( ASC 805 ) to the merger, which represents an acquisition by FHB of Northeast (the Predecessor Company ), with Northeast as the surviving company (the Successor Company ). In the application of ASC 805 to this transaction, the following was considered:

*Identify the Accounting Acquirer:* FHB was identified as the accounting acquirer. FHB, which was incorporated on March 9, 2009, acquired a controlling financial interest of approximately 60% of the Successor Company s total outstanding voting and non-voting common stock in exchange for contributed capital and cash consideration.

In the evaluation and identification of FHB as the accounting acquirer, it was concluded that FHB was a substantive entity involved in significant pre-merger activities, including the following: raising capital; incurring debt; incurring operating expenses; leasing office space; hiring staff to develop the surviving company s business plan; retaining professional services firms; and identifying acquisition targets and negotiating potential transactions, including the merger.

*Determine the Acquisition Date:* December 29, 2010, the closing date of the merger, was the date that FHB gained control of the combined entity.

*Recognize assets acquired and liabilities assumed:* Because neither the Predecessor Company (the acquired company) nor FHB (the accounting acquirer) exist as separate entities after the merger, a new basis of accounting at fair value for the Successor Company s assets and liabilities was established in the consolidated financial statements. At the acquisition date, the Successor Company recognized the identifiable assets acquired and the liabilities assumed based on their then fair values in accordance with ASC Topic 820, *Fair Value Measurement* ( ASC 820 ). The Successor Company recognized a bargain purchase gain as the difference between the total purchase price and the net assets acquired.

As a result of application of the acquisition method of accounting to the Successor Company s balance sheet, the Successor Company s financial statements from the periods prior to the transaction date are not directly comparable to the financial statements for periods subsequent to the transaction date. To make this distinction, the Company has labeled balances and results of operations prior to the transaction date as

Predecessor Company and balances and results of operations for periods subsequent to the transaction date as Successor Company. The lack of

## Edgar Filing: NORTHEAST BANCORP /ME/ - Form 10-Q

comparability arises from the assets and liabilities having new accounting bases as a result of recording them at their fair values as of the transaction date rather than at historical cost basis. To denote this lack of comparability, a heavy black line has been placed between the Successor Company and Predecessor Company columns in the Consolidated Financial Statements and in the tables in the Notes to the Unaudited Consolidated Financial Statements.



**Table of Contents**

In connection with the transaction, as part of the regulatory approval process the Company made certain commitments to the Board of Governors of the Federal Reserve System (the Federal Reserve) and the Maine Bureau of Financial Institutions (the Bureau), the most significant of which are, (i) maintain a Tier 1 leverage ratio of at least 10%, (ii) maintain a total risk-based capital ratio of at least 15%, (iii) limit purchased loans to 40% of total loans, (iv) fund 100% of the Company's loans with core deposits, and (v) hold commercial real estate loans (including owner-occupied commercial real estate) to within 300% of total risk-based capital. The Company is currently in compliance with all commitments to the Federal Reserve and the Bureau.

**3. Loans, Allowance for Loan Losses and Credit Quality**

The composition of the Company's loan portfolio is as follows on the dates indicated. The Company's originated loan portfolio consists of loans originated before and after the merger with FHB. The Company's purchased loan portfolio consists of loans acquired after the merger through the Company's Loan Acquisition and Servicing Group (LASG).

|  | March 31, 2012         | June 30, 2011     |
|--|------------------------|-------------------|
|  | (Dollars in thousands) |                   |
| <b>Loans:</b>                          |                        |                   |
| <b>Originated portfolio:</b>           |                        |                   |
| Residential real estate                | \$ 92,557              | \$ 95,417         |
| Home equity                            | 44,082                 | 50,060            |
| Commercial real estate                 | 110,731                | 117,124           |
| Construction                           | 1,497                  | 2,015             |
| Commercial business                    | 21,635                 | 22,225            |
| Consumer                               | 18,359                 | 22,435            |
| <b>Total originated portfolio</b>      | <b>288,861</b>         | <b>309,276</b>    |
| <b>Purchased portfolio:</b>            |                        |                   |
| Commercial real estate                 | 53,329                 | 637               |
| Residential real estate                | 3,587                  | 0                 |
| <b>Total purchased portfolio</b>       | <b>56,916</b>          | <b>637</b>        |
| <b>Total loans</b>                     | <b>345,777</b>         | <b>309,913</b>    |
| <b>Less: Allowance for loan losses</b> | <b>748</b>             | <b>437</b>        |
| <b>Loans, net</b>                      | <b>\$ 345,029</b>      | <b>\$ 309,476</b> |

In the fourth quarter of Fiscal 2011, the Company launched its loan acquisition and servicing business, which operates at the Company's office in Boston, Massachusetts. The LASG purchases performing commercial real estate loans, on a nationwide basis, at a discount from their outstanding principal balance, producing yields higher than those normally achieved on the Company's originated loan portfolio. The Company intends to continue to grow this segment of its loan portfolio, both in absolute terms and as a percentage of its total loan portfolio.

The Company's loan origination activities are predominantly conducted in south-central and western Maine and south-eastern New Hampshire through the Bank's Community Banking Division. In its Maine and New Hampshire market areas, the Company originates single-family and multi-family residential loans, commercial real estate loans, commercial business loans and a variety of consumer loans. In addition, the Company originates loans for the construction of residential homes, multi-family properties, commercial real estate properties, and for land development. The majority of loans originated by the Company are collateralized by real estate. The ability and willingness of residential and commercial real estate, commercial business and construction loan borrowers to honor their repayment commitments is generally dependent on the health of the real estate sector in the borrowers' geographic area and/or the general economy.

The accrual of interest on all loans is discontinued at the time the loan is 90 days past due unless the loan is well secured by collateral and in process of collection. The determination of past due status is based on the contractual terms of the loan. In all cases, the Company ceases the accrual of interest if the Company considers collection of principal or interest to be doubtful. All interest accrued but not collected for loans that are placed on nonaccrual are reversed against interest income. The interest on these loans is accounted for on a cash or cost recovery basis, until

Edgar Filing: NORTHEAST BANCORP /ME/ - Form 10-Q

the loan qualifies for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

**Table of Contents**

Loans purchased by the Company are accounted for under ASC 310-30, *Receivables – Loans and Debt Securities Acquired with Deteriorated Credit Quality* (ASC 310-30). The Company has elected to account for all purchased loans under ASC 310-30, including those with insignificant or no credit deterioration. At acquisition, the effective interest rate is determined based on the discount rate that equates the present value of the Company's estimate of cash flows with the purchase price of the loan. Prepayments are not generally assumed in determining a purchased loan's effective interest rate and income accretion.

The application of ASC 310-30 limits the yield that may be accreted on the purchased loan, or the accretable yield, to the excess of the Company's estimate, at acquisition, of the expected undiscounted principal, interest, and other cash flows over the Company's initial investment in the loan. The excess of contractually required payments receivable over the cash flows expected to be collected on the loan represents the purchased loan's nonaccretable difference. Subsequent improvements in expected cash flows of loans with nonaccretable differences result in a prospective increase to the loan's effective yield through a reclassification of some, or all, of the nonaccretable difference to accretable yield. The effect of subsequent declines in expected cash flows of purchased loans are recorded through a specific allocation in the allowance for loan losses.

Purchased credit impaired (PCI) include those loans acquired with specific evidence of deterioration of credit quality since origination and for which it is probable, at acquisition, that the Company will be unable to collect all contractually required payments receivable. The Company does not characterize purchased loans with no or insignificant credit impairment as PCI loans.

The following table presents a summary of PCI loans acquired through the merger on December 29, 2010. There were no acquisitions of PCI loans subsequent to the merger through March 31, 2011.

|  | Residential Real Estate<br>and Consumer | Commercial Real Estate<br>and Commercial Business<br>(Dollars in thousands) | Total    |
|--|---|---|----------|
| Contractually required payments receivable | \$ 3,677                                | \$ 6,066  | \$ 9,743 |
| Nonaccretable difference                   | (938)                                   | (2,410)   | (3,348)  |
| Cash flows expected to be collected        | 2,739                                   | 3,656   | 6,395    |
| Accretable yield                           | (1,204)                                 | (486)   | (1,690)  |
| Fair value of PCI loans acquired           | \$ 1,535                                | \$ 3,170  | \$ 4,705 |

The following table presents a summary of PCI loans purchased during the three and nine months ended March 31, 2012. PCI loans purchased during each period consisted of commercial real estate and commercial business loans.

|  | PCI Loans Acquired     |                                     |
|--|------------------------|-------------------------------------|
|  | Three Months Ended     |                                     |
|  | March 31,<br>2012      | Nine Months Ended<br>March 31, 2012 |
|  | (Dollars in thousands) |                                     |
| Contractually required payments receivable | \$ 3,879               | \$ 13,943                           |
| Nonaccretable difference                   | (1,053)                | (4,011)                             |
| Cash flows expected to be collected        | 2,826                  | 9,932                               |
| Accretable yield                           | (305)                  | (3,427)                             |
| Fair value of loans acquired               | \$ 2,521               | \$ 6,505                            |

Activity in Accretable Yield

Edgar Filing: NORTHEAST BANCORP /ME/ - Form 10-Q

|   | Three Months Ended     |                                     |
|---|------------------------|-------------------------------------|
|   | March 31,<br>2012      | Nine Months Ended<br>March 31, 2012 |
|   | (Dollars in thousands) |                                     |
| Beginning balance                               | \$ 2,154               | \$ 0                                |
| Accretion                                       | (214)                  | (778)                               |
| Acquisitions                                    | 305                    | 3,427                               |
| Reclassifications from nonaccretable difference | 100                    | 310                                 |
| Disposals and transfers                         | 0                      | (614)                               |
| End balance                                     | \$ 2,345               | \$ 2,345                            |

The following table provides information related the unpaid principal balance and carrying amounts of PCI loans.

|                          | March 31, 2012         |           |           | June 30, 2011          |           |          |
|--------------------------|------------------------|-----------|-----------|------------------------|-----------|----------|
|                          | Acquired through       |           | Total     | Acquired through       |           | Total    |
|                          | Merger                 | Purchased |           | Merger                 | Purchased |          |
|                          | (Dollars in thousands) |           |           | (Dollars in thousands) |           |          |
| Unpaid principal balance | \$ 4,343               | \$ 9,602  | \$ 13,945 | \$ 7,110               | \$ 159    | \$ 7,269 |
| Carrying amount          | \$ 2,453               | \$ 5,646  | \$ 8,099  | \$ 4,228               | \$ 0      | \$ 4,228 |

---

## **Table of Contents**

### **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. Loan losses 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 periodically based upon management's review of available information, including, but not limited to, the quality of the loan portfolio, certain economic conditions, the value of the underlying collateral and the level of non-accruing and criticized loans. Management relies on its loan quality reviews, its experience and evaluation of economic conditions, among other factors, in determining the amount of provision required for the allowance for loan losses. Determining the allowance for loan losses inherently involves a high degree of subjectivity and requires the Company to make significant estimates of current credit risks and future trends, all of which may undergo material changes.

The general component of the allowance for loan losses is based on historical loss experience adjusted for qualitative factors stratified by the following loan segments: residential real estate (including home equity loans), commercial real estate, commercial business, and consumer. The Company currently considers its loss experience subsequent to the merger in its quantitative historical loss analysis. The Company does not weight periods used in that analysis to determine the average loss rate in each portfolio segment. Further, the Company considers qualitative information, including certain experience of the Predecessor Company, in determining its average loss factor for purposes of Company's allowance for loan losses. Qualitative factors considered in the Company's analysis include: levels/trends in delinquencies and substandard loans; trends in volumes and terms of loans; effects of changes in risk rating and underwriting standards and other changes in lending policies, procedures and practices; experience/ability/depth of lending management and staff; and national and regional economic trends and conditions. There were no significant changes in the Company's policies or methodology pertaining to the general component of the allowance for loan losses during the three or nine months ended March 31, 2012.

The qualitative factors are determined based on the various risk characteristic of each loan segment. Risk characteristics relevant to each portfolio segment are as follows:

**Residential real estate:** The Company generally does not originate loans with a loan-to-value ratio greater than 80 percent and does not grant subprime loans. All loans in this segment are collateralized by residential real estate and repayment is dependent on the credit quality of the individual borrower. The overall health of the economy, particularly unemployment rates and housing prices, has a significant effect on the credit quality in this segment. For purposes of the Company's allowance for loan loss calculation, home equity loans and lines of credit are included in residential real estate.

**Commercial real estate:** Loans in this segment are primarily income-producing properties. For owner-occupied properties, the cash flows are derived from an operating business, and the underlying cash flows may be adversely affected by deterioration in the financial condition of the operating business. The underlying cash flows generated by non-owner occupied properties may be adversely affected by increased vacancy rates. Management periodically obtains rent rolls, with which it monitors the cash flows of these loans. Adverse developments in either of these areas will have an adverse effect on the credit quality of this segment. For purposes of the allowance for loan losses, this segment also includes construction loans.

**Commercial business:** Loans in this segment are made to businesses and are generally secured by the assets of the business. Repayment is expected from the cash flows of the business. Weak national or regional economic conditions, and a resultant decrease in consumer or business spending, will have an adverse effect on the credit quality of this segment.

**Consumer:** Loans in this segment are generally secured, and repayment is dependent on the credit quality of the individual borrower. Repayment of consumer loans is generally based on the earnings of individual borrowers, which may be adversely impacted by regional labor market conditions.

**Purchased:** Loans in this segment are secured by commercial real estate, multi-family residential real estate, or business assets and have been acquired by the LASG. Loans acquired by the LASG are, with limited exceptions, performing loans at the date of purchase that may have some credit deterioration since origination. Repayment of these loans is largely dependent on cash flow from the successful operation of the property, in the case of non-owner occupied property, or operating business, in the case of owner-occupied property. Loan performance may be adversely affected by factors affecting the general economy or conditions



**Table of Contents**

specific to the real estate market such as geographic location or property type. Loans in this segment are evaluated for impairment under ASC 310-30. The Company reviews expected cash flows from purchased loans on a quarterly basis. The effect of a decline in expected cash flows subsequent to the acquisition of the loan is recognized through a specific allocation in the allowance for loan losses.

The allocated component of the allowance for loan losses relates to loans that are classified as impaired. Impairment is measured on a loan-by-loan basis for commercial business and commercial real estate loans by either the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent. An allowance is established when the discounted cash flows (or collateral value) of the impaired loan is lower than the carrying value of that loan. Large groups of smaller-balance homogeneous loans, such as consumer and residential real estate loans are collectively evaluated for impairment based on the group's historical loss experience adjusted for changes in trends, conditions and other relevant factors that affect repayment of the loans. Accordingly, the Company does not separately identify individual consumer and residential loans for individual impairment and disclosure. However, all loans modified in troubled debt restructurings are individually reviewed for impairment.

For all segments except the purchased loan segment, a loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. For the purchased loan segment, a loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to realize cash flows as estimated at acquisition. Loan impairment of purchased loans is measured based on the decrease in expected cash flows from those estimated at acquisition, excluding changes due to decreases in interest rate indices. Factors considered by management in determining impairment include payment status, collateral value, and the probability of the collecting scheduled principal and interest payments when due.

The Company periodically may agree to modify the contractual terms of loans. When a loan is modified and a concession is made to a borrower experiencing financial difficulty, the modification is considered a troubled debt restructuring (TDR). The Company considers all loans identified as being modified in a TDR as impaired loans. By policy, the Company does not remove TDRs from impairment classification.

The following table sets forth activity in the Company's allowance for loan losses.

## Successor Company

|                     | Three months ended March 31, 2012 |                |            |          |               |        |
|---------------------|-----------------------------------|----------------|------------|----------|---------------|--------|
|                     | Residential<br>Real Estate        | Commercial     | Commercial |          | Purchased (1) | Total  |
|                     |                                   | Real<br>Estate | Business   | Consumer |               |        |
|                     | (Dollars in thousands)            |                |            |          |               |        |
| Beginning balance   | \$ 125                            | \$ 147         | \$ 231     | \$ 234   | \$ 0          | \$ 737 |
| Provision (benefit) | 20                                | (11)           | 17         | 74       | 0             | 100    |
| Recoveries          | 1                                 | 0              | 2          | 4        | 0             | 7      |
| Charge-offs         | (20)                              | 0              | 0          | (76)     | 0             | (96)   |
| Ending balance      | \$ 126                            | \$ 136         | \$ 250     | \$ 236   | \$ 0          | \$ 748 |

## Successor Company

|                     | Nine months ended March 31, 2012 |                |            |          |               |        |
|---------------------|----------------------------------|----------------|------------|----------|---------------|--------|
|                     | Residential<br>Real Estate       | Commercial     | Commercial |          | Purchased (1) | Total  |
|                     |                                  | Real<br>Estate | Business   | Consumer |               |        |
|                     | (Dollars in thousands)           |                |            |          |               |        |
| Beginning balance   | \$ 34                            | \$ 147         | \$ 238     | \$ 18    | \$ 0          | \$ 437 |
| Provision (benefit) | 171                              | 13             | (17)       | 467      | 0             | 634    |
| Recoveries          | 2                                | 0              | 37         | 30       | 0             | 69     |

Edgar Filing: NORTHEAST BANCORP /ME/ - Form 10-Q

|                |        |        |        |        |      |        |
|----------------|--------|--------|--------|--------|------|--------|
| Charge-offs    | (81)   | (24)   | (8)    | (279)  | 0    | (392)  |
| Ending balance | \$ 126 | \$ 136 | \$ 250 | \$ 236 | \$ 0 | \$ 748 |

- (1) Purchased loans included above include commercial real estate, commercial business, and commercial loans secured by residential real estate. The Company separately analyzes loans purchased by the LASG from other segments in determining the allowance for loan losses. There have been no charge-offs or reductions in the cash flow estimates made at the time of loan acquisition in the Company's purchased loan portfolio. As a result, no provision has been made for potential losses related to such loans from inception of the Company's LASG through March 31, 2012.

|                   | Successor Company                       |                                 | Predecessor Company                    |
|-------------------|---|---------------------------------|--|
|                   | Three months ended<br>March 31,<br>2011 | 93 days ended<br>March 31, 2011 | 181 days ended<br>December 28,<br>2010 |
|                   | (Dollars in thousands)                  |                                 |  |
| Beginning balance | \$ 0                                    | \$ 0                            | \$ 5,806                               |
| Provision         | 49                                      | 49                              | 912                                    |
| Recoveries        | 20                                      | 20                              | 108                                    |
| Charge-offs       | (55)                                    | (55)                            | (859)                                  |
| Ending balance    | \$ 14                                   | \$ 14                           | \$ 5,967                               |



**Table of Contents**

The following table sets forth information regarding the allowance for loan losses by portfolio segment and impairment methodology.

|                            | Residential<br>Real Estate | Commercial<br>Real Estate | March 31, 2012         |               | Total         |
|----------------------------|----------------------------|---------------------------|------------------------|---------------|---------------|
|                            |                            |                           | Commercial<br>Business | Consumer      |               |
| (Dollars in thousands)     |                            |                           |                        |               |               |
| Allowance for loan losses: |                            |                           |                        |               |               |
| Individually evaluated     | \$ 3                       | \$ 79                     | \$ 236                 | \$ 0          | \$ 318        |
| Collectively evaluated     | 123                        | 57                        | 14                     | 236           | 430           |
| Purchased (1)              | 0                          | 0                         | 0                      | 0             | 0             |
| <b>Total</b>               | <b>\$ 126</b>              | <b>\$ 136</b>             | <b>\$ 250</b>          | <b>\$ 236</b> | <b>\$ 748</b> |

| Loans:                 |                   |                   |                  |                  |                   |
|------------------------|-------------------|-------------------|------------------|------------------|-------------------|
| Individually evaluated | \$ 424            | \$ 1,920          | \$ 1,175         | \$ 21            | \$ 3,540          |
| Collectively evaluated | 136,215           | 110,308           | 20,460           | 18,338           | 285,321           |
| Purchased (1)          | 3,587             | 53,329            | 0                | 0                | 56,916            |
| <b>Total</b>           | <b>\$ 140,226</b> | <b>\$ 165,557</b> | <b>\$ 21,635</b> | <b>\$ 18,359</b> | <b>\$ 345,777</b> |

|                            | Residential<br>Real Estate | Commercial<br>Real Estate | June 30, 2011          |              | Total         |
|----------------------------|----------------------------|---------------------------|------------------------|--------------|---------------|
|                            |                            |                           | Commercial<br>Business | Consumer     |               |
| (Dollars in thousands)     |                            |                           |                        |              |               |
| Allowance for loan losses: |                            |                           |                        |              |               |
| Individually evaluated     | \$ 0                       | \$ 119                    | \$ 196                 | \$ 0         | \$ 315        |
| Collectively evaluated     | 34                         | 28                        | 42                     | 18           | 122           |
| Purchased (1)              | 0                          | 0                         | 0                      | 0            | 0             |
| <b>Total</b>               | <b>\$ 34</b>               | <b>\$ 147</b>             | <b>\$ 238</b>          | <b>\$ 18</b> | <b>\$ 437</b> |

| Loans:                 |                   |                   |                  |                  |                   |
|------------------------|-------------------|-------------------|------------------|------------------|-------------------|
| Individually evaluated | \$ 0              | \$ 1,221          | \$ 1,922         | \$ 0             | \$ 3,143          |
| Collectively evaluated | 146,585           | 116,810           | 20,303           | 22,435           | 306,133           |
| Purchased (1)          | 0                 | 637               | 0                | 0                | 637               |
| <b>Total</b>           | <b>\$ 146,585</b> | <b>\$ 118,668</b> | <b>\$ 22,225</b> | <b>\$ 22,435</b> | <b>\$ 309,913</b> |

- (1) Expected cash flows from individual purchased loans are reviewed quarterly by the Company. Post acquisition, the effect of a decline in expected cash flows is recorded through the allowance for loan losses as a specific allocation.

**Table of Contents**

The following table sets forth information regarding impaired loans. The recorded investment in impaired loans includes discounts or premiums from acquisition through purchase or merger. Interest income recognized includes interest received or accrued based on loan principal and contractual interest rates; amounts do not include accretion or amortization of acquisition discounts or premiums as such amounts related to impaired loans are insignificant. Loans acquired with deteriorated credit quality that have performed based on cash flow and accretible yield expectations determined at date of acquisition are not considered impaired assets and have been excluded from the tables below.

|  | March 31, 2012         |                                |                      | For the three months ended<br>March 31, 2012 |                                  | For the nine months ended<br>March 31, 2012 |                                  |
|--|------------------------|--------------------------------|----------------------|--|----------------------------------|---|----------------------------------|
|  | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Average<br>Recorded<br>Investment            | Interest<br>Income<br>Recognized | Average<br>Recorded<br>Investment           | Interest<br>Income<br>Recognized |
|  | (Dollars in thousands) |                                |                      | (Dollars in thousands)                       |                                  | (Dollars in thousands)                      |                                  |
| <b>Impaired loans without a valuation allowance:</b> |                        |                                |                      |  |                                  |   |                                  |
| Residential real estate                              | \$ 318                 | \$ 497                         | \$ 0                 | \$ 430                                       | \$ 9                             | \$ 215                                      | \$ 17                            |
| Consumer   | 21                     | 21                             | 0                    | 11   | 0                                | 5   | 0                                |
| Commercial real estate                               | 666                    | 817                            | 0                    | 1,540  | 12                               | 1,028                                       | 70                               |
| Commercial business                                  | 487                    | 799                            | 0                    | 483  | 2                                | 555   | 7                                |
| <b>Total</b>   | <b>1,492</b>           | <b>2,134</b>                   | <b>0</b>             | <b>2,464</b>                                 | <b>23</b>                        | <b>1,803</b>                                | <b>94</b>                        |
| <b>Impaired loans with a valuation allowance:</b>    |                        |                                |                      |  |                                  |   |                                  |
| Residential real estate                              | 106                    | 103                            | 3                    | 53   | 0                                | 63  | 0                                |
| Consumer   | 0                      | 0                              | 0                    | 0  | 0                                | 0   | 0                                |
| Commercial real estate                               | 1,254                  | 1,270                          | 79                   | 721  | 16                               | 666   | 19                               |
| Commercial business                                  | 688                    | 720                            | 236                  | 664  | 0                                | 728   | 0                                |
| <b>Total</b>   | <b>2,048</b>           | <b>2,093</b>                   | <b>318</b>           | <b>1,438</b>                                 | <b>16</b>                        | <b>1,457</b>                                | <b>19</b>                        |
| <b>Total impaired loans</b>                          | <b>\$ 3,540</b>        | <b>\$ 4,227</b>                | <b>\$ 318</b>        | <b>\$ 3,902</b>                              | <b>\$ 39</b>                     | <b>\$ 3,260</b>                             | <b>\$ 113</b>                    |

|  | June 30, 2011          |                                |                      |
|--|------------------------|--------------------------------|----------------------|
|  | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance |
|  | (Dollars in thousands) |                                |                      |
| <b>Impaired loans without a valuation allowance:</b> |                        |                                |                      |
| Commercial real estate                               | \$ 348                 | \$ 348                         | \$ 0                 |
| Commercial business                                  | 1,054                  | 1,054                          | 0                    |
| <b>Total</b>   | <b>1,402</b>           | <b>1,402</b>                   | <b>0</b>             |
| <b>Impaired loans with a valuation allowance:</b>    |                        |                                |                      |
| Commercial real estate                               | 873                    | 873                            | 119                  |
| Commercial business                                  | 868                    | 868                            | 196                  |
| <b>Total</b>   | <b>1,741</b>           | <b>1,741</b>                   | <b>315</b>           |
| <b>Total impaired loans</b>                          | <b>\$ 3,143</b>        | <b>\$ 3,143</b>                | <b>\$ 315</b>        |

**Table of Contents**

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

|                                   | March 31, 2012         |               |             |                 |                 |                   |                   |                 |
|-----------------------------------|------------------------|---------------|-------------|-----------------|-----------------|-------------------|-------------------|-----------------|
|                                   | 30-59                  | 60-89         | Past Due    | Past Due        | Total           | Total             | Total             | Non-            |
|                                   | Days                   | Days          | 90 Days or  | 90 Days or      | Past            | Current           | Loans             | Accrual         |
|                                   |                        |               | More-Still  | More-           | Due             |                   |                   | Loans           |
|                                   |                        |               | Accruing    | Nonaccrual      |                 |                   |                   |                 |
|                                   | (Dollars in thousands) |               |             |                 |                 |                   |                   |                 |
| <b>Originated portfolio:</b>      |                        |               |             |                 |                 |                   |                   |                 |
| Residential real estate           | \$ 412                 | \$ 0          | \$ 0        | \$ 2,764        | \$ 3,176        | \$ 89,381         | \$ 92,557         | \$ 3,067        |
| Home equity                       | 209                    | 74            | 0           | 150             | 433             | 43,649            | 44,082            | 255             |
| Commercial real estate            | 96                     | 0             | 0           | 442             | 538             | 110,193           | 110,731           | 442             |
| Construction                      | 0                      | 0             | 0           | 0               | 0               | 1,497             | 1,497             | 0               |
| Commercial business               | 207                    | 0             | 0           | 994             | 1,201           | 20,434            | 21,635            | 1,108           |
| Consumer                          | 259                    | 163           | 0           | 300             | 722             | 17,637            | 18,359            | 309             |
| <b>Total originated portfolio</b> | <b>1,183</b>           | <b>237</b>    | <b>0</b>    | <b>4,650</b>    | <b>6,070</b>    | <b>282,791</b>    | <b>288,861</b>    | <b>5,181</b>    |
| <b>Purchased portfolio:</b>       |                        |               |             |                 |                 |                   |                   |                 |
| Residential real estate           | 30                     | 0             | 0           | 0               | 30              | 3,557             | 3,587             | 0               |
| Commercial real estate            | 1,014                  | 0             | 0           | 0               | 1,014           | 52,315            | 53,329            | 0               |
| <b>Total purchased portfolio</b>  | <b>1,044</b>           | <b>0</b>      | <b>0</b>    | <b>0</b>        | <b>1,044</b>    | <b>55,872</b>     | <b>56,916</b>     | <b>0</b>        |
| <b>Total loans</b>                | <b>\$ 2,227</b>        | <b>\$ 237</b> | <b>\$ 0</b> | <b>\$ 4,650</b> | <b>\$ 7,114</b> | <b>\$ 338,663</b> | <b>\$ 345,777</b> | <b>\$ 5,181</b> |

|                                   | June 30, 2011 |                 |               |                 |                 |                   |                   |                 |
|-----------------------------------|---------------|-----------------|---------------|-----------------|-----------------|-------------------|-------------------|-----------------|
|                                   | 30-59         | 60-89           | Past Due      | Past Due        | Total           | Total             | Total             | Non-            |
|                                   | Days          | Days            | 90 Days or    | 90 Days or      | Past            | Current           | Loans             | Accrual         |
|                                   |               |                 | More-Still    | More-           | Due             |                   |                   | Loans           |
|                                   |               |                 | Accruing      | Nonaccrual      |                 |                   |                   |                 |
| <b>Originated portfolio:</b>      |               |                 |               |                 |                 |                   |                   |                 |
| Residential real estate           | \$ 257        | \$ 1,021        | \$ 0          | \$ 1,779        | \$ 3,057        | \$ 92,360         | \$ 95,417         | \$ 2,195        |
| Home equity                       | 117           | 0               | 0             | 89              | 206             | 49,854            | 50,060            | 205             |
| Commercial real estate            | 0             | 492             | 0             | 934             | 1,426           | 115,698           | 117,124           | 3,601           |
| Construction                      | 0             | 0               | 0             | 121             | 121             | 1,894             | 2,015             | 121             |
| Commercial business               | 4             | 75              | 751           | 416             | 1,246           | 20,979            | 22,225            | 559             |
| Consumer                          | 566           | 338             | 0             | 508             | 1,412           | 21,023            | 22,435            | 527             |
| <b>Total originated portfolio</b> | <b>944</b>    | <b>1,926</b>    | <b>751</b>    | <b>3,847</b>    | <b>7,468</b>    | <b>301,808</b>    | <b>309,276</b>    | <b>7,208</b>    |
| <b>Purchased portfolio:</b>       |               |                 |               |                 |                 |                   |                   |                 |
| Commercial real estate            | 0             | 0               | 0             | 0               | 0               | 637               | 637               | 0               |
| <b>Total purchased portfolio</b>  | <b>0</b>      | <b>0</b>        | <b>0</b>      | <b>0</b>        | <b>0</b>        | <b>637</b>        | <b>637</b>        | <b>0</b>        |
| <b>Total loans</b>                | <b>\$ 944</b> | <b>\$ 1,926</b> | <b>\$ 751</b> | <b>\$ 3,847</b> | <b>\$ 7,468</b> | <b>\$ 302,445</b> | <b>\$ 309,913</b> | <b>\$ 7,208</b> |

The following table shows the troubled debt restructurings which occurred during the nine months ended March 31, 2012 and the change in the recorded investment subsequent to the modifications occurring. All concessions given during the period consisted of either rate reductions or maturity extensions, or combinations thereof. There was no forgiveness of principal related to loans modified in a TDR during the period.

|                                   | Number of<br>Contracts | Recorded<br>Investment<br>Pre-Modification<br>(Dollars in thousands) | Recorded<br>Investment<br>Post-Modification |
|-----------------------------------|------------------------|--|---|
| <b>Originated portfolio:</b>      |                        |  |   |
| Residential real estate           | 2                      | \$ 161   | \$ 161                                      |
| Home equity                       | 0                      | 0  | 0   |
| Commercial real estate            | 0                      | 0  | 0   |
| Construction                      | 0                      | 0  | 0   |
| Commercial business               | 0                      | 0  | 0   |
| Consumer                          | 0                      | 0  | 0   |
| <b>Total originated portfolio</b> | <b>2</b>               | <b>161</b>   | <b>161</b>                                  |
| <b>Purchased portfolio:</b>       |                        |  |   |
| Residential real estate           | 0                      | 0  | 0   |
| Commercial real estate            | 0                      | 0  | 0   |
| <b>Total purchased portfolio</b>  | <b>0</b>               | <b>0</b>   | <b>0</b>                                    |
| <b>Total</b>                      | <b>2</b>               | <b>\$ 161</b>  | <b>\$ 161</b>                               |

There were no defaults of loans previously modified in a TDR during the three or nine months ended March 31, 2012.

**Table of Contents**

The following table shows the Company's total TDRs as of the dates indicated.

|                                   | March 31, 2012         |                      |                 | June 30, 2011          |                      |               |
|-----------------------------------|------------------------|----------------------|-----------------|------------------------|----------------------|---------------|
|                                   | On Accrual Status      | On Nonaccrual Status | Total           | On Accrual Status      | On Nonaccrual Status | Total         |
|                                   | (Dollars in thousands) |                      |                 | (Dollars in thousands) |                      |               |
| <b>Originated portfolio:</b>      |                        |                      |                 |                        |                      |               |
| Residential real estate           | \$ 92                  | \$ 161               | \$ 253          | \$ 93                  | \$ 0                 | \$ 93         |
| Home equity                       | 0                      | 0                    | 0               | 0                      | 0                    | 0             |
| Commercial real estate            | 0                      | 861                  | 861             | 0                      | 859                  | 859           |
| Construction                      | 0                      | 0                    | 0               | 0                      | 0                    | 0             |
| Commercial business               | 0                      | 0                    | 0               | 0                      | 0                    | 0             |
| Consumer                          | 0                      | 0                    | 0               | 0                      | 0                    | 0             |
| <b>Total originated portfolio</b> | <b>92</b>              | <b>1,022</b>         | <b>1,114</b>    | <b>93</b>              | <b>859</b>           | <b>952</b>    |
| <b>Purchased portfolio:</b>       |                        |                      |                 |                        |                      |               |
| Residential real estate           | 0                      | 0                    | 0               | 0                      | 0                    | 0             |
| Commercial real estate            | 0                      | 0                    | 0               | 0                      | 0                    | 0             |
| <b>Total purchased portfolio</b>  | <b>0</b>               | <b>0</b>             | <b>0</b>        | <b>0</b>               | <b>0</b>             | <b>0</b>      |
| <b>Total</b>                      | <b>\$ 92</b>           | <b>\$ 1,022</b>      | <b>\$ 1,114</b> | <b>\$ 93</b>           | <b>\$ 859</b>        | <b>\$ 952</b> |

**Credit Quality Indicators**

As of January 1, 2011, the Company updated its internal loan rating system from an eight to ten point scale. Risk ratings for periods prior to January 1, 2011 have been retroactively adjusted for comparative purposes.

The Company utilizes a ten point internal loan rating system for commercial real estate, construction and commercial business loans as follows:

Loans rated 1 - 6: Loans in these categories are considered pass rated loans with low to average risk.

Loans rated 7: Loans in this category are considered special mention. These loans are beginning to show signs of potential weakness and are being closely monitored by management.

Loans rated 8: Loans in this category are considered substandard. Generally, a loan is considered substandard if the current net worth inadequately protects it and the paying capacity of the obligors or the collateral pledged. There is a distinct possibility that the Company will sustain some loss if the weakness is not corrected.

Loans rated 9: Loans in this category are considered doubtful. Loans classified as doubtful have all the weaknesses inherent in those loans classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of current existing facts, highly questionable and improbable.

Loans rated 10: Loans in this category are considered loss and of such little value that their continuance as loans is not warranted.

On an annual basis, or more often if needed, the Company formally reviews the ratings of all commercial real estate, construction, and commercial business loans. Semi-annually, the Company engages an independent third-party to review a significant portion of loans within these segments. Management uses the results of these reviews as part of its annual review process. Risk ratings on purchased loans, with and without evidence of credit deterioration at acquisition, are determined relative to the Company's recorded investment in that loan, which may be significantly lower than the loan's unpaid principal balance.



**Table of Contents**

The following tables present the Company's loans by risk rating.

|                        | March 31, 2012               |                      |                        |                           |
|------------------------|------------------------------|----------------------|------------------------|---------------------------|
|                        | Commercial<br>Real<br>Estate | Originated Portfolio |                        | Purchased Portfolio       |
|                        |                              | Construction         | Commercial<br>Business | Commercial<br>Real Estate |
| (Dollars in thousands) |                              |                      |                        |                           |
| Loans rated 1- 6       | \$ 105,006                   | \$ 1,497             | \$ 20,118              | \$ 53,329                 |
| Loans rated 7          | 1,668                        | 0                    | 265                    | 0                         |
| Loans rated 8          | 4,057                        | 0                    | 1,252                  | 0                         |
| Loans rated 9          | 0                            | 0                    | 0                      | 0                         |
| Loans rated 10         | 0                            | 0                    | 0                      | 0                         |
|                        | \$ 110,731                   | \$ 1,497             | \$ 21,635              | \$ 53,329                 |

|                        | June 30, 2011                |                      |                        |                           |
|------------------------|------------------------------|----------------------|------------------------|---------------------------|
|                        | Commercial<br>Real<br>Estate | Originated Portfolio |                        | Purchased Portfolio       |
|                        |                              | Construction         | Commercial<br>Business | Commercial<br>Real Estate |
| (Dollars in thousands) |                              |                      |                        |                           |
| Loans rated 1- 6       | \$ 106,717                   | \$ 2,015             | \$ 18,201              | \$ 637                    |
| Loans rated 7          | 3,133                        | 0                    | 1,169                  | 0                         |
| Loans rated 8          | 7,274                        | 0                    | 2,855                  | 0                         |
| Loans rated 9          | 0                            | 0                    | 0                      | 0                         |
| Loans rated 10         | 0                            | 0                    | 0                      | 0                         |
|                        | \$ 117,124                   | \$ 2,015             | \$ 22,225              | \$ 637                    |

**4. Securities Available-for-Sale**

Securities available-for-sale at amortized cost and approximate fair values are summarized below:

|   | March 31, 2012         |               | June 30, 2011     |               |
|---|------------------------|---------------|-------------------|---------------|
|   | Amortized<br>Cost      | Fair<br>Value | Amortized<br>Cost | Fair<br>Value |
|   | (Dollars in thousands) |               |                   |               |
| Debt securities issued by U.S. Government-sponsored enterprises | \$ 45,958              | \$ 45,871     | \$ 48,827         | \$ 48,737     |
| Mortgage-backed securities issued by government agencies        | 91,368                 | 90,859        | 99,637            | 99,558        |
| Equity securities   | 0                      | 0             | 193               | 216           |
| Trust preferred securities                                      | 0                      | 0             | 466               | 451           |
|   | \$ 137,326             | \$ 136,730    | \$ 149,123        | \$ 148,962    |

The gross unrealized gains and unrealized losses on available-for-sale securities are as follows:

Edgar Filing: NORTHEAST BANCORP /ME/ - Form 10-Q

|   | March 31, 2012               |                               | June 30, 2011                |                               |
|---|------------------------------|-------------------------------|------------------------------|-------------------------------|
|   | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses |
|   | (Dollars in thousands)       |                               |                              |                               |
| Debt securities issued by U.S. Government-sponsored enterprises | \$ 6                         | \$ 93                         | \$ 7                         | \$ 97                         |
| Mortgage-backed securities issued by government agencies        | 0                            | 509                           | 212                          | 291                           |
| Equity securities   | 0                            | 0                             | 23                           | 0                             |
| Trust preferred securities                                      | 0                            | 0                             | 8                            | 23                            |
|   | \$ 6                         | \$ 602                        | \$ 250                       | \$ 411                        |

When securities are sold, the adjusted cost of the specific security sold is used to compute the gain or loss on sale. The following table summarizes realized gains and losses on available-for-sale securities.

| Successor Company     | Three Months Ended     | Nine Months Ended | Three Months Ended | 93 Days Ended |
|-----------------------|------------------------|-------------------|--------------------|---------------|
|                       | March 31,<br>2012      |                   | March 31,<br>2011  |               |
|                       | (Dollars in thousands) |                   |                    |               |
| Gross realized gains  | \$ 731                 | \$ 1,180          | \$ 47              | \$ 47         |
| Gross realized losses | 0                      | 69                | 0                  | 0             |
| Net security gains    | \$ 731                 | \$ 1,111          | \$ 47              | \$ 47         |

| Predecessor Company   | 181 Days Ended<br>December 28, 2010<br>(Dollars in thousands) |
|-----------------------|---|
| Gross realized gains  | \$ 17   |
| Gross realized losses | 0   |
| Net security gains    | \$ 17   |



**Table of Contents**

The following summarizes the Company's gross unrealized losses and fair values aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position.

|   | Less than 12 Months |                   | March 31, 2012<br>More than 12 Months |                   | Total      |                   |
|---|---------------------|-------------------|---------------------------------------|-------------------|------------|-------------------|
|   | Fair Value          | Unrealized Losses | Fair Value                            | Unrealized Losses | Fair Value | Unrealized Losses |
| Debt securities issued by U.S. Government-sponsored enterprises | \$ 42,734           | \$ 93             | \$ 0                                  | \$ 0              | \$ 42,734  | \$ 93             |
| Mortgage-backed securities issued by government agencies        | 90,769              | 509               | 0                                     | 0                 | 90,769     | 509               |
|   | \$ 133,503          | \$ 602            | \$ 0                                  | \$ 0              | \$ 133,503 | \$ 602            |

|   | Less than 12 Months |                   | June 30, 2011<br>More than 12 Months |                   | Total      |                   |
|---|---------------------|-------------------|--------------------------------------|-------------------|------------|-------------------|
|   | Fair Value          | Unrealized Losses | Fair Value                           | Unrealized Losses | Fair Value | Unrealized Losses |
| Debt securities issued by U.S. Government-sponsored enterprises | \$ 46,130           | \$ 97             | \$ 0                                 | \$ 0              | \$ 46,130  | \$ 97             |
| Mortgage-backed securities issued by government agencies        | 51,367              | 291               | 0                                    | 0                 | 51,367     | 291               |
| Trust preferred securities                                      | 174                 | 23                | 0                                    | 0                 | 174        | 23                |
|   | \$ 97,671           | \$ 411            | \$ 0                                 | \$ 0              | \$ 97,671  | \$ 411            |

There were no other-than-temporary impairment losses on securities during the three or nine months ended March 31, 2012. There were no other-than-temporary impairment losses on securities for the three months or 93 days ended March 31, 2011, nor the 181 days ended December 28, 2010.

At March 31, 2012, the Company had 38 available-for-sale securities with continuous unrealized losses for less than twelve months, representing aggregate depreciation from amortized cost of less than 1%. No securities in an unrealized loss position had continuous losses greater than twelve months. At March 31, 2012, all of the Company's available-for-sale securities were issued by either government agencies or government-sponsored enterprises. The decline in fair value of the Company's available-for-sale securities at March 31, 2012 is attributable to changes in interest rates.

The amortized cost and fair values of available-for-sale debt securities by contractual maturity are shown below as of March 31, 2012. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

|  | Amortized Cost | Fair Value |
|--|----------------|------------|
| Due after one year through five years  | \$ 45,958      | \$ 45,871  |
| Due after five years through ten years | 0              | 0          |
| Due after ten years                    | 0              | 0          |
|  | 45,958         | 45,871     |
| Mortgage-backed securities             | 91,368         | 90,859     |

\$ 137,326      \$ 136,730

**5. Stock-Based Compensation**

A summary of the stock option activity for the nine months ended March 31, 2012 follows.

|                                    | Shares  | Weighted<br>Average<br>Exercise Price |
|------------------------------------|---------|---------------------------------------|
| Outstanding at beginning of period | 764,549 | \$ 14.05                              |
| Granted                            | 40,000  | 12.63                                 |
| Exercised                          | 0       | 0                                     |
| Forfeited                          | (8,500) | 13.10                                 |
| Outstanding and at end of period   | 796,049 | 13.98                                 |
| Exercisable                        | 54,175  | \$ 14.11                              |

**Table of Contents**

The fair value of options granted during the nine months ended March 31, 2012 was estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions.

|                         |         |
|-------------------------|---------|
| Assumptions:            |         |
| Dividend yield          | 2.81%   |
| Expected life           | 6 years |
| Expected volatility     | 33.86%  |
| Risk-free interest rate | 0.98%   |

Weighted average fair value per option \$ 4.39

The expected volatility is based on historical volatility. The risk-free interest rate is for periods within the expected life of the awards are based on the U.S. Treasury yield curve in effect at the time of the grant. The expected life is based on historical and expected exercise experience. The dividend yield assumption is based on the Company's history and expectation of dividend payouts.

The following table summarizes information about stock options outstanding at March 31, 2012.

| Weighted Average<br>Exercise Price | Options Outstanding |                                    |                              | Options Exercisable                |        |                                    |                              |
|------------------------------------|---------------------|------------------------------------|------------------------------|------------------------------------|--------|------------------------------------|------------------------------|
|                                    | Number              | Weighted Average<br>Remaining Life | Aggregate<br>Intrinsic Value | Weighted Average<br>Exercise Price | Number | Weighted Average<br>Remaining Life | Aggregate<br>Intrinsic Value |
| \$ 12.63                           | 40,000              | 9.8 years                          | \$ 0                         | \$ 0                               | 0      | 9.8 years                          | \$ 0                         |
| 13.93                              | 594,039             | 8.8 years                          | 0                            | 13.93                              | 37,975 | 8.8 years                          | 0                            |
| 14.52                              | 162,010             | 8.8 years                          | 0                            | 14.52                              | 16,200 | 8.8 years                          | 0                            |
| 13.98                              | 796,049             | 9.0 years                          | 0                            | 14.11                              | 54,175 | 8.8 years                          | 0                            |

At March 31, 2012, all unvested stock options outstanding are expected to vest.

On December 29, 2010, the Company granted 13,026 shares of the Company's restricted stock to a senior executive of the Company. The holder of this award participates fully in the rewards of stock ownership of the Company, including voting rights and dividend rights. This award has been determined to have a fair value of \$13.93 per share based on the average price at which the Company's common stock traded on the date of grant. Forty percent of the award will vest on December 29, 2012, and the remainder will vest in three equal annual installments commencing on December 29, 2013. At March 31, 2012, no restricted common shares were vested. All restricted common shares are expected to vest.

At March 31, 2012, performance-based stock appreciation rights ( SARs ) with underlying shares of non-voting common stock totaling 81,006 were outstanding. As of March 31, 2012, 2011, the Company has accrued the maximum liability payable under the SAR grant, which equates to \$0.59 per share, or a total of \$48 thousand. The SARs expire in December of 2020.

The estimated amount and timing of future pre-tax stock-based compensation expense to be recognized are as follows.

|                  | Fiscal Years Ending June 30: |        |        |        |        |       | Total    |
|------------------|------------------------------|--------|--------|--------|--------|-------|----------|
|                  | April<br>June 2012           | 2013   | 2014   | 2015   | 2016   | 2017  |          |
| Stock options    | \$ 105                       | \$ 419 | \$ 405 | \$ 386 | \$ 256 | \$ 69 | \$ 1,640 |
| Restricted stock | 9                            | 36     | 36     | 36     | 18     | 0     | 135      |
|                  | \$ 114                       | \$ 455 | \$ 441 | \$ 422 | \$ 274 | \$ 69 | \$ 1,775 |

## Edgar Filing: NORTHEAST BANCORP /ME/ - Form 10-Q

At March 31, 2012, the Company had outstanding a warrant to purchase 67,958 shares of common stock issued to the U.S. Department of the Treasury (the Treasury ) on December 12, 2008 in connection with the Company's participation in the TARP Capital Purchase Program on December 12, 2008. The warrant has an exercise price of \$9.33 per share and expires on December 12, 2018. The warrant is recorded as a permanent component of stockholders' equity in accordance with ASC 815, *Derivatives and Hedging*. At March 31, 2012, the intrinsic value of the warrant was \$199 thousand.

**Table of Contents****6. Discontinued Operations**

On August 31, 2011, the Company sold customer lists and certain fixed assets of its wholly-owned subsidiary, Northeast Bank Insurance Group, Inc. ( NBIG ) to local insurance agencies in two separate transactions. The Varney Agency, Inc. of Bangor, Maine purchased the assets of nine NBIG offices in Anson, Auburn, Augusta, Bethel, Livermore Falls, Scarborough, South Paris, Thomaston and Turner, Maine. The NBIG office in Berwick, Maine, which operates under the name of Spence & Matthews, was acquired by Bradley Scott, previously a member of NBIG's senior management team. The following is a summary of the sale transactions.

|   | (Dollars in thousands) |
|---|------------------------|
| Sale proceeds                                   | \$ 9,863               |
| Less:   |                        |
| Customer lists and other intangible assets, net | 7,379                  |
| Fixed assets, net of accumulated depreciation   | 165                    |
| Severance and other direct expenses             | 768                    |
| Pre-tax gain recognized                         | \$ 1,551               |

Operations associated with NBIG for the periods presented have been classified as discontinued operations in the accompanying consolidated statements of income. The Company has eliminated all intercompany transactions in presenting discontinued operations for each period. Insurance commissions associated with NBIG were \$965 thousand for the nine months ended March 31, 2012, all of which was recognized in the first quarter of fiscal 2012. Insurance commissions were \$1.5 million for the three months and 93 days ended March 31, 2011 and \$2.7 million for 181 days ended December 28, 2010. Intangible and fixed assets associated with discontinued operations totaled approximately \$7.4 million and \$168 thousand, respectively, at June 30, 2011. In connection with the transaction, the Company repaid borrowings associated with NBIG totaling \$2.1 million.

NBIG had previously sold customer lists and certain fixed assets of its agency offices in Jackman, Maine to Worldwide Risk Management, Inc. on December 22, 2010; in Rangeley, Maine to Morton & Furbish Insurance Agency on January 31, 2010; and in Mexico, Maine to UIG, Inc. on December 31, 2009.

**Table of Contents****7. Earnings Per Share (EPS)**

EPS is computed by dividing net income allocated to common shareholders by the weighted average common shares outstanding. The following table shows the weighted average number of shares outstanding for the periods indicated. Shares issuable relative to stock options granted have been reflected as an increase in the shares outstanding used to calculate diluted EPS, after applying the treasury stock method. The number of shares outstanding for basic and diluted EPS is presented as follows:

|   | Successor Company                                       |  |   |                                    | Predecessor Company                    |
|---|---|--|---|------------------------------------|--|
|   | Three months ended<br>March 31,<br>2012                 | Nine months ended<br>March 31,<br>2012 | Three months ended<br>March 31,<br>2011 | 93 days ended<br>March 31,<br>2011 | 181 days ended<br>December 28,<br>2010 |
|   | (Dollars in thousands, except share and per share data) |  |   |                                    |  |
| Net income (loss) from continuing operations  | \$ 154  | \$ (22)                                | \$ 36                                   | \$ 11,877                          | \$ 1,667                               |
| Preferred stock dividends   | (53)  | (159)                                  | (53)                                    | (55)                               | (104)                                  |
| Accretion of preferred stock  | (45)  | (135)                                  | (45)                                    | (45)                               | (15)                                   |
| Net income (loss) from continuing operations available to common shareholders           | \$ 56   | \$ (316)                               | \$ (62)                                 | 11,777                             | \$ 1,548                               |
| Undistributed earnings of continuing operations allocated to participating securities   | 0   | (1)                                    | 0                                       | 44                                 | 0                                      |
| Net income from continuing operations allocated to common shareholders                  | \$ 56   | \$ (315)                               | \$ (62)                                 | 11,733                             | \$ 1,548                               |
| Net income from discontinued operations available to common shareholders                | \$ 14   | \$ 1,137                               | \$ 120                                  | \$ 114                             | \$ 129                                 |
| Undistributed earnings of discontinued operations allocated to participating securities | 0   | 4                                      | 0                                       | 0                                  | 0                                      |
| Net income from discontinued operations allocated to common shareholders                | \$ 14   | \$ 1,133                               | \$ 120                                  | 114                                | \$ 129                                 |
| Weighted average shares used in calculation of basic earnings per share                 | 3,494,498   | 3,494,498                              | 3,492,498                               | 3,492,498                          | 2,330,197                              |
| Incremental shares from assumed exercise of dilutive securities                         | 17,775  | 0                                      | 67,375                                  | 67,780                             | 24,188                                 |
| Weighted average shares used in calculation of diluted earnings per share               | 3,512,273   | 3,494,498                              | 3,559,873                               | 3,560,278                          | 2,354,385                              |
| Earnings per common share:  |   |  |   |                                    |  |
| Income (loss) from continuing operations  | \$ 0.02   | \$ (0.09)                              | \$ (0.01)                               | 3.36                               | \$ 0.67                                |
| Income from discontinued operations   | 0.00  | 0.32                                   | 0.03                                    | 0.03                               | 0.05                                   |
| Earnings per common share   | \$ 0.02   | \$ 0.23                                | \$ 0.02                                 | 3.39                               | \$ 0.72                                |
| Diluted earnings per common share:  |   |  |   |                                    |  |

Edgar Filing: NORTHEAST BANCORP /ME/ - Form 10-Q

|  |    |      |    |        |    |        |      |    |      |
|--|----|------|----|--------|----|--------|------|----|------|
| Income (loss) from continuing operations | \$ | 0.02 | \$ | (0.09) | \$ | (0.01) | 3.30 | \$ | 0.66 |
| Income from discontinued operations      |    | 0.00 |    | 0.32   |    | 0.03   | 0.03 |    | 0.05 |
| Diluted earnings per common share        | \$ | 0.02 | \$ | 0.23   | \$ | 0.02   | 3.33 | \$ | 0.71 |

796,049 stock options were anti-dilutive and excluded from the calculation of dilutive earnings per share for the three and nine months ended March 31, 2012. 67,958 shares issuable upon the exercise of the warrant issued to the Treasury were anti-dilutive during the nine months ended March 31, 2012 due to the Company's loss from continuing operations.

---

## **Table of Contents**

### **8. Fair Value Measurements**

Fair value is a market-based measure considered from the perspective of a market participant rather than an entity-specific measure. Therefore, even when market assumptions are not readily available, the Company's own assumptions are set to reflect those that market participants would use in pricing the asset or liability at the measurement date. If there has been a significant decrease in the volume and level of activity for the asset or liability, regardless of the valuation technique(s) used, the objective of a fair value measurement remains the same. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. The Company uses prices and inputs that are current as of the measurement date, including in periods of market dislocation. In periods of market dislocation, the observability of prices and inputs may be reduced for many instruments. This condition could cause an instrument to be reclassified from one level to another.

ASC 820 defines fair value and establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under ASC 820 are described below:

**Level 1** Inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

**Level 2** Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly.

**Level 3** Prices or valuations that require inputs that are both significant to the fair value measurement and unobservable.

To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgment. Accordingly, the degree of judgment exercised by the Company in determining fair value is greatest for instruments categorized in Level 3. A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

*Valuation techniques* There have been no changes in the valuation techniques used during the current period.

*Cash and cash equivalents* The fair value of cash, due from banks, interest bearing deposits and Federal Home Loan Bank ( FHLB ) overnight deposits approximates their relative book values, as these financial instruments have short maturities.

*Available-for-sale securities* Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Examples of such instruments include publicly-traded common and preferred stocks. If quoted prices are not available, then fair values are estimated by using pricing models (*i.e.*, matrix pricing) and market interest rates and credit assumptions or quoted prices of securities with similar characteristics and are classified within Level 2 of the valuation hierarchy. Examples of such instruments include government agency and government sponsored agency mortgage-backed securities, as well as certain preferred and trust preferred stocks. Level 3 securities are securities for which significant unobservable inputs are utilized.

*FHLB and Federal Reserve stock* The carrying value of FHLB stock and Federal Reserve stock approximates fair value based on redemption provisions of the FHLB and the Federal Reserve.

*Loans* Fair values are estimated for portfolios of loans with similar financial characteristics. The fair value of performing loans is calculated by discounting scheduled cash flows through the estimated maturity using estimated market discount rates that reflect the credit and interest rate risk inherent in the loan. The estimates of maturity are based on the Company's historical experience with repayments for each loan classification, modified, as required, by an estimate of the effect of current economic conditions, lending conditions and the effects of estimated prepayments.

Valuations of impaired loans are determined by reviewing collateral values or through discounted cash flow analyses using a rate commensurate with the risk associated with the estimated cash flows. Assumptions regarding credit risk, cash flows and discount rates are developed using available market information and historical information. Certain inputs used in appraisals and cash flow analyses are not always observable, and therefore impaired loans may be categorized as Level 3 within the fair value hierarchy. When inputs used are primarily observable, they are classified as Level 2.

*Loans held for sale* The fair value of loans held-for-sale is estimated based on bid quotations received from loan dealers.



## Edgar Filing: NORTHEAST BANCORP /ME/ - Form 10-Q

*Interest receivable* The fair value of this financial instrument approximates the book value as this financial instrument has a short maturity. It is the Company's policy to stop accruing interest on loans past due by more than ninety days. Therefore, this financial instrument has been adjusted for estimated credit loss.

**Table of Contents**

*Repossessed collateral* The fair values of other real estate owned and other repossessed collateral are estimated based upon appraised values less estimated costs to sell. Certain inputs used in appraisals are not always observable, and therefore repossessed collateral may be categorized as Level 3 within the fair value hierarchy. When inputs used in appraisals are primarily observable, they are classified as Level 2.

*Derivative financial instruments* The valuation of the Company's interest rate swaps and caps are determined using widely accepted valuation techniques including discounted cash flow analyses on the expected cash flows of derivatives. These analyses reflect the contractual terms of the derivatives, including the period to maturity, and use observable market-based inputs, including interest rate curves and implied volatilities. Unobservable inputs, such as credit valuation adjustments are insignificant to the overall valuation of the Company's derivative financial instruments. Accordingly, the Company has determined that its interest rate derivatives fall within Level 2 of the fair value hierarchy.

The fair value of derivative loan commitments and forward loan sale agreements are estimated using the anticipated market price based on pricing indications provided from syndicate banks. These commitments and agreements are categorized as Level 2. The fair value of such instruments was nominal at each date presented.

*Deposits* The fair value of deposits with no stated maturity, such as noninterest-bearing demand deposits, savings, NOW accounts and money market accounts, is equal to the amount payable on demand. The fair values of time deposits are based on the discounted value of contractual cash flows. The discount rate is estimated using the rates currently offered for deposits of similar remaining maturities. The fair value estimates do not include the benefit that results from the low-cost funding provided by the deposit liabilities compared to the cost of borrowing funds in the market. If that value were considered, the fair value of the Company's net assets could increase.

*Borrowings* The fair value of the Company's borrowings with the FHLB is estimated by discounting the cash flows through maturity or the next repricing date based on current rates available to the Company for borrowings with similar maturities. The fair value of the Company's short-term borrowings, capital lease obligations, structured repurchase agreements and other borrowings is estimated by discounting the cash flows through maturity based on current rates available to the Company for borrowings with similar maturities.

*Off-Balance Sheet Credit-Related Instruments* Fair values for off-balance-sheet, credit-related financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. The fair value of such instruments was nominal at each date presented.

Assets and liabilities measured at fair value on a recurring basis are summarized below.

|   | Total     | March 31, 2012<br>(Dollars in thousands) |           | Level 3 |
|---|-----------|--|-----------|---------|
|   |           | Level 1                                  | Level 2   |         |
| <b>Assets</b>   |           |  |           |         |
| Securities available-for-sale                                   |           |  |           |         |
| Debt securities issued by U.S. Government sponsored enterprises | \$ 45,871 | \$ 0                                     | \$ 45,871 | \$ 0    |
| Mortgage-backed securities issued by government agencies        | 90,859    | 0  | 90,859    | 0       |
| Other assets interest rate caps                                 | 4         | 0  | 4         | 0       |
| <b>Liabilities</b>  |           |  |           |         |
| Other liabilities interest rate swap                            | \$ 593    | \$ 0                                     | \$ 593    | \$ 0    |

|   | Total     | June 30, 2011<br>(Dollars in thousands) |           | Level 3 |
|---|-----------|---|-----------|---------|
|   |           | Level 1                                 | Level 2   |         |
| <b>Assets</b>   |           |   |           |         |
| Securities available-for-sale                                   |           |   |           |         |
| Debt securities issued by U.S. Government sponsored enterprises | \$ 48,737 | \$ 0                                    | \$ 48,737 | \$ 0    |
| Mortgage-backed securities issued by government agencies        | 99,558    | 0                                       | 99,558    | 0       |
| Equity securities   | 216       | 216                                     | 0         | 0       |
| Trust preferred securities                                      | 451       | 451                                     | 0         | 0       |
| Other assets interest rate caps                                 | 46        | 0                                       | 46        | 0       |
| <b>Liabilities</b>  |           |   |           |         |

|                   |                    |        |      |      |        |
|-------------------|--------------------|--------|------|------|--------|
| Other liabilities | interest rate swap | \$ 503 | \$ 0 | \$ 0 | \$ 503 |
|-------------------|--------------------|--------|------|------|--------|

**Table of Contents**

Assets measured at fair value on a nonrecurring basis are summarized below.

|                        | Total    | March 31, 2012         |         | Level 3  |
|------------------------|----------|------------------------|---------|----------|
|                        |          | Level 1                | Level 2 |          |
|                        |          | (Dollars in thousands) |         |          |
| Impaired loans         | \$ 1,191 | \$ 0                   | \$ 0    | \$ 1,191 |
| Repossessed collateral | 915      | 0                      | 0       | 915      |

|                        | Total    | June 30, 2011          |         | Level 3  |
|------------------------|----------|------------------------|---------|----------|
|                        |          | Level 1                | Level 2 |          |
|                        |          | (Dollars in thousands) |         |          |
| Impaired loans         | \$ 1,426 | \$ 0                   | \$ 0    | \$ 1,426 |
| Repossessed collateral | 690      | 0                      | 0       | 690      |
| Premises               | 361      | 0                      | 0       | 361      |

The following table presents the estimated fair value of the Company's financial instruments.

|                                  | Carrying Amount | Fair Value Measurements at March 31, 2012 |           |         |         |
|----------------------------------|-----------------|---|-----------|---------|---------|
|                                  |                 | Total                                     | Level 1   | Level 2 | Level 3 |
|                                  |                 | (Dollars in thousands)                    |           |         |         |
| <b>Financial assets:</b>         |                 |   |           |         |         |
| Cash and cash equivalents        | \$ 64,880       | \$ 64,880                                 | \$ 64,880 | \$ 0    | \$ 0    |
| Available-for-sale securities    | 136,730         | 136,730                                   | 0         | 136,730 | 0       |
| Regulatory stock                 | 5,473           | 5,473                                     | 0         | 5,473   | 0       |
| Loans held for sale              | 6,354           | 6,364                                     | 0         | 6,364   | 0       |
| Loans, net                       | 345,029         | 360,339                                   | 0         | 0       | 360,339 |
| Accrued interest receivable      | 1,659           | 1,659                                     | 0         | 1,659   | 0       |
| Interest rate caps               | 4               | 4   | 0         | 4       | 0       |
| <b>Financial liabilities:</b>    |                 |   |           |         |         |
| Deposits                         | 403,735         | 408,834                                   | 0         | 0       | 408,834 |
| FHLB advances                    | 43,567          | 45,799                                    | 0         | 45,799  | 0       |
| Structured repurchase agreements | 66,636          | 67,856                                    | 0         | 67,856  | 0       |
| Other borrowings                 | 0               | 0   | 0         | 0       | 0       |
| Short-term borrowings            | 1,836           | 1,836                                     | 0         | 1,836   | 0       |
| Capital lease obligation         | 1,953           | 2,236                                     | 0         | 2,236   | 0       |
| Subordinated debentures          | 8,066           | 8,602                                     | 0         | 0       | 8,602   |
| Interest rate swaps              | 593             | 593                                       | 0         | 593     | 0       |

|                               | Carrying Amount | Fair Value Measurements at June 30, 2011 |           |         |         |
|-------------------------------|-----------------|--|-----------|---------|---------|
|                               |                 | Total                                    | Level 1   | Level 2 | Level 3 |
|                               |                 | (Dollars in thousands)                   |           |         |         |
| <b>Financial assets:</b>      |                 |  |           |         |         |
| Cash and cash equivalents     | \$ 83,931       | \$ 83,931                                | \$ 83,931 | \$ 0    | \$ 0    |
| Available-for-sale securities | 148,962         | 148,962                                  | 0         | 148,962 | 0       |
| Regulatory stock              | 5,760           | 5,760                                    | 0         | 5,760   | 0       |
| Loans held for sale           | 5,176           | 5,209                                    | 0         | 5,209   | 0       |
| Loans, net                    | 309,476         | 316,361                                  | 0         | 0       | 316,361 |
| Accrued interest receivable   | 1,244           | 1,244                                    | 0         | 1,244   | 0       |
| Interest rate caps            | 46              | 46                                       | 0         | 46      | 0       |
| <b>Financial liabilities:</b> |                 |  |           |         |         |

Edgar Filing: NORTHEAST BANCORP /ME/ - Form 10-Q

|                                  |         |         |   |        |         |
|----------------------------------|---------|---------|---|--------|---------|
| Deposits                         | 401,118 | 403,481 | 0 | 0      | 403,481 |
| FHLB advances                    | 43,922  | 45,465  | 0 | 45,465 | 0       |
| Structured repurchase agreements | 68,008  | 69,364  | 0 | 69,364 | 0       |
| Other borrowings                 | 2,229   | 2,280   | 0 | 2,280  | 0       |
| Short-term borrowings            | 2,515   | 2,515   | 0 | 2,515  | 0       |
| Capital lease obligation         | 2,075   | 2,306   | 0 | 2,306  | 0       |
| Subordinated debentures          | 7,957   | 7,979   | 0 | 0      | 7,979   |
| Interest rate swaps              | 503     | 503     | 0 | 0      | 503     |

**9. Derivatives and Hedging Activities**

The Company has stand alone derivative financial instruments in the form of interest rate caps that derive their value from a fee paid and are adjusted to fair value based on index and strike rate, and a swap agreement that derives its value from the underlying interest rate. These transactions involve both credit and market risk. The notional amounts are amounts on which calculations, payments and the value of the derivative are based. Notional amounts do not represent direct credit exposures. Direct credit exposure is limited to the net difference between the calculated amounts to be received and paid, if any. Such differences, which represent the fair value of the derivative instruments, are reflected on the Company's balance sheet as derivative assets and derivative liabilities.

The Company is exposed to credit-related losses in the event of nonperformance by the counterparties to these agreements. The Company controls the credit risk of its financial contracts through credit approvals, limits and monitoring procedures, and does not expect any counterparties to fail their obligations. The Company deals only with primary dealers.

**Table of Contents**

Derivative instruments are generally negotiated over-the-counter contracts. Negotiated over-the-counter derivative contracts are generally entered into between two counterparties that negotiate specific agreement terms, including the underlying instrument, amount, exercise prices and maturity.

*Risk Management Policies Hedging Instruments*

The Company evaluates the effectiveness of entering into any derivative instrument agreement by measuring the cost of such an agreement in relation to the reduction in net income volatility within an assumed range of interest rates.

*Interest Rate Risk Management Cash Flow Hedging Instruments*

The Company uses long-term variable rate debt as a source of funds for use in the Company's lending and investment activities and other general business purposes. These debt obligations expose the Company to variability in interest payments due to changes in interest rates. If interest rates increase, interest expense increases. Conversely, if interest rates decrease, interest expense decreases. Management believes it is prudent to limit the variability of a portion of its interest payments and, therefore, generally hedges a portion of its variable-rate interest payments. To meet this objective, management entered into interest rate caps whereby the Company receives variable interest payments above a specified interest rate and swap agreements whereby the Company receives variable interest rate payments and makes fixed interest rate payments during the contract period.

The Company holds two interest rate caps which expire on September 30, 2014. The swap agreement provides for the Company to receive payments at a variable rate determined by a specified index (three month LIBOR) in exchange for making payments at a fixed rate.

Information pertaining to outstanding interest rate caps and swap agreements used to hedge variable rate debt is as follows.

|  | March 31, 2012         |                       |
|--|------------------------|-----------------------|
|  | Interest<br>Rate Caps  | Interest<br>Rate Swap |
|  | (Dollars in thousands) |                       |
| Notional amount                        | \$ 6,000               | \$ 10,000             |
| Weighted average pay rate              |                        | 4.69%                 |
| Weighted average receive rate          |                        | 2.19%                 |
| Strike rate based on three month LIBOR | 2.51%                  |                       |
| Weighted average maturity in years     | 2.50                   | 2.92                  |
| Unrealized loss                        | \$ 72                  | \$ 303                |

|  | June 30, 2011          |                       |
|--|------------------------|-----------------------|
|  | Interest<br>Rate Caps  | Interest<br>Rate Swap |
|  | (Dollars in thousands) |                       |
| Notional amount                        | \$ 6,000               | \$ 10,000             |
| Weighted average pay rate              |                        | 4.69%                 |
| Weighted average receive rate          |                        | 2.23%                 |
| Strike rate based on three month LIBOR | 2.51%                  |                       |
| Weighted average maturity in years     | 3.25                   | 3.67                  |
| Unrealized loss                        | \$ 45                  | \$ 137                |

**Table of Contents**

During the three and nine months ended March 31, 2012, no interest rate cap or swap agreements were terminated prior to maturity. Changes in the fair value of interest rate caps and swaps designated as hedging instruments of the variability of cash flows associated with long-term debt are reported in other comprehensive income. These amounts subsequently are reclassified into interest expense as a yield adjustment in the same period in which the related interest on the long-term debt affects earnings. Risk management results for the three and nine months ended March 31, 2012 related to the balance sheet hedging of long-term debt indicates that the hedges were 100% effective and that there was no component of the derivative instruments gain or loss which was excluded from the assessment of hedge effectiveness. No amounts were reclassified to interest expense during the Fiscal 2012 or 2011 periods presented as a result of hedge ineffectiveness.

The following sets forth the fair values and location of derivatives designated as hedging instruments.

| March 31, 2012<br>(Dollars in thousands) |  |                        |            |
|--|--|------------------------|------------|
| Asset Derivatives                        |  | Balance Sheet Location | Fair Value |
| Interest rate caps                       |  | Other assets           | \$ 4       |

| March 31, 2012<br>(Dollars in thousands) |  |                        |            |
|--|--|------------------------|------------|
| Liability Derivatives                    |  | Balance Sheet Location | Fair Value |
| Interest rate swap                       |  | Other liabilities      | \$ 593     |

| June 30, 2011<br>(Dollars in thousands) |  |                        |            |
|---|--|------------------------|------------|
| Asset Derivatives                       |  | Balance Sheet Location | Fair Value |
| Interest rate caps                      |  | Other assets           | \$ 46      |

| June 30, 2011<br>(Dollars in thousands) |  |                        |            |
|---|--|------------------------|------------|
| Liability Derivatives                   |  | Balance Sheet Location | Fair Value |
| Interest rate swap                      |  | Other liabilities      | \$ 503     |

Derivative contracts involve the risk of dealing with derivative counterparties and their ability to meet contractual terms. Institutional counterparties must have an investment grade credit rating and be approved by the Company's Board of Directors. The Company's credit exposure on interest rate swaps is limited to the net positive fair value and accrued interest of all swaps with each counterparty.

The Company currently holds derivative instruments that contain credit-risk related contingent features that are in a net liability position, which require the Company to assign collateral. Collateral required to be maintained at dealer banks by the Company is monitored and adjusted as necessary. At March 31, 2012, the Company had cash totaling \$800 thousand in a margin account with the dealer bank associated with its interest rate swap.



**Table of Contents****10. Other Comprehensive Income (Loss)**

The components of other comprehensive income (loss) are as follows:

| Successor Company  | Three Months Ended March 31, 2012 |                       |                  | Nine Months Ended March 31, 2012 |                       |                  |
|--|-----------------------------------|-----------------------|------------------|----------------------------------|-----------------------|------------------|
|  | Pre-tax Amount                    | Tax Expense (Benefit) | After-tax Amount | Pre-tax Amount                   | Tax Expense (Benefit) | After-tax Amount |
|  | (Dollars in thousands)            |                       |                  | (Dollars in thousands)           |                       |                  |
| Unrealized holding (losses) gains on available-for-sale securities | \$ (687)                          | \$ (233)              | \$ (454)         | \$ 677                           | \$ 230                | \$ 447           |
| Less: Realized gains on available-for-sale securities              | 731                               | 249                   | 482              | 1,112                            | 378                   | 734              |
| Unrealized losses on available-for-sale securities, net            | (1,418)                           | (482)                 | (936)            | (435)                            | (148)                 | (287)            |
| Unrealized losses on cash flow hedges                              | (7)                               | (2)                   | (5)              | (194)                            | (66)                  | (128)            |
| Total other comprehensive loss                                     | \$ (1,425)                        | \$ (484)              | \$ (941)         | \$ (629)                         | \$ (214)              | \$ (415)         |

|  | Three Months Ended March 31, 2011 |                       |                  | 93 Days Ended March 31, 2011 |                       |                  |
|--|-----------------------------------|-----------------------|------------------|------------------------------|-----------------------|------------------|
|  | Pre-tax Amount                    | Tax Expense (Benefit) | After-tax Amount | Pre-tax Amount               | Tax Expense (Benefit) | After-tax Amount |
|  | (Dollars in thousands)            |                       |                  | (Dollars in thousands)       |                       |                  |
| Unrealized holding losses on available-for-sale securities | \$ (288)                          | \$ (97)               | \$ (191)         | \$ (3)                       | \$ 0                  | \$ (3)           |
| Less: Realized gains on available-for-sale securities      | 47                                | 16                    | 31               | 47                           | 16                    | 31               |
| Unrealized losses on available-for-sale securities, net    | (335)                             | (113)                 | (222)            | (50)                         | (16)                  | (34)             |
| Unrealized gains on cash flow hedges                       | 100                               | 34                    | 66               | 100                          | 34                    | 66               |
| Total other comprehensive income (loss)                    | \$ (235)                          | \$ (79)               | \$ 156           | \$ 50                        | \$ 18                 | \$ 32            |

| Predecessor Company  | 181 Days Ended December 28, 2010 |                       |                  |
|--|----------------------------------|-----------------------|------------------|
|  | Pre-tax Amount                   | Tax Expense (Benefit) | After-tax Amount |
|  | (Dollars in thousands)           |                       |                  |
| Unrealized holding losses on available-for-sale securities | \$ (2,806)                       | \$ (954)              | \$ (1,852)       |
| Less: Realized gains on available-for-sale securities      | 17                               | 6                     | 11               |
| Unrealized losses on available-for-sale securities, net    | (2,823)                          | (960)                 | (1,863)          |
| Unrealized losses on cash flow hedges                      | (16)                             | (6)                   | (10)             |

Edgar Filing: NORTHEAST BANCORP /ME/ - Form 10-Q

|                                |            |          |            |
|--------------------------------|------------|----------|------------|
| Total other comprehensive loss | \$ (2,839) | \$ (966) | \$ (1,873) |
|--------------------------------|------------|----------|------------|

Accumulated other comprehensive loss is comprised of the following components:

|  | March 31, 2012         | June 30, 2011 |
|--|------------------------|---------------|
|  | (Dollars in thousands) |               |
| Unrealized loss on available-for-sale securities | \$ (596)               | \$ (161)      |
| Tax effect                                       | 202                    | 55            |
| Net-of-tax amount                                | (394)                  | (106)         |
| Unrealized loss on cash flow hedges              | (375)                  | (182)         |
| Tax effect                                       | 128                    | 62            |
| Net-of-tax amount                                | (247)                  | (120)         |
| Accumulated other comprehensive loss             | \$ (641)               | \$ (226)      |

**11. Troubled Asset Relief Capital Purchase Program**

On December 12, 2008, in connection with the Company's participation in the federal government's TARP Capital Purchase Program, the Company issued 4,227 shares of Fixed Rate Cumulative Perpetual Preferred Stock, Series A, liquidation preference \$1,000 per share (the "Series A Preferred Stock"), and a warrant to purchase 67,958 shares of the Company's common stock (the "TARP Warrant") to the Treasury for aggregate proceeds of \$4.2 million.

**Table of Contents**

The Series A Preferred Stock qualifies as Tier 1 capital and pays cumulative dividends at a rate of 5% per annum until February 14, 2014. Thereafter, the dividend rate will increase to 9% per annum. On and after February 15, 2012, the Company may, at its option, redeem shares of Series A Preferred Stock, in whole or in part, at any time and from time to time, for cash at a per share amount equal to the sum of the liquidation preference per share plus any accrued and unpaid dividends. The Series A Preferred Stock may be redeemed, in whole or in part, at any time and from time to time, at the option of the Company, subject to consultation with the Company's primary federal banking regulator, provided that any partial redemption must be for at least 25% of the issue price of the Series A Preferred Stock. Any redemption of a share of Series A Preferred Stock would be at one hundred percent (100%) of its issue price, plus any accrued and unpaid dividends and the Series A Preferred Stock may be redeemed without regard to whether the Company has replaced such funds from any other source, or to any waiting period.

The TARP Warrant is exercisable at \$9.33 per share at any time on or before December 12, 2018. The number of shares of the Company's common stock issuable upon exercise of the TARP Warrant and the exercise price per share will be adjusted if specific events occur. Treasury has agreed not to exercise voting power with respect to any shares of common stock issued upon exercise of the TARP Warrant. Neither the Series A Preferred Stock nor the TARP Warrant will be subject to any contractual restrictions on transfer, except that the Treasury may not transfer a portion of the Warrant with respect to, or exercise the TARP Warrant for, more than one-half of the shares of common stock underlying the TARP Warrant prior to the date on which the Company has received aggregate gross proceeds of not less than \$4.2 million from one or more qualified equity offerings.

**12. Recent Accounting Pronouncements**

In April 2011, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) No. 2011-02, *Receivables (Topic 310): A Creditors Determination of Whether a Restructuring is a Troubled Debt Restructuring*. This update provides guidance and clarification to help creditors in determining whether a creditor has granted a concession and whether a debtor is experiencing financial difficulties for purposes of determining whether a restructuring constitutes a troubled debt restructuring. The amendments in this update are effective for the first interim or annual period beginning on or after June 15, 2011 and should be applied retrospectively to the beginning of the annual period of adoption. The adoption of this guidance did not result in the identification of newly impaired loans for which impairment was previously measured under ASC 450, *Contingencies*.

In April 2011, the FASB issued ASU No. 2011-03, *Transfers and Servicing (Topic 860): Reconsideration of Effective Control for Repurchase Agreements*. The main provisions in this amendment remove from the assessment of effective control (1) the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee, and (2) the collateral maintenance implementation guidance related to that criterion. Eliminating the transferor's ability criterion and related implementation guidance from an entity's assessment of effective control should improve the accounting for repos and other similar transactions. The guidance in this update is effective for the first interim or annual period beginning on or after December 15, 2011 and should be applied prospectively to transactions or modifications of existing transactions that occur on or after the effective date. Early adoption is not permitted. The adoption of this guidance did not have a material impact on the consolidated financial statements.

In May 2011, the FASB issued ASU No. 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*. The amendments in this update are a result of the work by the FASB and the International Accounting Standards Board to develop common requirements for measuring fair value and for disclosing information about fair value measurements in accordance with GAAP and International Financial Reporting Standards ( IFRS ). The amendments change the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. For many of the requirements, the FASB does not intend for these amendments to result in a change in the application of the requirements of Topic 820. The amendments are to be applied prospectively. The amendments are effective during interim and annual periods beginning after December 15, 2011. Early application is not permitted. The adoption of this guidance did not have a material impact on the consolidated financial statements.

In June 2011, the FASB issued ASU No. 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income ( ASU 2011-05 )*. The objective of this update is to improve the comparability, consistency, and transparency of financial reporting and to increase the prominence of items reported in other comprehensive income. The amendments in this update require that all non-owner changes in stockholders' equity be presented either in as single continuous statement of comprehensive income or in two separate but consecutive statements. The amendments are to be applied prospectively. The amendments are effective during interim and annual periods beginning after December 15, 2011. Early adoption is permitted. The adoption of this guidance did not have a material impact on the consolidated financial statements.

In December 2011, the FASB issued ASU No. 2011-11, *Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities ( ASU 2011-11 )*. The update requires entities to disclose information about offsetting and related arrangements of financial instruments and derivative

## Edgar Filing: NORTHEAST BANCORP /ME/ - Form 10-Q

instruments. The amendments require enhanced disclosures by requiring improved information about financial instruments and derivative instruments that are either (i) offset in accordance with current literature or (2) subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are offset in accordance with current literature. ASU 2011-11 is effective for fiscal years, and interim periods within those years, beginning on or after January 1, 2013. The Company does not anticipate that the adoption of this guidance will have a material impact on the consolidated financial statements.

**Table of Contents**

In December 2011, the FASB issued ASU No. 2011-12, *Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05*. The amendments in this update defer those changes in ASU 2011-05 that relate to the presentation of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income for all periods presented. All other requirements in ASU 2011-05 are not affected by this update. The amendments are effective during interim and annual periods beginning after December 15, 2011. The Company does not anticipate that the adoption of this guidance will have a material impact on the consolidated financial statements.

---

## **Table of Contents**

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

The following discussion should be read in conjunction with the consolidated financial statements, notes and tables included in Northeast Bancorp's Annual Report on Form 10-K for the fiscal year ended June 30, 2011, filed with the Securities and Exchange Commission.

#### **A Note about Forward Looking Statements**

This report contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended, such as statements relating to the Company's financial condition, prospective results of operations, future performance or expectations, plans, objectives, prospects, loan loss allowance adequacy, simulation of changes in interest rates, capital spending and finance sources, and revenue sources. These statements relate to expectations concerning matters that are not historical facts. Accordingly, statements that are based on management's projections, estimates, assumptions, and judgments constitute forward-looking statements. These forward-looking statements, which are based on various assumptions (some of which are beyond the Company's control), may be identified by reference to a future period or periods, or by the use of forward-looking terminology such as believe, expect, estimate, anticipate, continue, plan, approximately, intend, objective, goal, project, or other similar terms or variations thereof, or the future or conditional verbs such as will, may, should, could, and would. In addition, the Company may from time to time make such oral or written forward-looking statements in future filings with the Securities and Exchange Commission (including exhibits thereto), in its reports to shareholders, and in other communications made by or with the Company's approval.

Such forward-looking statements reflect the Company's current views and expectations based largely on information currently available to its management, and on the Company's current expectations, assumptions, plans, estimates, judgments, and projections about its business and industry, and they involve inherent risks and uncertainties. Although the Company believes that these forward-looking statements are based on reasonable estimates and assumptions, they are not guarantees of future performance and are subject to known and unknown risks, uncertainties, contingencies, and other factors. Accordingly, the Company cannot give you any assurance that its expectations will, in fact, occur or that its estimates or assumptions will be correct. The Company cautions you that actual results could differ materially from those expressed or implied by such forward-looking statements as a result of, among other factors, changes in interest rates and real estate values; competitive pressures from other financial institutions; the effects of a continuing deterioration in general economic conditions on a national basis or in the local markets in which the Company operates, including changes which adversely affect borrowers' ability to service and repay the Company's loans; changes in loan defaults and charge-off rates; changes in the value of securities and other assets, adequacy of loan loss reserves, or deposit levels necessitating increased borrowing to fund loans and investments; increasing government regulation, such as the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010; changes in the rules of participation for the TARP Capital Purchase Program promulgated by the U.S. Department of the Treasury under the Emergency Economic Stabilization Act of 2008, which may be changed unilaterally and restrictively by legislative or regulatory actions; establishment of a consumer financial protection bureau with the broad authority to implement new consumer protection regulations; the risk that the Company may not be successful in the implementation of its business strategy; the risk that intangibles recorded in the Company's financial statements will become impaired; changes in assumptions used in making such forward-looking statements; and the other risks and uncertainties detailed in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2011 and other filings submitted to the Securities and Exchange Commission. These forward-looking statements speak only as of the date of this report and the Company does not undertake any obligation to update or revise any of these forward-looking statements to reflect events or circumstances occurring after the date of this report or to reflect the occurrence of unanticipated events.

#### **Financial Statement Presentation**

On December 29, 2010, the merger of the Company and FHB Formation LLC, a Delaware limited liability company (FHB), was consummated. As a result of the merger, the surviving company received a capital contribution of \$16.2 million (in addition to the approximately \$13.1 million in cash consideration paid to former shareholders), and the former members of FHB collectively acquired approximately 60% of the Company's outstanding common stock. The Company has applied the acquisition method of accounting, as described in ASC 805, *Business Combinations* (ASC 805) to the merger, which represents an acquisition by FHB of Northeast (the Predecessor Company), with Northeast as the surviving company (the Successor Company). In the application of ASC 805 to this transaction, the following was considered:

***Identify the Accounting Acquirer:*** FHB was identified as the accounting acquirer. FHB, which was incorporated on March 9, 2009, acquired a controlling financial interest of approximately 60% of the Successor Company's total outstanding voting and non-voting common stock in exchange for contributed capital and cash consideration.

In the evaluation and identification of FHB as the accounting acquirer, it was concluded that FHB was a substantive entity involved in significant pre-merger activities, including the following: raising capital; incurring debt; incurring operating expenses; leasing office space; hiring staff to develop the surviving company's business plan; retaining professional services firms; and identifying acquisition targets and negotiating potential transactions, including the merger.



---

## **Table of Contents**

**Determine the Acquisition Date:** December 29, 2010, the closing date of the merger, was the date that FHB gained control of the combined entity.

**Recognize assets acquired and liabilities assumed:** Because neither the Predecessor Company (the acquired company) nor FHB (the accounting acquirer) exist as separate entities after the merger, a new basis of accounting at fair value for the Successor Company's assets and liabilities was established in the consolidated financial statements. At the acquisition date, the Successor Company recognized the identifiable assets acquired and the liabilities assumed based on their then fair values in accordance with ASC Topic 820, *Fair Value Measurement* (ASC 820). The Successor Company recognized a bargain purchase gain as the difference between the total purchase price and the net assets acquired.

As a result of application of the acquisition method of accounting to the Successor Company's balance sheet, the Successor Company's financial statements from the periods prior to the transaction date are not directly comparable to the financial statements for periods subsequent to the transaction date. To make this distinction, the Company has labeled balances and results of operations prior to the transaction date as

Predecessor Company and balances and results of operations for periods subsequent to the transaction date as Successor Company. The lack of comparability arises from the assets and liabilities having new accounting bases as a result of recording them at their fair values as of the transaction date rather than at historical cost basis. To denote this lack of comparability, a heavy black line has been placed between the Successor Company and Predecessor Company columns in the Consolidated Financial Statements and in the tables in the Notes to the Unaudited Consolidated Financial Statements and the discussion herein.

As a result of the sale of the Company's insurance agency business in the first quarter of Fiscal 2012 and discontinuation of further significant business activities in the insurance agency segment, the Company has classified the results of its insurance agency division as discontinued operations in the Company's consolidated financial statements and discussion herein.

### **Critical Accounting Policies**

Critical accounting policies are those that involve significant judgments and assessments by management, and which could potentially result in materially different results under different assumptions and conditions. Northeast considers the following to be its critical accounting policies:

#### *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. Loan losses 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 periodically based upon management's review of available information, including, but not limited to, the quality of the loan portfolio, certain economic conditions, the value of the underlying collateral and the level of nonperforming and criticized loans. Management relies on its loan quality reviews, its experience and evaluation of economic conditions, among other factors, in determining the amount of provision required for the allowance for loan losses. Determining the allowance for loan losses inherently involves a high degree of subjectivity and requires the Company to make significant estimates of current credit risks and future trends, all of which may undergo material changes.

The general component of the allowance for loan losses is based on historical loss experience adjusted for qualitative factors stratified by the following loan segments: residential real estate (including home equity loans), commercial real estate, commercial business, and consumer. Management uses a rolling average of historical losses based on a time frame appropriate to capture relevant loss data for each loan segment. This historical loss factor is adjusted for the following qualitative factors: levels/trends in delinquencies and substandard loans; trends in volumes and terms of loans; effects of changes in risk selection and underwriting standards and other changes in lending policies, procedures and practices; experience/ability/depth of lending management and staff; and national and regional economic trends and conditions. For a further discussion of the allowance for loan losses, please refer to *Asset Quality* below.

The allocated component of the allowance for loan losses relates to loans that are classified as impaired. Impairment is measured on a loan-by-loan basis for commercial business and commercial real estate loans by either the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent. An allowance is established when the discounted cash flows (or collateral value) of the impaired loan is lower than the carrying value of that loan. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company generally does not specifically identify or measure individual consumer and residential real estate loans for impairment or disclosure, unless such loans are individually significant or subject to a troubled debt restructuring agreement.



## Edgar Filing: NORTHEAST BANCORP /ME/ - Form 10-Q

For all segments except the purchased loan segment, a loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as

## Table of Contents

impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. For the purchased loan segment, a loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to realize cash flows as estimated at acquisition. Loan impairment of purchased loans is measured based on the decrease in expected cash flows from those estimated at acquisition, excluding changes due to interest rate indices, discounted at the loan's original effective rate. Factors considered by management in determining impairment include payment status, collateral value, and the probability of the collecting scheduled principal and interest payments when due.

### *Purchased Loans*

The Company considers its accounting policy related to purchased loans significant. There is inherent uncertainty in the process of estimating the amount and timing of expected cash flows from purchased loans because these estimates depend on factors outside of the Company's control, such as borrower behavior or external economic conditions, and therefore requires the Company's management to exercise judgment with respect to the amount and timing of cash flows. To the extent that expected cash flows are overestimated, the Company may recognize provisions for loan losses in future periods. If expected cash flows are underestimated, interest income recognized in current periods may have been understated, while interest income in future periods may be recorded at a higher rate.

Loans purchased by the Company are accounted for under ASC 310-30, *Receivables - Loans and Debt Securities Acquired with Deteriorated Credit Quality* (ASC 310-30). The Company has elected to account for all purchased loans under ASC 310-30, including those with insignificant or no credit deterioration. At acquisition, the effective interest rate is determined based on the discount rate that equates the present value of the Company's estimate of cash flows with the purchase price of the loan. Prepayments are not assumed in determining a purchased loan's effective interest rate and income accretion.

The application of ASC 310-30 limits the yield that may be accreted on the purchased loan, the accretable yield, to the excess of the Company's estimate, at acquisition, of the expected undiscounted principal, interest, and other cash flows over the Company's initial investment in the loan. The excess of contractually required payments receivable over the cash flows expected to be collected on the loan represents the purchased loan's nonaccretable difference. Subsequent improvements in expected cash flows of loans with nonaccretable differences result in a prospective increase to the loan's effective yield through a reclassification of some, or all, of the nonaccretable difference to accretable yield. The effect of subsequent declines in expected cash flows of purchased loans are recorded through a specific allocation in the allowance for loan losses.

Purchased credit impaired (PCI) loans are defined as those loans acquired with specific evidence of deterioration of credit quality since origination and for which it is probable, at acquisition, that the purchaser will be unable to collect all contractually required payments receivable. The Company does not characterize purchased loans with no or insignificant credit impairment as PCI loans.

### *Business Combination Accounting*

The application of the acquisition method of accounting for a business combination, in accordance with ASC 805, *Business Combinations*, requires the use of significant estimates and assumptions in the determination of the fair value of assets acquired and liabilities assumed in order to properly allocate purchase price consideration. The Company considers accounting policies related to these fair value measurements to be critical because they are important to the portrayal of the Company's financial condition and results subsequent to the Merger, and they require subjective and complex judgment as a result of the need to make estimates about the effects of matters that are inherently uncertain. The Company's estimates of the fair values of assets and liabilities acquired are based upon assumptions believed to be reasonable, and when appropriate, include assistance from independent third-party appraisal firms.

Loans acquired were recorded at fair value in accordance with the fair value methodology prescribed in ASC 820. The fair value estimates associated with acquired loans include estimates related to expected prepayments and the amount and timing of undiscounted expected principal, interest and other cash flows. The fair value adjustments recorded at December 29, 2010 in connection with loans acquired through the Merger follows:

|                 | Predecessor Company | Fair Value<br>Adjustment, net<br>(Dollars in thousands) | Successor Company |
|-----------------|---------------------|---|-------------------|
| Mortgage loans: |                     |   |                   |

Edgar Filing: NORTHEAST BANCORP /ME/ - Form 10-Q

|                     |            |            |            |
|---------------------|------------|------------|------------|
| Residential         | \$ 99,888  | \$ (37)    | \$ 99,851  |
| Commercial          | 118,602    | (1,549)    | 117,053    |
| Construction        | 9,311      | (188)      | 9,123      |
| Home equity         | 52,308     | (500)      | 51,808     |
|                     | 280,109    | (2,274)    | 277,835    |
| Other loans:        |            |            |            |
| Commercial business | 27,529     | (1,815)    | 25,714     |
| Consumer            | 59,647     | (1,455)    | 58,192     |
| Total               | \$ 367,285 | \$ (5,544) | \$ 361,741 |

**Table of Contents**

Loans acquired by the Company through the merger that have experienced a deterioration in credit quality from origination for which it is probable that the acquirer will be unable to collect all contractually required payments receivable, including both principal and interest, are accounted for under ASC 310-30. In the assessment of credit quality deterioration, the Company must make numerous assumptions, interpretations and judgments using internal and third-party credit quality information to determine whether it is probable that the Company will be able to collect all contractually required payments. This is a point in time assessment and inherently subjective due to the nature of the available information and judgment involved. The following table presents a summary of loans acquired through the merger with specific evidence of credit deterioration.

|  | Residential Real Estate<br>and<br>Consumer | Commercial Real Estate<br>and<br>Commercial Business<br>(Dollars in thousands) | Total    |
|--|--|--|----------|
| Contractually required payments receivable | \$ 3,677                                   | \$ 6,066   | \$ 9,743 |
| Nonaccretable difference                   | (938)                                      | (2,410)  | (3,348)  |
| Cash flows expected to be collected        | 2,739                                      | 3,656  | 6,395    |
| Accretable yield                           | (1,204)                                    | (486)  | (1,690)  |
| Fair value of PCI loans acquired           | \$ 1,535                                   | \$ 3,170   | \$ 4,705 |

This discussion has highlighted those accounting policies that management considers to be critical; however, all accounting policies are important, and therefore the reader is encouraged to review each of the policies included in the Company's annual consolidated financial statements on Form 10-K.

**Description of Operations and Business Strategy**

Northeast Bancorp is the holding company for Northeast Bank, a Maine-chartered bank organized in 1872 and headquartered in Lewiston, Maine. The Company is focused on gathering retail deposits through its Community Banking Division's banking offices in Maine and through its online affinity deposit program, ableBanking; originating loans through its Community Banking Division; and purchasing performing commercial real estate loans at a discount through its Loan Acquisition and Servicing Group. The Company operates its Community Banking Division, with ten full-service branches, four investment centers and three loan production offices, from the Company's headquarters in Lewiston, Maine. The Company operates ableBanking and the Loan Acquisition and Servicing Group ( LASG ) from its offices in Boston, Massachusetts.

At March 31, 2012, the Company had total assets of \$595.0 million; total loans, including loans held for sale, of \$352.1 million; total deposits of \$403.7 million and total stockholders' equity of \$64.9 million. The Company's deposits consist primarily of demand, NOW, money market and savings accounts and certificates of deposit with balances of less than \$250 thousand. The Company's originated loans are primarily secured residential and commercial real estate loans, consumer loans, commercial business loans and, to a much lesser extent, construction loans. The Company's purchased loans are primarily performing commercial real estate loans.

The Company launched the pilot of its online affinity deposit program in the third quarter of Fiscal 2012. Operating as ableBanking, a division of Northeast Bank, the affinity deposit program is a savings platform designed to give customers the ability to generate payments to benefit the non-profit organization of their choice. The Company anticipates making ableBanking available to the public at large in the fourth quarter of Fiscal 2012.

*Recent History*

On December 29, 2010, the Company completed a merger with FHB. As a result of the merger, the Company received a capital contribution of \$16.2 million (in addition to the approximately \$13.1 million in cash consideration paid to former shareholders), and the former members of FHB acquired shares of the Company's voting and non-voting common stock. In connection with the transaction, as part of the regulatory approval process, the Company made certain commitments to the Federal Reserve and the Maine Bureau of Financial Institutions, the most significant of which are (i) to maintain a Tier 1 leverage ratio of at least 10%, (ii) to maintain a total risk-based capital ratio of at least 15%, (iii) to limit purchased loans to 40% of total loans, (iv) to fund 100% of the Company's loans with core deposits (defined as non-maturity deposits and non-brokered insured time deposits), and (v) to hold commercial real estate loans (including owner-occupied commercial real

## Edgar Filing: NORTHEAST BANCORP /ME/ - Form 10-Q

estate) to within 300% of total risk-based capital. The Company is currently in compliance with its commitments to the Federal Reserve and the Maine Bureau of Financial Institutions. At March 31, 2012, the Company had \$396.4 million in core deposits, and capacity to hold a total of \$212.1 million in commercial real estate loans. The Company is currently in compliance with all commitments to the Federal Reserve and the Maine Bureau of Financial Institutions.

On August 31, 2011, the customer lists and certain other assets of the Company's insurance agency subsidiary, Northeast Bank Insurance Group, Inc. ( NBIG ) were sold in two transactions to two Maine-based insurance agencies. NBIG's insurance agency office in Berwick was sold to a former senior manager of NBIG and will operate under the name Spence & Matthews. The agency offices in Southern, Western and Central Maine were sold to the Varney Agency, Inc. of Bangor Maine. The aggregate sale price of these assets was \$9.8 million, which after expenses and taxes had the effect of increasing the Company's tangible equity by approximately \$8.4 million, or \$2.40 per share. Principally as a result of this transaction, the Company's tangible book value increased to \$15.94 per share at March 31, 2012 from \$13.58 per share at June 30, 2011.

**Table of Contents**

**Overview**

Net income for the three and nine months ended March 31, 2012 was \$168 thousand and \$1.1 million, respectively. Net income available to common shareholders for the three and nine months ended March 31, 2012 was \$70 thousand, or \$0.02 per diluted share, and \$821 thousand, or \$0.23 per diluted share, respectively. The Company's net income for the three and nine months ended March 31, 2012 included net income from discontinued operations of \$14 thousand, or \$0.00 per diluted share, and \$1.1 million, or \$0.32 per diluted share, respectively.

The Company's net interest margin was 3.44% and 3.36% for the three and nine months ended March 31, 2012, respectively. Increased noninterest income, resulting from gains on available-for-sale securities and gains on the sales of portfolio loans, was partially offset by increased noninterest expenses such as salaries and professional fees, related to implementation of the Company's business strategy.

Including the results of discontinued operations, the return on average equity was 1.03% and 2.26% for three and nine months ended March 31, 2012, respectively. Including the results of discontinued operations, the return on average assets was 0.11% and 0.25% for three and nine months ended March 31, 2012, respectively.

**Financial Condition**

**Overview**

Total assets decreased by \$1.4 million or 0.2% to \$595.0 million at March 31, 2012, compared to total assets of \$596.4 million on June 30, 2011. The principal components of the change in the balance sheet during the nine months ended March 31, 2012 were:

1. A \$31.3 million, or 13.4%, decrease in cash and investments, principally as a result of growth in loans during the period. At quarter end, the Company continues to maintain a level of balance sheet liquidity that is intended in part for future purchases of commercial loans.
2. Loan growth of \$35.9 million or 11.6%, principally due to growth of \$56.3 million in loans purchased by the Company's Loan Acquisition and Servicing Group, offset in part by amortization and payoffs from the originated loan portfolio of \$20.4 million;
3. A \$4.6 million, or 3.7%, reduction in borrowed funds, resulting primarily from the \$2.1 million repayment of insurance agency debt in connection with the sale of the Company's insurance agency division assets;
4. A \$2.6 million, or 0.7%, increase in deposits. The Company's new affinity deposit program, ableBanking, recently launched its pilot program, and at quarter end had raised \$1.1 million of new deposits;
5. An \$8.4 million, or 63.8%, decrease in intangible assets, resulting primarily from the sale of insurance agency division assets.

**Assets**

*Cash, Short-term Investments and Securities*

Cash and short-term investments were \$64.9 million as of March 31, 2012, a decrease of \$19.0 million, or 22.7%, from \$83.9 million at June 30, 2011. This decrease is the net of the cash received on the sale of the insurance agency division of \$9.9 million and \$28.9 million spent primarily for purchased loans.

Available-for-sale securities were \$136.7 million as of March 31, 2012, a decrease of \$12.3 million, or 8.3%, due to principal payments on mortgage-backed securities and security sales, from \$149.0 million as of June 30, 2011. At March 31, 2012, all of the Company's available-for-sale securities were debt securities issued by either government agencies or government-sponsored enterprises. Certain government sponsored enterprise bonds were pledged to the Federal Home Loan Bank ( FHLB ) of Boston as collateral for FHLB advances, structured

repurchase agreements, and availability at the FHLB for future borrowings.

**Table of Contents***Loan Portfolio*

Total loans, excluding loans held for sale, amounted to \$345.8 million as of March 31, 2012, an increase of \$35.9 million, or 11.6%, from \$309.9 million as of June 30, 2011. Compared to June 30, 2011, commercial real estate loans increased \$46.3 million, or 39.3%, residential real estate and home equity loans decreased \$5.3 million, or 3.6%, commercial business loans decreased \$0.1 million, or 2.7%, and consumer loans decreased \$4.1 million, or 18.2%. The increase in commercial real estate loans was driven primarily by loans purchased by the Company's LASG, offset in part by amortization and payoffs within the originated commercial real estate loan portfolio. The decrease in residential real estate loans was driven principally by continued refinances and runoff of fixed rate loans, partially offset by LASG loan purchases of \$3.6 million. The following table shows the composition of the loan portfolio.

|                                   | March 31, 2012    |                | June 30, 2011     |                |
|-----------------------------------|-------------------|----------------|-------------------|----------------|
|                                   | Amount            | Percent        | Amount            | Percent        |
| (Dollars in thousands)            |                   |                |                   |                |
| <b>Originated portfolio:</b>      |                   |                |                   |                |
| Residential real estate           | \$ 92,557         | 26.77%         | \$ 95,417         | 30.79%         |
| Commercial real estate            | 110,731           | 32.02%         | 117,124           | 37.79%         |
| Construction                      | 1,497             | 0.43%          | 2,015             | 0.65%          |
| Home equity                       | 44,082            | 12.75%         | 50,060            | 16.15%         |
| Commercial business               | 21,635            | 6.26%          | 22,225            | 7.17%          |
| Consumer                          | 18,359            | 5.31%          | 22,435            | 7.24%          |
| <b>Total originated portfolio</b> | <b>288,861</b>    | <b>83.54%</b>  | <b>309,276</b>    | <b>99.79%</b>  |
| <b>Purchased portfolio:</b>       |                   |                |                   |                |
| Residential real estate           | 3,587             | 1.04%          | 0                 | 0.00%          |
| Commercial real estate            | 53,329            | 15.42%         | 637               | 0.21%          |
| <b>Total purchased portfolio</b>  | <b>56,916</b>     | <b>16.46%</b>  | <b>637</b>        | <b>0.21%</b>   |
| <b>Total loans</b>                | <b>345,777</b>    | <b>100.00%</b> | <b>309,913</b>    | <b>100.00%</b> |
| Allowance for loan losses         | 748               |                | 437               |                |
| <b>Total loans, net</b>           | <b>\$ 345,029</b> |                | <b>\$ 309,476</b> |                |

The Company continues to sell most of its originated fixed-rate residential real estate loans to the secondary market. The principal balance of residential real estate loans sold during the three and nine months ended March 31, 2012 totaled \$29.3 million and \$92.7 million, respectively, resulting in net gains of \$634 thousand and \$2.1 million during the three and nine month periods, respectively.

At March 31, 2012, approximately 60% of total portfolio loans were variable rate, compared to 61% at June 30, 2011.

*Classification of Assets*

Loans are classified as non-performing when 90 days past due, unless a loan is well-secured and in process of collection. Loans less than 90 days past due, for which collection of principal or interest is considered doubtful, also may be designated as non-performing. In both situations, accrual of interest ceases. The Company typically maintains such loans as non-performing until the respective borrowers have demonstrated a sustained period of payment performance.

Other nonperforming assets include other real estate owned (OREO) and other personal property securing loans repossessed by the Company. The real estate and personal property collateral for commercial and consumer loans is written down to its estimated realizable value upon repossession. Revenues and expenses are recognized in the period when received or incurred on other real estate and in substance foreclosures. Gains and losses on disposition are recognized in noninterest income.





**Table of Contents**

The following table shows the composition of the Company's non-performing loans and repossessed collateral at the dates indicated. The net decrease in nonperforming loans was principally the result of the sale of a nonperforming commercial loan during the second quarter, in addition to improved performance of several previously nonperforming commercial real estate relationships. There were no nonperforming loans in the Company's purchased loan portfolio at March 31, 2012 or June 30, 2011.

|   | March 31, 2012         | June 30, 2011   |
|---|------------------------|-----------------|
|   | (Dollars in thousands) |                 |
| <b>Originated portfolio:</b>                  |                        |                 |
| Residential real estate                       | \$ 3,067               | \$ 2,195        |
| Commercial real estate                        | 442                    | 3,601           |
| Construction                                  | 0                      | 121             |
| Home equity                                   | 255                    | 205             |
| Commercial business                           | 1,108                  | 559             |
| Consumer                                      | 309                    | 527             |
| <b>Total originated portfolio</b>             | <b>5,181</b>           | <b>7,208</b>    |
| <b>Purchased portfolio:</b>                   |                        |                 |
| Residential real estate                       | 0                      | 0               |
| Commercial real estate                        | 0                      | 0               |
| <b>Total purchased portfolio</b>              | <b>0</b>               | <b>0</b>        |
| <b>Total nonperforming loans</b>              | <b>5,181</b>           | <b>7,208</b>    |
| Repossessed collateral                        | 915                    | 690             |
| <b>Total nonperforming assets</b>             | <b>\$ 6,096</b>        | <b>\$ 7,898</b> |
| Ratio of nonperforming loans to total loans   | 1.50%                  | 2.33%           |
| Ratio of nonperforming assets to total assets | 1.02%                  | 1.32%           |

At March 31, 2012 and June 30, 2011, the Company had \$411 thousand and \$3.1 million, respectively, of nonperforming loans that were paying in accordance with their contractual terms. Nonperforming loans are returned to accrual status if a period of satisfactory repayment performance has been met and doubt no longer exists surrounding the ultimate collectability of all amounts contractually due. Generally, the Company considers six months of regular repayment as satisfactory performance.

Loans modified in a troubled debt restructuring ( TDR ) are initially classified as nonperforming until satisfactory repayment performance has occurred under the loan's restructured terms. Included in nonperforming loans at March 31, 2012 and June 30, 2011 were loans modified in a TDR totaling \$161 thousand and \$859 thousand, respectively that were paying in accordance with their modified terms. The Company had total TDRs of \$1.1 million and \$952 thousand at March 31, 2012 and June 30, 2011, respectively.

Commercial real estate, construction, and commercial business loans are periodically evaluated under a ten-point risk rating system. These ratings are guidelines in assessing the risk of a particular loan. The Company had loans totaling \$5.3 million and \$10.1 million at March 31, 2012 and June 30, 2011, respectively, classified as substandard or lower under its risk rating system. This decrease was primarily due to loan payoffs or improvements in the standing of commercial borrowers previously experiencing weaknesses in the underlying businesses.

The Company's ratio of loans 30 days or more past due as a percentage of total loans was 2.06% at March 31, 2012 and 2.41% at June 30, 2011.

*Allowance for Loan Losses*

The Company's allowance for loan losses was \$748 thousand as of March 31, 2012, which represents an increase of \$311 thousand from \$437 thousand as of June 30, 2011. In connection with the application of the acquisition method of accounting for the merger on December 29, 2010, the allowance for loan losses was reduced to zero when the loan portfolio was marked to its then current fair value. Since that date, the Company has provided for an allowance for loan losses as new loans are originated or in the event that credit exposure in the pre-merger loan portfolio exceeds the exposure estimated when fair values were determined.

## Edgar Filing: NORTHEAST BANCORP /ME/ - Form 10-Q

The allowance for loan losses represents management's estimate of credit risk in the loan portfolio. This evaluation process is subject to numerous estimates and judgments. The frequency of default, risk ratings, and the loss recovery rates, among other things, are considered in making this evaluation, as are the size and diversity of individual large credits. Changes in these estimates could have a direct impact on the provision and could result in a change in the allowance. The larger the provision for loan losses, the greater the negative impact on the Company's net income. Larger balance, commercial business and commercial real estate loans representing significant individual credit exposures are evaluated based upon the borrower's overall financial condition, resources, and payment record, the prospects for support from any financially responsible guarantors and, if appropriate, the realizable value of any collateral. The allowance for loan losses attributed to these loans is established through a process that includes estimates of historical and projected default rates and loss severities, internal risk ratings and geographic, industry and other environmental factors. Management also considers overall portfolio

**Table of Contents**

indicators, including trends in internally risk-rated loans, classified loans, nonaccrual loans and historical and projected charge-offs and a review of industry, geographic and portfolio concentrations, including current developments. In addition, management considers the current business strategy and credit process, including credit limit setting and compliance, credit approvals, loan underwriting criteria and loan workout procedures.

Within the allowance for loan losses, amounts are specified for larger-balance commercial business and commercial real estate loans that have been individually determined to be impaired. These specific reserves consider all available evidence including, as appropriate, the present value of the expected future cash flows discounted at the loan's contractual effective rate and the fair value of collateral. Each portfolio of smaller balance, residential real estate and consumer loans is collectively evaluated for impairment. The allowance for loan losses for these loans is established pursuant to a process that includes historical delinquency and credit loss experience, together with analyses that reflect current trends and conditions. Management also considers overall portfolio indicators, including historical credit losses, delinquent, non-performing and classified loans, trends in volumes, terms of loans, an evaluation of overall credit quality and the credit process, including lending policies and procedures and economic factors. During the nine months ended March 31, 2012, the Company has not significantly changed its approach in the determination of the allowance for loan losses. There have been no significant changes in the assumptions or estimation techniques as compared to prior periods in determining the adequacy of the allowance for loan losses.

Loans purchased by the Company are accounted for under ASC 310-30. The Company has elected to account for all purchased loans under ASC 310-30, including those with insignificant or no credit deterioration. At acquisition, the effective interest rate is determined based on the discount rate that equates the present value of the Company's estimate of cash flows with the purchase price of the loan. This application of ASC 310-30 limits the yield that may be accreted on the purchased loan, or the accretible yield, to the excess of the Company's estimate, at acquisition, of the expected undiscounted principal, interest, and other cash flows over the Company's initial investment in the loan. The excess of contractually required payments receivable over the cash flows expected to be collected on the loan represents the purchased loan's nonaccretible difference. Subsequent improvements in expected cash flows of loans with nonaccretible differences result in a prospective increase to the loan's effective yield through a reclassification of some, or all, of the nonaccretible difference to accretible yield. The effect of subsequent declines in expected cash flows of purchased loans are recorded through a specific allocation in the allowance for loan losses. For loans purchased by the LASG subsequent to the Merger, there have been no reductions from the cash flow estimates made at the time of loan acquisition. As a result, no allowance for loan losses has been established related to such loans at March 31, 2012.

The following table allocates the allowance for loan losses by loan category and shows the percent of loans in each category to total loans at the dates indicated below. The allowance for loan losses allocated to each category is not indicative of future losses and does not restrict the use of the allowance to absorb losses in other categories.

|                                   | March 31, 2012                     |                                    |  | June 30, 2011                      |                                    |   |
|-----------------------------------|------------------------------------|------------------------------------|--|------------------------------------|------------------------------------|---|
|                                   | Allowance<br>For<br>Loan<br>Losses | Loan<br>Balances<br>By<br>Category | Percent<br>of Loans<br>In Each<br>Category<br>to Total<br>Loans<br>(Dollar in thousands) | Allowance<br>For<br>Loan<br>Losses | Loan<br>Balances<br>By<br>Category | Percent<br>of Loans<br>In Each<br>Category<br>to Total<br>Loans |
| <b>Originated portfolio:</b>      |                                    |                                    |  |                                    |                                    |   |
| Residential real estate           | \$ 86                              | \$ 92,557                          | 26.77%   | \$ 26                              | \$ 95,417                          | 30.79%  |
| Commercial real estate            | 135                                | 110,731                            | 32.02%   | 147                                | 117,124                            | 37.79%  |
| Construction                      | 1                                  | 1,497                              | 0.43%  | 0                                  | 2,015                              | 0.65%   |
| Home equity                       | 40                                 | 44,082                             | 12.75%   | 8                                  | 50,060                             | 16.15%  |
| Commercial business               | 250                                | 21,635                             | 6.26%  | 238                                | 22,225                             | 7.17%   |
| Consumer                          | 236                                | 18,359                             | 5.31%  | 18                                 | 22,435                             | 7.24%   |
| <b>Total originated portfolio</b> | <b>748</b>                         | <b>288,861</b>                     | <b>83.54%</b>  | <b>437</b>                         | <b>309,276</b>                     | <b>99.79%</b>   |
| <b>Purchased portfolio:</b>       |                                    |                                    |  |                                    |                                    |   |
| Residential                       | 0                                  | 3,587                              | 1.04%  | 0                                  | 0                                  | 0.00%   |
| Commercial                        | 0                                  | 53,329                             | 15.42%   | 0                                  | 637                                | 0.21%   |
| <b>Total purchased portfolio</b>  | <b>0</b>                           | <b>56,916</b>                      | <b>16.46%</b>  | <b>0</b>                           | <b>637</b>                         | <b>0.21%</b>  |

Edgar Filing: NORTHEAST BANCORP /ME/ - Form 10-Q

|       |        |            |         |        |            |         |
|-------|--------|------------|---------|--------|------------|---------|
| Total | \$ 748 | \$ 345,777 | 100.00% | \$ 437 | \$ 309,913 | 100.00% |
|-------|--------|------------|---------|--------|------------|---------|

The following table details ratios related to the allowance for loan losses and nonperforming loans.

| Ratios:   | March 31, 2012 | June 30, 2011 |
|---|----------------|---------------|
| Allowance for loan losses to nonperforming loans at end of period | 14.44%         | 6.06%         |
| Allowance for loan losses to total loans at end of period         | 0.22%          | 0.14%         |

While management believes that it uses the best information available to make its determinations with respect to the allowance, there can be no assurance that the Company will not have to increase its provision for loan losses in the future as a result of changing economic conditions, adverse markets for real estate or other factors.

**Table of Contents***Other Assets*

The cash surrender value of the Company's bank-owned life insurance ( BOLI ) assets increased \$377 thousand, or 2.7%, to \$14.2 million at March 31, 2012, compared to \$13.8 million at June 30, 2011. BOLI assets are invested in the general account of three insurance companies and in separate accounts of a fourth insurance company. A general account policy's cash surrender value is supported by the general assets of the insurance company. A separate account policy's cash surrender value is supported by assets segregated from the general assets of the insurance company. Standard and Poor's rated these companies A+ or better at March 31, 2012. Interest earnings, net of mortality costs, increase the cash surrender value. These interest earnings are based on interest rates which reset each year, and are subject to minimum guaranteed rates. These increases in cash surrender value are recognized in other income and are not subject to income taxes. Borrowing on or surrendering a policy may subject the Company to income tax expense on the increase in cash surrender value. For these reasons, management considers BOLI an illiquid asset. BOLI represented 20.3% of the Company's total risk-based capital at March 31, 2012.

Intangible assets totaled \$4.7 million and \$13.1 million at March 31, 2012 and June 30, 2011, respectively. The \$8.4 million reduction was the result of the sale of \$7.4 million of intangible assets (principally customer lists) in connection with the insurance agency transaction in the first quarter of Fiscal 2012, as well as core deposit intangible asset amortization.

**Deposits, Borrowed Funds, Capital Resources and Liquidity***Deposits*

The Company's principal source of funding is its core deposit accounts. At March 31, 2012, non-maturity accounts and certificates of deposit with balances less than \$250 thousand represented 98.2% of total deposits.

Total deposits increased \$2.6 million to \$403.7 million as of March 31, 2012 from \$401.1 million as of June 30, 2011. The increase was the result of an increase in certificate accounts, offset by a decrease in non-maturity accounts. The reduction in non-maturity accounts was principally due to the Company's decision to exit the trust business in the first quarter of Fiscal 2012 and discontinuation of the Company's sweep account product. At March 31, 2012, the Company had \$1.1 million in deposits through its online affinity deposit program, ableBanking.

|   | March 31, 2012         |                | June 30, 2011     |                |
|---|------------------------|----------------|-------------------|----------------|
|   | Amount                 | % of Total     | Amount            | % of Total     |
|   | (Dollars in thousands) |                |                   |                |
| Demand deposits                                 | \$ 41,613              | 10.31%         | \$ 48,215         | 12.02%         |
| NOW accounts                                    | 55,773                 | 13.81%         | 55,458            | 13.83%         |
| Regular and other savings                       | 33,087                 | 8.20%          | 34,346            | 8.56%          |
| Money market deposits                           | 45,589                 | 11.29%         | 48,695            | 12.14%         |
| <b>Total non-certificate accounts</b>           | <b>176,062</b>         | <b>43.61%</b>  | <b>186,714</b>    | <b>46.55%</b>  |
| Term certificates less than \$250 thousand      | 220,303                | 54.57%         | 186,075           | 46.33%         |
| Term certificates of \$250 thousand or more (1) | 7,370                  | 1.82%          | 28,329            | 7.12%          |
| <b>Total certificate accounts</b>               | <b>227,673</b>         | <b>56.39%</b>  | <b>214,404</b>    | <b>53.45%</b>  |
| <b>Total deposits</b>                           | <b>\$ 403,735</b>      | <b>100.00%</b> | <b>\$ 401,118</b> | <b>100.00%</b> |

(1) Term certificates in this category represent the current account balance, exclusive of fair value adjustments associated with the Merger.

*Borrowed Funds*

Advances from the FHLB were \$43.6 million and \$43.9 million at March 31, 2012 and June 30, 2011, respectively. At March 31, 2012, the Company had pledged certain residential real estate loans, commercial real estate loans, and FHLB deposits free of liens or pledges to secure

FHLB advances.

Structured repurchase agreements were \$66.6 million and \$68.0 million at March 31, 2012 and June 30, 2011, respectively. The Company had pledged cash and mortgage-backed securities with a fair value of \$82.6 million as collateral for those borrowings at March 31, 2012. One of the six structured repurchase agreements has embedded purchased interest rate caps to reduce the risk to net interest income in periods of rising interest rates.

Short-term borrowings, consisting of sweep accounts, were \$1.8 million as of March 31, 2012, a decrease of \$679 thousand, or 27.0%, from \$2.5 million as of June 30, 2011. The decrease is attributable to the discontinuation of the sweep account product. At March 31, 2012, sweep accounts were secured by letters of credit issued by the FHLB totaling \$2.0 million.

**Table of Contents***Liquidity*

The following table is a summary of the liquidity the Company had the ability to access as of March 31, 2012, in addition to traditional retail deposit products. The following table excludes \$64.9 million of cash and due from banks and short-term investments defined as cash equivalents.

|  | (Dollars in thousands) |
|--|------------------------|
| Unencumbered investment securities     | \$ 54,176              |
| FHLB (1)                               | 6,333                  |
| Federal Reserve (2)                    | 477                    |
| Brokered time deposits (3)             | 145,322                |
| <b>Total unused borrowing capacity</b> | <b>\$ 206,308</b>      |

- (1) Unused advance capacity subject to eligible and qualified collateral
- (2) Discount window Borrower-in-Custody; unused credit line subject to the pledge of indirect auto loans
- (3) Subject to internal policy limitation of 25% of total assets

Retail deposits and other core deposit sources including deposit listing services are used by the Company to manage its overall liquidity position. While the Company currently does not seek wholesale funding such as FHLB advances and brokered deposits, the ability to raise them remains an important part of its liquidity contingency planning. While management closely monitors and forecasts the Company's liquidity position, it is affected by asset growth, deposit withdrawals and other contractual obligations and commitments. The accuracy of management's forecast assumptions may increase or decrease the Company's overall available liquidity. At March 31, 2012, no additional purchased of FHLB stock would be necessary to utilize the FHLB advance capacity. At March 31, 2012, the Company had \$206.3 million of immediately accessible liquidity, defined as cash that could be raised within seven days through collateralized borrowings, brokered deposits or security sales. This position represented 34.7% of total assets. The relatively high level of short-term liquidity on the balance sheet as of March 31, 2012 reflects the Company's intention to increase purchases of commercial loans by the LASG in the near term.

Management believes that there are adequate funding sources to meet its liquidity needs for the foreseeable future. Primary funding sources are the repayment of principal and interest on loans, the renewal of time deposits, the potential growth in the deposit base, and the credit availability from the FHLB and the Federal Reserve's Borrower-in-Custody program. Management does not believe that the terms and conditions that will be present at the renewal of these funding sources will significantly impact the Company's operations, due to its management of the maturities of its assets and liabilities.

*Capital*

The following table summarizes the outstanding junior subordinated debentures as of March 31, 2012. This debt represents qualifying Tier 1 capital for the Company, up to a maximum of 25% of total Tier 1 capital. At March 31, 2012, the carrying amounts of the junior subordinated notes, net of the Company's \$496 thousand investment in the affiliated trusts, qualified as Tier 1 capital. The following table sets forth certain information related to the Company's junior subordinated debentures.

| Affiliated Trusts     | Carrying<br>Amount     | Principal<br>Amount<br>Due | Contractual<br>Interest<br>Rate | Maturity Date     |
|-----------------------|------------------------|----------------------------|---------------------------------|-------------------|
|                       | (Dollars in thousands) |                            |                                 |                   |
| NBN Capital Trust II  | \$ 1,740               | \$ 3,093                   | 3.27%                           | March 30, 2034    |
| NBN Capital Trust III | 1,740                  | 3,093                      | 3.27%                           | March 30, 2034    |
| NBN Capital Trust IV  | 4,586                  | 10,310                     | 2.38%                           | February 23, 2035 |
| <b>Total</b>          | <b>\$ 8,066</b>        | <b>\$ 16,496</b>           |                                 |                   |



## Edgar Filing: NORTHEAST BANCORP /ME/ - Form 10-Q

Under the terms of the Treasury's TARP Capital Purchase Program, in which the Company participates, the Company must have the consent of Treasury to redeem, purchase, or acquire any shares of our common stock or other equity or capital securities, other than in connection with benefit plans consistent with past practice and certain other circumstances specified in the purchase agreement entered into by Treasury and the Company.

Total stockholders' equity was \$64.9 million and \$65.0 million at March 31, 2012 and June 30, 2011, respectively. The change reflects net income for the period, dividends paid on common and preferred stock, and other comprehensive loss during the period. Book value per outstanding common share was \$17.29 at March 31, 2012 and \$17.33 at June 30, 2011. Tier 1 capital to total average assets of the Company was 11.85% as of March 31, 2012 and 10.35% at June 30, 2011.

The Federal Deposit Insurance Corporation Improvement Act of 1991 ( FDICIA ) contains various provisions intended to capitalize the Deposit Insurance Fund and also affects a number of regulatory reforms that impact all insured depository institutions, regardless of the insurance fund in which they participate. Among other things, FDICIA grants the Federal Reserve broader regulatory authority to take prompt corrective action against insured institutions that do not meet these capital requirements, including placing undercapitalized institutions into conservatorship or receivership. FDICIA also grants the Federal Reserve broader regulatory authority to take corrective action against insured institutions that are otherwise operating in an unsafe and unsound manner.

**Table of Contents**

FDICIA defines specific capital categories based on an institution's capital ratios. To be considered adequately capitalized or better, regulations require a minimum Tier 1 capital equal to 4.0% of adjusted total average assets, Tier 1 risk-based capital of 4.0% and a total risk-based capital standard of 8.0%. The prompt corrective action regulations define specific capital categories based on an institution's capital ratios. The capital categories, in declining order are well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. Further, the Bank and the Company are subject to capital commitments with the Federal Reserve and the Maine Bureau of Financial Institutions that require higher minimum capital ratios, as discussed in Note 2 in the Notes to Unaudited Consolidated Financial Statements. As of March 31, 2012, the most recent notification from the Federal Reserve categorized the Bank as well capitalized.

The Company's and the Bank's regulatory capital ratios are set forth below.

|   | Actual    |        | Minimum Capital Requirements |       | Minimum To Be Well Capitalized Under Prompt Correction Action Provisions |        |
|---|-----------|--------|------------------------------|-------|--|--------|
|   | Amount    | Ratio  | Amount                       | Ratio | Amount   | Ratio  |
| <b>March 31, 2012:</b>                  |           |        |                              |       |  |        |
| Total capital to risk weighted assets:  |           |        |                              |       |  |        |
| Company                                 | \$ 70,694 | 19.49% | \$ 29,016                    | ≥8.0% | \$ N/A   | N/A    |
| Bank                                    | 74,205    | 20.40% | 29,102                       | ≥8.0% | 36,721   | ≥10.0% |
| Tier 1 capital to risk weighted assets: |           |        |                              |       |  |        |
| Company                                 | 69,946    | 19.28% | 14,508                       | ≥4.0% | N/A  | N/A    |
| Bank                                    | 69,648    | 19.15% | 14,551                       | ≥4.0% | 22,033   | ≥6.0%  |
| Tier 1 capital to average assets:       |           |        |                              |       |  |        |
| Company                                 | 69,946    | 11.85% | 23,602                       | ≥4.0% | N/A  | N/A    |
| Bank                                    | 69,648    | 11.91% | 23,339                       | ≥4.0% | 29,170   | ≥5.0%  |
| <b>June 30, 2011:</b>                   |           |        |                              |       |  |        |
| Total capital to risk weighted assets:  |           |        |                              |       |  |        |
| Company                                 | \$ 61,860 | 18.99% | \$ 26,061                    | ≥8.0% | \$ N/A   | N/A    |
| Bank                                    | 66,956    | 20.43% | 26,216                       | ≥8.0% | 32,770   | ≥10.0% |
| Tier 1 capital to risk weighted assets: |           |        |                              |       |  |        |
| Company                                 | 61,424    | 18.86% | 13,030                       | ≥4.0% | N/A  | N/A    |
| Bank                                    | 62,842    | 19.18% | 13,108                       | ≥4.0% | 19,662   | ≥6.0%  |
| Tier 1 capital to average assets:       |           |        |                              |       |  |        |
| Company                                 | 61,424    | 10.35% | 23,736                       | ≥4.0% | N/A  | N/A    |
| Bank                                    | 62,842    | 10.69% | 23,523                       | ≥4.0% | 29,404   | ≥5.0%  |

**Off-balance Sheet Arrangements and Aggregate Contractual Obligations**

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, unused lines of credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest-rate risk in excess of the amounts recognized in the condensed consolidated balance sheet. The contract or notional amounts of these instruments reflect the extent of the Company's involvement in particular classes of financial instruments.

The Company's exposure to credit loss in the event of nonperformance by the counterparty to the financial instrument for commitments to extend credit, unused lines of credit and standby letters of credit is represented by the contractual amount of those instruments. To control the credit risk associated with entering into commitments and issuing letters of credit, the Company uses the same credit quality, collateral policies and monitoring controls in making commitments and letters of credit as it does with its lending activities. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation.

## Edgar Filing: NORTHEAST BANCORP /ME/ - Form 10-Q

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 generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total committed amounts do not necessarily represent future cash requirements.

Standby letters of credit are conditional commitments issued by the Company 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 loans to customers.

Unused lines of credit and commitments to extend credit typically result in loans with a market interest rate.

**Table of Contents**

A summary of the amounts of the Company's contractual obligations (amounts shown do not reflect fair value adjustments) and other commitments with off-balance sheet risk at March 31, 2012, follows.

| Contractual obligations                              | Total             | Less Than        | 1-3              | 4-5              | After 5          |
|--|-------------------|------------------|------------------|------------------|------------------|
|  |                   | 1 Year           | Years            | Years            | Years            |
| (Dollars in thousands)                               |                   |                  |                  |                  |                  |
| FHLB advances  | \$ 42,500         | \$ 10,000        | \$ 17,500        | \$ 10,000        | \$ 5,000         |
| Structured repurchase agreements                     | 65,000            | 40,000           | 15,000           | 10,000           | 0                |
| Junior subordinated debentures                       | 16,496            | 0                | 16,496           | 0                | 0                |
| Capital lease obligation                             | 1,953             | 170              | 367              | 478              | 938              |
| <b>Total long-term debt</b>                          | <b>125,949</b>    | <b>50,170</b>    | <b>49,363</b>    | <b>20,478</b>    | <b>5,938</b>     |
| Operating lease obligations (1)                      | 1,420             | 589              | 456              | 228              | 147              |
| <b>Total contractual obligations</b>                 | <b>\$ 127,369</b> | <b>\$ 50,759</b> | <b>\$ 49,819</b> | <b>\$ 20,706</b> | <b>\$ 6,085</b>  |
| Commitments with off-balance sheet risk              | Total             | Less Than        | 1-3              | 4-5              | After 5          |
|  |                   | 1 Year           | Years            | Years            | Years            |
| (Dollars in thousands)                               |                   |                  |                  |                  |                  |
| Commitments to extend credit (2)(4)                  | \$ 5,510          | \$ 5,510         | \$ 0             | \$ 0             | \$ 0             |
| Commitments related to loans held for sale (3)       | 7,011             | 7,011            | 0                | 0                | 0                |
| Unused lines of credit (4)(5)                        | 40,933            | 20,896           | 4,308            | 3,022            | 12,707           |
| Standby letters of credit (6)                        | 602               | 601              | 1                | 0                | 0                |
| <b>Total commitments with off-balance sheet risk</b> | <b>\$ 54,056</b>  | <b>\$ 34,018</b> | <b>\$ 4,309</b>  | <b>\$ 3,022</b>  | <b>\$ 12,707</b> |

- (1) Represents an off-balance sheet obligation.  
(2) Represents commitments outstanding for residential real estate, commercial real estate, and commercial business loans.  
(3) Commitments for residential real estate loans that will be held for sale upon origination.  
(4) Loan commitments and unused lines of credit for commercial and construction loans expire or are subject to renewal in twelve months or less.  
(5) Represents unused lines of credit from commercial, construction, and home equity loans.  
(6) Standby letters of credit generally expire in twelve months.  
Management believes that the Company has adequate resources to fund all of its commitments.

The Company has written options limited to those residential real estate loans designated for sale in the secondary market and subject to a rate lock. These rate-locked loan commitments are used for trading activities, not as a hedge. The fair value of the outstanding written options at March 31, 2012 was nominal.

**Results of Operations – Continuing Operations****General***Successor Company*

As discussed earlier, the results of operations for the nine months ended March 31, 2012 are not directly comparable to the prior year period due to the application of acquisition accounting in connection with the merger on December 29, 2010. Nonetheless, the discussion that follows will compare, to the extent appropriate and useful, certain results for each period. The three months ended March 31, 2011 was the first complete quarter of operations after the merger on December 29, 2010. Accordingly, results of operations for the three months ended March 31, 2012 and 2011 are compared in the discussion that follows.

## Edgar Filing: NORTHEAST BANCORP /ME/ - Form 10-Q

Net income from continuing operations for the three months ended March 31, 2012 was \$154 thousand, compared to \$36 thousand for the three months ended March 31, 2011. Items of significance affecting the Company's earnings for the three months ended March 31, 2012 compared to the prior year period included increased security gains, and increased gains on the sales of residential mortgages and other portfolio loans during the current year period. These increases were partially offset by certain nonrecurring noninterest expenses during the three months ended March 31, 2012, including compensation costs resulting from the termination of the Company's self-insured employee benefits program and replacing it with a third-party insurance program, as well as nonrecurring professional fees, including consulting costs associated with new information technology initiatives and legal expense.

For the nine months ended March 31, 2012, the Company recorded a net loss from continuing operations of \$22 thousand. The year-to-date loss from continuing operations is principally the result of increased noninterest expenses associated with implementing the Company's post-merger business strategies. During the nine months ended March 31, 2012, the Company purchased \$59.8 million in loans, and earned an average yield on the purchased portfolio of 14.21%, a result that includes regularly scheduled interest and accretion and accelerated accretion and fees recognized on loan payoffs. The Company also monitors the total return on its purchased loan portfolio, a measure that includes gains on sales of purchased loans, as well as interest, scheduled accretion and accelerated accretion. On this basis, the purchased loan portfolio earned a total return of 15.20% during the nine months ended March 31, 2012. The following table details the components of the return on purchased loans during the three and nine months ended March 31, 2012. Transactional income includes fees and accelerated accretion recognized from an unscheduled payoff or principal payment, as well as gains on sales of purchased loans.

**Table of Contents**

|   | Total Return on Purchased Loans   |               |                                   |               |
|---|-----------------------------------|---------------|-----------------------------------|---------------|
|   | Three Months Ended March 31, 2012 |               | Three Months Ended March 31, 2011 |               |
|   | Income                            | Return (1)    | Income                            | Return (1)    |
|   | (Dollars in thousands)            |               |                                   |               |
| Regularly scheduled interest and accretion                | \$ 1,298                          | 10.10%        | \$ 2,374                          | 10.78%        |
| Transactional income:                                     |                                   |               |                                   |               |
| Gains on loan sales                                       | 219                               | 1.70%         | 219                               | 0.99%         |
| Accelerated accretion and fees recognized on loan payoffs | 274                               | 2.13%         | 756                               | 3.43%         |
| <b>Total</b>  | <b>\$ 1,791</b>                   | <b>13.94%</b> | <b>\$ 3,349</b>                   | <b>15.20%</b> |

(1) The total return on purchased loan represents the interest and noninterest income recorded during the period divided by the average purchased loan balance, on an annualized basis.

For the 93 days ended March 31, 2011, the Company earned net income from continuing operations of \$11.9 million. Income for the 93 days ended March 31, 2011 included a bargain purchase gain of \$15.2 million and merger expenses of \$3.2 million recorded at the date of the merger.

*Predecessor Company*

For the 181 days ended December 28, 2010, the Company earned net income from continuing operations of \$1.7 million. Financial highlights for 181 days ended December 28, 2010 included gains on sales of fixed rate residential mortgages of \$1.9 million, investment commission income of \$1.2 million, and net interest income of \$8.5 million.

*Net Interest Income**Successor Company Three Months Ended March 31, 2012 and 2011*

Net interest income for the three months ended March 31, 2012 and 2011 was \$4.8 million and \$5.0 million, respectively. Net interest income in the prior year period was affected by significant accretion of the fair value adjustments resulting from the Merger, resulting in a higher level of favorable noncash adjustments on both earning assets and interest-bearing liabilities in comparison to the three months ended March 31, 2012. The following summarizes the effects of noncash accretion.

|                                      | Noncash Accretion (Amortization) of Fair Value Adjustments |                  |                        |                                   |                  |                        |
|--------------------------------------|--|------------------|------------------------|-----------------------------------|------------------|------------------------|
|                                      | Three Months Ended March 31, 2012                          |                  |                        | Three Months Ended March 31, 2011 |                  |                        |
|                                      | Average Balance  | Income (Expense) | Effect on Yield / Rate | Average Balance                   | Income (Expense) | Effect on Yield / Rate |
|                                      | (Dollars in thousands)                                     |                  |                        |                                   |                  |                        |
| <b>Interest-earning assets:</b>      |  |                  |                        |                                   |                  |                        |
| Investment securities                | \$ 132,681   | \$ (8)           | -0.02%                 | \$ 143,482                        | \$ (389)         | -1.10%                 |
| Loans                                | 348,777  | 8                | 0.01%                  | 357,376                           | 396              | 0.45%                  |
| Other interest-earning assets        | 73,584   | 0                | 0.00%                  | 64,169                            | 0                | 0.00%                  |
| <b>Total interest-earning assets</b> | <b>\$ 555,042</b>  | <b>\$ 0</b>      | <b>0.00%</b>           | <b>\$ 565,027</b>                 | <b>\$ 7</b>      | <b>0.01%</b>           |
| <b>Interest-bearing liabilities:</b> |  |                  |                        |                                   |                  |                        |
| Interest-bearing deposits            | 357,949  | 286              | 0.32%                  | 343,845                           | 466              | 0.55%                  |
| Short-term borrowings                | 1,321  | 0                | 0.00%                  | 34,822                            | 0                | 0.00%                  |
| Borrowed funds                       | 112,468  | 570              | 2.04%                  | 117,152                           | 553              | 1.91%                  |
| Junior subordinated debentures       | 8,047  | (18)             | -0.90%                 | 7,902                             | (8)              | -0.41%                 |

Edgar Filing: NORTHEAST BANCORP /ME/ - Form 10-Q

|                                       |            |        |       |            |          |       |
|---------------------------------------|------------|--------|-------|------------|----------|-------|
| Total interest-bearing liabilities    | \$ 479,785 | \$ 838 | 0.70% | \$ 503,721 | \$ 1,011 | 0.81% |
| Total effect of noncash accretion on: |            |        |       |            |          |       |
| Net interest income                   |            | \$ 838 |       |            | \$ 1,018 |       |
| Net interest margin                   |            | 0.61%  |       |            | 0.73%    |       |

**Table of Contents**

Partially offsetting the aforementioned decrease was increased volume and yield on the Company's purchased loan portfolio during Fiscal 2012. The following summarizes interest income and related yields recognized on the Company's purchased loan and originated loan portfolios for the three months ended March 31, 2012 and 2011.

|                  | Interest Income and Yield on Loans |                    |              |                                   |                    |              |
|------------------|------------------------------------|--------------------|--------------|-----------------------------------|--------------------|--------------|
|                  | Three Months Ended March 31, 2012  |                    |              | Three Months Ended March 31, 2011 |                    |              |
|                  | Average<br>Balance                 | Interest<br>Income | Yield        | Average<br>Balance                | Interest<br>Income | Yield        |
|                  | (Dollars in thousands)             |                    |              |                                   |                    |              |
| Loans originated | \$ 297,100                         | \$ 4,298           | 5.82%        | \$ 357,376                        | \$ 5,649           | 6.41%        |
| Loans purchased  | 51,677                             | 1,572              | 12.23%       | 0                                 | 0                  | 0.00%        |
| <b>Total</b>     | <b>\$ 348,777</b>                  | <b>\$ 5,870</b>    | <b>6.77%</b> | <b>\$ 357,376</b>                 | <b>\$ 5,649</b>    | <b>6.41%</b> |

The Company's interest rate spread for the three months ended March 31, 2012 and 2011 was 3.26% and 3.50%, respectively. The Company's net interest margin for the three months ended March 31, 2012 and 2011 was 3.44% and 3.62%, respectively. The current period decreases were principally the result of a lower market rate on investment securities, and the aforementioned level of accretion in the three months ended March 31, 2011.

The following sets forth the average balances and interest income and interest expense for the three months ended March 31, 2012 and 2011.

|  | Successor Company (1)             |                                |                           |                                   |                                |                           |
|--|-----------------------------------|--------------------------------|---------------------------|-----------------------------------|--------------------------------|---------------------------|
|  | Three Months Ended March 31, 2012 |                                |                           | Three Months Ended March 31, 2011 |                                |                           |
|  | Average<br>Balance                | Interest<br>Income/<br>Expense | Average<br>Yield/<br>Rate | Average<br>Balance                | Interest<br>Income/<br>Expense | Average<br>Yield/<br>Rate |
|  | (Dollars in thousands)            |                                |                           |                                   |                                |                           |
| <b>Assets:</b>                                 |                                   |                                |                           |                                   |                                |                           |
| <b>Interest-earning assets:</b>                |                                   |                                |                           |                                   |                                |                           |
| Investment securities                          | \$ 132,681                        | \$ 422                         | 1.28%                     | \$ 143,482                        | \$ 910                         | 2.67%                     |
| Loans (3) (4)                                  | 348,777                           | 5,870                          | 6.77%                     | 357,376                           | 5,649                          | 6.41%                     |
| Regulatory stock                               | 5,697                             | 15                             | 1.06%                     | 5,486                             | 12                             | 0.89%                     |
| Short-term investments (5)                     | 67,887                            | 45                             | 0.27%                     | 58,683                            | 33                             | 0.23%                     |
| <b>Total interest-earning assets</b>           | <b>555,042</b>                    | <b>6,352</b>                   | <b>4.60%</b>              | <b>565,027</b>                    | <b>6,604</b>                   | <b>4.76%</b>              |
| Cash and due from banks                        | 2,881                             |                                |                           | 3,423                             |                                |                           |
| Other non-interest earning assets              | 35,651                            |                                |                           | 44,046                            |                                |                           |
| <b>Total assets</b>                            | <b>\$ 593,574</b>                 |                                |                           | <b>\$ 612,496</b>                 |                                |                           |
| <b>Liabilities &amp; Stockholders' Equity:</b> |                                   |                                |                           |                                   |                                |                           |
| <b>Interest-bearing liabilities:</b>           |                                   |                                |                           |                                   |                                |                           |
| NOW accounts                                   | \$ 54,242                         | \$ 48                          | 0.36%                     | \$ 55,994                         | \$ 79                          | 0.57%                     |
| Money market accounts                          | 43,602                            | 38                             | 0.35%                     | 54,041                            | 70                             | 0.53%                     |
| Savings accounts                               | 32,923                            | 12                             | 0.15%                     | 35,638                            | 34                             | 0.39%                     |
| Time deposits                                  | 227,182                           | 777                            | 1.38%                     | 198,172                           | 591                            | 1.21%                     |
| <b>Total interest-bearing deposits</b>         | <b>357,949</b>                    | <b>875</b>                     | <b>0.98%</b>              | <b>343,845</b>                    | <b>774</b>                     | <b>0.91%</b>              |
| Short-term borrowings (6)                      | 1,321                             | 7                              | 2.13%                     | 34,822                            | 60                             | 0.70%                     |
| Borrowed funds                                 | 112,468                           | 528                            | 1.89%                     | 117,152                           | 559                            | 1.94%                     |
| Junior subordinated debentures                 | 8,047                             | 188                            | 9.40%                     | 7,902                             | 174                            | 8.93%                     |



Edgar Filing: NORTHEAST BANCORP /ME/ - Form 10-Q

|   |            |          |       |            |          |       |
|---|------------|----------|-------|------------|----------|-------|
| Total interest-bearing liabilities                          | 479,785    | 1,598    | 1.34% | 503,721    | 1,567    | 1.26% |
| Interest-bearing liabilities of discontinued operations (7) | 0          |          |       | 2,134      |          |       |
| Non-interest bearing liabilities:                           |            |          |       |            |          |       |
| Demand deposits and escrow accounts                         | 44,249     |          |       | 37,379     |          |       |
| Other liabilities   | 3,972      |          |       | 4,444      |          |       |
| Total liabilities   | 528,006    |          |       | 547,678    |          |       |
| Stockholders' equity  | 65,568     |          |       | 64,818     |          |       |
| Total liabilities and stockholders' equity                  | \$ 593,574 |          |       | \$ 612,496 |          |       |
| Net interest income   |            | \$ 4,754 |       |            | \$ 5,037 |       |
| Interest rate spread  |            |          | 3.26% |            |          | 3.50% |
| Net interest margin (8)                                     |            |          | 3.44% |            |          | 3.62% |

- (1) Successor Company means Northeast Bancorp and its subsidiary after the closing of the merger with FHB Formation LLC on December 29, 2010.
- (2) Predecessor Company means Northeast Bancorp and its subsidiary prior to the closing of the merger with FHB Formation LLC on December 29, 2010.
- (3) Includes Loans held for sale.
- (4) Nonaccrual loans are included in the computation of average, but unpaid interest has not been included for purposes of determining interest income.
- (5) Short term investments include FHLB overnight deposits and other interest-bearing deposits.
- (6) Short term borrowings include securities sold under repurchase agreements and sweep accounts.
- (7) The average balance of borrowings associated with discontinued operations has been excluded from interest expense, interest rate spread, and net interest margin.
- (8) Net interest margin is calculated as net interest income divided by total interest-earning assets.

**Table of Contents**

The following table presents the extent to which changes in volume and interest rates of interest earning assets and interest bearing liabilities have affected the Company's interest income and interest expense during the periods indicated. Information is provided in each category with respect to (i) changes attributable to changes in volume (changes in volume multiplied by prior period rate), (ii) changes attributable to changes in rates (changes in rates multiplied by prior period volume) and (iii) change attributable to a combination of changes in rate and volume (change in rates multiplied by the changes in volume). Changes attributable to the combined impact of volume and rate have been allocated proportionately to the changes due to volume and the changes due to rate.

|  | Three Months Ended March 31, 2012<br>Compared to the Three Months Ended March 31, 2011<br>Change Due to Volume Change Due to Rate Total Change<br>(In thousands) |                 |                 |
|--|--|-----------------|-----------------|
| <b>Interest earning assets:</b>                      |  |                 |                 |
| Investments securities                               | \$ (64)  | \$ (424)        | \$ (488)        |
| Loans  | (138)  | 359             | 221             |
| Regulatory stock                                     | 0  | 3               | 3               |
| Short-term investments                               | 5  | 7               | 12              |
| <b>Total decrease in interest income</b>             | <b>(197)</b>   | <b>(55)</b>     | <b>(252)</b>    |
| <b>Interest bearing liabilities:</b>                 |  |                 |                 |
| Interest bearing deposits                            | 33   | 68              | 101             |
| Short-term borrowings                                | (96)   | 43              | (53)            |
| Borrowed funds                                       | (22)   | (9)             | (31)            |
| Junior subordinated debentures                       | 3  | 11              | 14              |
| <b>Total increase (decrease) in interest expense</b> | <b>(82)</b>  | <b>113</b>      | <b>31</b>       |
| <b>Total decrease in net interest income</b>         | <b>\$ (115)</b>  | <b>\$ (168)</b> | <b>\$ (283)</b> |

*Successor Company Nine Months Ended March 31, 2012 and 93 Days Ended March 31, 2011*

Net interest income for the nine months ended March 31, 2012 was \$13.9 million. Interest income during the nine months ended March 31, 2012 was positively affected by the increased balances and effective yields associated with the Company's purchased loan portfolio. The Company generally acquires loans at a significant discount from the loan's unpaid principal balance, often giving rise to an effective yield substantially higher than the Company's originated loan portfolio. This was demonstrated during the nine months ended March 31, 2012, in which purchased loans earned a yield of 14.21%, as compared to a yield of 5.99% earned on originated loans. The following summarizes interest income and related yields recognized on the Company's purchased loan and originated loan portfolios for the nine months ended March 31, 2012.

|              |            | Nine Months Ended March 31, 2012 |                    |              |
|--------------|------------|----------------------------------|--------------------|--------------|
|              |            | Average<br>Balance               | Interest<br>Income | Yield        |
|              |            | (Dollars in thousands)           |                    |              |
| Loans        | originated | \$ 305,701                       | \$ 13,751          | 5.99%        |
| Loans        | purchased  | 29,315                           | 3,130              | 14.21%       |
| <b>Total</b> |            | <b>\$ 335,016</b>                | <b>\$ 16,881</b>   | <b>6.71%</b> |

The cost of interest bearing liabilities was 1.32% for the nine months ended March 31, 2012. The cost of time deposits and borrowings was affected by continued accretion of fair value adjustments associated with the merger, which resulted in average costs substantially lower than the stated interest rates of such borrowings and time deposits, with the exception of the Company's junior subordinated debentures, for which the rate is higher. The net effect of fair value adjustments, as well as reductions in non-maturity and time deposit rates paid, account for the overall

decrease in funding costs when compared to the Predecessor Company period discussed below.

**Table of Contents**

The following sets forth the average balances and interest income and interest expense for the nine months ended March 31, 2012. Such information for the 93 day period ended March 31, 2011 has been excluded given that interest and expense activity for the three day period ended December 31, 2010 was insignificant; the average balances and interest income and interest expense for the three months ended March 31, 2011 has been provided in the preceding section.

|   | Successor Company (1)<br>Nine Months Ended March 31, 2012 |                                |                           |
|---|---|--------------------------------|---------------------------|
|   | Average<br>Balance  | Interest<br>Income/<br>Expense | Average<br>Yield/<br>Rate |
| <b>Assets:</b>  |   |                                |                           |
| <b>Interest-earning assets:</b>                             |   |                                |                           |
| Investment securities                                       | \$ 139,834  | \$ 1,602                       | 1.52%                     |
| Loans (3) (4)   | 335,016   | 16,881                         | 6.71%                     |
| Regulatory stock  | 5,740   | 48                             | 1.11%                     |
| Short-term investments (5)                                  | 71,243  | 128                            | 0.24%                     |
| <b>Total interest-earning assets</b>                        | <b>551,833</b>  | <b>18,659</b>                  | <b>4.50%</b>              |
| Cash and due from banks                                     | 2,927   |                                |                           |
| Other non-interest earning assets                           | 37,143  |                                |                           |
| <b>Total assets</b>   | <b>\$ 591,903</b>   |                                |                           |
| <b>Liabilities &amp; Stockholders' Equity:</b>              |   |                                |                           |
| <b>Interest-bearing liabilities:</b>                        |   |                                |                           |
| NOW accounts  | \$ 55,080   | \$ 170                         | 0.41%                     |
| Money market accounts                                       | 44,613  | 130                            | 0.39%                     |
| Savings accounts  | 32,907  | 56                             | 0.23%                     |
| Time deposits   | 221,127   | 2,192                          | 1.32%                     |
| <b>Total interest-bearing deposits</b>                      | <b>353,727</b>  | <b>2,548</b>                   | <b>0.96%</b>              |
| Short-term borrowings (6)                                   | 1,030   | 15                             | 1.94%                     |
| Borrowed funds  | 113,109   | 1,592                          | 1.87%                     |
| Junior subordinated debentures                              | 8,009   | 556                            | 9.24%                     |
| <b>Total interest-bearing liabilities</b>                   | <b>475,875</b>  | <b>4,711</b>                   | <b>1.32%</b>              |
| Interest-bearing liabilities of discontinued operations (7) | 380   |                                |                           |
| <b>Non-interest bearing liabilities:</b>                    |   |                                |                           |
| Demand deposits and escrow accounts                         | 45,771  |                                |                           |
| Other liabilities   | 4,267   |                                |                           |
| <b>Total liabilities</b>                                    | <b>526,293</b>  |                                |                           |
| <b>Stockholders' equity</b>                                 | <b>65,610</b>   |                                |                           |
| <b>Total liabilities and stockholders' equity</b>           | <b>\$ 591,903</b>   |                                |                           |
| <b>Net interest income</b>                                  |   | <b>\$ 13,948</b>               |                           |
| Interest rate spread  |   |                                | 3.18%                     |

Net interest margin (8)

3.36%

- (1) Successor Company means Northeast Bancorp and its subsidiary after the closing of the merger with FHB Formation LLC on December 29, 2010.
- (2) Predecessor Company means Northeast Bancorp and its subsidiary prior to the closing of the merger with FHB Formation LLC on December 29, 2010.
- (3) Includes Loans held for sale.
- (4) Nonaccrual loans are included in the computation of average, but unpaid interest has not been included for purposes of determining interest income.
- (5) Short term investments include FHLB overnight deposits and other interest-bearing deposits.
- (6) Short term borrowings include securities sold under repurchase agreements and sweep accounts.
- (7) The average balance of borrowings associated with discontinued operations has been excluded from interest expense, interest rate spread, and net interest margin.
- (8) Net interest margin is calculated as net interest income divided by total interest-earning assets.

**Table of Contents***Predecessor Company*

The net interest margin for the 181 days ended December 28, 2010 was 2.92%. The yield on earning assets was 4.92%. The yield on earning assets included higher yielding investment securities, compared to market rates for such instruments in the current period, as well as higher funding costs. As indicated above, the results of the prior periods are not directly comparable with those of the current periods as a result of the accretion of fair value adjustments in the current periods. The following sets forth the average balances and interest income and interest expense for the 181 days ended December 28, 2010.

|   | Predecessor Company (2)          |                                |                           |
|---|----------------------------------|--------------------------------|---------------------------|
|   | 181 Days Ended December 28, 2010 |                                |                           |
|   | Average<br>Balance               | Interest<br>Income/<br>Expense | Average<br>Yield/<br>Rate |
| <b>Assets:</b>  |                                  |                                |                           |
| <b>Interest-earning assets:</b>                             |                                  |                                |                           |
| Investment securities                                       | \$ 161,894                       | \$ 3,182                       | 3.96%                     |
| Loans (3) (4)   | 385,286                          | 11,210                         | 5.87%                     |
| Regulatory stock  | 5,486                            | 18                             | 0.66%                     |
| Short-term investments (5)                                  | 39,212                           | 39                             | 0.20%                     |
| <b>Total interest-earning assets</b>                        | <b>591,878</b>                   | <b>14,449</b>                  | <b>4.92%</b>              |
| Cash and due from banks                                     | 3,340                            |                                |                           |
| Other non-interest earning assets                           | 34,724                           |                                |                           |
| <b>Total assets</b>   | <b>\$ 629,942</b>                |                                |                           |
| <b>Liabilities &amp; Stockholders Equity:</b>               |                                  |                                |                           |
| <b>Interest-bearing liabilities:</b>                        |                                  |                                |                           |
| NOW accounts  | \$ 53,780                        | \$ 183                         | 0.69%                     |
| Money market accounts                                       | 55,955                           | 213                            | 0.77%                     |
| Savings accounts  | 38,303                           | 99                             | 0.52%                     |
| Time deposits   | 196,318                          | 2,301                          | 2.36%                     |
| <b>Total interest-bearing deposits</b>                      | <b>344,356</b>                   | <b>2,796</b>                   | <b>1.64%</b>              |
| Short-term borrowings (6)                                   | 53,873                           | 376                            | 1.41%                     |
| Borrowed funds  | 117,688                          | 2,365                          | 4.05%                     |
| Junior subordinated debentures                              | 16,496                           | 340                            | 4.16%                     |
| <b>Total interest-bearing liabilities</b>                   | <b>532,413</b>                   | <b>5,877</b>                   | <b>2.23%</b>              |
| Interest-bearing liabilities of discontinued operations (7) | 2,462                            |                                |                           |
| <b>Non-interest bearing liabilities:</b>                    |                                  |                                |                           |
| Demand deposits and escrow accounts                         | 37,941                           |                                |                           |
| Other liabilities   | 5,576                            |                                |                           |
| <b>Total liabilities</b>                                    | <b>578,392</b>                   |                                |                           |
| Stockholders equity   | 51,550                           |                                |                           |
| <b>Total liabilities and stockholders equity</b>            | <b>\$ 629,942</b>                |                                |                           |

Edgar Filing: NORTHEAST BANCORP /ME/ - Form 10-Q

|                         |          |
|-------------------------|----------|
| Net interest income     | \$ 8,572 |
| Interest rate spread    | 2.69%    |
| Net interest margin (8) | 2.92%    |

- (1) Successor Company means Northeast Bancorp and its subsidiary after the closing of the merger with FHB Formation LLC on December 29, 2010.
- (2) Predecessor Company means Northeast Bancorp and its subsidiary prior to the closing of the merger with FHB Formation LLC on December 29, 2010.
- (3) Includes Loans held for sale.
- (4) Nonaccrual loans are included in the computation of average, but unpaid interest has not been included for purposes of determining interest income.
- (5) Short term investments include FHLB overnight deposits and other interest-bearing deposits.
- (6) Short term borrowings include securities sold under repurchase agreements and sweep accounts.
- (7) The average balance of borrowings associated with discontinued operations has been excluded from interest expense, interest rate spread, and net interest margin.
- (8) Net interest margin is calculated as net interest income divided by total interest-earning assets.

***Provision for Loan Losses***

Quarterly, the Company determines the amount of the allowance for loan losses that is adequate to provide for losses inherent in the Company's loan portfolios, with the provision for loan losses determined by the net change in the allowance for loan losses. For loans acquired with deteriorated credit quality, a provision for loan losses is recorded when estimates of future cash flows are lower than had been previously expected (i.e., there are reduced expected cash flows or higher net charge-offs than had been previously expected, requiring additional provision for loan losses). See Part I. Item I. Notes to Unaudited Consolidated Financial Statements Note 3: Loans, Allowance for Loan losses and Credit Quality for further discussion.

The provision for loan losses for periods subsequent to the merger reflects the impact of adjusting loans to their then fair values, as well as the elimination of the allowance for loan losses in accordance with the acquisition method of accounting. Subsequent to the merger, the provision for loan losses has been recorded based on estimates of inherent losses in newly originated loans and for incremental reserves required for pre-merger loans based on estimates of deteriorated credit quality post-merger.

**Table of Contents***Successor Company Three Months Ended March 31, 2012 and 2011*

The provision for loan losses for the three months ended March 31, 2012 and 2011 was \$100 thousand and \$49 thousand, respectively. The increase in the Company's loan loss provision in the quarter ended March 31, 2012 compared to 2011 resulted from increased loss experience, primarily in the Company's consumer loan segment.

*Successor Company Nine Months Ended March 31, 2012 and 93 Days Ended March 31, 2011*

The provision for loan losses for the nine months ended March 31, 2012 was \$643 thousand, reflecting provisions made in the Company's loan portfolio to adequately reserve for estimated inherent losses. The Company considers its historical loss experience, in addition to qualitative factors, in estimating the required level of allowance for loan losses. While management believes that it uses the best information available to make its determinations with respect to the allowance for loan losses, there can be no assurance that the Company will not have to increase its provision for loan losses in future periods as a result of changing economic conditions, adverse markets for real estate or other factors.

There was no provision for loan losses recorded during the three-day period ended December 31, 2010. Accordingly, the Company's provision for loan losses for the 93 days ended March 31, 2011 did not differ than that recorded during the three months ended March 31, 2011, as previously discussed.

*Predecessor Company*

The provision for loan losses for 181 days ended December 29, 2010 was \$912 thousand. As indicated above, the allowance for loan losses was eliminated at the time of merger. Loans with indicators of deteriorated credit quality at the time of the Merger were recorded at fair value and assigned a nonaccretable difference, hence the lower level of overall loan loss provisions associated with the Successor Company during the current year periods. See Part I. Item I. Notes to Unaudited Consolidated Financial Statements Note 3: Loans, Allowance for Loan losses and Credit Quality for further discussion.

***Noninterest Income****Successor Company Three Months Ended March 31, 2012 and 2011*

Noninterest income for the three months ended March 31, 2012 compared to the three months ended March 31, 2011 increased \$840 thousand. The increase principally resulted from increased security gains of \$684 thousand; increased gains on residential mortgage loan sales of \$144 thousand; and increased gains on portfolio loan sales of \$414 thousand.

Increases in security gains resulted from the sale of a substantial portion of the Company's available-for-sale investment portfolio during the period. The Company reinvested the sales proceeds in a mix of government guaranteed mortgage-backed and agency securities similar in composition to the securities sold, albeit at lower market yields. Increased gains on residential mortgage loan sales resulted principally from the volume of fixed-rate loan originations during the period, an increase driven primarily by an increased level of mortgage loan refinance activity. The Company sold \$29.3 million in residential mortgages during the three months ended March 31, 2012, compared to \$20.4 million in the comparable prior year period. In addition to residential mortgage loan sales, the Company also sold one commercial loan during the three months ended March 31, 2012, resulting in a gain of \$219 thousand. The loan had previously been purchased by the LASG. The gain of \$219 thousand during the three months ended March 31, 2012 compares to a loss of \$195 thousand realized on the sale of a substantial portion of the Company's indirect consumer loan portfolio in the comparable prior year period.

Increases in the aforementioned noninterest income categories during the three months ended March 31, 2012 were partially offset by the bargain purchased gain of \$296 thousand recorded in the three months ended March 31, 2011, as well as a decrease in other noninterest income of \$131 thousand. The decrease in other noninterest income principally resulted from gains on the sales of repossessed collateral in the prior year period, compared to losses from provisions and sales recorded in the three months ended March 31, 2012. Other noninterest income in the prior year period also includes trust income of \$81 thousand. The Company discontinued trust services in Fiscal 2011.

*Successor Company Nine Months Ended March 31, 2012 and 93 Days Ended March 31, 2011*

Noninterest income for the nine months ended March 31, 2012 totaled \$7.2 million. Significant items include net security gains of \$1.1 million; gains on loans held for sale of \$2.1 million; investment commissions of \$2.1 million; and portfolio loan sale gains of \$422 thousand. Portfolio loan sales during the period include the aforementioned gain on sale of a purchased loan during the three months ended March 31, 2012, as well as a gain of \$203 thousand related to the sale of a nonperforming loan in the preceding quarter.



Edgar Filing: NORTHEAST BANCORP /ME/ - Form 10-Q

Noninterest income for the 93 days ended March 31, 2011 totaled \$16.9 million, of which \$15.2 million was a bargain purchase gain associated with the merger.

## **Table of Contents**

### *Predecessor Company*

Noninterest income for the 181 days ended December 28, 2010 totaled \$4.2 million. Significant items included gains on sales of loans totaling \$1.9 million for the 181 days ended December 28, 2010, and investment commissions totaling \$1.2 million for the 181 days ended December 28, 2010.

### ***Noninterest Expense***

#### *Successor Company Three Months Ended March 31, 2012 and 2011*

Noninterest expense for the three months ended March 31, 2012 and 2011 totaled \$7.3 million and \$7.1 million, respectively. Noninterest expense for the three months ended March 31, 2011 included \$132 thousand of merger expenses. Excluding merger expenses, noninterest expenses increased \$288 thousand. The increase during the three months ended March 31, 2012 principally resulted from certain nonrecurring noninterest expenses, including compensation costs aggregating \$201 thousand, largely the result of terminating the Company's self-insured employee benefits program and replacing it with a third-party insurance program. The Company also incurred \$207 thousand in nonrecurring professional fees, principally consulting costs associated with new information technology initiatives and nonrecurring legal expense.

#### *Successor Company Nine Months Ended March 31, 2012 and 93 Days Ended March 31, 2011*

Noninterest expense for the nine months ended March 31, 2012 totaled \$20.8 million. As previously mentioned, increased compensation, and occupancy and equipment costs contributed to the increased level of noninterest expense during the period. Management believes that the investments made in the current fiscal year related to personnel, infrastructure, marketing, and use of professional services will serve the Company well as it seeks to grow its new business initiatives to scale over the next several years.

Noninterest expense for the 93 days ended March 31, 2011 totaled \$10.4 million, which includes \$3.2 million of expenses associated with the merger.

### *Predecessor Company*

Noninterest expense for the 181 days ended December 28, 2010 totaled \$9.5 million. With the exception of merger expenses of \$94 thousand during the 181 days ended December 28, 2010, noninterest expenses in the prior year period reflects normal operations of the Predecessor Company, and are therefore not directly comparable to the current year periods, given the additional business initiatives undertaken by the Successor Company.

### ***Income Taxes***

#### *Successor Company Three Months Ended March 31, 2012 and 2011*

The Company's income tax expense was \$15 thousand, or an effective rate of 8.9%, for the three months ended March 31, 2012. The effective rate for the period differs substantially from the Company's statutory rate because of the level of annual pre-tax income and favorable book to tax differences, such as fixed tax credits and tax exempt life insurance income.

The Company's income tax benefit was \$217 thousand for the three months ended March 31, 2011. Both the bargain purchase gain and merger expenses recorded during the period were not subject to income taxes.

#### *Successor Company Nine Months Ended March 31, 2012 and 93 Days Ended March 31, 2011*

The Company's income tax benefit was \$209 thousand for the nine months ended March 31, 2012. The Company's loss from operations, as well as the effects of favorable book to tax differences, such as tax exempt life insurance income and fixed tax credits, resulted in the benefit for the year to date period.

The bargain purchase gain and the merger expenses in the 93 days ended March 31, 2011 are not subject to income taxes. Excluding this merger-related activity from the quarter ended March 31, 2011, results in a pretax loss and an income tax benefit of \$233 thousand.

### *Predecessor Company*

## Edgar Filing: NORTHEAST BANCORP /ME/ - Form 10-Q

Income tax expense recorded for the 181 days ended December 28, 2010 was \$698 thousand. The Company's effective tax rate of 29.5% for the 181 days ended December 28, 2010 differed from statutory rates principally as a result of tax exempt security income and life insurance income, in addition to affordable housing tax credits. These favorable tax items were partially offset by merger expenses, which are not deductible for income tax purposes.

**Table of Contents****Results of Operations – Discontinued Operations**

In the first quarter of Fiscal 2012, the Company sold intangible assets (principally customer lists) and certain fixed assets of NBIG to local insurance agencies in two separate transactions. The Varney Agency, Inc. of Bangor, Maine purchased the assets of nine NBIG offices in Anson, Auburn, Augusta, Bethel, Livermore Falls, Scarborough, South Paris, Thomaston and Turner, Maine. The NBIG office in Berwick, Maine, which now operates under the name of Spence & Matthews, was acquired by a member of NBIG's senior management team. In connection with the transaction, the Company also repaid borrowings associated with NBIG totaling \$2.1 million. Customer lists and certain fixed assets of individual NBIG agency offices were also sold in Fiscal 2011 and 2010.

The Company no longer conducts any significant operations in the insurance agency business, and therefore has classified the operating results of NBIG, and the associated gain on sale of the division, as discontinued operations in the consolidated financial statements. See Part I. Item I.

Notes to Unaudited Consolidated Financial Statements – Note 6: Discontinued Operations – for further details.

*Successor Company – Three Months Ended March 31, 2012 and 2011*

Net income from discontinued operations for the three months ended March 31, 2012 and 2011 was \$14 thousand and \$120 thousand, respectively. Income for the three months ended March 31, 2012 included a \$22 thousand pre-tax gain on sale of discontinued operations recorded upon the receipt of contingent income less expenses incurred in excess of the Company's expectation at the closing of the transaction in the first quarter of Fiscal 2012. The Company recorded pre-tax income associated with discontinued operations of \$184 thousand during the three months ended March 31, 2011. Results of discontinued operations for the three months ended March 31, 2011 reflect normal operations of NBIG. Income taxes associated with discontinued operations totaled \$8 thousand and \$64 thousand for the three months ended March 31, 2012 and 2011, respectively.

*Successor Company – Nine Months Ended March 31, 2012 and 93 Days Ended March 31, 2011*

Net income from discontinued operations was \$1.1 million for the nine months ended March 31, 2012, which includes a pretax gain on sale of NBIG intangibles and certain fixed assets, net of expenses, of \$1.6 million. The Company also recorded pre-tax income associated with operations of \$186 thousand prior to disposal in the first quarter. Income tax expense associated with discontinued operations for the nine months ended March 31, 2012 was \$600 thousand or approximately 34.5% of pretax income.

The Company recorded pre-tax income associated with discontinued operations of \$176 thousand during the 93 days ended March 31, 2011. Results of discontinued operations for the 93 days ended March 31, 2011 reflect normal operations of NBIG. Income taxes associated with discontinued operations totaled \$62 thousand, or 35.2% of pre-tax income, for the 93 days ended March 31, 2011.

*Predecessor Company*

For the 181 days ended December 28, 2011, the Company reported net income from discontinued operations of \$129 thousand. Net income from discontinued operations includes a \$105 thousand gain on sale of customer lists and fixed assets associated with the NBIG office in Jackman, Maine. Income tax expense associated with discontinued operations for the 181 days ended December 28, 2010 was \$70 thousand, representing 35.2% of pretax income.

## **Table of Contents**

### **Item 3. Quantitative and Qualitative Disclosure about Market Risk**

Not required for smaller reporting companies.

### **Item 4. Controls and Procedures**

The Company maintains controls and procedures designed to ensure that information required to be disclosed in the reports the Company files or submits under the Securities Exchange Act of 1934 ( Exchange Act ) is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission, and that such information is accumulated and communicated to the Company s management, including the Chief Executive Officer and Chief Financial Officer (the Company s principal executive officer and principal financial officer, respectively), as appropriate to allow for timely decisions regarding timely disclosure. In designing and evaluating disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost/benefit relationship of possible controls and procedures.

The Company s management, with the participation of the Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of its disclosure controls and procedures (as defined in Rules 13a 15(e) and 15d 15(e) under the Exchange Act) as of the end of the period covered by this Quarterly Report on Form 10-Q.

Based on this evaluation of the Company s disclosure controls and procedures, the Chief Executive Officer and Chief Financial Officer have concluded that these disclosure controls and procedures were effective as of March 31, 2012.

There were no changes in the Company s internal controls over financial reporting (as defined in Rule 13a 15(f) of the Exchange Act) that occurred during the quarter ended March 31, 2012 that have materially affected, or is reasonably likely to materially affect, the Company s internal controls over financial reporting.

## **PART II OTHER INFORMATION**

### **Item 1. Legal Proceedings**

None.

### **Item 1A. Risk Factors**

Not required for smaller reporting companies.

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

On December 29, 2010, in connection with the closing of the Merger, the Company issued an aggregate of 2,099,099 shares of voting and non-voting common stock at a price equal to \$13.93, pursuant to the Agreement and Plan of Merger, dated March 30, 2010, by and between the Company and FHB. The issuance of the shares was exempt from registration pursuant to Section 4(2) of the Securities Act of 1933, as amended and Regulation D promulgated thereunder.

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

None.

**Item 4. Mine Safety Disclosures**  
Not applicable.

**Item 5. Other Information**  
None.

**Item 6. Exhibits**

**Table of Contents**

| Exhibits<br>No. | Description  |
|-----------------|--|
| 31.1            | Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Rule 13a-14(a)). *   |
| 31.2            | Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Rule 13a-14(a)). *   |
| 32.1            | Certificate of the Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Rule 13a-14(b)). **   |
| 32.2            | Certificate of the Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Rule 13a-14(b)). **   |
| 101             | The following materials from Northeast Bancorp's Quarterly Report on Form 10-Q for the quarter ended March 31, 2012 formatted in XBRL: (i) Consolidated Balance Sheets at March 31, 2012 and June 30, 2011; (ii) Consolidated Statements of Income for the three and nine months ended March 31, 2012, the three months and 93 days ended March 31, 2011, and the 181 days ended December 28, 2010; (iii) Consolidated Statements of Comprehensive Income for the three and nine months ended March 31, 2012, the three months and 93 days ended March 31, 2011, and the 181 days ended December 28, 2010; (iv) Consolidated Statements of Changes in Shareholders' Equity for the nine months ended March 31, 2012, the 93 days ended March 31, 2011, and the 181 days ended December 28, 2010; (v) Consolidated Statements of Cash Flows for the nine months ended March 31, 2012, the 93 days ended March 31, 2012, and the 181 days ended December 28, 2010; and (v) Notes to Unaudited Consolidated Financial Statements. *** |

\* Filed herewith

\*\* Furnished herewith

\*\*\* Pursuant to Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this Quarterly Report on Form 10-Q is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933, as amended, and Section 18 of the Securities Exchange Act of 1934, as amended.

**Table of Contents**

**SIGNATURES**

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

Date: April 30, 2012

**NORTHEAST BANCORP**

By: /s/ Richard Wayne  
Richard Wayne  
President and CEO

By: /s/ Claire S. Bean  
Claire S. Bean  
Chief Financial Officer

53



**Table of Contents****NORTHEAST BANCORP****Index to Exhibits**

| Exhibits<br>No. | Description  |
|-----------------|--|
| 31.1            | Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Rule 13a-14(a)). *   |
| 31.2            | Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Rule 13a-14(a)). *   |
| 32.1            | Certificate of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Rule 13a-14(b)). **   |
| 32.2            | Certificate of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Rule 13a-14(b)). **   |
| 101             | The following materials from Northeast Bancorp's Quarterly Report on Form 10-Q for the quarter ended March 31, 2012 formatted in XBRL: (i) Consolidated Balance Sheets at March 31, 2012 and June 30, 2011; (ii) Consolidated Statements of Income for the three and nine months ended March 31, 2012, the three months and 93 days ended March 31, 2011, and the 181 days ended December 28, 2010; (iii) Consolidated Statements of Comprehensive Income for the three and nine months ended March 31, 2012, the three months and 93 days ended March 31, 2011, and the 181 days ended December 28, 2010; (iv) Consolidated Statements of Changes in Shareholders' Equity for the nine months ended March 31, 2012, the 93 days ended March 31, 2011, and the 181 days ended December 28, 2010; (v) Consolidated Statements of Cash Flows for the nine months ended March 31, 2012, the 93 days ended March 31, 2012, and the 181 days ended December 28, 2010; and (v) Notes to Unaudited Consolidated Financial Statements. *** |

\* Filed herewith

\*\* Furnished herewith

\*\*\* Pursuant to Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this Quarterly Report on Form 10-Q is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933, as amended, and Section 18 of the Securities Exchange Act of 1934, as amended.