

NORTHEAST BANCORP /ME/
Form 10-Q
November 14, 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 September 30, 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 October 31, 2012, the registrant had outstanding 9,412,972 shares of voting common stock, \$1.00 par value per share and 970,469 shares of non-voting common stock, \$1.00 par value per share.

Table of Contents

Part I. <u>Financial Information</u>	3
Item 1. <u>Financial Statements (unaudited)</u>	3
<u>Consolidated Balance Sheets September 30, 2012 and June 30, 2012</u>	3
<u>Consolidated Statements of Income Three Months Ended September 30, 2012 and 2011</u>	4
<u>Consolidated Statements of Comprehensive Income Three Months Ended September 30, 2012 and 2011</u>	5
<u>Consolidated Statements of Changes in Stockholders' Equity Three Months Ended September 30, 2012 and 2011</u>	6
<u>Consolidated Statements of Cash Flows Three Months Ended September 30, 2012 and 2011</u>	7
<u>Notes to Consolidated Financial Statements</u>	8
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	27
Item 3. <u>Quantitative and Qualitative Disclosure about Market Risk</u>	42
Item 4. <u>Controls and Procedures</u>	42
Part II. <u>Other Information</u>	42
Item 1. <u>Legal Proceedings</u>	42
Item 1A. <u>Risk Factors</u>	42
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	42
Item 3. <u>Defaults Upon Senior Securities</u>	42
Item 4. <u>Mine Safety Disclosures</u>	42
Item 5. <u>Other Information</u>	42
Item 6. <u>Exhibits</u>	43

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)

	September 30, 2012	June 30, 2012
Assets		
Cash and due from banks	\$ 3,341	\$ 2,538
Short-term investments	99,231	125,736
Total cash and cash equivalents	102,572	128,274
Available-for-sale securities, at fair value	137,069	133,264
Loans held for sale	12,986	9,882
Loans	375,193	356,254
Less: Allowance for loan losses	668	824
Loans, net	374,525	355,430
Premises and equipment, net	9,295	9,205
Repossessed collateral, net	2,645	834
Accrued interest receivable	1,751	1,840
Federal Home Loan Bank stock, at cost	4,602	4,602
Federal Reserve Bank stock, at cost	871	871
Intangible assets, net	4,222	4,487
Bank owned life insurance	14,418	14,295
Other assets	5,952	6,212
Total assets	\$ 670,908	\$ 669,196
Liabilities and Stockholders Equity		
Liabilities		
Deposits		
Demand	\$ 47,071	\$ 45,323
Savings and interest checking	87,010	90,204
Money market	48,896	45,024
Time deposits	272,798	241,637
Total deposits	455,775	422,188
Federal Home Loan Bank advances	43,331	43,450
Structured repurchase agreements	35,821	66,183
Short-term borrowings	484	1,209
Junior subordinated debentures issued to affiliated trusts	8,146	8,106
Capital lease obligation	1,869	1,911
Other liabilities	6,625	7,010

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

Total liabilities	552,051	550,057
Commitments and contingencies		
Stockholders' equity		
Preferred stock, \$1.00 par value, 1,000,000 shares authorized; 4,227 shares issued and outstanding at September 30, 2012 and June 30, 2012; liquidation preference of \$1,000 per share	4	4
Voting common stock, \$1.00 par value, 13,500,000 shares authorized; 9,412,972 and 9,307,127 issued and outstanding at September 30, 2012 and June 30, 2012, respectively	9,413	9,307
Non-voting common stock, \$1.00 par value, 1,500,000 shares authorized; 970,469 and 1,076,314 issued and outstanding at September 30, 2012 and June 30, 2012, respectively	970	1,076
Warrants to purchase common stock	406	406
Additional paid-in capital	96,215	96,080
Unearned restricted stock	(118)	(127)
Retained earnings	12,236	12,235
Accumulated other comprehensive (loss) income	(269)	158
Total stockholders' equity	118,857	119,139
Total liabilities and stockholders' equity	\$ 670,908	\$ 669,196

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)

	Three Months Ended September 30,	
	2012	2011
Interest and dividend income:		
Interest on loans	\$ 7,341	\$ 5,137
Interest on available-for-sale securities	347	639
Dividends on regulatory stock	6	12
Other interest and dividend income	83	47
Total interest and dividend income	7,777	5,835
Interest expense:		
Deposits	978	837
Federal Home Loan Bank advances	259	258
Structured repurchase agreements	219	248
Short-term borrowings	6	5
Junior subordinated debentures issued to affiliated trusts	193	183
Obligation under capital lease agreements	24	26
Total interest expense	1,679	1,557
Net interest and dividend income before provision for loan losses	6,098	4,278
Provision for loan losses	228	400
Net interest and dividend income after provision for loan losses	5,870	3,878
Noninterest income:		
Fees for other services to customers	310	340
Net securities gains (losses)	792	(53)
Gain on sales of loans held for sale	756	656
Gain (loss) recognized on repossessed collateral, net	451	(77)
Investment commissions	675	687
Bank-owned life insurance income	123	127
Other noninterest income	43	44
Total noninterest income	3,150	1,724
Noninterest expense:		
Salaries and employee benefits	4,057	3,717
Occupancy and equipment expense	1,078	849
Professional fees	423	415
Data processing fees	268	274
Marketing expense	187	73
FDIC insurance premiums	117	117

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

Intangible asset amortization	265	336
Other noninterest expense	1,107	818
Total noninterest expense	7,502	6,599
Income (loss) from continuing operations before income tax expense (benefit)	1,518	(997)
Income tax expense (benefit)	484	(403)
Net income (loss) from continuing operations	\$ 1,034	\$ (594)
Discontinued operations:		
Income from discontinued operations	\$ 0	\$ 186
Gain on sale of discontinued operations	0	1,529
Income tax expense	0	592
Net income from discontinued operations	0	1,123
Net income	\$ 1,034	\$ 529
Net income available to common stockholders	\$ 936	\$ 431
Weighted-average shares outstanding:		
Basic	10,383,441	3,494,498
Diluted	10,383,441	3,513,545
Earnings per common share:		
Basic:		
Income (loss) from continuing operations	\$ 0.09	\$ (0.13)
Income from discontinued operations	0.00	0.25
Net income	\$ 0.09	\$ 0.12
Diluted:		
Income (loss) from continuing operations	\$ 0.09	\$ (0.13)
Income from discontinued operations	0.00	0.25
Net income	\$ 0.09	\$ 0.12
Cash dividends declared per common share	\$ 0.09	\$ 0.09

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)

	Three Months Ended September 30,	
	2012	2011
Net income	\$ 1,034	\$ 529
Other comprehensive (loss) income, before tax:		
Available-for-sale securities:		
Change in net unrealized gain or loss on available-for-sale securities	157	1,635
Reclassification adjustment for net (gains) losses included in net income	(792)	53
Total available-for-sale securities	(635)	1,688
Derivatives and hedging activities:		
Change in accumulated loss on effective cash flow hedges	6	(199)
Reclassification adjustments for net gains included in net income	(18)	(22)
Total derivatives and hedging activities	(12)	(221)
Total other comprehensive (loss) income, before tax	(647)	1,467
Income tax (benefit) expense related to other comprehensive (loss) income	(220)	498
Other comprehensive (loss) income, net of tax	(427)	969
Comprehensive income	\$ 607	\$ 1,498

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**

(Unaudited)

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

	Preferred Stock		Voting Common Stock		Non-voting Common Stock		Warrants to Purchase Common Stock	Additional Paid-in Capital	Unearned Restricted Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
	Shares	Amount	Shares	Amount	Shares	Amount						
Balance at June 30, 2011	4,227	\$ 4	3,312,173	\$ 3,312	195,351	\$ 195	\$ 406	\$ 49,700	\$ (163)	\$ 11,726	\$ (226)	\$ 64,954
Net income	0	0	0	0	0	0	0	0	0	529	0	529
Other comprehensive loss, net of tax	0	0	0	0	0	0	0	0	0	0	969	969
Dividends on preferred stock	0	0	0	0	0	0	0	0	0	(53)	0	(53)
Dividends on common stock at \$0.09 per share	0	0	0	0	0	0	0	0	0	(316)	0	(316)
Stock-based compensation	0	0	0	0	0	0	0	96	9	0	0	105
Accretion of preferred stock	0	0	0	0	0	0	0	45	0	(45)	0	0
Balance at September 30, 2011	4,227	\$ 4	3,312,173	\$ 3,312	195,351	\$ 195	\$ 406	\$ 49,841	\$ (154)	\$ 11,841	\$ 743	\$ 66,188
Balance at June 30, 2012	4,227	\$ 4	9,307,127	\$ 9,307	1,076,314	\$ 1,076	\$ 406	\$ 96,080	\$ (127)	\$ 12,235	\$ 158	\$ 119,139
Net income	0	0	0	0	0	0	0	0	0	1,034	0	1,034
Other comprehensive loss, net of tax	0	0	0	0	0	0	0	0	0	0	(427)	(427)
Conversion of non-voting common stock to voting common stock	0	0	105,845	106	(105,845)	(106)	0	0	0	0	0	0
Dividends on preferred stock	0	0	0	0	0	0	0	0	0	(53)	0	(53)
Dividends on common stock at \$0.09 per share	0	0	0	0	0	0	0	0	0	(935)	0	(935)
Stock-based compensation	0	0	0	0	0	0	0	90	9	0	0	99
Accretion of preferred stock	0	0	0	0	0	0	0	45	0	(45)	0	0

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

Balance at September 30, 2012	4,227	\$ 4	9,412,972	\$ 9,413	970,469	\$ 970	\$ 406	\$ 96,215	\$ (118)	\$ 12,236	\$ (269)	\$ 118,857
-------------------------------------	-------	------	-----------	----------	---------	--------	--------	-----------	----------	-----------	----------	------------

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)

	Three Months Ended September 30,	
	2012	2011
Operating activities:		
Net income	\$ 1,034	\$ 529
Adjustments to reconcile net income to net cash used in operating activities:		
Provision for loan losses	228	400
(Gain) loss on sale or impairment of repossessed collateral, net	(451)	77
Accretion of fair value adjustments on loans, net	(1,692)	(388)
Accretion of fair value adjustments on deposits, net	(275)	(373)
Accretion of fair value adjustments on borrowings, net	(441)	(544)
Originations of loans held for sale	(38,204)	(28,571)
Net proceeds from sales of loans held for sale	35,856	27,998
Gain on sales of loans held for sale	(756)	(656)
Amortization of intangible assets	265	406
Bank-owned life insurance income, net	(123)	(127)
Depreciation of premises and equipment	424	304
Loss on sale of premises and equipment	0	25
Net (gain) loss on sale of available-for-sale securities	(792)	53
Stock-based compensation	99	105
Gain on sale of assets of insurance division	0	(1,529)
Amortization of securities, net	420	373
Changes in other assets and liabilities:		
Interest receivable	89	(322)
Decrease in prepaid FDIC assessment	108	(116)
Other assets and liabilities	(25)	(736)
Net cash used in operating activities	(4,236)	(3,092)
Investing activities:		
Proceeds from sales of available-for-sale securities	159,579	606
Purchases of available-for-sale securities	(167,294)	0
Proceeds from maturities and principal payments on available-for-sale securities	3,647	6,390
Loan purchases	(31,023)	(11,428)
Loan originations and principal collections, net	11,437	5,006
Purchases of premises and equipment	(514)	(611)
Proceeds from sales of repossessed collateral	595	329
Proceeds from sale of assets of insurance division	0	9,726
Net cash (used in) provided by investing activities	(23,573)	10,018
Financing activities:		
Net increase (decrease) in deposits	33,862	(7,012)
Net decrease in short-term borrowings	(725)	(1,506)
Dividends paid on preferred stock	(53)	(53)
Dividends paid on common stock	(935)	(316)
Repayment of structured repurchase agreements	(30,000)	0

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

Repayment of other borrowings	0	(2,132)
Repayment of capital lease obligation	(42)	(40)
Net cash provided by (used in) financing activities	2,107	(11,059)
Net decrease in cash and cash equivalents	(25,702)	(4,133)
Cash and cash equivalents, beginning of period	128,274	89,931
Cash and cash equivalents, end of period	\$ 102,572	\$ 79,798
Supplemental schedule of noncash investing and financing activities:		
Transfers from loans to repossessed collateral	\$ 3,010	\$ 180
Transfers from repossessed collateral to loans	1,055	0

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

September 30, 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 September 30, 2012, the results of operations for the three months ended September 30, 2012 and 2011, comprehensive income for the three months ended September 30, 2012 and 2011, the changes in stockholders equity for the for the three months ended September 30, 2012 and 2011, and the cash flows for the for the three months ended September 30, 2012 and 2011. Operating results for the three months ended September 30, 2012 are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2013 (Fiscal 2013). For further information, refer to the audited consolidated financial statements and notes thereto for the fiscal year ended June 30, 2012 (Fiscal 2012) included in the Company s Annual Report on Form 10-K filed with the Securities and Exchange Commission.

2. Recent Accounting Pronouncements

In December 2011, the Financial Accounting Standards Board (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 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 (ii) 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.

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 effective for interim and annual periods beginning after December 15, 2011. The adoption of this guidance did not have a material impact on the consolidated financial statements.

In December 2011, the FASB issued ASU No. 2011-12, *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 for interim and annual periods beginning after December 15, 2011. The adoption of this guidance did not have a material impact on the consolidated financial statements.

Table of Contents**3. Securities Available-for-Sale**

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

	September 30, 2012		June 30, 2012	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(Dollars in thousands)			
U.S. Government agency securities	\$ 45,690	\$ 45,750	\$ 45,824	\$ 45,808
Agency mortgage-backed securities	91,389	91,319	86,816	87,456
	\$ 137,079	\$ 137,069	\$ 132,640	\$ 133,264

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

	September 30, 2012		June 30, 2012	
	Gross Unrealized Gains	Gross Unrealized Losses	Gross Unrealized Gains	Gross Unrealized Losses
	(Dollars in thousands)			
U.S. Government agency securities	\$ 60	\$ 0	\$ 5	\$ 21
Agency mortgage-backed securities	0	70	640	0
	\$ 60	\$ 70	\$ 645	\$ 21

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.

	Three Months Ended September 30,	
	2012	2011
	(Dollars in thousands)	
Gross realized gains	\$ 831	\$ 14
Gross realized losses	(39)	(67)
Net security gains (losses)	\$ 792	\$ (53)

At September 30, 2012, investment securities with a fair value of approximately \$54.9 million were pledged as collateral to secure outstanding borrowings.

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		September 30, 2012 More than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(Dollars in thousands)					
U.S. Government agency securities	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0

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

Agency mortgage-backed securities	19,776	70	0	0	19,776	70
	\$ 19,776	\$ 70	\$ 0	\$ 0	\$ 19,776	\$ 70

	Less than 12 Months		June 30, 2012 More than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Government agency securities	\$ 36,585	\$ 21	\$ 0	\$ 0	\$ 36,585	\$ 21
Agency mortgage-backed securities	0	0	0	0	0	0
	\$ 36,585	\$ 21	\$ 0	\$ 0	\$ 36,585	\$ 21

There were no other-than-temporary impairment losses on securities during the three months ended September 30, 2012 or 2011.

At September 30, 2012, the Company did not have any securities in a continuous loss position for greater than twelve months. At September 30, 2012, all of the Company's available-for-sale securities were issued or guaranteed by either government agencies or government-sponsored enterprises. The decline in fair value of the Company's available-for-sale securities at September 30, 2012 is attributable to changes in interest rates.

Table of Contents

Management of the Company, in addition to considering current trends and economic conditions that may affect the quality of individual securities within the Company's investment portfolio, also considers the Company's ability and intent to hold such securities to maturity or recovery of cost. Management does not believe any of the Company's available-for-sale securities are other-than-temporarily impaired at September 30, 2012.

The amortized cost and fair values of available-for-sale debt securities by contractual maturity are shown below as of September 30, 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
	(Dollars in thousands)	
Due within one year	\$ 3,080	\$ 3,086
Due after one year through five years	42,610	42,664
Due after five years through ten years	0	0
Due after ten years	0	0
	45,690	45,750
Mortgage-backed securities	91,389	91,319
	\$ 137,079	\$ 137,069

Table of Contents**4. Loans, Allowance for Loan Losses and Credit Quality**

Loans are carried at the principal amounts outstanding, or amortized acquired fair value in the case of acquired loans, adjusted by partial charge-offs and net of deferred loan costs or fees. Loan fees and certain direct origination costs are deferred and amortized into interest income over the expected term of the loan using the level-yield method. When a loan is paid off, the unamortized portion is recognized in interest income. Interest income is accrued based upon the daily principal amount outstanding except for loans on nonaccrual status.

All loans purchased by the Company in the secondary market by its Loan Acquisition and Servicing Group (LASG) are accounted for under ASC 310-30, *Receivables - Loans and Debt Securities Acquired with Deteriorated Credit Quality* (ASC 310-30). 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, 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.

Loans are generally placed on nonaccrual status when they are past due 90 days as to either principal or interest, or when in management's judgment the collectability of interest or principal of the loan has been significantly impaired. Loans accounted for under ASC 310-30 are placed on nonaccrual when it is not possible to reach a reasonable expectation of the timing and amount of cash flows to be collected on the loan. When a loan has been placed on nonaccrual status, previously accrued and uncollected interest is reversed against interest on loans. A loan is returned to accrual status when collectability of principal is reasonably assured and the loan has performed for a reasonable period of time.

In cases where a borrower experiences financial difficulties and the Company makes certain concessionary modifications to contractual terms, the loan is classified as a troubled debt restructuring (TDR). Concessionary modifications may include adjustments to interest rates, extensions of maturity, and other actions intended to minimize economic loss and avoid foreclosure or repossession of collateral. Nonaccrual loans that are restructured generally remain on nonaccrual for a minimum period of six months to demonstrate that the borrower can meet the restructured terms. If the restructured loan is on accrual status prior to being modified, it is reviewed to determine if the modified loan should remain on accrual status. If the borrower's ability to meet the revised payment schedule is not reasonably assured, the loan is classified as a nonaccrual loan. Loans classified as TDRs remain classified as such until the loan is paid off.

The composition of the Company's loan portfolio follows.

	September 30, 2012			June 30, 2012		
	Originated	Purchased	Total	Originated	Purchased	Total
	(Dollars in thousands)					
Residential real estate	\$ 89,545	\$ 3,655	\$ 93,200	\$ 90,944	\$ 3,931	\$ 94,875
Home equity	40,576	0	40,576	42,696	0	42,696
Commercial real estate	102,088	103,787	205,875	100,196	80,539	180,735
Construction	508	0	508	1,187	0	1,187
Commercial business	19,201	0	19,201	19,612	0	19,612
Consumer	15,833	0	15,833	17,149	0	17,149
Total loans	\$ 267,751	\$ 107,442	\$ 375,193	\$ 271,784	\$ 84,470	\$ 356,254

Table of Contents

Purchased credit impaired (PCI) loans 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 purchased by the LASG during the three months ended September 30, 2012 and 2011.

	PCI Loans Acquired Three Months Ended September 30, 2012 2011 (Dollars in thousands)	
Contractually required payments receivable	\$ 12,980	\$ 9,461
Nonaccretable difference	(4,113)	(2,597)
Cash flows expected to be collected	8,867	6,864
Accretable yield	(5,764)	(3,027)
Fair value of loans acquired	\$ 3,103	\$ 3,837

	PCI Loans: Activity in Accretable Yield Three Months Ended September 30, 2012 2011 (Dollars in thousands)	
Beginning balance	\$ 7,169	\$ 0
Accretion	(601)	(76)
Acquisitions	5,764	3,027
Reclassifications from nonaccretable difference	132	0
Disposals and transfers	(2,951)	0
End balance	\$ 9,513	\$ 2,951

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

	September 30, 2012	June 30, 2012
	(Dollars in thousands)	
Unpaid principal balance	\$ 24,423	\$ 21,359
Carrying amount	\$ 13,974	\$ 13,866

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 consists of general, specific, and unallocated reserves and reflects management's estimate of probable loan losses inherent in the loan portfolio at the balance sheet date. Management uses a consistent and systematic process and methodology to evaluate the adequacy of the allowance for loan losses on a quarterly basis. The calculation of the allowance for loan losses is segregated by portfolio segments, which include: commercial real estate, commercial business, consumer, residential real estate, and purchased loans. Risk characteristics relevant to each portfolio segment are as follows:

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

Residential real estate: The Company generally does not originate loans with a loan-to-value ratio greater than 80 percent and does not originate subprime loans. All loans in this segment are collateralized by residential real estate and repayment is primarily 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. Continued weakness in national or regional economic conditions, and a corresponding weakness in consumer or business spending, will have an adverse effect on the credit quality of this segment.

Table of Contents

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. Loans in this segment acquired with specific material credit deterioration since origination are identified as purchased credit-impaired. Repayment of loans in this segment 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 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 general component of the allowance for loan losses is based on historical loss experience adjusted for qualitative factors stratified by loan segment. The Company does not weight periods used in that analysis to determine the average loss rate in each portfolio segment. This historical loss factor is adjusted for the following qualitative factors:

Levels and trends in delinquencies

Trends in the volume and nature of loans

Trends in credit terms and policies, including underwriting standards, procedures and practices, and the experience and ability of lending management and staff

Trends in portfolio concentration

National and local economic trends and conditions.

Effects of changes or trends in internal risk ratings

Other effects resulting from trends in the valuation of underlying collateral

There were no changes in the Company's policies or methodology pertaining to the general component of the allowance for loan losses during the three months ended September 30, 2012.

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 qualitative factors. 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 portfolio 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.

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

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, discounted at the loan's effective rate assumed at acquisition. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due.

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

Total \$ 133,776 \$ 206,383 \$ 19,201 \$ 15,833 \$ 375,193

	June 30, 2012					Total
	Residential	Commercial	Commercial	Consumer		
	Real Estate	Real Estate	Business			
(Dollars in thousands)						
Allowance for loan losses:						
Individually evaluated	\$ 3	\$ 41	\$ 284	\$ 0		\$ 328
Collectively evaluated	211	52	8	225		496
Purchased ⁽¹⁾	0	0	0	0		0
Total	\$ 214	\$ 93	\$ 292	\$ 225		\$ 824
Loans:						
Individually evaluated	\$ 399	\$ 3,112	\$ 1,127	\$ 0		\$ 4,638
Collectively evaluated	133,241	99,326	18,485	17,149		268,201
Purchased ⁽¹⁾⁽²⁾	3,931	79,484	0	0		83,415
Total	\$ 137,571	\$ 181,922	\$ 19,612	\$ 17,149		\$ 356,254

- (1) Loans in this category are evaluated for impaired under ASC 310-30. Post acquisition, the effect of a decline in expected cash flows is recorded through the allowance for loan losses as a specific allocation.
- (2) At June 30, 2012, one purchased loan totaling \$1.1 million was nonperforming and considered collateral dependent for purposes of evaluation under ASC 310-10.

Table of Contents

The following table sets forth information regarding impaired loans. Interest income recognized includes interest received or accrued based on loan principal and contractual interest rates. Loans accounted for under ASC 310-30 that have performed based on cash flow and accretable yield expectations determined at date of acquisition are not considered impaired assets and have been excluded from the tables below.

	At September 30, 2012			For the Three Months Ended September 30, 2012	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
(Dollars in thousands)					
Impaired loans without a valuation allowance:					
Originated:					
Residential real estate	\$ 811	\$ 1,029	\$ 0	\$ 552	\$ 5
Consumer	45	48	0	22	1
Commercial real estate	1,249	1,443	0	1,366	20
Commercial business	163	337	0	270	3
Purchased:					
Commercial real estate	0	0	0	528	0
Residential real estate	0	0	0	0	0
Total	2,268	2,857	0	2,738	29
Impaired loans with a valuation allowance:					
Originated:					
Residential real estate	735	722	59	420	9
Consumer	75	77	31	37	1
Commercial real estate	526	517	43	550	6
Commercial business	47	82	47	398	0
Purchased:					
Commercial real estate	0	0	0	0	0
Residential real estate	0	0	0	0	0
Total	1,383	1,398	180	1,405	16
Total impaired loans	\$ 3,651	\$ 4,255	\$ 180	\$ 4,143	\$ 45

	At June 30, 2012		
	Recorded Investment	Unpaid Principal Balance	Related Allowance
(Dollars in thousands)			
Impaired loans without a valuation allowance:			
Originated:			
Residential real estate	\$ 293	\$ 483	\$ 0
Consumer	0	0	0
Commercial real estate	1,482	1,738	0
Commercial business	377	692	0
Purchased:			
Commercial real estate	1,055	1,462	0
Residential real estate	0	0	0
Total	3,207	4,375	0

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

Impaired loans with a valuation allowance:			
Originated:			
Residential real estate	106	103	3
Consumer	0	0	0
Commercial real estate	575	565	41
Commercial business	750	817	284
Purchased:			
Commercial real estate	0	0	0
Residential real estate	0	0	0
 Total	 1,431	 1,485	 328
 Total impaired loans	 \$ 4,638	 \$ 5,860	 \$ 328

Table of Contents

	For the Three Months Ended September 30, 2011	
	Average Recorded Investment	Interest Income Recognized
	(Dollars in thousands)	
Originated:		
Residential real estate	\$ 49	\$ 1
Consumer	0	0
Commercial real estate	1,846	21
Commercial business	1,090	4
Purchased:		
Commercial real estate	0	0
Residential real estate	0	0
	\$ 2,985	\$ 26

Credit Quality

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

Loans rated 1 - 6: Loans in these categories are considered pass rated loans. Loans in categories 1-5 are considered to have low to average risk. Loans rated 6 are considered marginally acceptable business credits and have more than 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. Loans classified as substandard are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified have a well defined weakness or weaknesses that jeopardize the orderly liquidation of the debt.

Loans rated 9: Loans in this category are considered doubtful. Loans classified as doubtful have all the weaknesses inherent in one graded 8 with the added characteristic that the weaknesses make the collection or liquidation in full, on the basis of currently existing facts, conditions and values, 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.

	September 30, 2012			
	Originated Portfolio			
	Commercial Real Estate	Construction	Commercial Business	Purchased Portfolio
	(Dollars in thousands)			
Loans rated 1- 6	\$ 98,878	\$ 508	\$ 18,686	\$ 106,124
Loans rated 7	1,872	0	247	207
Loans rated 8	1,338	0	268	1,111
Loans rated 9	0	0	0	0
Loans rated 10	0	0	0	0
	\$ 102,088	\$ 508	\$ 19,201	\$ 107,442

	June 30, 2012			
	Originated Portfolio			
	Commercial Real Estate	Construction	Commercial Business	Purchased Portfolio
	(Dollars in thousands)			
Loans rated 1- 6	\$ 96,963	\$ 1,187	\$ 18,223	\$ 83,415
Loans rated 7	1,886	0	250	1,055
Loans rated 8	1,347	0	1,139	0
Loans rated 9	0	0	0	0
Loans rated 10	0	0	0	0
	\$ 100,196	\$ 1,187	\$ 19,612	\$ 84,470

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

	September 30, 2012							
	30-59 Days	60-89 Days	Past Due	Past Due	Total Past Due	Total Current	Total Loans	Non-Accrual Loans
			90 Days or More-Still Accruing	90 Days or More-Nonaccrual				
	(Dollars in thousands)							
Originated portfolio:								
Residential real estate	\$ 151	\$ 343	\$ 0	\$ 2,869	\$ 3,363	\$ 86,182	\$ 89,545	\$ 3,184
Home equity	55	86	0	212	353	40,223	40,576	289
Commercial real estate	420	70	0	310	800	101,293	102,088	626
Construction	0	0	0	0	0	508	508	0
Commercial business	7	6	0	47	60	19,071	19,201	133
Consumer	257	117	0	246	620	15,278	15,833	181
Total originated portfolio	890	622	0	3,684	5,196	262,555	267,751	4,413
Purchased portfolio:								
Residential real estate	0	0	0	0	0	3,655	3,655	0

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

Commercial real estate	0	310	0	666	976	102,811	103,787	666
Total purchased portfolio	0	310	0	666	976	106,466	107,442	666
Total loans	\$ 890	\$ 932	\$ 0	\$ 4,350	\$ 6,172	\$ 369,021	\$ 375,193	\$ 5,079

	June 30, 2012							
	30-59 Days	60-89 Days	Past Due	Past Due	Total Past Due	Total Current	Total Loans	Non- Accrual Loans
			90 Days or More-Still Accruing	90 Days or More- Nonaccrual				
(Dollars in thousands)								
Originated portfolio:								
Residential real estate	\$ 261	\$ 183	\$ 0	\$ 2,907	\$ 3,351	\$ 87,593	\$ 90,944	\$ 3,090
Home equity	16	160	0	136	312	42,384	42,696	220
Commercial real estate	0	208	0	417	625	99,571	100,196	417
Construction	0	0	0	0	0	1,187	1,187	0
Commercial business	0	107	0	901	1,008	18,604	19,612	1,008
Consumer	259	137	0	206	602	16,547	17,149	324
Total originated portfolio	536	795	0	4,567	5,898	265,886	271,784	5,059
Purchased portfolio:								
Residential real estate	0	0	0	0	0	3,931	3,931	0
Commercial real estate	0	0	0	1,055	1,055	79,484	80,539	1,055
Total purchased portfolio	0	0	0	1,055	1,055	83,415	84,470	1,055
Total loans	\$ 536	\$ 795	\$ 0	\$ 5,622	\$ 6,953	\$ 349,301	\$ 356,254	\$ 6,114

Table of Contents

The following table shows loans modified in a TDR during the three months ended September 30, 2012 and the change in the recorded investment subsequent to the modifications occurring. Concessions occurring during the period included a combination of interest rate reductions and maturity extensions. There was no forgiveness of principal related to loans modified in a TDR during the period.

	Number of Contracts	Recorded Investment Pre-Modification (Dollars in thousands)	Recorded Investment Post-Modification
Originated portfolio:			
Residential real estate	1	\$ 222	\$ 222
Home equity	0	0	0
Commercial real estate	0	0	0
Construction	0	0	0
Commercial business	0	0	0
Consumer	0	0	0
Total originated portfolio	1	222	222
Purchased portfolio:			
Residential real estate	0	0	0
Commercial real estate	0	0	0
Total purchased portfolio	0	0	0
Total	1	\$ 222	\$ 222

Further, during the quarter ended September 30, 2012, the Company identified approximately \$1.1 million of residential and consumer loans for which the borrower's obligation had been discharged in bankruptcy in a prior period. Under recent regulatory guidance, these loans are required to be classified as TDRs and are considered collateral dependent impaired loans.

The Company considers TDRs past due 90 days or more to be in payment default. There were no payment defaults of loans previously modified in a TDR during the three months ended September 30, 2012. As of September 30, 2012, there were no further commitments to lend associated with loans modified in a TDR.

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

	September 30, 2012			June 30, 2012		Total
	On Accrual Status	On Nonaccrual Status	Total	On Accrual Status	On Nonaccrual Status	
Originated portfolio:						
Residential real estate	\$ 312	\$ 214	\$ 526	\$ 92	\$ 139	\$ 231
Home equity	34	49	83	20	0	20
Commercial real estate	1,059	0	1,059	1,053	0	1,053
Construction	0	0	0	0	0	0
Commercial business	0	0	0	0	0	0
Consumer	605	348	953	0	0	0
Total originated portfolio	2,010	611	2,621	1,165	139	1,304
Purchased portfolio:						
Residential real estate	0	0	0	0	0	0
Commercial real estate	0	0	0	0	0	0

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

Total purchased portfolio	0	0	0	0	0	0
Total	\$ 2,010	\$ 611	\$ 2,621	\$ 1,165	\$ 139	\$ 1,304

Table of Contents**5. Stock-Based Compensation**

In December 2010, the Company adopted the Northeast Bancorp 2010 Stock Option and Incentive Plan (the Plan), which provides for awards of stock-based compensation (stock options, stock appreciation rights, restricted stock awards, cash-based awards and other equity-based incentive awards). The maximum number of authorized shares of stock that may be issued under the plan is 810,054.

A summary of the stock option activity for the three months ended September 30, 2012 follows.

	Shares	Weighted Average Exercise Price
Outstanding at beginning of period	796,049	\$ 13.98
Granted	0	0.00
Exercised	0	0.00
Forfeited	(7,500)	12.63
Outstanding at end of period	788,549	14.00
Exercisable	54,175	\$ 14.11

The following table summarizes information about stock options outstanding at September 30, 2012.

Weighted Average Exercise Price	Options Outstanding			Weighted Average Exercise Price	Options Exercisable		
	Number	Weighted Average Remaining Life	Aggregate Intrinsic Value		Number	Weighted Average Remaining Life	Aggregate Intrinsic Value
\$ 12.63	32,500	9.3 years	\$ 0	\$ 12.63	0	9.3 years	\$ 0
13.93	594,039	8.3 years	0	13.93	37,975	8.3 years	0
14.52	162,010	8.3 years	0	14.52	16,200	8.3 years	0
14.00	788,549	8.3 years	0	14.11	54,175	8.3 years	0

At September 30, 2012, all unvested stock options outstanding are expected to vest.

On December 29, 2010, the Company granted a restricted stock award of 13,026 shares of the Company's common 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 was 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 September 30, 2012, no restricted common shares were vested. All restricted common shares are expected to vest.

At September 30, 2012, the Company has accrued a liability of \$48 thousand representing the maximum cash payment for performance-based stock appreciation rights (SARs) granted in the fiscal year ended June 30, 2011. 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.

2013	Fiscal Years Ending June 30,			Total
	2014	2015	2016 2017	
(Dollars in thousands)				

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

Stock options	\$ 309	\$ 399	\$ 380	\$ 250	\$ 64	\$ 1,402
Restricted stock	27	36	36	18	0	117
	\$ 336	\$ 435	\$ 416	\$ 268	\$ 64	\$ 1,519

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 recorded during the quarter ended September 30, 2011 (dollars in thousands).

Sale proceeds	\$ 9,726
Less:	
Customer lists and other intangible assets, net	7,379
Fixed assets, net of accumulated depreciation	157
Severance and other direct expenses	661
 Pre-tax gain recognized	 \$ 1,529

Subsequent to the quarter ended September 30, 2011, the Company recognized additional gain on sale of discontinued operations of \$37 thousand representing contingent proceeds received, net of expenses. The total gain on sale of discontinued operations was \$1.6 million for Fiscal 2012.

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. In connection with the transaction, the Company repaid borrowings associated with NBIG totaling \$2.1 million.

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:

	Three months Ended September 30, 2012 2011 (Dollars in thousands, except share and per share data)	
Net income	\$ 1,034	\$ 529
Preferred stock dividends	(53)	(53)
Accretion of preferred stock	(45)	(45)
Net income (loss) available to common shareholders	\$ 936	\$ 431
Weighted average shares used in calculation of basic earnings per share	10,383,441	3,494,498
Incremental shares from assumed exercise of dilutive securities	0	19,047
Weighted average shares used in calculation of diluted earnings per share	10,383,441	3,513,545
Earnings per common share:		
Income (loss) from continuing operations	\$ 0.09	\$ (0.13)
Income from discontinued operations	0.00	0.25
Earnings per common share	\$ 0.09	\$ 0.12
Diluted earnings per common share:		
Income (loss) from continuing operations	\$ 0.09	\$ (0.13)
Income from discontinued operations	0.00	0.25
Diluted earnings per common share	\$ 0.09	\$ 0.12

Anti-dilutive options and warrants excluded from the calculation of dilutive earnings per share follow.

	Three Months Ended September 30, 2012 2011	
Stock options	788,549	756,049
Warrants	67,958	0
	856,507	756,049

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

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

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 significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

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.

Table of Contents

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

Assets and Liabilities Measured at Fair Value on a Recurring Basis:

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.

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.

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis:

Impaired Loans Valuations of impaired loans measured at fair value are determined by a review of collateral values. Certain inputs used in appraisals are not always observable, and therefore impaired loans are generally categorized as Level 3 within the fair value hierarchy.

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.

Fair Value of other Financial Instruments:

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

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.

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

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.

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.

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

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.

Table of Contents

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	September 30, 2012		
		Level 1	Level 2	Level 3
(Dollars in thousands)				
Assets				
Securities available-for-sale				
U.S. Government agency securities	\$ 45,750	\$ 0	\$ 45,750	\$ 0
Agency mortgage-backed securities	91,319	0	91,319	0
Other assets interest rate caps	0	0	0	0
Liabilities				
Other liabilities interest rate swap	\$ 575	\$ 0	\$ 575	\$ 0

	Total	June 30, 2012		
		Level 1	Level 2	Level 3
(Dollars in thousands)				
Assets				
Securities available-for-sale				
U.S. Government agency securities	\$ 45,808	\$ 0	\$ 45,808	\$ 0
Agency mortgage-backed securities	87,456	0	87,456	0
Other assets interest rate caps	1	0	1	0
Liabilities				
Other liabilities interest rate swap	\$ 580	\$ 0	\$ 580	\$ 0

There were no significant transfers between the three levels of the fair value hierarchy for the quarters ended September 30, 2012 and 2011.

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

	Total	September 30, 2012		
		Level 1	Level 2	Level 3
(Dollars in thousands)				
Impaired loans	\$ 841	\$ 0	\$ 0	\$ 841
Reposessed collateral	1,129	0	0	1,129

	Total	June 30, 2012		
		Level 1	Level 2	Level 3
(Dollars in thousands)				
Impaired loans	\$ 1,103	\$ 0	\$ 0	\$ 1,103
Reposessed collateral	834	0	0	834

Table of Contents

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

	Carrying Amount	Fair Value Measurements at September 30, 2012			
		Total	Level 1	Level 2	Level 3
(Dollars in thousands)					
Financial assets:					
Cash and cash equivalents	\$ 102,572	\$ 102,572	\$ 102,572	\$ 0	\$ 0
Available-for-sale securities	137,069	137,069	0	137,069	0
Regulatory stock	5,473	5,473	0	5,473	0
Loans held for sale	12,986	13,005	0	13,005	0
Loans, net	374,525	396,947	0	0	396,947
Accrued interest receivable	1,751	1,751	0	1,751	0
Interest rate caps	0	0	0	0	0
Financial liabilities:					
Deposits	455,775	460,273	0	460,273	0
FHLB advances	43,331	45,662	0	45,662	0
Structured repurchase agreements	35,821	36,868	0	36,868	0
Short-term borrowings	484	484	0	484	0
Capital lease obligation	1,869	2,167	0	2,167	0
Subordinated debentures	8,146	8,324	0	0	8,324
Interest rate swaps	575	575	0	575	0

	Carrying Amount	Fair Value Measurements at June 30, 2012			
		Total	Level 1	Level 2	Level 3
(Dollars in thousands)					
Financial assets:					
Cash and cash equivalents	\$ 128,274	\$ 128,274	\$ 128,274	\$ 0	\$ 0
Available-for-sale securities	133,264	133,264	0	133,264	0
Regulatory stock	5,473	5,473	0	5,473	0
Loans held for sale	9,882	9,896	0	9,896	0
Loans, net	355,430	374,062	0	0	374,062
Accrued interest receivable	1,840	1,840	0	1,840	0
Interest rate caps	1	1	0	1	0
Financial liabilities:					
Deposits	422,188	425,782	0	425,782	0
FHLB advances	43,450	45,747	0	45,747	0
Structured repurchase agreements	66,183	67,314	0	67,314	0
Short-term borrowings	1,209	1,209	0	1,209	0
Capital lease obligation	1,911	2,202	0	2,202	0
Subordinated debentures	8,106	8,597	0	0	8,597
Interest rate swaps	580	580	0	580	0

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 recognized 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. Institutional counterparties must have an investment grade credit rating and be approved by the

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

Company's Board of Directors. The Company deals only with primary dealers. 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.

At September 30, 2012 and June 30, 2012, the Company had cash totaling \$800 thousand in a margin account with the dealer bank associated with its interest rate swap.

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.

Table of Contents*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 that 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.

During the three months ended September 30, 2012 and 2011, 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 months ended September 30, 2012 and 2011 related to the balance sheet hedging of long-term debt indicates that the hedges were effective.

The Company recorded interest income of \$25 thousand related to hedge ineffectiveness in each of the three months ended September 30, 2012 and 2011. This ineffectiveness related to the Company's interest rate swap. The Company expects to record interest income of \$100 thousand related to ineffectiveness in the next twelve months.

The Company reclassified interest expense of \$7 thousand and \$4 thousand related to the effective portion of purchased interest rate caps during the three months ended September 30, 2012 and 2011, respectively. The Company expects to record interest expense of \$28 thousand related to its purchased interest rate caps in the next twelve months.

	September 30, 2012		June 30, 2012	
	Interest Rate Caps	Interest Rate Swap	Interest Rate Caps	Interest Rate Swap
Notional amount	\$ 6,000	\$ 10,000	\$ 6,000	\$ 10,000
Weighted average pay rate		4.69%		4.69%
Weighted average receive rate		2.35%		2.36%
Strike rate based on three month LIBOR	2.51%		2.51%	
Weighted average maturity in years	2.00	2.42	2.25	2.67
Unrealized loss	\$ 63	\$ 335	\$ 69	\$ 315

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

	September 30, 2012 (Dollars in thousands)		Fair Value
	Asset Derivatives	Balance Sheet Location	
Interest rate caps		Other assets	\$ 0
Liability Derivatives		Balance Sheet Location	Fair Value
Interest rate swap		Other liabilities	\$ 575

June 30, 2012

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

(Dollars in thousands)

Asset Derivatives	Balance Sheet Location	Fair Value
Interest rate caps	Other assets	\$ 1

Liability Derivatives	Balance Sheet Location	Fair Value
Interest rate swap	Other liabilities	\$ 580

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

The components of other comprehensive (loss) income follow.

	Three Months Ended September 30,					
	2012			2011		
	Pre-tax Amount	Tax Expense (Benefit)	After-tax Amount	Pre-tax Amount	Tax Expense (Benefit)	After-tax Amount
	(Dollars in thousands)					
Unrealized holding gains on available-for-sale securities	\$ 157	\$ 53	\$ 104	\$ 1,635	\$ 556	\$ 1,079
Less: Realized gains (losses)	792	269	523	(53)	(18)	(35)
Unrealized (losses) gains on available-for-sale securities, net	(635)	(216)	(419)	1,688	574	1,114
Unrealized gains on cash flow hedges	6	2	4	(199)	(68)	(131)
Less: Realized gains	18	6	12	22	8	14
Unrealized losses on cash flow hedges, net	(12)	(4)	(8)	(221)	(76)	(145)
Total other comprehensive (loss) income	\$ (647)	\$ (220)	\$ (427)	\$ 1,467	\$ 498	\$ 969

Accumulated other comprehensive (loss) income is comprised of the following.

	September 30, 2012	June 30, 2012
	(Dollars in thousands)	
Unrealized (loss) gain on available-for-sale securities	\$ (10)	\$ 624
Tax effect	3	(212)
Net-of-tax amount	(7)	412
Unrealized loss on cash flow hedges	(399)	(384)
Tax effect	137	130
Net-of-tax amount	(262)	(254)
Accumulated other comprehensive (loss) income	\$ (269)	\$ 158

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 U.S. Department of the Treasury (the "Treasury") for aggregate proceeds of \$4.2 million.

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. 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.

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, 2012, 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; changes in government regulation; 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, 2012 as updated in the Company's Quarterly Reports on Form 10-Q 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.

Description of Business and Strategy

Business Overview

Northeast Bancorp (we, our, us, Northeast or the Company), a Maine corporation chartered in April 1987, is a bank holding company registered with the Board of Governors of the Federal Reserve System (Federal Reserve) under the Bank Holding Company Act of 1956, as amended. The Company's primary subsidiary and principal asset is its wholly-owned banking subsidiary, Northeast Bank (the Bank or Northeast Bank), which has ten banking branches. The Bank, which was originally organized in 1872 as a Maine-chartered mutual savings bank and was formerly known as Bethel Savings Bank F.S.B., is a Maine state-chartered bank and a member of the Federal Reserve System. As such, the Company and the Bank are currently subject to the regulatory oversight of the Federal Reserve and the State of Maine Bureau of Financial Institutions (the Bureau).

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 applied the acquisition method of accounting, as described in Accounting Standards Codification (ASC) 805, *Business Combinations* (ASC 805) to the merger, which represents an acquisition by FHB of Northeast, with Northeast as the surviving company.

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

In connection with the transaction, as part of the regulatory approval process, the Company and the Bank made certain commitments to the Federal Reserve and the Bureau, the most significant of which are (i) to maintain a Tier 1 leverage ratio of at least 10%, (ii) to

Table of Contents

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 estate) to within 300% of total risk-based capital. The Company and the Bank are currently in compliance with all commitments to the Federal Reserve and the Bureau.

As of September 30, 2012, the Company, on a consolidated basis, had total assets of \$670.9 million, total deposits of \$455.8 million, and stockholders' equity of \$118.9 million. The Company gathers retail deposits through its Community Banking Division's banking offices in Maine and through its online affinity deposit program, ableBanking; originates loans through its Community Banking Division; and purchases performing commercial real estate loans at a discount through its Loan Acquisition and Servicing Group (LASG). The Company operates the Community Banking Division from Lewiston, Maine, which operates ten full-service branches, some with investment centers, and four loan production offices that serve individuals and businesses located in western and south-central Maine and southern New Hampshire. The Company operates ableBanking and the LASG from its offices in Boston, Massachusetts.

In August of 2011, the Company sold the customer lists and certain other assets of its insurance agency division, Northeast Bank Insurance Group (NBIG). The operations of NBIG have been reported as discontinued operations in the consolidated financial statements and in the discussion herein.

In May of 2012, the Company raised net proceeds of \$52.7 million through the sale of shares of its common stock.

Unless the context otherwise requires, references herein to the Company include the Company and its subsidiary on a consolidated basis.

Strategy

The Company's goal is to prudently grow its franchise, while maintaining sound operations and risk management, by implementing the following strategies:

Measured growth of the purchased loan portfolio. The LASG purchases performing commercial real estate loans, on a nationwide basis, at a discount from their outstanding principal balances, producing yields higher than those normally achieved on our originated loan portfolio.

Loans are purchased on a nationwide basis from a variety of sources, including banks, insurance companies, investment funds and government agencies, either directly or indirectly through a broker. We expect that loans purchased by the LASG will, subject to compliance with applicable regulatory commitments, represent an increasing percentage of our total loan portfolio in the future.

Focus on core deposits. The Bank offers a full line of deposit products to customers in the Community Banking Division's market area through its ten-branch network. In addition, we launched our online affinity deposit program, ableBanking, a division of Northeast Bank in the quarter ended June 30, 2012. One of the Company's strategic goals is for ableBanking to provide an additional channel through which to raise core deposits to fund the acquisition of loans by the LASG.

Continuing our community banking tradition. The Community Banking Division retains a high degree of local autonomy and operational flexibility to better serve its customers. The Community Banking Division's focus on sales and service is expected to allow us to attract and retain core deposits in support of balance sheet growth, and to continue to generate new loans, particularly through the efforts of the residential mortgage origination team.

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. The reader is encouraged to review each of the policies included in Form 10-K for the year ended June 30, 2012 to gain a better understanding of how Northeast's financial performance is measured and reported. There has been no material change in critical accounting policies during the three months ended September 30, 2012.

Table of Contents**Overview**

Net income for the quarter ended September 30, 2012 was \$1.0 million, or \$0.09 per diluted common share, compared to net income of \$529 thousand, or \$0.12 per diluted common share, for the quarter ended September 30, 2011. The 2011 quarter included a \$594 thousand net loss, or \$0.13 per diluted share, from continuing operations and \$1.1 million of net income, or \$0.25 per diluted common share, from discontinued operations. Weighted average common shares outstanding increased to 10.4 million in the quarter ended September 30, 2012 from 3.5 million in the quarter ended September 30, 2011 as a result of the Company's public offering of common stock in May 2012.

The Company's net interest margin was 3.80% for the quarter ended September 30, 2012, compared to 3.11% in the quarter ended September 30, 2011, an increase principally attributable to net loan growth in the LASG portfolio. The average balance of purchased loans totaled \$83.4 million during the quarter ended September 30, 2012, compared to \$11.1 million during the quarter ended September 30, 2011.

During the quarter ended September 30, 2012, the LASG purchased loans totaling \$31.3 million, and grew the purchased loan portfolio on a net basis to \$107.4 million at quarter end. Additionally, the LASG originated \$8.8 million in commercial loans, thereby increasing its originated book to \$12.6 million at quarter end. An overview of LASG portfolio results for the three months ended September 30, 2012 follows.

	Purchased	Originated	Total LASG
	(Dollars in thousands)		
Purchased or originated during the three months ended September 30, 2012:			
Unpaid principal balance	\$ 42,273	\$ 8,799	\$ 51,072
Net investment basis (1)	31,349	8,799	40,148
Totals as of September 30, 2012:			
Unpaid principal balance	\$ 133,510	\$ 12,594	\$ 146,104
Net investment basis	107,442	12,595	120,037
Returns during the three months ended September 30, 2012:			
Yield	15.13%	9.54%	14.58%
Total Return (2)	17.41%	9.54%	16.63%

- (1) Net investment basis of loans purchased in the quarter ended September 30, 2012 includes \$326 thousand advanced on a purchased loan.
- (2) The total return on purchased loans represents scheduled accretion, accelerated accretion, gains on asset sales, and other noninterest income recorded in connection with purchased loans during the period divided by the average invested balance, on an annualized basis.

Financial Condition**Overview**

Total assets increased by \$1.7 million, or 0.3%, to \$670.9 million at September 30, 2012, compared to June 30, 2012. The principal components of the change in the balance sheet were as follows:

- Loan growth of \$18.9 million, or 5.3%, principally due to net growth of \$23.0 million in the Bank's purchased loan portfolio and \$7.5 million of commercial loans originated by the LASG, offset in part by net amortization and payoffs of \$11.6 million in the Community Banking Division loan portfolio. In conjunction with one purchased pool, the Bank acquired the right to service the guaranteed portion of \$44 million of SBA loans at an average annual gross servicing fee equal to approximately 1%.
- Deposit growth of \$33.6 million, or 8.0%, consisting of a \$10.5 million increase in deposits raised through ableBanking, the Bank's online affinity deposit platform, \$15.5 million raised through the Bank's community banking branch network, and \$7.6 million generated through deposit listing service referrals.

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

3. A \$31.2 million, or 25.8%, decrease in borrowings, the result primarily of the repayment of structured repurchase agreements totaling \$30.0 million during the quarter.

4. A \$25.7 million decrease in cash and equivalents, principally the result of loan growth during the quarter.

Table of ContentsAssets*Cash, Short-term Investments and Securities*

Cash and short-term investments were \$102.6 million as of September 30, 2012, a decrease of \$25.7 million, or 20.0%, from \$128.3 million at June 30, 2012. This decrease is principally the result of the following balance sheet changes: i) net loan growth of \$18.9 million, ii) net increases in investment securities and loans held for sale of \$3.8 million and \$3.1 million, respectively, iii) the repayment of structured repurchase agreements totaling \$30.0 million, and iv) net deposit growth of \$33.6 million.

Available-for-sale securities, consisting of securities issued by government agencies and government-sponsored enterprises, totaled \$137.1 million as of September 30, 2012. At quarter end, securities with a fair value of \$54.9 million were pledged for outstanding borrowings.

Loan Portfolio

Total loans, excluding loans held for sale, amounted to \$375.2 million as of September 30, 2012, an increase of \$18.9 million, or 5.3%, from \$356.3 million as of June 30, 2012. The increase consisted of growth in the purchased loan portfolio of \$23.0 million, partially offset by a \$4.1 million decrease in originated loans. The net decrease in originated loans consisted of an \$11.5 million decrease in loans originated by the Community Banking Division and a net increase of \$7.5 million of LASG originated commercial loans. The decrease in Community Banking Division loans was principally due to net runoff in residential and commercial real estate loan portfolios.

The Company continues to sell most of its originated fixed-rate residential real estate loans in the secondary market. The principal balance of residential real estate loans sold during the three months ended September 30, 2012 totaled \$35.1 million, resulting in net gains of \$756 thousand.

The composition of the Company's loan portfolio follows.

	September 30, 2012			Percent of Total
	Community Banking Division	LASG	Total	
	(Dollars in thousands)			
Originated loans:				
Residential real estate	\$ 89,394	\$ 151	\$ 89,545	23.87%
Home equity	40,576	0	40,576	10.81%
Commercial real estate	93,692	8,396	102,088	27.21%
Construction	508	0	508	0.14%
Commercial business	15,153	4,048	19,201	5.12%
Consumer	15,833	0	15,833	4.22%
Subtotal	255,156	12,595	267,751	71.37%
Purchased loans:				
Residential real estate	0	3,655	3,655	0.97%
Commercial real estate	0	103,787	103,787	27.66%
Subtotal	0	107,442	107,442	28.63%
Total	\$ 255,156	\$ 120,037	\$ 375,193	100.00%

	June 30, 2012			Percent of Total
	Community Banking Division	LASG	Total	
	(Dollars in thousands)			

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

Originated loans:				
Residential real estate	\$ 90,793	\$ 151	\$ 90,944	25.53%
Home equity	42,696	0	42,696	11.98%
Commercial real estate	97,146	3,050	100,196	28.12%
Construction	1,187	0	1,187	0.33%
Commercial business	17,732	1,880	19,612	5.51%
Consumer	17,149	0	17,149	4.81%
Subtotal	266,703	5,081	271,784	76.28%
Purchased loans:				
Residential real estate	0	3,931	3,931	1.10%
Commercial real estate	0	80,539	80,539	22.62%
Subtotal	0	84,470	84,470	23.72%
Total	\$ 266,703	\$ 89,551	\$ 356,254	100.00%

Table of Contents

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.

In cases where a borrower experiences financial difficulties and the Company makes certain concessionary modifications to contractual terms, the loan is classified as a troubled debt restructuring (TDR). Concessionary modifications may include adjustments to interest rates, extensions of maturity, and other actions intended to minimize economic loss and avoid foreclosure or repossession of collateral. Nonaccrual loans that are restructured generally remain on nonaccrual for a minimum period of six months to demonstrate that the borrower can meet the restructured terms. If the restructured loan is on accrual status prior to being modified, it is reviewed to determine if the modified loan should remain on accrual status. If the borrower's ability to meet the revised payment schedule is not reasonably assured, the loan is classified as a nonaccrual loan. Loans classified as TDRs remain classified as such until the loan is paid off.

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 details the Company's nonperforming assets and other credit quality indicators as of September 30, 2012 and June 30, 2012. The net increase in nonperforming assets during the quarter was principally due to the acquisition of a loan pool in late September that included \$667 thousand of nonperforming loans.

	Non-Performing Assets at September 30, 2012		
	Community		
	Banking Division	LASG	Total
	(Dollars in thousands)		
Loans:			
Residential real estate	\$ 3,184	\$ 0	\$ 3,184
Home equity	289	0	289
Commercial real estate	626	667	1,293
Construction	0	0	0
Commercial business	133	0	133
Consumer	181	0	181
Subtotal	4,413	667	5,080
Reposessed collateral	1,129	1,516	2,645
Total	\$ 5,542	\$ 2,183	\$ 7,725
Ratio of nonperforming loans to total loans			1.35%
Ratio of nonperforming assets to total assets			1.15%
Ratio of loans past due to total loans			1.65%
Nonperforming loans that are current			\$ 674
Commercial loans risk rated substandard or worse			\$ 2,717
Troubled debt restructurings:			
On accrual status			\$ 2,010
On nonaccrual status			\$ 611

	Non-Performing Assets at June 30, 2012		
	Community		
	Banking Division	LASG	Total
	(Dollars in thousands)		
Loans:			
Residential real estate	\$ 3,090	\$ 0	\$ 3,090
Home equity	220	0	220
Commercial real estate	417	1,055	1,472
Construction	0	0	0
Commercial business	1,008	0	1,008
Consumer	324	0	324
Subtotal	5,059	1,055	6,114
Reposessed collateral	834	0	834
Total	\$ 5,893	\$ 1,055	\$ 6,948
Ratio of nonperforming loans to total loans			1.72%
Ratio of nonperforming assets to total assets			1.04%
Ratio of loans past due to total loans			1.95%
Nonperforming loans that are current			\$ 377
Commercial loans risk rated substandard or worse			\$ 2,486
Troubled debt restructurings:			

On accrual status	\$ 1,165
Nonaccrual status	\$ 139

Table of Contents*Allowance for Loan Losses*

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 or other acquired loans exceeds the exposure estimated when initial fair values were determined.

The Company's allowance for loan losses was \$668 thousand as of September 30, 2012, which represents a decrease of \$156 thousand from \$824 thousand as of June 30, 2012. The decrease during the quarter ended September 30, 2012 was principally due to the partial charge-off related to one commercial loan relationship totaling \$203 thousand. Loan loss reserves related to this credit were allocated in a prior period.

The following table details ratios related to the allowance for loan losses for the periods indicated.

	September 30, 2012	June 30, 2012	September 30, 2011
Allowance for loan losses to nonperforming loans	13.15%	13.48%	9.55%
Allowance for loan losses to total loans	0.18%	0.23%	0.22%

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.

Other Assets

The cash surrender value of the Company's bank-owned life insurance (BOLI) assets increased \$123 thousand, or 0.9% to \$14.4 million at September 30, 2012, compared to \$14.3 million at June 30, 2012. 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 11.6% of the Company's total risk-based capital at September 30, 2012.

Intangible assets totaled \$4.2 million and \$4.5 million at September 30, 2012 and June 30, 2012, respectively. The \$265 thousand decrease was the result of core deposit intangible asset amortization during the period.

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

The Company's principal source of funding is its core deposit accounts. At September 30, 2012, non-maturity accounts and certificates of deposit with balances less than \$250 thousand represented 98.2% of total deposits.

Total deposits increased \$33.6 million to \$455.8 million as of September 30, 2012 from \$422.2 million as of June 30, 2012. The increase was the result of a \$10.5 million increase in deposits raised through ableBanking, the Bank's online affinity deposit platform, \$15.5 million raised through the Bank's community banking branch network, and \$7.6 million generated through deposit listing service referrals. The composition of total deposits at September 30, 2012 and June 30, 2012 follows.

	September 30, 2012		June 30, 2012	
	Amount	% of Total	Amount	% of Total
	(Dollars in thousands)			
Demand deposits	\$ 47,071	10.33%	\$ 45,323	10.74%
NOW accounts	56,448	12.39%	57,477	13.61%
Regular and other savings	30,562	6.71%	32,727	7.75%
Money market deposits	48,896	10.73%	45,024	10.66%

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

Total non-certificate accounts	182,977	40.16%	180,551	42.76%
Term certificates less than \$250 thousand	264,032	57.92%	232,948	55.18%
Term certificates of \$250 thousand or more	8,766	1.92%	8,689	2.06%
Total certificate accounts	272,798	59.84%	241,637	57.24%
Total deposits	\$ 455,775	100.00%	\$ 422,188	100.00%

Table of Contents*Borrowed Funds*

Advances from the FHLB were \$43.3 million and \$43.5 million at September 30, 2012 and June 30, 2012, respectively. At September 30, 2012, the Company had pledged investment securities with a fair value of \$12.3 million, as well as certain residential real estate loans, commercial real estate loans, and FHLB deposits free of liens or pledges to secure outstanding advances and available additional borrowing capacity.

Structured repurchase agreements were \$35.8 million and \$66.2 million at September 30, 2012 and June 30, 2012, respectively. During the quarter, the Company repaid structured repurchase agreements totaling \$30.0 million. At September 30, 2012, the Company had pledged investment securities with a fair value of \$42.7 million as collateral for outstanding structured repurchase agreements.

Short-term borrowings, consisting of sweep accounts, were \$484 thousand and \$1.2 million as of September 30, 2012 and June 30, 2012, respectively. At September 30, 2012, sweep accounts were secured by a letter of credit issued by the FHLB totaling \$2.0 million.

Liquidity

The following table is a summary of the liquidity the Company had the ability to access as of September 30, 2012, in addition to traditional retail deposit products.

Brokered time deposits	\$ 166,141	Subject to policy limitation of 25% of total assets
Federal Home Loan Bank of Boston	10,116	Subject to eligible and qualified collateral
Federal Reserve Discount Window Borrower-in-Custody	277	Subject to the pledge of indirect auto loans
Total unused borrowing capacity	176,534	
Unencumbered investment securities	82,128	
Total sources of liquidity	\$ 258,662	

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 September 30, 2012, the Company had \$258.7 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 39% of total assets. The Company also had \$102.6 million of cash and cash equivalents at September 30, 2012. This relatively high level of short-term liquidity is intended, in part, for future purchases of commercial loans by the LASG.

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 carrying amount and unpaid principal balance of junior subordinated debentures totaled \$8.1 million and \$16.5 million, respectively, as of September 30, 2012. This debt represents qualifying Tier 1 capital for the Company, up to a maximum of 25% of total Tier 1 capital. At September 30, 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.

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 its common stock or other equity or capital securities, other than in connection with

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

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 \$118.9 million and \$119.1 million at September 30, 2012 and June 30, 2012, 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 \$11.04 at September 30, 2012 and \$11.07 at June 30, 2012. Tier 1 capital to total average assets of the Company was 18.37% as of September 30, 2012 and 19.91% at June 30, 2012.

Table of Contents

In addition to the risk-based capital requirements, the Federal Reserve requires top-rated bank holding companies to maintain a minimum leverage capital ratio of Tier 1 capital (defined by reference to the risk-based capital guidelines) to its average total consolidated assets of at least 3.0%. For most other bank holding companies (including the Company), the minimum leverage capital ratio is 4.0%. Bank holding companies with supervisory, financial, operational or managerial weaknesses, as well as bank holding companies that are anticipating or experiencing significant growth, are expected to maintain capital ratios well above the minimum levels.

The Federal Reserve's capital adequacy standards also apply to state-chartered banks which are members of the Federal Reserve System, such as the Bank. Moreover, the Federal Reserve has promulgated corresponding regulations to implement the system of prompt corrective action established by Section 38 of the Federal Deposit Insurance Act. Under these regulations, a bank is "well capitalized" if it has: (i) a total risk-based capital ratio of 10.0% or greater; (ii) a Tier 1 risk-based capital ratio of 6.0% or greater; (iii) a leverage capital ratio of 5.0% or greater; and (iv) is not subject to any written agreement, order, capital directive or prompt corrective action directive to meet and maintain a specific capital level for any capital measure. A bank is "adequately capitalized" if it has: (1) a total risk-based capital ratio of 8.0% or greater; (2) a Tier 1 risk-based capital ratio of 4.0% or greater; and (3) a leverage capital ratio of 4.0% or greater (3.0% under certain circumstances) and does not meet the definition of a "well capitalized bank."

The Federal Reserve also must take into consideration: (i) concentrations of credit risk; (ii) interest rate risk; and (iii) risks from non-traditional activities, as well as an institution's ability to manage those risks, when determining the adequacy of an institution's capital. This evaluation will be made as a part of the institution's regular safety and soundness examination. The Bank is currently considered well-capitalized under all regulatory definitions.

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. These commitments require that the Company and the Bank (i) maintain a Tier 1 leverage ratio of at least 10%, (ii) maintain a total risk-based capital ratio of at least 15%, The Bank and the Company were in compliance with these commitments at September 31, 2012.

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
(Dollars in thousands)						
September 30, 2012:						
Total capital to risk weighted assets:						
Company	\$ 124,657	31.30%	\$ 31,861	38.0%	\$ N/A	N/A
Bank	86,340	21.67%	31,874	38.0%	39,843	310.0%
Tier 1 capital to risk weighted assets:						
Company	123,989	31.13%	15,932	34.0%	N/A	N/A
Bank	81,357	20.42%	15,937	34.0%	23,905	36.0%
Tier 1 capital to average assets:						
Company	123,989	18.37%	26,998	34.0%	N/A	N/A
Bank	81,357	12.16%	26,762	34.0%	33,453	35.0%
June 30, 2012:						
Total capital to risk weighted assets:						
Company	\$ 124,452	33.34%	\$ 29,863	38.0%	\$ N/A	N/A
Bank	75,081	20.14%	29,824	38.0%	37,280	310.0%
Tier 1 capital to risk weighted assets:						
Company	123,628	33.12%	14,931	34.0%	N/A	N/A
Bank	70,414	18.89%	14,910	34.0%	22,365	36.0%

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

Tier 1 capital to average assets:

Company	123,628	19.91%	24,837	34.0%	N/A	N/A
Bank	70,414	11.43%	24,642	34.0%	30,802	35.0%

Table of Contents***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.

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.

A summary of the amounts of the Company's contractual obligations and other commitments with off-balance sheet risk at September 30, follows.

Contractual obligations	Total	Less Than			After 5 Years
		1 Year	1-3 Years	4-5 Years	
		(Dollars in thousands)			
FHLB advances	\$ 42,500	\$ 15,000	\$ 12,500	\$ 10,000	\$ 5,000
Structured repurchase agreements	35,000	20,000	15,000	0	0
Junior subordinated debentures	16,496	0	0	0	16,496
Short-term borrowings	484	484	0	0	0
Capital lease obligation	2,278	264	535	612	867
Total long-term debt	96,758	35,748	28,035	10,612	22,363
Operating lease obligations (1)	9,820	796	2,134	1,931	4,959
Total contractual obligations	\$ 106,578	\$ 36,544	\$ 30,169	\$ 12,543	\$ 27,322

Commitments with off-balance sheet risk	Total	Less Than			After 5 Years
		1 Year	1-3 Years	4-5 Years	
		(Dollars in thousands)			
Commitments to extend credit (2)(4)	\$ 8,214	\$ 8,214	\$ 0	\$ 0	\$ 0
Commitments related to loans held for sale (3)	9,912	9,912	0	0	0
Unused lines of credit (4)(5)	36,025	17,434	3,435	3,041	12,115
Standby letters of credit (6)	417	416	1	0	0
Total commitments with off-balance sheet risk	\$ 54,568	\$ 35,976	\$ 3,436	\$ 3,041	\$ 12,115

- (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 September 30, 2012 was nominal.

Table of Contents**Results of Operations – Continuing Operations****General**

Net income from continuing operations for the three months ended September 30, 2012 was \$1.0 million, compared to a loss of \$594 thousand for the three months ended September 30, 2011. The increase in net income from continuing operations in the quarter ended September 30, 2012 was principally due to increased net interest income of \$1.8 million, increased security gains of \$845 thousand, increased gains recognized on repossessed collateral of \$528 thousand, and increased gains on the sales of residential mortgages of \$100 thousand, partially offset by increased noninterest expense of \$903 thousand, consisting of higher employee compensation, occupancy and equipment expense, and loan acquisition and collection costs.

In the quarter ended September 30, 2012, higher average balances in the Company's purchased loan portfolio, compared to the comparable 2011 quarter, contributed significantly to increased net interest income and earnings for the quarter. The Company's total return on its purchased loan portfolio, a measure that includes gains on asset sales, as well as interest, scheduled accretion and accelerated accretion, totaled 17.41% for the quarter ended September 30, 2012. The following table details the components of the return on purchased loans during the three months ended September 30, 2012 and 2011.

	Three Months Ended September 30,			
	2012		2011	
	Income	Return (1)	Income	Return (1)
	(Dollars in thousands)			
Regularly scheduled interest and accretion	\$ 1,911	9.01%	\$ 200	7.19%
Transactional income:				
Gain on sale of real estate owned	473	2.23%	0	0.00%
Other noninterest income	36	0.17%	0	0.00%
Accelerated accretion and loan fees	1,273	6.00%	0	0.00%
Total	\$ 3,693	17.41%	\$ 200	7.19%

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

Net Interest Income

Net interest income for the three months ended September 30, 2012 and 2011 was \$6.1 million and \$4.3 million, respectively. The increase of \$1.8 million was largely attributable to growth in the LASG loan portfolio, which earned an average yield of 14.6% for the quarter ended September 30, 2012 on an average outstanding balance of \$92.7 million. The following table summarizes interest income and related yields recognized on the Company's loans.

	Three Months Ended September 30,					
	2012			2011		
	Average Balance	Interest Income	Yield	Average Balance	Interest Income	Yield
	(Dollars in thousands)					
Community Banking Division	\$ 270,758	\$ 3,936	5.77%	\$ 304,041	\$ 4,937	6.46%
LASG:						
Originated	9,193	221	9.54%	1,141	29	10.11%
Purchased	83,475	3,184	15.13%	11,066	200	7.19%
Total LASG	92,668	3,405	14.58%	12,207	229	7.44%

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

Total	\$ 363,426	\$ 7,341	8.01%	\$ 316,248	\$ 5,137	6.46%
-------	------------	----------	-------	------------	----------	-------

Table of Contents

In the quarter ended September 30, 2012, net interest income was negatively affected by a lower level of noncash accretion of fair value adjustments resulting from the merger than in the comparable 2011 quarter. The effect of such accretion will continue to diminish as financial instruments held at the merger mature or prepay. The following table summarizes the effects of such accretion.

	Three Months Ended September 30,					
	2012			2011		
	Average Balance	Income (Expense)	Effect on Yield / Rate (Dollars in thousands)	Average Balance	Income (Expense)	Effect on Yield / Rate
Interest-earning assets:						
Investment securities	\$ 131,796	\$ (3)	-0.01%	\$ 147,692	\$ (61)	-0.16%
Loans	363,426	104	0.11%	316,248	355	0.45%
Other interest-earning assets	141,616	0	0.00%	84,112	0	0.00%
Total interest-earning assets	\$ 636,838	\$ 101	0.06%	\$ 548,052	\$ 294	0.21%
Interest-bearing liabilities:						
Interest-bearing deposits	393,267	276	0.28%	351,197	372	0.42%
Short-term borrowings	1,251	0	0.00%	1,141	0	0.00%
Borrowed funds	100,186	481	1.90%	113,746	579	2.03%
Junior subordinated debentures	8,124	(40)	-1.95%	7,971	(35)	-1.75%
Total interest-bearing liabilities	\$ 502,828	\$ 717	0.57%	\$ 474,055	\$ 916	0.77%
Total effect of noncash accretion on:						
Net interest income		\$ 818			\$ 1,210	
Net interest margin		0.51%			0.88%	

Table of Contents

The Company's interest rate spread and net interest margin increased by 59 basis points and 69 basis points, respectively, for the quarter ended September 30, 2012 compared to the quarter ended September 30, 2011. These increases were principally the result of the aforementioned increase in purchased loans. The following sets forth the average balance sheets, interest income and interest expense, and average yields and costs for the three months ended September 30, 2012 and 2011.

	Three Months Ended September 30,					
	2012			2011		
	Average Balance	Interest Income/Expense	Average Yield/Rate	Average Balance	Interest Income/Expense	Average Yield/Rate
(Dollars in thousands)						
Assets:						
Interest-earning assets:						
Investment securities (1)	\$ 131,796	\$ 347	1.04%	\$ 147,692	\$ 639	1.72%
Loans (2) (3)	363,426	7,341	8.01%	316,248	5,137	6.46%
Regulatory stock	5,473	6	0.43%	5,761	12	0.83%
Short-term investments (4)	136,143	83	0.24%	78,351	47	0.24%
Total interest-earning assets	636,838	7,777	4.84%	548,052	5,835	4.24%
Cash and due from banks	3,177			2,920		
Other non-interest earning assets	37,695			38,809		
Total assets	\$ 677,710			\$ 589,781		
Liabilities & Stockholders' Equity:						
Interest-bearing liabilities:						
NOW accounts	\$ 56,595	\$ 42	0.29%	\$ 56,182	\$ 69	0.49%
Money market accounts	47,349	53	0.44%	45,981	51	0.44%
Savings accounts	31,347	11	0.14%	33,439	26	0.31%
Time deposits	257,976	872	1.34%	215,595	691	1.28%
Total interest-bearing deposits	393,267	978	0.99%	351,197	837	0.95%
Short-term borrowings	1,251	6	1.90%	1,141	5	1.74%
Borrowed funds	100,186	502	1.99%	113,746	532	1.86%
Junior subordinated debentures	8,124	193	9.43%	7,971	183	9.13%
Total interest-bearing liabilities	502,828	1,679	1.32%	474,055	1,557	1.31%
Interest-bearing liabilities of discontinued operations (5)	0			1,140		
Non-interest bearing liabilities:						
Demand deposits and escrow accounts	49,815			44,553		
Other liabilities	6,223			4,478		
Total liabilities	558,866			524,226		
Stockholders' equity	118,844			65,555		
Total liabilities and stockholders' equity	\$ 677,710			\$ 589,781		
Net interest income		\$ 6,098			\$ 4,278	

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

Interest rate spread	3.52%	2.93%
Net interest margin (6)	3.80%	3.11%

- (1) Interest income and yield are stated on an annualized fully tax-equivalent basis using a 34% tax rate.
- (2) Includes loans held for sale.
- (3) Nonaccrual loans are included in the computation of average, but unpaid interest has not been included for purposes of determining interest income.
- (4) Short term investments include FHLB overnight deposits and other interest-bearing deposits.
- (5) The average balance of borrowings associated with discontinued operations has been excluded from interest expense, interest rate spread, and net interest margin.
- (6) Net interest margin is calculated as net interest income divided by total interest-earning assets, on an annualized basis.

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 September 30, 2012 Compared to the Three Months Ended September 30, 2011		
	Change Due to Volume	Change Due to Rate	Total Change
	(Dollars in thousands)		
Interest earning assets:			
Investments securities	\$ (63)	\$ (229)	\$ (292)
Loans	844	1,360	2,204
Regulatory stock	(1)	(5)	(6)
Short-term investments	35	1	36
Total increase in interest income	815	1,127	1,942
Interest bearing liabilities:			
Interest bearing deposits	146	(5)	141
Short-term borrowings	1	0	1
Borrowed funds	(65)	35	(30)
Junior subordinated debentures	4	6	10
Total increase in interest expense	86	36	122
Total increase in net interest income	\$ 729	\$ 1,091	\$ 1,820

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 4: 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.

The provision for loan losses for the three months ended September 30, 2012 and 2011 was \$228 thousand and \$400 thousand, respectively. The decrease in the Company's loan loss provision resulted principally from lower levels of nonperforming and impaired loans requiring specific allocations within the Company's allowance for loan losses.

Noninterest Income

Noninterest income totaled \$3.2 million for the three months ended September 30, 2012 compared to \$1.7 million the three months ended September 30, 2011, an increase of \$1.5 million. This increase was principally due to net gains recognized on repossessed collateral of \$451 thousand for the three months ended September 30, 2012, compared to a net loss of \$77 thousand for the quarter ended September 30, 2012, an

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

increase of \$100 thousand, or 15.2%, on sales of residential mortgage loans, compared to the quarter ended September 30, 2011 and net securities gains of \$792 thousand for the quarter ended September 30, 2012, compared to a net loss of \$53 thousand in the quarter ended September 30, 2011.

The net gain recognized on repossessed collateral during the quarter ended September 30, 2012 principally resulted from \$473 thousand realized on the sale of real estate previously securing a purchased loan. 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 government guaranteed mortgage-backed 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 by an increased level of mortgage loan refinance and purchase activity. The Company sold \$35.1 million in residential mortgages during the three months ended September 30, 2012, compared to \$27.3 million in quarter ended September 30, 2011.

Table of Contents

Noninterest Expense

Noninterest expense totaled \$7.5 million for the three months ended September 30, 2012 compared to \$6.6 million the three months ended September 30, 2011, an increase of \$903 thousand. The primary components of this increase were an increase of \$172 thousand in loan acquisition and collection costs, a \$340 thousand increase in employee compensation, and a \$229 thousand increase in occupancy and equipment expense.

The aforementioned increases were associated with the implementation of the Company's business strategy over the past twelve months. Loan costs, such as acquisition diligence, collections, and servicing have increased principally due to growth in the Company's purchased loan portfolio. Employee compensation has increased principally due to staff increases in LASG, ableBanking, and risk management, finance, and back-office operations. Full-time equivalent employees totaled 205 at September 30, 2012, compared to 192 at September 30, 2011. Increased occupancy and equipment expenses are principally due to depreciation and maintenance associated with investments in new business initiatives, such as ableBanking.

Income Taxes

The Company's income tax expense was \$484 thousand, or an effective rate of 31.9%, for the quarter ended September 30, 2012, as compared to a tax benefit of \$403 thousand for the quarter ended September 30, 2011. The effective rate for quarter ended September 30, 2012 differs from the Company's statutory rate because of the level of projected annual pre-tax income and favorable book to tax differences, such as tax credits and tax exempt life insurance income. The tax benefit realized in the quarter ended September 30, 2011 was the result of a net loss from continuing operations, in addition favorable book to tax differences.

Results of Operations – Discontinued Operations

In the quarter ended September 30, 2011, 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.

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.

Net income from discontinued operations for the quarter ended September 30, 2011 was \$1.1 million. Income for the quarter included a \$1.5 million pre-tax gain on sale of the assets of NBIG, and pre-tax income associated with operations of \$186 thousand. Income taxes associated with discontinued operations totaled \$592 thousand, or an effective rate of 34.6%, for the quarter ended September 30, 2011.

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 September 30, 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 September 30, 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

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Table of Contents**Item 6. Exhibits**

Exhibits 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 September 30, 2012 formatted in XBRL: (i) Consolidated Balance Sheets at September 30, 2012 and June 30, 2012; (ii) Consolidated Statements of Income for the three months ended September 30, 2012 and 2011; (iii) Consolidated Statements of Comprehensive Income for the three months ended September 30, 2012 and 2011; (iv) Consolidated Statements of Changes in Shareholders' Equity for the three months ended September 30, 2012 and 2011; (v) Consolidated Statements of Cash Flows for the three months ended September 30, 2012 and 2011; 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: November 14, 2012

NORTHEAST BANCORP

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

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

Table of Contents

NORTHEAST BANCORP

Index to Exhibits

Exhibits 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 September 30, 2012 formatted in XBRL: (i) Consolidated Balance Sheets at September 30, 2012 and June 30, 2012; (ii) Consolidated Statements of Income for the three months ended September 30, 2012 and 2011; (iii) Consolidated Statements of Comprehensive Income for the three months ended September 30, 2012 and 2011; (iv) Consolidated Statements of Changes in Shareholders' Equity for the three months ended September 30, 2012 and 2011; (v) Consolidated Statements of Cash Flows for the three months ended September 30, 2012 and 2011; and (vi) 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.