BAR HARBOR BANKSHARES
Form 10-Q
November 08, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2013

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission File Number: **01-13349**

BAR HARBOR BANKSHARES

(Exact name of registrant as specified in its charter)

Maine	**01-0393663**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
PO Box 400 **82 Main Street, Bar Harbor, ME**	**04609-0400**
(Address of principal executive offices)	(Zip Code)

(207) 288-3314

(Registrant's telephone number, including area code)

Inapplicable

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES **þ** 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 **þ** 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 the definitions of large accelerated filer , accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act: Large accelerated filer ¨ Accelerated filer **þ** Non-accelerated filer (do not check if a smaller reporting company) ¨ Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act): YES: ¨ NO: **þ**

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date:

Class of Common Stock	Number of Shares Outstanding November 1, 2013
$2.00 Par Value	**3,938,374**

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PART I. FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

BAR HARBOR BANKSHARES AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

SEPTEMBER 30, 2013 AND DECEMBER 31, 2012

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

(*unaudited*)

	September 30, 2013	December 31, 2012
Assets		
Cash and cash equivalents	$ 11,806	$ 14,992
Securities available for sale, at fair value		
(amortized cost of $467,584 and $405,769, respectively)	462,356	418,040
Federal Home Loan Bank stock	18,331	18,189
Loans	845,933	815,004
Allowance for loan losses	(8,380)	(8,097)
Loans, net of allowance for loan losses	837,553	806,907
Premises and equipment, net	19,877	19,255
Goodwill	4,935	4,935
Bank owned life insurance	7,819	7,633
Other assets	16,593	12,984
TOTAL ASSETS	$1,379,270	$1,302,935
Liabilities		
Deposits:		
Demand and other non-interest bearing deposits	$ 84,487	$ 71,865
NOW accounts	135,976	123,015
Savings and money market deposits	277,504	230,325
Time deposits	386,629	370,560
Total deposits	884,596	795,765
Short-term borrowings	255,014	224,077
Long-term advances from Federal Home Loan Bank	104,000	142,490
Junior subordinated debentures	5,000	5,000
Other liabilities	7,257	7,557
TOTAL LIABILITIES	1,255,867	1,174,889
Shareholders' equity		

Capital stock, par value $2.00; authorized 10,000,000 shares; issued 4,525,635 shares at September 30, 2013 and December 31, 2012	9,051	9,051
Surplus	26,903	26,693
Retained earnings	100,147	93,900
Accumulated other comprehensive (loss) income:		
Prior service cost and unamortized net actuarial losses on employee benefit plans, net of tax of ($248) and ($207), at September 30, 2013 and December 31, 2012, respectively	(482)	(401)
Net unrealized (depreciation) appreciation on securities available for sale, net of tax of ($2,044) and $4,099, at September 30, 2013 and December 31, 2012, respectively	(3,968)	7,954
Portion of OTTI attributable to non-credit gains, net of tax of $267 and $74, at September 30, 2013 and December 31, 2012, respectively	518	144
Total accumulated other comprehensive (loss) income	(3,932)	7,697
Less: cost of 587,902 and 605,591 shares of treasury stock at September 30, 2013 and December 31, 2012, respectively	(8,766)	(9,295)
TOTAL SHAREHOLDERS' EQUITY	123,403	128,046
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$1,379,270	$1,302,935

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

BAR HARBOR BANKSHARES AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2013 AND 2012

(Dollars in thousands, except per share data)

(unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2013	2012	2013	2012
Interest and dividend income:				
Interest and fees on loans	$ 9,404	$ 9,422	$27,991	$27,155
Interest on securities	3,412	3,432	9,630	10,663
Dividend on FHLB stock	18	22	52	63
Total interest and dividend income	12,834	12,876	37,673	37,881
Interest expense:				
Deposits	1,626	1,941	4,997	5,795
Short-term borrowings	127	105	359	319
Long-term debt	1,112	1,416	3,576	4,383
Total interest expense	2,865	3,462	8,932	10,497
Net interest income	9,969	9,414	28,741	27,384
Provision for loan losses	170	427	928	1,302
Net interest income after provision for loan losses	9,799	8,987	27,813	26,082
Non-interest income:				
Trust and other financial services	900	850	2,657	2,468
Service charges on deposit accounts	346	351	962	887
Credit and debit card service charges and fees	440	419	1,172	1,075
Net securities gains	138	597	659	1,834
Total other-than-temporary impairment ("OTTI") losses	(73)	(173)	(241)	(1,007)
Non-credit portion of OTTI losses (before taxes) (1)	---	72	53	226
Net OTTI losses recognized in earnings	(73)	(101)	(188)	(781)
Other operating income	174	182	487	489
Total non-interest income	1,925	2,298	5,749	5,972
Non-interest expense:				
Salaries and employee benefits	4,025	3,670	11,328	10,161
Occupancy expense	482	408	1,459	1,183
Furniture and equipment expense	506	387	1,487	1,294
Credit and debit card expenses	98	99	286	274
FDIC insurance assessments	175	237	516	609
Other operating expense	1,549	1,758	4,661	5,003
Total non-interest expense	6,835	6,559	19,737	18,524

Income before income taxes	4,889	4,726	13,825	13,530
Income taxes	1,356	1,358	3,906	3,894
Net income	$3,533	$3,368	$ 9,919	$ 9,636
Per Common Share Data:				
Basic earnings per share	$ 0.90	$ 0.86	$ 2.52	$ 2.47
Diluted earnings per share	$ 0.89	$ 0.86	$ 2.51	$ 2.46

(1)

Included in other comprehensive loss, net of tax

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

BAR HARBOR BANKSHARES AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2013 AND 2012

(Dollars in thousands)

(unaudited)

	Three Months Ended September 30,	
	2013	**2012**
Net income	$ 3,533	$ 3,368
Other comprehensive income:		
Net unrealized appreciation on securities available for sale, net of tax of $196 and $1,359, respectively	380	2,635
Less reclassification adjustment for net gains related to securities available for sale included in net income, net of tax of $47 and $203, respectively	(91)	(394)
Add other-than-temporary impairment adjustment, net of tax of $25 and $58, respectively	48	115
Less non-credit portion of other-than-temporary impairment losses, net of tax of $0 and $25, respectively	---	(47)
Net amortization of prior service cost and actuarial (gain) loss for supplemental executive retirement plan, net of related tax of $0 and $52 respectively	---	(100)
Actuarial loss (gain) on supplemental executive retirement plan, net of related tax of $4 and ($114), respectively	8	(222)
Total other comprehensive income	345	1,987
Total comprehensive income	$ 3,878	$ 5,355

	Nine Months Ended September 30,	
	2013	**2012**
Net income	$ 9,919	$ 9,636
Other comprehensive (loss) income:		
Net unrealized (depreciation) appreciation on securities available for sale, net of tax of ($5,790) and $2,357, Respectively	(11,237)	4,573
Less reclassification adjustment for net gains related to securities available for sale included in net income, net of tax of ($224) and ($624), respectively	(435)	(1,210)
Add other-than-temporary impairment adjustment, net of tax of $82 and $342, respectively	159	665
	(35)	(149)

Less non-credit portion of other-than-temporary impairment losses, net of tax of $18 and $77, respectively		
Net amortization of prior service cost and actuarial (gain) loss for supplemental executive retirement plan, net of related tax of ($56) and ($51), respectively	(109)	(99)
Actuarial loss (gain) on supplemental executive retirement plan, net of related tax of $15 and ($114), respectively	28	(222)
Total other comprehensive (loss) income	(11,629)	3,558
Total comprehensive (loss) income	$ (1,710)	$13,194

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

BAR HARBOR BANKSHARES AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2013 AND 2012

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

(unaudited)

	Capital Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive income (loss)	Treasury Stock	Total Shareholders' Equity
Balance December 31, 2011	$9,051	$ 26,512	$ 86,198	$ 7,024	$(10,535)	$118,250
Net income	---	---	9,636	---	---	9,636
Total other comprehensive income	---	---	---	3,558	---	3,558
Dividend declared:						
Common stock ($0.870 per share)	---	---	(3,388)	---	---	(3,388)
Stock options exercised (38,621 shares),						
including related tax effects	---	28	(197)	---	1,168	999
Recognition of stock based compensation expense	---	160	20	---	---	180
Restricted stock grants (1,380 shares)	---	(49)	8	---	41	---
Balance September 30, 2012	$9,051	$26,651	$ 92,277	$ 10,582	$ (9,326)	$129,235
Balance December 31, 2012	$9,051	$26,693	$ 93,900	$ 7,697	$ (9,295)	$128,046
Net income	---	---	9,919	---	---	9,919
Total other comprehensive (loss)	---	---	---	(11,629)	---	(11,629)
Dividend declared:					---	---
Common stock ($0.9300 per share)						
Purchase of treasury stock (700 shares)	---	---	---	---	(24)	(24)
Stock options exercised (15,019 shares),						
including related tax effects	---	108	(44)	---	450	514
Recognition of stock based compensation expense	---	223	10	---	---	233
Restricted stock grants (3,370 shares)	---	(121)	17	---	103	(1)
Balance September 30, 2013	$9,051	$26,903	$100,147	$ (3,932)	$(8,766)	$123,403

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

BAR HARBOR BANKSHARES AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2013 AND 2012

(Dollars in thousands)

(unaudited)

	2013	2012
Cash flows from operating activities:		
Net income	$ 9,919	$ 9,636
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of premises and equipment	1,084	905
Amortization of core deposit intangible	(69)	---
Provision for loan losses	928	1,302
Net securities gains	(659)	(1,834)
Other-than-temporary impairment	188	781
Net amortization of bond premiums and discounts	4,205	2,869
Recognition of stock based expense	233	180
Gains on sale of other real estate owned	(53)	---
Net change in other assets	871	(390)
Net change in other liabilities	(300)	2,215
Net cash provided by operating activities	16,347	15,664
Cash flows from investing activities:		
Net cash received in acquisition	---	1,197
Purchases of securities available for sale	(155,548)	(134,170)
Proceeds from maturities, calls and principal paydowns of mortgage-backed securities	77,283	67,157
Proceeds from sales of securities available for sale	12,717	34,664
Net increase in Federal Home Loan Bank stock	(142)	(1,351)
Net loans made to customers	(31,314)	(48,197)
Proceeds from sale of other real estate owned	1,065	356
Capital expenditures	(1,706)	(3,597)
Net cash used in investing activities	(97,645)	(83,941)
Cash flows from financing activities:		
Net increase in deposits	88,831	52,217
Net (decrease) increase in securities sold under repurchase agreements and fed funds purchased	(812)	3,988
Proceeds from Federal Home Loan Bank advances	27,900	53,999
Repayments of Federal Home Loan Bank advances	(34,641)	(38,213)
Purchases of Treasury Stock	(24)	---
Proceeds from stock option exercises, including excess tax benefits	513	999
Payments of dividends	(3,655)	(3,388)

Net cash provided by financing activities	78,112	69,602
Net (decrease) increase in cash and cash equivalents	(3,186)	1,325
Cash and cash equivalents at beginning of period	14,992	8,720
Cash and cash equivalents at end of period	$ 11,806	$ 10,045
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$ 9,077	$ 10,574
Income taxes	3,047	2,988
Schedule of noncash investing activities:		
Transfers from loans to other real estate owned	$ 261	$ 912
Acquisitions:		
Fair value of noncash assets acquired	$ ---	$ 41,576
Fair value of liabilities assumed	$ ---	(42,773)

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

BAR HARBOR BANKSHARES AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

SEPTEMBER 30, 2013

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

(*unaudited*)

Note 1: Basis of Presentation

The accompanying consolidated interim financial statements are unaudited. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. All inter-company transactions have been eliminated in consolidation. Amounts in the prior period financial statements are reclassified whenever necessary to conform to current period presentation. The net income reported for the three and nine months ended September 30, 2013, is not necessarily indicative of the results that may be expected for the year ending December 31, 2013, or any other interim periods.

The consolidated balance sheet at December 31, 2012, has been derived from audited consolidated financial statements at that date. The accompanying unaudited interim consolidated financial statements have been prepared in accordance with United States (U.S.) generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X (17 CFR Part 210). Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. For further information, please refer to the consolidated financial statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2012, and notes thereto.

Note 2: Management s Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of the allowance for loan losses, other-than-temporary impairments on securities, income tax estimates, and the valuation of intangible assets.

Allowance for Loan Losses: The allowance for loan losses (the allowance) is a significant accounting estimate used in the preparation of the Company s consolidated financial statements. The allowance is available to absorb losses on loans and is maintained at a level that, in management s judgment, is appropriate for the amount of risk inherent in the loan portfolio, given past and present conditions. The allowance is increased by provisions charged to operating expense and by recoveries on loans previously charged-off, and is decreased by loans charged-off as uncollectible.

Arriving at an appropriate level of allowance involves a high degree of judgment. The determination of the adequacy of the allowance and provisioning for estimated losses is evaluated regularly based on review of loans, with particular emphasis on non-performing or other loans that management believes warrant special consideration. The ongoing evaluation process includes a formal analysis, which considers among other factors: the character and size of the loan portfolio, business and economic conditions, real estate market conditions, collateral values, changes in product offerings or loan terms, changes in underwriting and/or collection policies, loan growth, previous charge-off experience, delinquency trends, non-performing loan trends, the performance of individual loans in relation to contract terms, and estimated fair values of collateral.

The allowance consists of allowances established for specific loans including impaired loans; allowances for pools of loans based on historical charge-offs by loan types; and supplemental allowances that adjust historical loss experience to reflect current economic conditions, industry specific risks, and other observable data.

While management uses available information to recognize losses on loans, changing economic conditions and the economic prospects of the borrowers may necessitate future additions or reductions to the allowance. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the allowance, which also may necessitate future additions or reductions to the allowance, based on information available to them at the time of their examination.

***Other-Than-Temporary Impairments on Investment Securities*: ** One of the significant estimates relating to securities is the evaluation of other-than-temporary impairment. If a decline in the fair value of a security is judged to be other-than-temporary, and management does not intend to sell the security and believes it is more-likely-than-not the Company will not be required to sell the security prior to recovery of cost or amortized cost, the portion of the total impairment attributable to the credit loss is recognized in earnings, and the remaining difference between the security s amortized cost basis and its fair value is included in other comprehensive income.

For impaired available for sale debt securities that management intends to sell, or where management believes it is more-likely-than-not that the Company will be required to sell, an other-than-temporary impairment charge is recognized in earnings equal to the difference between fair value and cost or amortized cost basis of the security. The fair value of the other-than-temporarily impaired security becomes its new cost basis.

The evaluation of securities for impairments is a quantitative and qualitative process, which is subject to risks and uncertainties and is intended to determine whether declines in the fair value of securities should be recognized in current period earnings. The risks and uncertainties include changes in general economic conditions, the issuer s financial condition and/or future prospects, the effects of changes in interest rates or credit spreads and the expected recovery period of unrealized losses. The Company has a security monitoring process that identifies securities that, due to certain characteristics, as described below, are subjected to an enhanced analysis on a quarterly basis.

Securities that are in an unrealized loss position are reviewed at least quarterly to determine if an other-than-temporary impairment is present based on certain quantitative and qualitative factors and measures. The primary factors considered in evaluating whether a decline in value of securities is other-than-temporary include: (a) the cause of the impairment; (b) the financial condition, credit rating and future prospects of the issuer; (c) whether the debtor is current on contractually obligated interest and principal payments; (d) the volatility of the securities fair value; (e) performance indicators of the underlying assets in the security including default rates, delinquency rates, percentage of non-performing assets, loan to collateral value ratios, conditional payment rates, third party guarantees, current levels of subordination, vintage, and geographic concentration and; (f) any other information and observable data considered relevant in determining whether other-than-temporary impairment has occurred, including the expectation of the receipt of all principal and interest due.

In addition, for securitized financial assets with contractual cash flows, such as private label mortgage-backed securities, the Company periodically updates its best estimate of cash flows over the life of the security. The Company s best estimate of cash flows is based upon assumptions consistent with the current economic environment, similar to those the Company believes market participants would use. If the fair value of a securitized financial asset is less than its cost or amortized cost and there has been an adverse change in timing or amount of anticipated future cash flows since the last revised estimate to the extent that the Company does not expect to receive the entire amount of future contractual principal and interest, an other-than-temporary impairment charge is recognized in earnings representing the estimated

credit loss if management does not intend to sell the security and believes it is more-likely-than-not the Company will not be required to sell the security prior to recovery of cost or amortized cost. Estimating future cash flows is a quantitative and qualitative process that incorporates information received from third party sources along with certain assumptions and judgments regarding the future performance of the underlying collateral. In addition, projections of expected future cash flows may change based upon new information regarding the performance of the underlying collateral.

Income Taxes: The Company uses the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. If current available information indicates that it is more-likely-than-not that deferred tax assets will not be realized, a valuation allowance is established. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Significant management judgment is required in determining income tax expense and deferred tax assets and liabilities. As of September 30, 2013, and December 31, 2012, there was no valuation allowance for deferred tax assets. Deferred tax assets are included in other assets on the consolidated balance sheet.

Goodwill and Identifiable Intangible Assets: In connection with acquisitions, the Company generally records as assets on its consolidated financial statements both goodwill and identifiable intangible assets, such as core deposit intangibles.

The Company evaluates whether the carrying value of its goodwill has become impaired, in which case the value is reduced through a charge to its earnings. Goodwill is evaluated for impairment at least annually, or upon a triggering event using certain fair value techniques. Goodwill impairment testing is performed at the segment (or reporting unit) level. Goodwill is assigned to reporting units at the date the goodwill is initially recorded. Once goodwill has been assigned to the reporting units, it no longer retains its association with a particular acquisition, and all of the activities within a reporting unit, whether acquired or organically grown, are available to support the value of the goodwill.

Goodwill represents the excess of the purchase price over the fair value of net assets acquired in accordance with the purchase method of accounting for business combinations. Goodwill is not amortized but, instead, is subject to impairment tests on at least an annual basis or more frequently if an event occurs or circumstances change that reduce the fair value of a reporting unit below its carrying amount. The Company completes its annual goodwill impairment test as of December 31 of each year. The impairment testing process is conducted by assigning assets and goodwill to each reporting unit. Currently, the Company s goodwill is evaluated at the entity level as there is only one reporting unit. The Company first assesses certain qualitative factors to determine if it is more likely than not that the fair value of the reporting unit is less than its carrying value. If it is more likely than not that the fair value of the reporting unit is less than the carrying value, then the fair value of each reporting unit is compared to the recorded book value step one. If the fair value of the reporting unit exceeds its carrying value, goodwill is not considered impaired and step two is not considered necessary. If the carrying value of a reporting unit exceeds its fair value, the impairment test continues (step two) by comparing the carrying value of the reporting unit s goodwill to the implied fair value of goodwill. The implied fair value is computed by adjusting all assets and liabilities of the reporting unit to current fair value with the offset adjustment to goodwill. The adjusted goodwill balance is the implied fair value of the goodwill.

An impairment charge is recognized if the carrying fair value of goodwill exceeds the implied fair value of goodwill. At December 31, 2012, there was no indication of impairment that led the Company to believe it needed to perform a two-step test.

Any changes in the estimates used by the Company to determine the carrying value of its goodwill, or which otherwise adversely affect their value or estimated lives, would adversely affect the Company s consolidated results of operations.

Note 3: Business Combinations

On August 10, 2012, Bar Harbor Bank & Trust (the Bank), a wholly-owned first tier operating subsidiary of Bar Harbor Bankshares, completed its acquisition of the operations of the Border Trust Company (Border Trust), a state chartered bank headquartered in Augusta, Maine, by acquiring certain assets and assuming certain liabilities, including all deposits for a net purchase price of $133. This transaction represented a strategic extension of the Company s franchise with three branch locations located in Kennebec and Sagadahoc counties.

The Company has determined that the acquisition of the net assets of Border Trust constituted a business combination as defined by the FASB ASC Topic 805, *Business Combinations*. Accordingly, the assets acquired and liabilities assumed were recorded at their fair values. Fair values were determined based on the requirements of FASB ASC Topic 820, *Fair Value Measurements*. In many cases, the determination of these fair values required management to make estimates about discount rates, future expected cash flows, market conditions and other future events that are highly subjective in nature and subject to change. These fair value estimates are subject to change for up to one year after the closing date of the transaction as additional information relative to closing date fair values becomes available. In addition, the tax treatment is complex and subject to interpretations that may result in future adjustments of deferred taxes as of the acquisition date.

The results of Border Trust s operations are included in the Consolidated Statements of Income from the date of acquisition. In connection with this transaction, the consideration paid, the assets acquired, and the liabilities assumed were recorded at fair value on the date of acquisition, as summarized in the following table, as of August 10, 2012.

Fair value of total consideration paid:	
Cash consideration paid at closing to Border Trust	$ 133
Fair value of identifiable assets acquired:	
Cash and cash equivalents	$ 1,330
Securities	3,537
Federal Home Loan Bank Common stock	770
Loans	33,606
Premises and equipment	563
Core deposit intangible	783
Other assets	540
Total identifiable assets acquired	41,129
Fair value of liabilities assumed:	
Deposits	38,520

Borrowings	3,776
Other liabilities	477
Total liabilities assumed	42,773
Fair value of net identifiable liabilities assumed	1,644
Goodwill resulting from transaction	$ 1,777

Goodwill of $1,777 was recorded after adjusting for the fair value of net identifiable assets acquired. The estimated goodwill from the acquisition represents the inherent long-term value anticipated from the synergies and business opportunities expected to be achieved as a result of the transaction. The estimated core deposit intangible asset is being amortized over its estimated life of eight and one-half years.

Note 4: Earnings Per Share

Basic earnings per share excludes dilution and is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the Company, such as the Company s dilutive stock options.

The following is a reconciliation of basic and diluted earnings per share for the three and nine months ended September 30, 2013, and 2012:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	**2012**	**2013**	**2012**
Net income	$ 3,533	$ 3,368	$ 9,919	$ 9,636
Weighted average common shares outstanding				
Basic	3,936,129	3,912,237	3,929,859	3,894,653
Effect of dilutive employee stock options	23,808	20,965	19,371	19,787
Diluted	3,959,937	3,933,202	3,949,230	3,914,440
Anti-dilutive options excluded from earnings per share calculation	40,210	25,500	48,636	30,500
Per Common Share Data:				
Basic earnings per share	$ 0.90	$ 0.86	$ 2.52	$ 2.47
Diluted earnings per share	$ 0.89	$ 0.86	$ 2.51	$ 2.46

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Note 5: Securities Available For Sale

The following tables summarize the securities available for sale portfolio as of September 30, 2013, and December 31, 2012:

September 30, 2013		**Gross**	**Gross**	
	Amortized	**Unrealized**	**Unrealized**	**Estimated**
Available for Sale:	**Cost**	**Gains**	**Losses**	**Fair Value**
Mortgage-backed securities:				
US Government-sponsored enterprises	$278,954	$ 5,424	$ 5,638	$278,740
US Government agency	86,906	1,227	1,323	86,810
Private label	5,918	854	70	6,702
Obligations of states and political subdivisions thereof	95,806	1,215	6,917	90,104
Total	$467,584	$ 8,720	$13,948	$462,356

December 31, 2012		**Gross**	**Gross**	
	Amortized	**Unrealized**	**Unrealized**	**Estimated**
Available for Sale:	**Cost**	**Gains**	**Losses**	**Fair Value**
Mortgage-backed securities:				
US Government-sponsored enterprises	$238,974	$ 7,913	$ 1,064	$245,823
US Government agency	82,397	2,080	216	84,261
Private label	8,063	571	521	8,113
Obligations of states and political subdivisions thereof	76,335	4,040	532	79,843
Total	$405,769	$14,604	$ 2,333	$418,040

Securities Maturity Distribution: The following table summarizes the maturity distribution of the amortized cost and estimated fair value of securities available for sale as of September 30, 2013. Actual maturities may differ from the final maturities noted below because issuers may have the right to prepay or call certain securities. In the case of mortgage-backed securities, actual maturities may also differ from expected maturities due to the amortizing nature of the underlying mortgage collateral, and the fact that borrowers have the right to prepay.

	Amortized	**Estimated**
Securities Available for Sale	**Cost**	**Fair Value**

Due one year or less	$ ---	$ ---
Due after one year through five years	8,055	8,262
Due after five years through ten years	20,382	21,028
Due after ten years	439,147	433,066
Total	$467,584	$462,356

Securities Impairment: As a part of the Company s ongoing security monitoring process, the Company identifies securities in an unrealized loss position that could potentially be other-than-temporarily impaired (OTTI).

For the three and nine months ended September 30, 2013, the Company recorded total OTTI losses of $73 and $241 in the statement of income (before taxes), related to three, available for sale, private label mortgage-backed securities (MBS), which the Company had previously determined to be other-than-temporarily impaired. Of the $241 in total year-to-date OTTI losses, $188 (before taxes) represented estimated credit losses on the collateral underlying these securities, while $53 (before taxes) represented unrealized losses for the same securities resulting from factors other than credit. The $188 in estimated credit losses were recorded in earnings (before taxes), with the $53 non-credit portion of the unrealized losses recorded within accumulated other comprehensive loss. The

additional credit losses principally reflected an increase in the future loss severity and constant default rate estimates resulting from still-recovering real estate markets, extended foreclosure and collateral liquidation timelines, and still-depressed economic conditions that affected the expected performance of the mortgage loans underlying these securities.

The OTTI losses recognized in earnings during the three and nine months ended September 30, 2013 represented management s best estimate of credit losses inherent in the securities based on discounted, bond-specific future cash flow projections using assumptions about cash flows associated with the pools of mortgage loans underlying each security. In estimating those cash flows the Company takes a variety of factors into consideration including, but not limited to, loan level credit characteristics, current delinquency and non-performing loan rates, current levels of subordination and credit support, recent default rates and future constant default rate estimates, original and current loan to collateral value ratios, recent collateral loss severities and future collateral loss severity estimates, recent and historical conditional prepayment rates and future conditional prepayment rate assumptions, and other estimates of future collateral performance.

Despite elevated levels of delinquencies, defaults and losses in the underlying residential mortgage loan collateral, given credit enhancements resulting from the structures of the individual securities, the Company currently expects that as of September 30, 2013 it will recover the amortized cost basis of its private label mortgage-backed securities as depicted in the table below and has therefore concluded that such securities were not other-than-temporarily impaired as of that date. Nevertheless, given recent market conditions, it is possible that adverse changes in repayment performance and fair value could occur in future periods that could impact the Company s current best estimates.

The following table displays the beginning balance of OTTI related to historical credit losses on debt securities held by the Company at the beginning of the current reporting period, as well as changes in credit losses recognized in pre-tax earnings for the three and nine months ending September 30, 2013, and 2012.

	2013	2012
Estimated credit losses as of June 30,	$4,555	$4,958
Additions for credit losses for securities on which		
OTTI has been previously recognized	73	53
Additions for credit losses for securities on which		
OTTI has not been previously recognized	---	48
Reductions for securities paid off during the period	---	---
Estimated credit losses as of September 30,	$4,628	$5,059
Estimated credit losses as of prior year-end,	$5,131	$4,697
Additions for credit losses for securities on which	188	675

OTTI has been previously recognized		
Additions for credit losses for securities on which		
OTTI has not been previously recognized	---	106
Reductions for securities paid off during the period	691	419
Estimated credit losses as of September 30,	$4,628	$5,059

Upon initial impairment of a security, total OTTI losses represent the excess of the amortized cost over the fair value. For subsequent impairments of the same security, total OTTI losses represent additional credit losses and or declines in fair value subsequent to the previously recorded OTTI losses, if applicable. Unrealized OTTI losses recognized in accumulated other comprehensive income (OCI) represent the non-credit component of OTTI losses on debt securities. Net impairment losses recognized in earnings represent the credit component of OTTI losses on debt securities.

As of September 30, 2013, the Company held fourteen private label MBS (debt securities) with a total amortized cost (i.e. carrying value) of $2,937 for which OTTI losses have previously been recognized in pre-tax earnings (dating back to the fourth quarter of 2008). For twelve of these securities, the Company previously recognized credit losses in excess of the unrealized losses in accumulated OCI, creating an unrealized gain of $539, net of tax, as included in accumulated OCI as of September 30, 2013. For the remaining two securities, the total OTTI losses included in accumulated OCI amounted to $21, net of tax, as of September 30, 2013. As of September 30, 2013, the total net unrealized gains included in accumulated OCI for securities held where OTTI has been historically recognized in pre-tax earnings amounted to $518, net of tax, compared with net unrealized gains of $144, net of tax, at December 31, 2012.

As of September 30, 2013, based on a review of the remaining securities in the securities portfolio, the Company concluded that it expects to recover its amortized cost basis for such securities. This conclusion was based on the issuers continued satisfaction of the securities obligations in accordance with their contractual terms and the expectation that they will continue to do so through the maturity of the security, the expectation that the Company will receive the entire amount of future contractual cash flows, as well as the evaluation of the fundamentals of the issuers financial condition and other objective evidence. Accordingly, the Company concluded that the declines in the values of those securities were temporary and that any additional other-than-temporary impairment charges were not appropriate at September 30, 2013. As of that date, the Company did not intend to sell nor anticipated that it would more-likely-than-not be required to sell any of its impaired securities, that is, where fair value is less than the cost basis of the security.

The following table summarizes the fair value of securities with continuous unrealized losses for less than 12 months and those that have been in a continuous unrealized loss position for 12 months or longer as of September 30, 2013 and December 31, 2012. All securities referenced are debt securities.

	Less than 12 months			**12 months or longer**			**Total**		
September 30, 2013	**Estimated Fair Value**	**Number of Investments**	**Unrealized Losses**	**Estimated Fair Value**	**Number of Investments**	**Unrealized Losses**	**Estimated Fair Value**	**Number of Investments**	**Unrea Los**
Description of Securities:									
Mortgage-backed securities:									
US Government-sponsored enterprises	$ 92,101	122	$ 3,903	$27,171	28	$1,735	$119,272	150	$
US Government agency	34,079	41	995	8,081	11	328	42,160	52	
Private label	664	8	14	901	8	56	1,565	16	
Obligations of states and political subdivisions thereof	63,785	144	6,139	3,282	15	778	67,067	159	
Total	$190,629	315	$11,051	$39,435	62	$2,897	$230,064	377	$1

	Less than 12 months			**12 months or longer**			**Total**		
December 31, 2012	**Estimated Fair Value**	**Number of Investments**	**Unrealized Losses**	**Estimated Fair Value**	**Number of Investments**	**Unrealized Losses**	**Estimated Fair Value**	**Number of Investments**	**Unrea Los**
Description of Securities:									
Mortgage-backed securities:									
US Government-sponsored enterprises	$ 56,008	55	$ 1,064	$ ---	---	$ ---	$ 56,008	55	$
US Government agency	15,281	18	216	56	2	---	15,337	20	
Private label	783	6	48	2,196	14	473	2,979	20	
	10,476	27	261	2,561	12	271	13,037	39	

Obligations of states and Political subdivisions thereof									
Total	$ 82,548	106	$ 1,589	$ 4,813	28	$ 744	$ 87,361	134	$

For securities with unrealized losses, the following information was considered in determining that the impairments were not other-than-temporary:

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Mortgage-backed securities issued by U.S. Government-sponsored enterprises: As of September 30, 2013, the total unrealized losses on these securities amounted to $5,638, compared with $1,064 at December 31, 2012. All of these securities were credit rated AA+ by the major credit rating agencies. Company management believes these securities have minimal credit risk, as these Government-sponsored enterprises play a vital role in the nation s financial markets. Management s analysis indicates that the unrealized losses at September 30, 2013 were attributed to changes in current market yields and pricing spreads for similar securities since the date the underlying securities were purchased, and does not consider these securities to be other-than-temporarily impaired at September 30, 2013.

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Mortgage-backed securities issued by U.S. Government agencies: As of September 30, 2013, the total unrealized losses on these securities amounted to $1,323, compared with $216 at December 31, 2012. All of these securities were credit rated AA+ by the major credit rating agencies. Management s analysis indicates that these securities bear little or no credit risk because they are backed by the full faith and credit of the United States. The Company attributes the unrealized losses at September 30, 2013 to changes in current market yields and pricing spreads for similar securities since the date the underlying securities were purchased, and does not consider these securities to be other-than-temporarily impaired at September 30, 2013.

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Private label mortgage-backed securities: As of September 30, 2013, the total unrealized losses on the Bank s private label mortgage-backed securities amounted to $70, compared with $521 at December 31, 2012. The Company attributes the unrealized losses at September 30, 2013 to the current illiquid market for non-agency mortgage-backed securities, a still recovering housing market, continued home foreclosures, risk-related market pricing discounts for non-agency mortgage-backed securities and credit rating downgrades on certain private label mortgage-backed securities owned by the Company. Based upon the

foregoing considerations and the expectation that the Company will receive all of the future contractual cash flows related to amortized cost on these securities, the Company does not consider there to be any additional other-than-temporary impairment with respect to these securities at September 30, 2013.

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Obligations of states of the U.S. and political subdivisions thereof: As of September 30, 2013, the total unrealized losses on the Bank s municipal securities amounted to $6,917, compared with $532 at December 31, 2012. The Bank s municipal securities primarily consist of general obligation bonds and to a lesser extent, revenue bonds. General obligation bonds carry less risk, as they are supported by the full faith, credit and taxing authority of the issuing government and in the cases of school districts, are additionally supported by state aid. Revenue bonds are generally backed by municipal revenue streams generated through user fees or lease payments associated with specific municipal projects that have been financed.

Municipal bonds are frequently supported with insurance, which guarantees that in the event the issuer experiences financial problems, the insurer will step in and assume payment of both principal and interest. Historically, insurance support has strengthened an issuer s underlying credit rating to AAA or AA status. Starting in 2008 and continuing through 2013, many of the insurance companies providing municipal bond insurance experienced financial difficulties and, accordingly, were downgraded by at least one of the major credit rating agencies. Consequently, since 2008 a portion of the Bank s municipal bond portfolio was downgraded by at least one of the major credit rating agencies. Notwithstanding the credit rating downgrades, at September 30, 2013, the Bank s municipal bond portfolio did not contain any below investment grade securities as reported by major credit rating agencies. In addition, at September 30, 2013, all municipal bond issuers were current on contractually obligated interest and principal payments.

The Company attributes the unrealized losses at September 30, 2013 to changes in current market yields and pricing spreads for similar securities since the date the underlying securities were purchased and, to a lesser extent, changes in credit ratings on certain securities. The Company also attributes the unrealized losses to ongoing media attention and market concerns about the prolonged recovery from the national economic recession and the impact it might have on the future financial stability of municipalities throughout the country. Accordingly, the Company does not consider these municipal securities to be other-than-temporarily impaired at September 30, 2013.

At September 30, 2013, the Company had no intent to sell nor believed it is more-likely-than-not that it would be required to sell any of its impaired securities as identified and discussed immediately above, and therefore did not consider these securities to be other-than-temporarily impaired as of that date.

Securities Gains and Losses: The following table summarizes realized gains and losses and other-than-temporary impairment losses on securities available for sale for the three and nine months ended September 30, 2013 and 2012.

	Proceeds from Sale of Securities Available for Sale	**Realized Gains**	**Realized Losses**	**Other Than Temporary Impairment Losses**	**Net**
Three months ended September 30,					
2013	$ 3,088	$ 138	$---	$ 73	$ 65
2012	$10,431	$ 614	$17	$101	$ 496
Nine months ended September 30,					
2013	$12,717	$ 667	$ 8	$188	$ 471
2012	$34,664	$1,857	$23	$781	$1,053

Note 6: Loans and Allowance for Loan Losses

Loans are carried at the principal amounts outstanding adjusted by partial charge-offs and net deferred loan origination costs or fees.

Interest on loans is accrued and credited to income based on the principal amount of loans outstanding. Residential real estate and home equity loans are generally placed on non-accrual status when reaching 90 days past due, or in process of foreclosure, or sooner if judged appropriate by management. Consumer loans are generally placed on non-accrual status when reaching 90 days or more past due, or sooner if judged appropriate by management. Secured consumer loans are written down to realizable value and unsecured consumer loans are charged-off upon reaching 120 days past due. Commercial real estate loans and commercial business loans that are 90 days or more past due are generally placed on non-accrual status, unless secured by sufficient cash or other assets immediately convertible to cash, and the loan is in the process of collection. Commercial real estate and commercial business loans may be placed on non-accrual status prior to the 90 days delinquency date if considered appropriate by management. When a loan has been placed on non-accrual status, previously accrued and uncollected interest is reversed against interest on loans. A loan can be returned to accrual status when principal is reasonably assured and the loan has performed for a period of time, generally six months.

Commercial real estate and commercial business loans are considered impaired when it becomes probable the Bank will not be able to collect all amounts due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status and collateral value. In considering loans for evaluation of impairment, management generally excludes smaller balance, homogeneous loans, residential mortgage loans, home equity loans, and all consumer loans, unless such loans were restructured in a troubled debt restructuring. These loans are collectively evaluated for risk of loss.

Loan origination and commitment fees and direct loan origination costs are deferred, and the net amount is amortized as an adjustment of the related loans yield, using the level yield method over the estimated lives of the related loans.

The Company s lending activities are principally conducted in downeast, midcoast and central Maine. The following table summarizes the composition of the loan portfolio as of September 30, 2013, and December 31, 2012:

LOAN PORTFOLIO SUMMARY

	September 30, 2013	December 31, 2012
Commercial real estate mortgages	$329,973	$324,493
Commercial and industrial	75,104	59,373
Commercial construction and land development	16,624	22,120
Agricultural and other loans to farmers	27,783	24,922
Total commercial loans	449,484	430,908
Residential real estate mortgages	316,395	297,103
Home equity loans	49,588	53,303
Other consumer loans	15,479	19,001
Total consumer loans	381,462	369,407
Tax exempt loans	15,263	15,244
Net deferred loan costs and fees	(276)	(555)
Total loans	845,933	815,004
Allowance for loan losses	(8,380)	(8,097)
Total loans net of allowance for loan losses	$837,553	$806,907

Loan Origination/Risk Management: The Company has certain lending policies and procedures in place that are designed to maximize loan income within an acceptable level of risk. The Company s board of directors reviews and approves these policies and procedures on a regular basis. A reporting system supplements the review process by providing management and the board with frequent reports related to loan production, loan quality, concentrations of credit, loan delinquencies and non-performing loans and potential problem loans. The Company seeks to diversify the loan portfolio as a means of managing risk associated with fluctuations in economic conditions.

Commercial Real Estate Mortgages: The Bank s commercial real estate mortgage loans are collateralized by liens on real estate, typically have variable interest rates (or five year or less fixed rates) and amortize over a 15 to 20 year period. These loans are underwritten primarily as cash flow loans and secondarily as loans secured by real estate. Payments on loans secured by such properties are largely dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Accordingly, repayment of these loans may be subject to adverse economic conditions to a greater extent than other types of loans. The Company seeks to minimize these risks in a variety of ways, including giving careful consideration to the property s operating history, future operating projections, current and projected occupancy, location and physical condition in connection with underwriting these loans. The underwriting analysis also includes credit verification, analysis of global cash flows, appraisals and a review of the financial condition of the borrower. Reflecting the Bank s business region, at September 30, 2013, approximately 32.0% of the commercial real estate mortgage portfolio was represented by loans to the

lodging industry. The Bank underwrites lodging industry loans as operating businesses, lending primarily to seasonal establishments with stabilized cash flows.

Commercial and Industrial Loans: Commercial and industrial loans are underwritten after evaluating and understanding the borrower s ability to operate profitability, and prudently expand its business. Commercial and industrial loans are primarily made in the Bank s market areas and are underwritten on the basis of the borrower s ability to service the debt from income. As a general practice, the Bank takes as collateral a lien on any available real estate, equipment or other assets owned by the borrower and obtains a personal guaranty of the borrower(s) or principal(s). Working capital loans are primarily collateralized by short-term assets whereas term loans are primarily collateralized by long-term assets. In general, commercial and industrial loans involve more credit risk than residential mortgage loans and commercial mortgage loans and, therefore, usually yield a higher return. The increased risk in commercial

and industrial loans is principally due to the type of collateral securing these loans. The increased risk also derives from the expectation that commercial and industrial loans generally will be serviced principally from the operations of the business, and, if not successful, these loans are primarily secured by tangible, non-real estate collateral. As a result of these additional complexities, variables and risks, commercial and industrial loans generally require more thorough underwriting and servicing than other types of loans.

Construction and Land Development Loans: The Company makes loans to finance the construction of residential and, to a lesser extent, non-residential properties. Construction loans generally are collateralized by first liens on real estate. The Company conducts periodic inspections, either directly or through an agent, prior to approval of periodic draws on these loans. Underwriting guidelines similar to those described immediately above are also used in the Company s construction lending activities. Construction loans involve additional risks attributable to the fact that loan funds are advanced against a project under construction and the project is of uncertain value prior to its completion. Because of uncertainties inherent in estimating construction costs, the market value of the completed project and the effects of governmental regulation on real property, it can be difficult to accurately evaluate the total funds required to complete a project and the related loan to value ratio. As a result of these uncertainties, construction lending often involves the disbursement of substantial funds with repayment dependent, in part, on the success of the ultimate project rather than the ability of a borrower or guarantor to repay the loan. In many cases the success of the project can also depend upon the financial support/strength of the sponsorship. If the Company is forced to foreclose on a project prior to completion, there is no assurance that the Company will be able to recover the entire unpaid portion of the loan. In addition, the Company may be required to fund additional amounts to complete a project and may have to hold the property for an indeterminate period of time. While the Company has underwriting procedures designed to identify what it believes to be acceptable levels of risks in construction lending, no assurance can be given that these procedures will prevent losses from the risks described above.

Residential Real Estate Mortgages: The Company originates first-lien, adjustable-rate and fixed-rate, one-to-four-family residential real estate loans for the construction, purchase or refinancing of residential property. These loans are principally collateralized by owner-occupied properties, and to a lesser extent second homes and vacation properties, and are amortized over 10 to 30 years. From time to time the Company will sell longer-term, low rate, residential mortgage loans to the Federal Home Loan Mortgage Corporation (FHLMC) with servicing rights retained. This practice allows the Company to better manage interest rate risk and liquidity risk. In an effort to manage risk of loss and strengthen secondary market liquidity opportunities, management typically uses secondary market underwriting, appraisal, and servicing guidelines for all loans, including those held in its portfolio. Loans on one-to-four-family residential real estate are mostly originated in amounts of no more than 80% of appraised value or have private mortgage insurance. Mortgage title insurance and hazard insurance are required. Construction loans have a unique risk, because they are secured by an incomplete dwelling. This risk is reduced through more stringent underwriting standards, including regular inspections throughout the construction period.

Home Equity Loans: The Company originates home equity lines of credit and second mortgage loans (loans which are secured by a junior lien position on one-to-four-family residential real estate). These loans carry a higher risk than first mortgage residential loans as they are in a second position relating to collateral. Risk is reduced through underwriting criteria, which include credit verification, appraisals and evaluations, a review of the borrower's financial condition,

and personal cash flows. A security interest, with title insurance when necessary, is taken in the underlying real estate.

Non-performing Loans: the following table sets forth information regarding non-accruing loans and accruing loans 90 days or more overdue at September 30, 2013, and December 31, 2012.

TOTAL NON-PERFORMING LOANS

	September 30, 2013	**December 31, 2012**
Commercial real estate mortgages	$1,317	$1,888
Commercial and industrial loans	553	818
Commercial construction and land development	1,845	2,359
Agricultural and other loans to farmers	67	664
Total commercial loans	3,782	5,729
Residential real estate mortgages	3,072	3,017
Home equity loans	863	814
Other consumer loans	54	72
Total consumer loans	3,989	3,903
Total non-accrual loans	7,771	9,632
Accruing loans contractually past due 90 days or more	2	235
Total non-performing loans	$7,773	$9,867
Allowance for loan losses to non-performing loans	107.8%	82.1%
Non-performing loans to total loans	0.92%	1.21%
Allowance to total loans	0.99%	0.99%

Troubled Debt Restructures: A Troubled Debt Restructure (TDR) results from a modification to a loan to a borrower who is experiencing financial difficulty in which the Bank grants a concession to the debtor that it would not otherwise consider but for the debtor s financial difficulties. Financial difficulty arises when a debtor is bankrupt or contractually past due, or is likely to become so, based upon its ability to pay. A concession represents an accommodation not generally available to other customers, which may include a below-market interest rate, deferment of principal payments, extension of maturity dates, etc. Such accommodations extended to customers who are not experiencing financial difficulty do not result in TDR classification.

Summary information pertaining to the TDRs that occurred during the three and nine months ended September 30, 2013 and 2012 follows:

	For the Three Months Ended September 30, 2013			For the Nine Months Ended September 30, 2013		
	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial real estate mortgages	0	$ ---	$ ---	1	$ 50	$ 47
Total commercial loans	0	---	---	1	50	$ 47
Residential real estate mortgages	1	166	166	1	166	166
Home equity loans	0	---	---	1	16	21
Other consumer loans	0	---	---	1	14	13
Total consumer loans	1	166	166	3	196	200
Total	1	$166	$166	4	$246	$247

	For the Three Months Ended September 30, 2012			For the Nine Months Ended September 30, 2012		
	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial and industrial loans	0	$ ---	$ ---	2	$ 67	$ 67
Total commercial loans	0		$ ---	2	67	67
Residential real estate mortgages	0	---	---	1	56	56
Home equity loans	0	---	---	0	---	---
Other consumer loans	0	---	---	0	---	---
Total consumer loans	0	---	$ ---	1	56	56
Total	0	$ ---	$ ---	3	$123	$123

The following table shows the Company s post-modification balance of TDRs listed by type of modification for the three and nine months ended September 30, 2013 and 2012:

	September 30, 2013		September 30, 2012	
	Three Months Ended	Nine Months Ended	Three Months Ended	Nine Months Ended
Extended maturity and adjusted interest rate	$ ---	$ 81	$---	$ 67
Temporary payment amount adjustment	---	---	---	56
Court ordered concession	166	166	---	---
Total	$166	$247	$---	$123

As of September 30, 2013, the Bank had seven real estate secured loans, four commercial and industrial loans, and one consumer loan, to nine relationships totaling $1,329 that were classified as TDRs. At September 30, 2013, six of these TDRs totaling $348 were classified as non-accrual, and none were past due 30 days or more and still accruing.

During the nine months ended September 30, 2013, two loans totaling $212 that had been modified as TDRs within the previous twelve months defaulted on the modified loan. During the nine months ended September 30, 2012, there were no defaults on loans that had been modified as TDRs within the previous twelve months. A default for purposes of this disclosure is a TDR in which the borrower is 90 days or more past due or results in foreclosure and repossession of the applicable collateral.

As of December 31, 2012, the Bank had four real estate secured and three commercial and industrial loans to four relationships totaling $934 that were classified as TDRs. At December 31, 2012, three TDR s totaling $114 were past due or classified as non-performing.

Past Due Loans: Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. The following tables set forth information regarding past due loans at September 30, 2013, and December 31, 2012. Amounts shown exclude deferred loan origination fees and costs.

September 30, 2013	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater	Total Past Due	Current	Total Loans	Non-Accrual	>90 Days Past Due and Accruing
Commercial real estate mortgages	$2,713	$ 667	$ 714	$ 4,094	$325,879	$329,973	$1,317	$ ---

Commercial and industrial	591	31	360	982	74,122	75,104	553	---
Commercial construction and land development	---	73	1,845	1,918	14,706	16,624	1,845	---
Agricultural and other loans to farmers	133	65	---	198	27,585	27,783	67	---
Residential real estate mortgages	995	1,270	1,498	3,763	312,632	316,395	3,072	---
Home equity	127	---	354	481	49,107	49,588	863	2
Other consumer loans	95	11	44	150	15,329	15,479	54	---
Tax exempt	---	---	---	---	15,263	15,263	---	---
Total	$4,654	$2,117	$4,815	$11,586	$834,623	$846,209	$7,771	$ 2

December 31, 2012	**30-59 Days Past Due**	**60-89 Days Past Due**	**90 Days or Greater**	**Total Past Due**	**Current**	**Total Loans**	**Non-Accrual**	**>90 Days Past Due and Accruing**
Commercial real estate mortgages	$ 228	$ 238	$1,041	$ 1,507	$322,986	$324,493	$1,888	$ ---
Commercial and industrial	22	61	990	1,073	58,300	59,373	818	216
Commercial construction and land development	---	---	2,359	2,359	19,761	22,120	2,359	---
Agricultural and other loans to farmers	203	12	490	705	24,217	24,922	664	---
Residential real estate mortgages	2,452	769	1,951	5,172	291,931	297,103	3,017	---
Home equity	219	---	274	493	52,810	53,303	814	---
Other consumer loans	75	97	77	249	18,752	19,001	72	19
Tax exempt	---	---	---	---	15,244	15,244	---	---
Total	$3,199	$1,177	$7,182	$11,558	$804,001	$815,559	$ 9,632	$235

Impaired Loans: Impaired loans are all commercial loans for which the Company believes it is probable that it will be unable to collect all amounts due according to the contractual terms of the loan agreement, as well as all loans modified into a TDR, if any. Allowances for losses on impaired loans are determined by the lower of the present value of the expected cash flows related to the loan, using the original contractual interest rate, and its recorded value, or in the case of collateral dependant loans, the lower of the fair value of the collateral, less costs to dispose, and the recorded amount of the loans. When foreclosure is probable, impairment is measured based on the fair value of the collateral less cost to sell.

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Details of impaired loans as of September 30, 2013 and December 31, 2012 follows:

	September 30, 2013			December 31, 2012		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance:						
Commercial real estate mortgages	$2,080	$2,159	$---	$2,662	$3,072	$ ---
Commercial and industrial	571	571	---	841	966	---
Commercial construction and land development	---	---	---	---	---	---
Agricultural and other loans to farmers	67	67	---	664	748	---
Residential real estate loans	424	454	---	77	77	---
Home equity loans	21	21	---	---	---	---
Other consumer	13	16	---	---	---	
Subtotal	$3,176	$3,288	$---	$4,244	$4,863	$ ---
With an allowance:						
Commercial real estate mortgages	$ ---	$ ---	$---	$ ---	$ ---	$ ---
Commercial and industrial	---	---	---	---	---	---
Commercial construction and land development	1,845	3,770	20	2,359	4,329	120
Agricultural and other loans to farmers	---	---	---	---	---	---
Residential real estate loans	---	---	---	---	---	---
Home equity loans	---	---	---	---	---	---
Other consumer	---	---	---	---	---	---
Subtotal	$1,845	$3,770	$20	$2,359	$4,329	$120
Total	$5,021	$7,058	$20	$6,603	$9,192	$120

Details of impaired loans for the three and nine months ended September 30, 2013 and 2012 follows:

	September 30, 2013				September 30, 2012			
	Three Months Ended		Nine Months Ended		Three Months Ended		Nine Months Ended	
	Average Recorded Investment	Interest Recorded	Average Recorded Investment	Interest Recorded	Average Recorded Investment	Interest Recorded	Average Recorded Investment	Interest Recorded
With no related allowance:								
Commercial real	$2,441	$17	$2,465	$49	$3,814	$47	$3,589	$ 96

estate mortgages								
Commercial and industrial	596	2	703	4	603	6	702	6
Commercial construction and land development	---	---	---	---	2,424	---	2,813	---
Agricultural and other loans to farmers	119	---	340	---	603	---	605	---
Residential real estate mortgages	457	---	350	---	135	1	138	3
Home equity loans	21	---	20	1	---	---	---	---
Other consumer	13	---	14	1	---	---	---	---
Subtotal	$3,647	$19	$3,892	$55	$7,579	$54	$7,847	$105
With an allowance:								
Commercial real estate mortgages	$ ---	$---	$ ---	$---	$ ---	$---	$ ---	$ ---
Commercial and industrial	---	---	---		100	---	100	---
Commercial construction and land development	1,965	---	2,075	---	593	---	704	---
Agricultural and other loans to farmers	---	---	---	---	---	---	---	---
Residential real estate mortgages	---	---	---	---	---	---	---	---
Home equity loans	---	---	---	---	---	---	---	---
Other consumer	---	---	---	---	---	---	---	---
Subtotal	$1,965	$---	$2,075	$---	$ 693	$---	$ 804	$ ---
Total	$5,612	$19	$5,967	$55	$8,272	$54	$8,651	$105

Credit Quality Indicators/Classified Loans: In monitoring the credit quality of the portfolio, management applies a credit quality indicator to all categories of commercial loans. These credit quality indicators range from one through nine, with a higher number correlating to increasing risk of loss. These ratings are used as inputs to the calculation of the allowance for loan losses. Loans rated one through five are consistent with the regulators Pass ratings, and are generally allocated a lesser percentage allocation in the allowance for loan losses than loans rated from six through nine.

Consistent with regulatory guidelines, the Bank provides for the classification of loans which are considered to be of lesser quality as substandard, doubtful, or loss. The Bank considers a loan substandard if it is inadequately protected by the current net worth and paying capacity of the borrower or of the collateral pledged, if any. Substandard loans have a well defined weakness that jeopardizes liquidation of the debt. Substandard loans include those loans where there is the distinct possibility of some loss of principal, if the deficiencies are not corrected.

Loans that the Bank classifies as doubtful have all of the weaknesses inherent in those loans that are classified as substandard but also have the added characteristic that the weaknesses present make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The possibility of loss is high but because of certain important and reasonably specific pending factors which may work to the advantage and strengthening of the loan, its classification as an estimated loss is deferred until its more exact status may be determined. Pending factors include proposed merger, acquisition, or liquidation procedures, capital injection, perfecting liens on additional collateral and refinancing plans. The entire amount of the loan might not be classified as doubtful when collection of a specific portion appears highly probable. Loans are generally not classified doubtful for an extended period of time (i.e., over a year).

Loans that the Bank classifies as loss are those considered uncollectible and of such little value that their continuance as an asset is not warranted and the uncollectible amounts are charged off. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be affected in the future. Losses are taken in the period in which they surface as uncollectible.

Loans that do not expose the Bank to risk sufficient to warrant classification in one of the aforementioned categories, but which possess some weaknesses, are designated special mention. A special mention loan has potential weaknesses that deserve management s close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the institution s credit position at some future date. This might include loans which the lending officer may be unable to supervise properly because of: lack of expertise, inadequate loan agreement, the poor condition of or lack of control over collateral, failure to obtain proper documentation or any other deviations from prudent lending practices. Economic or market conditions which may, in the future, affect the obligor may warrant special mention of the asset. Loans for which an adverse trend in the borrower's operations or an imbalanced position in the balance sheet which has not reached a point where the liquidation is jeopardized may be included in this classification. Special mention assets are not adversely classified and do not expose an institution to sufficient risks to warrant classification.

The following tables summarize the commercial loan portfolio as of September 30, 2013, and December 31, 2012, by credit quality indicator. Credit quality indicators are reassessed for each applicable commercial loan at least annually, or upon receipt and analysis of the borrower s financial statements, when applicable. Consumer loans, which principally consist of residential mortgage loans, are not rated, but are evaluated for credit quality after origination based on delinquency status (see past due loan aging table above).

September 30, 2013	Commercial real estate mortgages	Commercial and industrial	Commercial construction and land development	Agricultural and other loans to farmers	Total
Pass	$303,067	$59,395	$12,984	$27,216	$402,662
Other Assets Especially					
Mentioned	19,501	12,713	434	218	32,866
Substandard	7,405	2,996	3,206	349	13,956
Doubtful	---	---	---	---	---
Loss	---	---	---	---	---
Total	$329,973	$75,104	$16,624	$27,783	$449,484

December 31, 2012	Commercial real estate mortgages	Commercial and industrial	Commercial construction and land development	Argicultural and other loans to farmers	Total
Pass	$293,505	$46,872	$17,469	$23,806	$381,652
Other Assets Especially					
Mentioned	21,522	9,112	2,292	242	33,168
Substandard	9,466	3,389	2,359	874	16,088
Doubtful	---	---	---	---	---
Loss	---	---	---	---	---
Total	$324,493	$59,373	$22,120	$24,922	$430,908

Allowance for Loan Losses: The allowance for loan losses (the allowance) is a reserve established through a provision for loan losses (the provision) charged to expense, which represents management s best estimate of probable losses that have been incurred within the existing portfolio of loans. The allowance, in the judgment of management, is necessary to provide for estimated loan losses and risks inherent in the loan portfolio. The Company s allowance for loan loss methodology includes allowance allocations calculated in accordance with ASC Topic 310, Receivables and allowance allocations calculated in accordance with ASC Topic 450, Contingencies. Accordingly, the methodology is based on historical loss experience by type of credit and internal risk grade, specific homogeneous risk pools and specific loss allocations, with adjustments for current events and conditions. The Company s process for determining the appropriate level of the allowance is designed to account for credit deterioration as it occurs. The provision reflects loan quality trends, including the levels of and trends related to non-accrual loans, past due loans, potential problem loans, criticized loans and net charge-offs or recoveries, among other factors. The provision also reflects the totality of actions taken on all loans for a particular period. In other words, the amount of the provision reflects not only the necessary increases in the allowance related to newly identified criticized loans, but it also reflects actions taken related to other loans including, among other things, any necessary increases or decreases in required allowances for

specific loans or loan pools.

The level of the allowance reflects management s continuing evaluation of industry concentrations, specific credit risks, loan loss experience, current loan portfolio quality, present economic, political and regulatory conditions and unidentified losses inherent in the current loan portfolio. While management utilizes its best judgment and information available, the ultimate adequacy of the allowance is dependent upon a variety of factors beyond the Company s control, including, among other things, the performance of the Company s loan portfolio, the economy, changes in interest rates and the view of the regulatory authorities toward loan classifications.

The Company s allowance for loan losses consists of three principal elements: (i) specific valuation allowances determined in accordance with ASC Topic 310 based on probable losses on specific loans; (ii) historical valuation allowances determined in accordance with ASC Topic 450 based on historical loan loss experience for similar loans with similar characteristics and trends, adjusted, as necessary, to reflect the impact of current conditions; and (iii) general valuation allowances determined in accordance with ASC Topic 450 based on general economic conditions and other qualitative risk factors both internal and external to the Company.

The allowances established for probable losses on specific loans are based on a regular analysis and evaluation of problem loans. Loans are classified based on an internal credit risk grading process that evaluates, among other things: (i) the obligor s ability to repay; (ii) the underlying collateral, if any; and (iii) the economic environment and industry in which the borrower operates. This analysis is performed at the relationship level for all commercial loans. When a loan has a classification of seven or higher, the Company analyzes the loan to determine whether the loan is impaired and, if impaired, the need to specifically allocate a portion of the allowance to the loan. Specific valuation allowances are determined by analyzing the borrower s ability to repay amounts owed, collateral deficiencies, the relative risk grade of the loan and economic conditions affecting the borrower s industry, among other observable considerations.

Historical valuation allowances are calculated based on the historical loss experience of specific types of loans and the internal risk grade of such loans at the time they were charged-off. The Company calculates historical loss ratios for pools of similar loans with similar characteristics based on the proportion of actual charge-offs experienced to the total population of loans in the pool. The historical loss ratios are periodically updated based on actual charge-off experience. A historical valuation allowance is established for each pool of similar loans based upon the product of the historical loss ratio and the total dollar amount of the loans in the pool, net of any loans for which reserves are already established. The Company s pools of similar loans include similarly risk-graded groups of, commercial real estate loans, commercial and industrial loans, consumer real estate loans and consumer and other loans.

General valuation allowances are based on general economic conditions and other qualitative risk factors both internal and external to the Company. In general, such valuation allowances are determined by evaluating, among other things: (i) the experience, ability and effectiveness of the Bank s lending management and staff; (ii) the effectiveness of the Bank s loan policies, procedures and internal controls; (iii) changes in asset quality; (iv) changes in loan portfolio volume; (v) the composition and concentrations of credit; (vi) the impact of competition on loan structuring and pricing; (vii) the effectiveness of the internal loan review function; (viii) the impact of environmental risks on portfolio risks; and (ix) the impact of rising interest rates on portfolio risk. Management evaluates the degree of risk that each one of these components has on the quality of the loan portfolio on a quarterly basis. The results are then used to determine an appropriate general valuation allowance.

Loans identified as losses by management, external loan review and/or bank examiners, are charged-off. Furthermore, consumer loan accounts are charged-off based on regulatory requirements.

The following tables detail activity in the allowance for loan losses by portfolio segment for the three and nine months ended September 30, 2013, and 2012. The tables also provide details regarding the Company s recorded investment in loans related to each balance in the allowance for loan losses by portfolio segment and disaggregated on the basis of the Company s impairment methodology. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

Three Months Ended September 30, 2013	Commercial Real Estate	Commercial And Industrial	Commercial Construction and land development	Agricultural	Residential Real Estate	Consumer	Home Equity	Tax Exempt	Total
Beginning Balance	$ 4,435	$ 1,062	$ 355	$ 323	$ 1,421	$ 147	$ 270	$ 154	$ 8,167
Charged Off	(55)	(8)	---	---	(32)	(12)	---	---	(107)
Recoveries	102	12	---	24	5	7	---	---	150
Provision	223	146	19	(5)	(169)	3	(57)	10	170
Ending Balance	$ 4,705	$ 1,212	$ 374	$ 342	$ 1,225	$ 145	$ 213	$ 164	$ 8,380

Nine Months Ended September 30, 2013	Commercial Real Estate	Commercial and Industrial	Commercial Construction and land development	Agricultural	Residential Real Estate	Consumer	Home Equity	Tax Exempt	Total
Beginning Balance	$ 4,320	$ 1,026	$ 515	$ 303	$ 1,330	$ 207	$ 255	$ 141	$ 8,097
Charged Off	(139)	(186)	---	(81)	(319)	(80)	(34)	---	(839)
Recoveries	105	22	---	25	6	17	19	---	194
Provision	419	350	(141)	95	208	1	(27)	23	928
Ending Balance	$ 4,705	$ 1,212	$ 374	$ 342	$ 1,225	$ 145	$ 213	$ 164	$ 8,380
Amount for loans individually evaluated for impairment	$ ----	$ ---	$ 20	$ ---	$ ---	$ ---	$ ---	$ ---	$ 20
Amount for loans collectively evaluated for impairment	$ 4,705	$ 1,212	$ 354	$ 342	$ 1,225	$ 145	$ 213	$ 164	$ 8,360
Loans individually									

evaluated for impairment	$ 1,317	$ 553	$ 1,845	$ 67	$ ---	$ ---	$ ---	$ ---	$ 3,782
Loans collectively evaluated for impairment	$328,656	$74,551	$14,779	$27,716	$316,395	$ 15,479	$49,588	$15,263	$842,427

Three Months Ended September 30, 2012	**Commercial Real Estate**	**Commercial and Industrial**