NORTHEAST BANCORP /ME/
Form 10-K
September 27, 2013
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United States

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended June 30, 2013

OR

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

For the transition period from to

Commission file number (1-14588)

NORTHEAST BANCORP

(Exact name of registrant as specified in its charter)

Maine (State or other jurisdiction of incorporation or organization)	**01-0425066** (I.R.S. Employer Identification No.)
500 Canal Street, Lewiston, Maine (Address of principal executive offices)	**04240** (Zip Code)

Registrant s telephone number, including area code:

(207) 786-3245

Securities registered pursuant to Section 12(b) of the Act:

Title of each class:	**Name of each exchange on which registered:**
Voting Common Stock, $1.00 par value	The NASDAQ Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer as defined in Rule 405 of the Securities Act. Yes o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No x

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, 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 x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

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

Large Accelerated Filer	o	Accelerated filer	o
Non-accelerated filer	o	Smaller Reporting Company	x

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

The aggregate market value of the registrant s voting and non-voting common stock held by non-affiliates, computed by reference to the last reported sales price of the registrant s voting common stock on the NASDAQ Global Market on December 31, 2012 was approximately $65,996,772.

As of September 16, 2013, the registrant had outstanding 9,552,587 shares of voting common stock, $1.00 par value per share, and 880,963 shares of non-voting common stock, $1.00 par value per share.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s proxy statement for the 2013 Annual Meeting of Shareholders to be held on November 21, 2013 are incorporated by reference in Items 10, 11, 12, 13 and 14 of Part III of this Annual Report on Form 10-K. The registrant intends to file such proxy statement with the Securities and Exchange Commission no later than 120 days after the end of its fiscal year ended June 30, 2013.

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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 our 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, 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 on those terms, or the 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 approval of the Company.

Such forward-looking statements reflect our current views and expectations based largely on information currently available to our management, and on our current expectations, assumptions, plans, estimates, judgments, and projections about our business and our 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 our expectations will in fact occur or that our 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, the factors referenced in this report under Item 1A. Risk Factors ; changes in interest rates; 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 our loans; changes in loan defaults and charge-off rates; changes in the value of securities and other assets, adequacy of loan loss reserves, or deposit levels necessitating increased borrowing to fund loans and investments; increasing government regulation, such as the Dodd-Frank Wall Street Reform and Consumer Protection Act; the risk that we may not be successful in the implementation of our business strategy; the risk that intangibles recorded in the Company s financial statements will become impaired; and changes in assumptions used in making such forward-looking statements. 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.

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PART I

Item 1. Business

Overview

Northeast Bancorp (we, our, us, Northeast or the Company), a Maine corporation chartered in April 1987, is a bank holding company registe 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.

In connection with the transaction, as part of the regulatory approval process, the Company and the Bank made certain commitments to the Federal Reserve, the most significant of which are (i) to maintain a Tier 1 leverage ratio of at least 10%, (ii) to maintain a total risk-based capital ratio of at least 15%, (iii) to limit purchased loans to 40% of total loans, (iv) to fund 100% of the Company s loans with core deposits (defined as non-maturity deposits and non-brokered insured time deposits), and (v) to hold commercial real estate loans (including owner-occupied commercial real estate) to within 300% of total risk-based capital. On June 28, 2013, the Federal Reserve approved the amendment of the commitment to hold commercial real estate loans to within 300% of total risk-based capital to exclude owner-occupied commercial real estate loans. All other commitments made to the Federal Reserve in connection with the merger remain unchanged. The Company and the Bank are currently in compliance with all commitments to the Federal Reserve.

As of June 30, 2013, the Company, on a consolidated basis, had total assets of $670.6 million, total deposits of $484.6 million, and stockholders equity of $113.8 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 and originates commercial loans through its Loan Acquisition and Servicing Group. The Company operates the Community Banking Division, with ten full-service branches and six loan production offices, from the Bank s headquarters in Lewiston, Maine. The Company operates ableBanking and the Loan Acquisition and Servicing Group 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. Refer to Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations for additional information on the sale of insurance assets in

August 2011.

In May of 2012, the Company raised net proceeds of $52.7 million through the sale of shares of its common stock. Refer to Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations Capital for additional information on the common stock offering in May 2012.

In the quarter ended December 31, 2012, the Company paid $4.2 million to redeem, at par value, all shares of preferred stock issued to the U.S. Department of the Treasury (the UST) under the Troubled Asset Relief Program (TARP) and repurchased the warrant for 67,958 shares of common stock issued to the UST in connection with TARP for $95 thousand.

In August of 2013, the Company announced its intention to exit the investment brokerage business. The Company expects that all investment brokerage activities will conclude in the first half of fiscal 2014.

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 commercial loan portfolio. The Company s Loan Acquisition and Servicing Group 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. To a lesser extent, this group also originates, on a nationwide basis, commercial real estate and commercial business loans.

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

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.

Market Area and Competition

Northeast Bancorp is the holding company for Northeast Bank, a full-service bank headquartered in Lewiston, Maine. Northeast Bank offers traditional banking services through its Community Banking Division, which operates ten full-service branches and six loan production offices that serve individuals and businesses located in western and south-central Maine, southern New Hampshire and southeastern Massachusetts. Northeast Bank s Loan Acquisition and Servicing Group purchases and originates commercial loans for the Bank s portfolio. ableBanking, a division of Northeast Bank, offers savings products to consumers online.

The Community Banking Division s primary market area covers the western and south central regions of the State of Maine. We also operate two residential mortgage lending offices in southeastern Massachusetts and one in southern New Hampshire. We encounter significant competition in our Community Banking Division market area in making loans, attracting deposits, and selling other customer products and services. Our Maine-based competitors include savings banks, commercial banks, credit unions, mutual funds, insurance companies, brokerage and investment banking companies, finance companies, and other financial intermediaries operating in Maine. Many of our primary competitors there have substantially greater resources, larger established customer bases, higher lending limits, extensive branch networks, numerous ATMs and greater advertising and marketing budgets. They may also offer services that we do not currently provide.

The Loan Acquisition and Servicing Group has a nationwide scope in its loan purchasing, origination, and servicing activities. It competes with regional banks, national private equity funds, and community banks in its bid to acquire performing commercial loans. ableBanking also has nationwide scope in its deposit gathering activities and competes with banks and credit unions, as well as other, larger, online direct banks having a national reach.

Lending Activities

General

We conduct our loan-related activities through two primary channels: our Community Banking Division and our Loan Acquisition and Servicing Group. Our Community Banking Division originates loans directly to consumers and businesses located in its market area. Our Loan

Acquisition and Servicing Group purchases primarily 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 the Company s originated loan portfolio. To a lesser extent, our Loan Acquisition and Servicing Group also originates commercial real estate and commercial business loans on a nationwide basis. At June 30, 2013, of our total loan portfolio of $435.4 million, $229.7 million, or 52.8%, was originated in the Community Banking Division and $205.7 million, or 47.2%, was purchased or originated by our Loan Acquisition and Servicing Group. Pursuant to commitments made to the Federal Reserve in connection with the merger, the Company is required to limit purchased loans to 40% of total loans. At June 30, 2013, the Company s ratio of purchased loans to total loans was 37.6%.

We individually underwrite the loans that we originate and all loans that we purchase. Our loan underwriting policies are reviewed and approved annually by our board of directors. Each loan, regardless of whether it is originated or purchased, must meet underwriting criteria set forth in our lending policies and the requirements of applicable federal and state lending regulations of our regulators. We typically retain servicing rights for all loans that we originate or purchase, except for residential loans that we originate and sell servicing released in the secondary market.

Community Banking Division

Originated Loan Portfolio. Our originated loan portfolio consists primarily of loans to consumers and businesses in our Community Banking Division s primary market area.

- *Residential Mortgage Loans*. We originate residential mortgage loans secured by one- to four-family properties throughout Maine, southeastern Massachusetts, and southern New Hampshire. Such loans may be originated for sale in the secondary market or to be held on the Bank s balance sheet. We also offer home equity loans and home equity lines of credit, which are secured by first or second mortgages on one- to four-family owner-occupied properties and which are held on our balance sheet. At June 30, 2013, portfolio residential loans totaled $125.0 million, or 28.7% of total loans. Of the residential loans we held for investment at June 30, 2013, 46.5% were adjustable rate. Included in residential loans are home equity lines of credit and other second mortgage loans aggregating approximately $35.4 million.

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- *Commercial Real Estate Loans*. We originate multi-family and other commercial real estate loans secured by property located primarily in our Community Banking Division s market area. At June 30, 2013, commercial real estate loans outstanding were $78.9 million, or 18.1% of total loans. Although the largest commercial real estate loan originated by our Community Banking Division had a principal balance of $2.1 million at June 30, 2013, the majority of the commercial real estate loans originated by our Community Banking Division had principal balances less than $500 thousand.

- *Commercial Business Loans.* We originate commercial business loans, including term loans, lines of credit and equipment and receivables financing to businesses located primarily in our Community Banking Division s market area. At June 30, 2013, commercial business loans outstanding were $12.4 million, or 2.9% of total loans. At June 30, 2013, there were 164 commercial business loans outstanding with an average principal balance of $77 thousand. The largest of these commercial business loans had a principal balance of $1.2 million at June 30, 2013.

- *Consumer Loans.* We originate, on a direct basis, automobile, boat and recreational vehicle loans. At June 30, 2013, consumer loans outstanding were $13.3 million, or 3.1% of total loans.

- *Construction Loans.* From time to time, we originate residential construction loans to finance the construction of single-family, owner-occupied homes. At June 30, 2013, construction loans outstanding were $42 thousand.

Underwriting of Originated Loans. Most residential loans, including those held for investment, are originated in accordance with the standards of the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, the Federal Housing Authority, or other third party correspondent lenders. Our underwriting and approval process for all other loans originated by our Community Banking Division is as follows:

- Most of our originated loans are sourced through relationships between loan officers and their third party referral sources or current or previous customers.

- After a loan officer has taken basic information from the borrower, the request is submitted to the Community Banking Division s loan production department. The loan production department obtains comprehensive information from the borrower and third parties, and conducts verification and analysis of the borrower information, which is assembled into a single underwriting package that is submitted for final approval.

- Loans of $500 thousand or more (determined on a relationship basis) require approval from the Community Banking Division Credit Committee, which is comprised of senior managers of the Bank. Loans of less than $500 thousand (determined on a relationship basis) require approval from two underwriters with appropriate lending authority.

Loan Acquisition and Servicing Group

General. Our Loan Acquisition and Servicing Group (the LASG) purchases and originates commercial loans secured by income-producing collateral and on a nationwide basis. Although the Bank s legal lending limit was $19.9 million at June 30, 2013 (equal to 20% of Northeast Bank s capital plus surplus), our credit policy currently requires prior Board approval for the purchase or origination of a loan with an initial investment greater than 10% of the Company s tier one capital, determined on a relationship basis. We focus primarily on loans with balances between $1.0 million and $5.0 million. Loans are sourced on a nationwide basis from banks, insurance companies, investment funds and government agencies, either directly or indirectly through advisors. We seek to build a loan portfolio that is diverse with respect to geography, loan type and collateral type. Of the loans originated or purchased by our Loan Acquisition and Servicing Group that were outstanding as of June 30, 2013, $185.5 million, or 90.2%, consisted of commercial real estate loans. The following table summarizes the LASG loan portfolio as of June 30, 2013.

	Purchased	Originated	Total
		(Dollars in thousands)	
Non-owner occupied commercial real estate	$ 125,506	$ 18,126	$ 143,632
Owner occupied commercial real estate	38,540	3,361	41,901
Commercial business	34	17,242	17,276
1-4 family residential	2,706	150	2,856
Total	$ 166,786	$ 38,879	$ 205,665

Since the inception of the LASG through June 30, 2013, we have purchased loans for an aggregate investment of $223.8 million, of which $121.3 million was purchased during fiscal 2013. We have also originated loans totaling $42.6 million, of which $37.2 million was originated in fiscal 2013. As of June 30, 2013, the unpaid principal balance of loans purchased or originated by the LASG ranged from $1 thousand to $12.0 million, with an average of $741 thousand, and were secured by retail, industrial, mixed use, multi-family and office properties in 39 states.

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The following table shows the LASG loan portfolio by investment size as of June 30, 2013.

Investment Range		Amount (Dollars in thousands)	Percent of Total
$0 - $500	$	34,014	16.54%
$500 - $1,000		29,600	14.39%
$1,000 - $2,000		36,667	17.83%
$2,000 - $3,000		25,487	12.39%
$3,000 - $4,000		23,374	11.37%
Greater than $4,000		56,523	27.48%
	$	205,665	100.00%

The following tables show the LASG loan portfolio by location and type of collateral as of June 30, 2013.

Collateral Type		Amount (Dollars in thousands)	Percent of Total	State		Amount (Dollars in thousands)	Percent of Total
Multifamily	$	37,704	18.33%	CA	$	50,169	24.39%
Office		36,910	17.95%	NY		43,845	21.32%
Hospitality		29,777	14.48%	WI		7,446	3.62%
Retail		29,634	12.95%	NV		6,914	3.36%
Industrial		25,741	12.52%	IL		6,374	3.10%
Mixed use		21,782	10.59%	FL		6,015	2.92%
Securities		12,000	5.83%	LA		5,699	2.77%
Other real estate		5,124	2.49%	MN		5,268	2.56%
All other		6,993	4.86%	All other		73,935	35.96%
	$	205,665	100.00%		$	205,665	100.00%

Loan Purchase Strategies. Our Loan Acquisition and Servicing Group s loan purchasing strategy involves the acquisition of commercial loans, typically secured by real estate or other business assets located throughout the United States. The Loan Acquisition and Servicing Group includes a team of credit analysts, real estate analysts, servicing specialists and legal counsel with extensive experience in the loan acquisition business.

We acquire performing commercial loans typically at a discount to their unpaid principal balances. While we acquire loans on a nationwide basis, we seek to avoid significant concentration in any geographic region or in any one collateral type. We do not seek acquisition opportunities where the primary collateral is land, construction, or one- to four-family residential property, although in a very limited number of cases, loans secured by such collateral may be included in a pool of otherwise desirable loans.

We focus on servicing released, whole loan or lead participation transactions so that we can control the management of our portfolio through our experienced asset management professionals. Purchased loans can be acquired as a single relationship or combined with other borrowers in a larger pool. We generally avoid small average balance transactions (i.e. less than $250 thousand) due to the relatively higher operational and opportunity costs of managing and underwriting these assets. Loans are bid to a minimal acceptable yield to maturity based on the overall risk of the loan, including expected repayment terms and the underlying collateral value. Updated loan-to-value ratios and loan terms both influence the amount of discount the Bank requires in determining whether a loan meets the Bank s guidelines. We often achieve actual results in excess of our minimal acceptable yield to maturity when a loan is prepaid.

At June 30, 2013, purchased loans had an unpaid principal balance of $204.3 million and net investment basis of $166.8 million, representing discount across the portfolio of 18.4%.

The following table shows the purchased loan portfolio as of June 30, 2013 by original purchase price.

Investment as a % of Unpaid Principal Balance		**Amount (Dollars in thousands)**	**Percent of Total**
0% - 60%	$	6,938	4.16%
60% - 70%		8,015	4.81%
70% - 80%		30,763	18.44%
80% - 90%		43,318	25.97%
90% - 100%		77,752	46.62%
	$	166,786	100.00%

Secondary Market for Commercial Loans. Commercial whole loans are typically sold either directly by sellers or through loan sale advisors. Because a central database for commercial whole loans does not exist, we attempt to compile our own statistics by both polling major loan sale advisors to obtain their aggregate trading volume and tracking the deal flow that we see directly via a proprietary database. This data reflects only a portion of the total market, as commercial whole loans that are sold in private direct sales or through other loan sale advisors are not included in our surveys. In recent years, the ratio of performing loans to total loans in the market has increased, in part, because, we believe, sellers have worked through their most troubled, non-performing loans or are looking to minimize the discount they would receive in a secondary transaction. While the recent economic crisis has led to a high level of trading volume, we expect the market to remain active in times of economic prosperity, as sellers tend to have additional

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reserve capacity to sell their unwanted assets. Furthermore, we believe that the continued consolidation of the banking industry will create secondary market activity as acquirers often sell non-strategic borrowing relationships or assets that create excess loan concentrations.

Underwriting of Purchased Loans. We review many loan purchase opportunities and commence underwriting on a relatively small percentage of them. During fiscal 2013, we reviewed approximately 165 transactions representing loans with $1.8 billion in unpaid principal balance. Of those transactions that we reviewed, we placed bids in 39 transactions representing loans with $359 million in unpaid principal balance. Ultimately, we closed 31 transactions in which we acquired $155.2 million in unpaid principal balance for an aggregate purchase price of $121.3 million, or 78.2% of the unpaid principal balance.

Each of our purchased loans is individually underwritten by a team of in-house, seasoned analysts before being considered for approval. Prior to commencing underwriting, each loan or portfolio of loans is analyzed for its performance characteristics, loan terms, collateral quality, and price expectations. We also consider whether the loan or portfolio of loans would make our total purchased loan portfolio more or less diverse with respect to geography, loan type and collateral type. The opportunity is underwritten once it has been identified as fitting our investment parameters. While the extent of underwriting may vary based on investment size, procedures generally include the following:

- A loan analyst reviews and analyzes financial statements and third party research, including credit reports and other data with respect to the borrower, guarantors, corporate sponsors and any major tenants, in order to assess credit risk.

- With the assistance of local counsel, where appropriate, an in-house attorney makes a determination regarding the quality of loan documentation and enforceability of loan terms.

- An in-house real estate specialist performs a detailed evaluation of all real estate collateral, including canvassing local market experts, conducting original market research for trends and sale and lease comparables, and creates a written valuation that is based on current data reflecting what we believe are recent trends.

- An environmental assessment is performed on real estate collateral.

- A property inspection is performed on all real estate collateral securing a loan, focusing on several characteristics, including, among other things, the physical quality of the property, current occupancy, general quality and occupancy within the neighborhood, market position and nearby property listings.

- A detailed underwriting package containing the results of all this analysis and information is assembled and reviewed by a separate credit analyst on our team before being submitted for approval by the Loan Acquisition and Servicing Group Credit Committee.

Collateral Valuation. The estimated value of the real property collateralizing the loan is determined by the Loan Acquisition and Servicing Group s in-house real estate group, which considers, among other factors, the type of property, its condition, location and its highest and best use in its marketplace. An inspection is conducted for the real property securing all loans bid upon, and for all loans that represent an investment in excess of $1.0 million, members of the Loan Acquisition and Servicing Group typically conduct an in-person site inspection.

We generally view cash flow from operations as the primary source of repayment on purchased loans. The Loan Acquisition and Servicing Group analyzes the current and likely future cash flows generated by the collateral to repay the loan. Also considered are minimum debt service coverage ratios, consisting of the ratio of net operating income to total principal and interest payments. For example, our credit policy provides that the debt service coverage ratio for a purchased commercial real estate loan generally should not be less than 120 percent of the monthly principal and interest payments resulting from a re-amortization of the Bank s basis, at a market interest rate.

Loan Pricing. In determining the amount that we are willing to bid to acquire individual loans or loan pools, the Loan Acquisition and Servicing Group considers the following:

- the collateral securing the loan;
- the geographic location;
- the financial resources of the borrower or guarantors, if any;
- the recourse nature of the loan;
- the age and performance of the loan;
- the length of time during which the loan has performed in accordance with its repayment term;
- the yield expected to be earned; and
- servicing restrictions, if any.

In addition to the factors listed above and despite the fact that purchased loans are typically performing loans, the Loan Acquisition and Servicing Group also estimates the amount that we may realize through collection efforts or foreclosure and sale of the collateral, net of expenses, and the length of time and costs required to complete the collection or foreclosure process in the event a loan becomes non-performing or is non-performing at the time of purchase.

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Approvals. All loan purchases must be approved by the Loan Acquisition and Servicing Group Credit Committee. This committee is comprised of members of the executive management team and senior management from the Loan Acquisition and Servicing Group. The committee discusses all loans on an individual basis. Our credit policy currently requires prior Board approval for the purchase of a loan with an initial investment greater than $10% of the Company s tier one capital, determined on a relationship basis.

Loan Servicing. We conduct all loan servicing with an in-house team of experienced asset managers who actively manage the loan portfolio. Asset managers initiate and maintain regular borrower contact, and ensure that the loan credit analysis is accurate. Collateral valuations, property inspections, and other collateral characteristics are updated periodically as a result of our ongoing in-house real estate analysis. All asset management activity and analysis is contained within a central database.

Competition for Purchased of Loans. Our Loan Acquisition and Servicing Group competes primarily with community banks, regional banks and private equity funds operating nationwide. We believe that we have a competitive advantage in bidding against private equity funds on performing loans because those funds generally have higher funding costs and, therefore, higher expectations for return on investment than we do. Furthermore, many private equity funds do not compete for small balance commercial loans and typically pursue larger, bulk transactions.

We believe that we have a competitive advantage in bidding against many banks that purchase commercial loans in the secondary market because we have a specialized group with experience in purchasing commercial real estate loans. Most banks we compete against are community banks looking to acquire loans in their market; these banks usually have specific criteria for their acquisition activities and do not pursue pools with collateral or geographic diversity. We believe that there are a limited number of banks pursuing a similar, nationwide commercial loan acquisition strategy.

Loan Originations. In addition to purchasing loans, our Loan Acquisition and Servicing Group also originates commercial loans. Capitalizing on our purchased loan infrastructure, LASG is in a position to review and act quickly on a variety of lending opportunities. Risk management and due diligence for these loans is similar to that for purchased loans, with the exception of a the appraisal and documentation process, which mirrors more traditional lenders in employing local attorneys and real estate appraisers to assist in the process. We believe that the LASG has an advantage in originating commercial loans because of its ability to utilize in-house staff to quickly and accurately screen loan opportunities and accelerate the underwriting process.

Brokerage and Investment Advisory Services

For over fifteen years, the Bank s investment brokerage division, Northeast Financial Services (Northeast Financial), offered an array of investment and financial planning products and services through the Bank s branch network. In August of 2013, the Company announced its intention to exit the investment brokerage business. The Company expects that all investment brokerage activities will conclude in the first half of fiscal 2014.

Investment Activities

Our securities portfolio and short-term investments provide and maintain liquidity, assist in managing the interest rate sensitivity of our balance sheet, and serve as collateral for certain of our obligations. Individual investment decisions are made based on the credit quality of the investment, liquidity requirements, potential returns, cash flow targets, and consistency with our asset/liability management objectives.

Sources of Funds

Deposits have traditionally been the primary source of the Bank s funds for lending and other investment purposes. In addition to deposits, the Bank obtains funds from the amortization and prepayment of loans and mortgage-backed securities, the sale, call or maturity of investment securities, advances from the Federal Home Loan Bank of Boston (the FHLB), other term borrowings and cash flows generated by operations.

Deposits

We offer a full line of deposit products to customers in western and south-central Maine through our ten-branch network. Our deposit products consist of demand deposit, NOW, money market, savings and certificate of deposit accounts. Our customers access their funds through ATMs, Mastercard® Debit Cards, Automated Clearing House funds (electronic transfers) and checks. We also offer telephone banking, Internet banking, Internet bill payment and remote deposit capture services. Interest rates on our deposits are based upon factors that include prevailing loan demand, deposit maturities, alternative costs of funds, interest rates offered by competing financial institutions and other financial service firms, and general economic conditions. At June 30, 2013, we had core deposits of $476.4 million (of which $367.8 million were generated through the Community Banking Division), representing 98.3% of total deposits. We define core deposits as non-maturity deposits and non-brokered insured time deposits.

Our online affinity deposit program, ableBanking, provides an additional channel through which to obtain core deposits to support our growth. ablebanking, which was launched in late fiscal 2012 as a division of Northeast Bank, had $71.8 million in money market and time deposits as of June 30, 2013. We also use deposit listing services to gather deposits from time to time, in support of

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our liquidity and asset/liability management objectives. At June 30, 2013, listing service deposits totaled $36.8 million, most of which were 5-year time deposits.

Borrowings

While we currently consider core deposits (defined as non-maturity deposits and non-brokered insured time deposits) as our primary source of funding to support asset growth, advances from the FHLB and other sources of wholesale funding remain an important part of our liquidity contingency planning. Northeast Bank may borrow up to 50.0% of its total assets from the FHLB, and borrowings are typically collateralized by mortgage loans and securities pledged to the FHLB. At June 30, 2013, we had $20.5 million available immediately and an additional $275.9 million, subject to the purchase of additional FHLB stock and the availability of additional collateral, available from the FHLB. Northeast Bank can also borrow from the Federal Reserve Bank of Boston, with any such borrowing collateralized by consumer loans pledged to the Federal Reserve.

For the foreseeable future we expect to rely less on borrowings than other banks of similar size, because of our regulatory commitment to fund 100% of our loans with core deposits, although the availability of FHLB and Federal Reserve Bank of Boston advances and other sources of wholesale funding remain an important part of our liquidity contingency planning.

Recent Technology and Operational Enhancements

Over the past few years, we have made investments in technology and customer service to develop the infrastructure to support the Loan Acquisition and Servicing Group, ableBanking, and the Community Banking Division. In addition, we invested in new software, hardware, and staffing to support our growing Customer Contact Center in Lewiston, Maine, and to ensure that we will continue to deliver a high level of personal service to our customers as we grow. We expect that future investments in technology, customer service and operational support functions will generally be proportionate to our growth.

Employees

As of June 30, 2013, the Company employed 210 full-time and 17 part-time employees. The Company s employees are not represented by any collective bargaining unit. The Company believes that its relations with its employees are good.

Other Subsidiaries

At June 30, 2013, the Bank had four wholly-owned non-bank subsidiaries:

- Northeast Bank Insurance Group, Inc. (NBIG). The insurance agency assets of NBIG were sold on September 1, 2011. The entity currently holds the real estate formerly used in its insurance agency business.

- 200 Elm Realty, LLC, which was established to hold commercial real estate acquired as a result of loan workouts.

- 500 Pine Realty, LLC, which was established to hold residential real estate acquired as a result of loan workouts.

- 17 Dogwood Realty, LLC, which was established to hold commercial real estate acquired as a result of loan workouts.

The Company s wholly-owned subsidiary, ASI Data Services, Inc. (ASI), is an inactive corporate subsidiary. ASI initially provided data processing services to the Company and its subsidiaries. The Company s board transferred the assets and operations of ASI to the Bank in 1996.

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Supervision and Regulation

General

As a bank holding company registered under the Bank Holding Company Act of 1956, as amended (the BHCA), the Company is subject to regulation and supervision by the Federal Reserve. As an FDIC-insured Maine-chartered bank and member of the Federal Reserve System, the Bank is subject to regulation and supervision by the Federal Reserve, the Bureau and the FDIC. This regulatory framework is intended to protect depositors, the federal deposit insurance fund, consumers and the banking system as a whole, and not necessarily investors in the Company. The following discussion is qualified in its entirety by reference to the full text of the statutes, regulations, policies and guidelines described below.

Financial Regulatory Reform Legislation

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), enacted on July 21, 2010, comprehensively reformed the regulation of financial institutions, products and services. Among other things, the Dodd-Frank Act:

- grants the Federal Reserve increased supervisory authority and codifies the source of strength doctrine, as discussed in more detail in Source of Strength below;
- provides for new capital standards applicable to the Company, as discussed in more detail in Capital Adequacy and Safety and Soundness Regulatory Capital Requirements below;
- modifies deposit insurance coverage, as discussed in Capital Adequacy and Safety and Soundness Deposit Insurance below;
- bars banking organizations, such as the Company, from engaging in proprietary trading and from sponsoring and investing in hedge funds and private equity funds, except as permitted under certain limited circumstances, as discussed in Bank Holding Company Regulation below;
- established new corporate governance and proxy disclosure requirements, as discussed in Corporate Governance and Executive Compensation below;
- established the Bureau of Consumer Financial Protection (the CFPB), as discussed in Consumer Protection Regulation below;

- established new minimum mortgage underwriting standards for residential mortgages, as discussed in Mortgage Reform below;

- authorizes the Federal Reserve to regulate interchange fees for debit card transactions;

- permits the payment of interest on business demand deposit accounts;

- established and empowered the Financial Stability Oversight Council to designate certain activities as posing a risk to the U.S. financial system and recommend new or heightened standards and safeguards for financial institutions engaging in such activities; and

- established the Office of Financial Research, which has the power to require reports from financial services companies such as the Company.

Bank Holding Company Regulation

Unless a bank holding company becomes a financial holding company under the Gramm-Leach-Bliley Act (GLBA) as discussed below, the BHCA prohibits (with the exceptions noted below in this paragraph) a bank holding company from acquiring a direct or indirect interest in or control of more than 5% of the voting shares of any company that is not a bank or a bank holding company. The BHCA requires every bank holding company to obtain the prior approval of the Federal Reserve before it may acquire substantially all of the assets of any bank, or ownership or control of any voting shares of a bank, if, after such acquisition, it would own or control, directly or indirectly, more than 5% of the voting stock of such bank. In addition, the BHCA prohibits a bank holding company from engaging directly or indirectly in activities other than those of banking, managing or controlling banks or furnishing services to its subsidiary banks. However, a bank holding company may engage in, and may own shares of companies engaged in certain activities, that the Federal Reserve determines to be so closely related to banking or managing and controlling banks so as to be incident thereto. In making such determinations, the Federal Reserve is required to weigh the expected benefit to the public, including such factors as greater convenience, increased competition or gains in efficiency, against the possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests or unsafe or unsound banking practices.

Under GLBA, bank holding companies are permitted to offer their customers virtually any type of service that is financial in nature or incidental thereto, including banking, securities underwriting, insurance (both underwriting and agency), and merchant banking. Under the Dodd-Frank Act, however, a bank holding company and its affiliates are prohibited from engaging in proprietary trading and from sponsoring and investing in hedge funds and private equity funds, expect as permitted under certain limited circumstances. In order to engage in financial activities under GLBA, a bank holding company must qualify and register with the Federal Reserve as

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a financial holding company by demonstrating that each of its bank subsidiaries is well capitalized , well managed, and has at least a satisfactory rating under the Community Reinvestment Act of 1977 (CRA). Although the Company believes that it meets the qualifications to become a financial holding company under GLBA, it has not elected financial holding company status, but rather to retain its pre-GLBA bank holding company regulatory status for the present time.

The Company is required by the BHCA to file an annual report and additional reports required with the Federal Reserve. The Federal Reserve also makes periodic inspections of the Company and its subsidiaries.

Dividends

The Company is a legal entity separate and distinct from the Bank. The revenue of the Company (on a parent company only basis) is derived primarily from interest and dividends paid to it by the Bank. The right of the Company, and consequently the right of shareholders of the Company, to participate in any distribution of the assets or earnings of the Bank through the payment of such dividends or otherwise is necessarily subject to the prior claims of creditors of the Bank (including depositors), except to the extent that certain claims of the Company in a creditor capacity may be recognized.

It is the policy of the Federal Reserve that bank holding companies should pay dividends only out of current earnings and only if, after paying such dividends, the bank holding company would remain adequately capitalized. The Federal Reserve has the authority to prohibit a bank holding company, such as the Company, from paying dividends if it deems such payment to be an unsafe or unsound practice.

The Federal Reserve has the authority to use its enforcement powers to prohibit a bank from paying dividends if, in its opinion, the payment of dividends would constitute an unsafe or unsound practice. Federal law also prohibits the payment of dividends by a bank that will result in the bank failing to meet its applicable capital requirements on a pro forma basis. Maine law requires the approval of the BFI for any dividend that would reduce a bank s capital below prescribed limits.

Source of Strength

Under the Dodd-Frank Act, the Company is required to serve as a source of financial strength for the Bank in the event of the financial distress of the Bank. This provision codifies the longstanding policy of the Federal Reserve. In addition, any capital loans by a bank holding company to any of its bank subsidiaries are subordinate to the payment of deposits and to certain other indebtedness. In the event of a bank holding company s bankruptcy, any commitment by the bank holding company to a federal bank regulatory agency to maintain the capital of a bank subsidiary will be assumed by the bankruptcy trustee and entitled to a priority of payment.

Certain Transactions by Bank Holding Companies with their Affiliates

There are various statutory restrictions on the extent to which bank holding companies and their non-bank subsidiaries may borrow, obtain credit from or otherwise engage in covered transactions with their insured depository institution subsidiaries. The Dodd-Frank Act amended the definition of affiliate to include an investment fund for which the depository institution or one of its affiliates is an investment adviser. An insured depository institution (and its subsidiaries) may not lend money to, or engage in covered transactions with, its non-depository institution affiliates if the aggregate amount of covered transactions outstanding involving the bank, plus the proposed transaction exceeds the following limits: (a) in the case of any one such affiliate, the aggregate amount of covered transactions of the insured depository institution and its subsidiaries cannot exceed 10% of the capital stock and surplus of the insured depository institution; and (b) in the case of all affiliates, the aggregate amount of covered transactions of the insured depository institution and its subsidiaries cannot exceed 20% of the capital stock and surplus of the insured depository institution. For this purpose, covered transactions are defined by statute to include a loan or extension of credit to an affiliate, a purchase of or investment in securities issued by an affiliate, a purchase of assets from an affiliate unless exempted by the Federal Reserve, the acceptance of securities issued by an affiliate as collateral for a loan or extension of credit to any person or company, the issuance of a guarantee, acceptance or letter of credit on behalf of an affiliate, securities borrowing or lending transactions with an affiliated that creates a credit exposure to such affiliate, or a derivatives transaction with an affiliate that creates a credit exposure to such affiliate. Covered transactions are also subject to certain collateral security requirements. Covered transactions as well as other types of transactions between a bank and a bank holding company must be on market terms and not otherwise unduly favorable to the holding company or an affiliate of the holding company. Moreover, Section 106 of the BHCA provides that, to further competition, a bank holding company and its subsidiaries are prohibited from engaging in certain tying arrangements in connection with any extension of credit, lease or sale of property of any kind, or furnishing of any service.

Regulation of the Bank

As a Maine-chartered bank and member of the Federal Reserve System, the Bank is subject to the supervision of and regulation by the BFI and the Federal Reserve. Additionally, the Bank is subject to the regulation and supervision of the FDIC as the Bank s insurer of deposits. This supervision and regulation is for the protection of depositors, the FDIC s Deposit Insurance Fund (DIF), and consumers, and is not for the protection of the Company s shareholders. The prior approval of the Federal Reserve and the BFI is required, among other things, for the Bank to establish or relocate an additional branch office, assume deposits, or engage in any

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merger, consolidation, purchase or sale of all or substantially all of the assets of any bank. Under the Dodd-Frank Act, the Federal Reserve may directly examine the subsidiaries of the Company, including the Bank.

Capital Adequacy and Safety and Soundness

Regulatory Capital Requirements. The Federal Reserve has issued risk-based and leverage capital guidelines applicable to United States banking organizations. In addition, the Federal Reserve may from time to time require that a banking organization maintain capital above the minimum levels, due to the banking organization s financial condition or actual or anticipated growth.

Current Federal Reserve risk-based guidelines define a three-tier capital framework. Tier 1 capital for bank holding companies generally consists of the sum of common stockholders equity, perpetual preferred stock and trust preferred securities (both subject to certain limitations and, in the case of the latter, to specific limitations on the kind and amount of such securities which may be included as Tier 1 capital and certain additional restrictions described below), and minority interests in the equity accounts of consolidated subsidiaries, less goodwill and other non-qualifying intangible assets. Pursuant to the Dodd-Frank Act, trust preferred securities issued after May 19, 2010, will not count as Tier 1 capital; however, under the Dodd-Frank Act, the Company s currently outstanding trust preferred securities were grandfathered for Tier 1 eligibility. Tier 2 capital generally consists of hybrid capital instruments, perpetual debt and mandatory convertible debt securities; perpetual preferred stock and trust preferred securities, to the extent it is not eligible to be included as Tier 1 capital; term subordinated debt and intermediate-term preferred stock; and, subject to limitations, general allowances for loan losses. The sum of Tier 1 and Tier 2 capital less certain required deductions, such as investments in unconsolidated banking or finance subsidiaries, represents qualifying total capital. Risk-based capital ratios are calculated by dividing Tier 1 and total capital, respectively, by risk-weighted assets. Assets and off-balance sheet credit equivalents are assigned to one of four categories of risk-weights, based primarily on relative credit risk. The minimum Tier 1 risk-based capital ratio is 4% and the minimum total risk-based capital ratio is 8%. As of June 30, 2013, the Company s Tier 1 risk-based capital ratio was 27.29% and its total risk-based capital ratio was 27.54%. The Company is currently considered well capitalized under all regulatory definitions.

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 Company s leverage capital ratio as of June 30, 2013 was 17.78%.

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 (FDIA). 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.

Generally, a bank, upon receiving notice that it is not adequately capitalized (i.e., that it is undercapitalized), becomes subject to the prompt corrective action provisions of Section 38 of FDIA that, for example, (i) restrict payment of capital distributions and management fees, (ii) require that the Federal Reserve monitor the condition of the institution and its efforts to restore its capital, (iii) require submission of a capital restoration plan, (iv) restrict the growth of the institution s assets and (v) require prior regulatory approval of certain expansion proposals. A bank that is required to submit a capital restoration plan must concurrently submit a performance guarantee by each company that controls the bank. A bank that is critically undercapitalized (i.e., has a ratio of tangible equity to total assets that is equal to or less than 2.0%) will be subject to further restrictions, and generally will be placed in conservatorship or receivership within 90 days.

The Basel Committee on Banking Supervision has also released new capital requirements, known as Basel III, setting forth higher capital requirements, enhanced risk coverage, a global leverage ratio, provisions for counter-cyclical capital, and liquidity standards. On July 2, 2013, the Federal Reserve, along with the other federal banking agencies, issued a final rule (the Final Capital Rule) implementing the Basel III capital standards and establishing the minimum capital requirements for banks and bank holding companies required under the Dodd-Frank Act. The majority of the provisions of the Final Capital Rule apply to bank holding companies and banks with consolidated assets of $500 million or more, such as the Company and the Bank. The Final Capital Rule establishes a new capital risk-based capital ratio, a minimum common equity Tier 1 capital ratio of 6.5% of risk-weighted assets to be

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a well capitalized institution, and increase the minimum total Tier 1 capital ratio to be a well capitalized institution from 6.0% to 8.0%. Additionally, the Final Capital Rule requires that an institution establish a capital conservation buffer of common equity Tier 1 capital in an amount above the minimum risk-based capital requirements equal to 2.5% of total risk weight assets. The Final Capital Rule revises certain capital definitions and generally makes the capital requirements more stringent. Further, the Final Capital Rule increases the required capital for certain categories of assets, including higher-risk construction real estate loans and certain exposures related to securitizations. Under the Final Capital Rule, the Company may make a one-time, permanent election to continue to exclude accumulated other comprehensive income from capital. If the Company does not make this election, unrealized gains and losses would be included in the calculation of its regulatory capital.

The Company must comply with the Final Capital Rule beginning on January 1, 2015.

Deposit Insurance. Substantially all of the deposits of the Bank are insured up to applicable limits by the DIF and are subject to deposit insurance assessments to maintain the DIF. The FDIA, as amended by the Federal Deposit Insurance Reform Act and the Dodd-Frank Act, requires the FDIC to set a ratio of deposit insurance reserves to estimated insured deposits of the Bank are insured up to applicable limits by the DIF and are subject to deposit insurance premiums based upon a risk matrix that takes into account a bank s capital level and supervisory rating (CAMELS rating). CAMELS ratings reflect the applicable bank regulatory agency to applicable limits by the DIF and are subject to deposit, management, earnings, liquidity and sensitivity to risk. Assessment rates may also vary for certain institutions based on long-term debt issuer ratings, secured or brokered deposits. Pursuant to the Dodd-Frank Act, deposit premiums are based on assets rather than insurable deposits. To determine its actual deposit insurance premiums, the Bank computes the base amount on its average consolidated assets less its average tangible equity (defined as the amount of Tier 1 capital) and its applicable assessment rate. Assessment rates range from 2.5 to 9 basis points on the broader assessment base for banks in the lowest risk category up to 30 to 45 basis points for banks in the highest risk category.

Pursuant to the Dodd-Frank Act, FDIC deposit insurance has been permanently increased from $100,000 to $250,000 per depositor. On December 31, 2012, unlimited FDIC insurance on noninterest-bearing transaction accounts under the Dodd-Frank Act expired.

Under the FDIA, the FDIC may terminate deposit insurance upon a finding that the institution has engaged in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC.

Safety and Soundness Standard. The FDIA requires the federal bank regulatory agencies to prescribe standards, by regulations or guidelines, relating to internal controls, information systems and internal audit systems, loan documentation, credit underwriting, interest rate risk exposure, asset growth, asset quality, earnings, stock valuation and compensation, fees and benefits, and such other operational and managerial standards as the agencies deem appropriate. Guidelines adopted by the federal bank regulatory agencies establish general standards relating to internal controls and information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth and compensation, fees and benefits. In general, these guidelines require, among other things, appropriate systems and practices to identify and manage the risk and exposures specified in the guidelines. The guidelines prohibit excessive compensation as an unsafe and unsound practice and describe compensation as excessive when the amounts paid are unreasonable or disproportionate to the services performed by an executive officer, employee, director or principal stockholder. In addition, the federal banking agencies adopted regulations that authorize, but do not require, an agency to order an institution that has been given notice by an agency that it is not satisfying any of such safety and soundness standards to submit a compliance plan. If, after being so notified, an institution fails to submit an acceptable compliance plan or fails in any material respect to implement an acceptable compliance plan, the agency must issue an order directing action to correct the deficiency and may issue an order directing other actions of the types to which an undercapitalized institution is subject under the prompt corrective action provisions of FDIA. See Regulatory Capital Requirements above. If an institution fails to comply with such an order, the agency may seek to enforce such order in judicial proceedings and to impose civil money penalties.

Depositor Preference. The FDIA provides that, in the event of the liquidation or other resolution of an insured depository institution, the claims of depositors of the institution, including the claims of the FDIC as subrogee of insured depositors, and certain claims for administrative expenses of the FDIC as a receiver, will have priority over other general unsecured claims against the institution. If an insured depository institution fails, insured and uninsured depositors, along with the FDIC, will have priority in payment ahead of unsecured, non-deposit creditors, including depositors whose deposits are payable only outside of the United States and the parent bank holding company, with respect to any extensions of credit they have made to such insured depository institution.

Real Estate Lending Standards

The Federal Deposit Insurance Corporation Improvement Act requires the federal bank regulatory agencies to adopt uniform real estate lending standards. The Federal Reserve has adopted regulations, which establish supervisory limitations on loan-to-value (LTV) ratios in real estate loans by state-chartered banks that are members of the Federal Reserve System, such as the Bank. The regulations require banks to establish LTV ratio limitations within or below the prescribed uniform range of supervisory limits.

Activities and Investments of Insured State Banks

The powers of a Maine-chartered bank, such as the Bank, include provisions designed to provide Maine banks with competitive equity to the powers of national banks. GLBA includes a section of the FDIA governing subsidiaries of state banks that engage in activities

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as principal that would only be permissible for a national bank to conduct in a financial subsidiary. This provision permits state banks, to the extent permitted under state law, to engage in certain new activities, which are permissible for subsidiaries of a financial holding company. Further, it expressly preserves the ability of a state bank to retain all existing subsidiaries. Because Maine law explicitly permits banks chartered by the state to engage in all activities permissible for federally-chartered banks, the Bank is permitted to form subsidiaries to engage in the activities authorized by GLBA. In order to form a financial subsidiary, a state bank must be well-capitalized, and the state bank would be subject to certain capital deduction, risk management and affiliate transaction rules.

Consumer Protection Regulation

The Company and the Bank are subject to a number of federal and state laws designed to protect consumers and prohibit unfair or deceptive business practices. These laws include the Equal Credit Opportunity Act, the Fair Housing Act, Home Ownership Protection Act, the Fair Credit Reporting Act, as amended by the Fair and Accurate Credit Transactions Act of 2003 (FACT Act), GLBA, the Truth in Lending Act, CRA, the Home Mortgage Disclosure Act, the Real Estate Settlement Procedures Act, the National Flood Insurance Act and various state law counterparts. These laws and regulations mandate certain disclosure requirements and regulate the manner in which financial institutions must interact with customers when taking deposits, making loans, collecting loans and providing other services. Further, the Dodd-Frank Act established the CFPB, which has the responsibility for making rules and regulations under the federal consumer protection laws relating to financial products and services. The CFPB also has a broad mandate to prohibit unfair or deceptive acts and practices and is specifically empowered to require certain disclosures to consumers and draft model disclosure forms. Failure to comply with consumer protection laws and regulations can subject financial institutions to enforcement actions, fines and other penalties. The Federal Reserve examines the Bank for compliance with CFPB rules and enforces CFPB rules with respect to the Bank.

Mortgage Reform

The Dodd-Frank Act prescribes certain standards that mortgage lenders must consider before making a residential mortgage loan, including verifying a borrower s ability to repay such mortgage loan. The Dodd-Frank Act also allows borrowers to assert violations of certain provisions of the Truth-in-Lending Act as a defense to foreclosure proceedings. Under the Dodd-Frank Act, prepayment penalties are prohibited for certain mortgage transactions and creditors are prohibited from financing insurance policies in connection with a residential mortgage loan or home equity line of credit. The Dodd-Frank Act requires mortgage lenders to make additional disclosures prior to the extension of credit, in each billing statement and for negative amortization loans and hybrid adjustable rate mortgages. Additionally, the Dodd-Frank Act prohibits mortgage originators from receiving compensation based on the terms of residential mortgage loans and generally limits the ability of a mortgage originator to be compensated by others if compensation is received from a consumer.

Privacy and Customer Information Security

GLBA requires financial institutions to implement policies and procedures regarding the disclosure of nonpublic personal information about consumers to nonaffiliated third parties. In general, the Bank must provide its customers with an annual disclosure that explains its policies and procedures regarding the disclosure of such nonpublic personal information and, except as otherwise required or permitted by law, the Bank is prohibited from disclosing such information except as provided in such policies and procedures. GLBA also requires that the Bank develop, implement and maintain a comprehensive written information security program designed to ensure the security and confidentiality of customer information (as defined under GLBA), to protect against anticipated threats or hazards to the security or integrity of such information; and to protect against unauthorized access to or use of such information that could result in substantial harm or inconvenience to any customer. The Bank is also required to send a notice to customers whose sensitive information has been compromised if unauthorized use of this information is reasonably possible. Most states, including Maine, have enacted legislation concerning breaches of data security and the duties of the Bank in response to a data breach. Congress continues to consider federal legislation that would require consumer notice of data security breaches. Pursuant to the FACT Act, the Bank must also develop and implement a written identity theft prevention program to detect, prevent, and mitigate identity theft in connection with the opening of certain accounts or certain existing accounts. Additionally, the FACT Act amends the Fair Credit Reporting Act to generally prohibit a person from using information received from an affiliate to make a solicitation for marketing purposes to a consumer, unless the consumer is given notice and a reasonable opportunity and a reasonable and simple method to opt out of the making of such solicitations.

Regulatory Enforcement Authority

The enforcement powers available to the federal banking agencies include, among other things, the ability to assess civil money penalties, to issue cease and desist or removal orders and to initiate injunctive actions against banking organizations and institution-affiliated parties, as defined. In general, these enforcement actions may be initiated for violations of law and regulations and unsafe or unsound practices. Other actions or inactions may provide the basis for enforcement action, including misleading or untimely reports filed with regulatory authorities. Under certain circumstances, federal and state law requires public disclosure and reports of certain criminal offenses and also final enforcement actions by the federal banking agencies.

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Community Reinvestment Act

Pursuant to the CRA, regulatory authorities review the performance of the Bank in meeting the credit needs of the communities it serves. The applicable regulatory authorities consider compliance with this law in connection with the applications for, among other things, approval for *de novo* branches, branch relocations and acquisitions of banks and bank holding companies. The Bank received a satisfactory rating at its CRA examination dated June 10, 2013, its most recent exam.

Failure of an institution to receive at least a satisfactory rating could inhibit such institution or its holding company from undertaking certain activities, including engaging in activities newly permitted as a financial holding company under GLBA, and acquisitions of other financial institutions. The Federal Reserve must take into account the record of performance of banks in meeting the credit needs of the entire community served, including low- and moderate-income neighborhoods. Current CRA regulations for large banks primarily rely on objective criteria of the performance of institutions under three key assessment tests: a lending test, a service test and an investment test. For smaller banks, current CRA regulations primarily evaluate the performance of institutions under two key assessment tests: a lending test and a community development test. The Company is committed to meeting the existing or anticipated credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with safe and sound banking operations.

Branching and Acquisitions

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, as amended (Riegle-Neal) and the Dodd-Frank Act permit well capitalized and well managed bank holding companies, as determined by the Federal Reserve, to acquire banks in any state subject to certain concentration limits and other conditions. Riegle-Neal also generally authorizes the interstate merger of banks. In addition, among other things, Riegle-Neal and the Dodd-Frank Act permit banks to establish new branches on an interstate basis to the same extent a bank chartered by the host state may establish branches. Bank holding companies and banks are required to obtain prior Federal Reserve approval to acquire more than 5% of a class of voting securities, or substantially all of the assets, of a bank holding company, bank or savings association.

Anti-Money Laundering and the Bank Secrecy Act

Under the Bank Secrecy Act (BSA), a financial institution is required to have systems in place to detect certain transactions, based on the size and nature of the transaction. Financial institutions are generally required to report to the United States Treasury any cash transactions involving more than $10 thousand. In addition, financial institutions are required to file suspicious activity reports for transactions that involve more than $5 thousand and which the financial institution knows, suspects or has reason to suspect involves illegal funds, is designed to evade the requirements of the BSA or has no lawful purpose. The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the USA PATRIOT Act), which amended the BSA, is designed to deny terrorists and others the ability to obtain anonymous access to the U.S. financial system. The USA PATRIOT Act has significant implications for financial institutions and businesses of other types involved in the transfer of money. The USA PATRIOT Act, together with the implementing regulations of various federal regulatory agencies, has caused financial institutions, such as the Bank, to adopt and implement additional policies or amend existing policies and procedures with respect to, among other things, anti-money laundering compliance, suspicious activity, currency transaction reporting, customer identity verification and customer risk analysis. In evaluating an application under Section 3 of the BHCA to acquire a bank or an application under the Bank Merger Act to merge banks or affect a purchase of assets and assumption of deposits and other liabilities, the applicable federal banking regulator must consider the anti-money laundering compliance record of both the applicant and the target.

The United States has imposed economic sanctions that affect transactions with designated foreign countries, nationals and others. These sanctions, which are administered by the Treasury Office of Foreign Assets Control (OFAC), take many different forms. Generally, however, they contain one or more of the following elements: (i) restrictions on trade with or investment in a sanctioned country, including prohibitions against direct or indirect imports from and exports to a sanctioned country and prohibitions on U.S. persons engaging in financial transactions relating to making investments in, or providing investment-related advice or assistance to, a sanctioned country; and (ii) a blocking of assets in which the government or specially designated nationals of the sanctioned country have an interest, by prohibiting transfers of property subject to U.S. jurisdiction (including property in the possession or control of U.S. persons). Blocked assets (for example, property and bank deposits) cannot be paid out, withdrawn, set off or transferred in any manner without a license from OFAC.

Federal Home Loan Bank System

The Bank is a member of the Federal Home Loan Bank of Boston (the FHLBB), which is one of the regional Federal Home Loan Banks comprising the Federal Home Loan Bank System. Each Federal Home Loan Bank provides a central credit facility primarily for member institutions. Member institutions are required to acquire and hold shares of capital stock in the FHLBB in an amount at least equal to the sum of 0.35% of the aggregate principal amount of its unpaid residential mortgage loans and similar obligations at the beginning of each year and 4.5% of its advances (borrowings) from the FHLBB. The Bank was in compliance with this requirement with an investment in FHLBB stock as of June 30, 2013 of $4.2 million. The Bank receives dividends on its FHLBB stock. The FHLBB has recently declared dividends equal to an annual yield of approximately the daily average three-month LIBOR yield for the quarter for which the dividend has been declared. Dividend income on FHLBB stock of $20 thousand was recorded during the most recent fiscal year.

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Any advances from the FHLBB must be secured by specified types of collateral, and long-term advances may be used for the purpose of providing funds for residential housing finance, commercial lending and to purchase investments. Long term advances may also be used to help manage interest rate risk for asset and liability management purposes. As of June 30, 2013, the Bank had $27.5 million in outstanding FHLBB advances.

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Item 1A. Risk Factors

Investing in our common stock involves a high degree of risk. You should carefully consider the following risks and uncertainties, together with all other information in this prospectus, including our consolidated financial statements and related notes, before investing in our common stock. Any of the risk factors we describe below could adversely affect our business, financial condition or results of operations. The trading price of our voting common stock could decline if one or more of these risks or uncertainties actually occurs, causing you to lose all or part of your investment. Certain statements below are forward-looking statements. See A Note About Forward-Looking Statements.

Risks Associated With Our Business

We may not be successful in the implementation of our business strategy.

Following our merger with FHB Formation LLC in December 2010, we substantially revised our business strategy to include the building of a Loan Acquisition and Servicing Group to grow our loan portfolio and the introduction of an online affinity savings program, known as ableBanking, to grow our core deposits. Our ability to develop and offer new products and services depends, in part, on whether we can hire and retain enough suitably experienced and talented employees, identify suitable loans for purchase at attractive prices, identify enough suitable deposit customers, successfully build the systems and obtain the other resources necessary for creating the new product and service offerings. We may not be able to do so, or, doing so may be more expensive, or take longer, than we expect. Our experience with each of these initiatives is limited.

We are subject to regulatory conditions that could constrain our ability to grow our loan acquisition business.

In conjunction with the regulatory approvals received for the merger with FHB Formation LLC, we committed to maintain a Tier 1 leverage ratio of at least 10%, fund 100% of our loans with core deposits, limit purchased loans to 40% of total loans and hold commercial real estate loans to within 300% of total risk-based capital. Core deposits, for purposes of this commitment, are defined as non-brokered non-maturity deposits and non-brokered insured time deposits. At June 30, 2013, the ratio of our purchased loans to total loans was 37.6%. Our ability to purchase loans will be dependent on our ability to grow our originated loan portfolio. To the extent our ability to originate loans is constrained by market forces or for any other reason, our ability to execute our loan acquisition strategy would be similarly constrained.

We may not be able to grow our core deposits through ableBanking, or doing so may be more expensive or take longer than we expect.

Our online affinity deposit program, ableBanking, was launched in the fourth quarter of fiscal 2012 to provide an additional channel through which to obtain core deposits to support our growth. Our strategy with regard to ableBanking, which through June 30, 2013 had generated $71.8 million in deposits, is not yet mature and there can be no assurance that we will be able to continue to grow core deposits through ableBanking at the rate we anticipate, or that in obtaining such deposits, we will not be forced to price products on less advantageous terms to retain or attract clients, which would adversely affect our profitability. One of the commitments that we made in connection with securing the regulatory approvals for our merger with FHB Formation LLC is that we must fund 100% of our loans with core deposits. To the extent that we are unable to grow our core deposits, our ability to achieve loan growth would be constrained.

We may not be able to attract and retain qualified key employees, which could adversely affect our business prospects, including our competitive position and results of operations.

Our success in implementing our business plan, especially our loan purchasing business, is dependent upon our ability to attract and retain highly skilled individuals. There is significant competition for those individuals with the experience and skills required to conduct many of our business activities. We may not be able to hire or retain the key personnel that we depend upon for success. Since our merger with FHB Formation LLC in December 2010, we have hired ten senior employees to work in our Loan Acquisition and Servicing Group. The unexpected loss of services of one or more of these or other key personnel could have a material adverse impact on our business because of their skills, knowledge of the markets in which we operate, years of industry experience and the difficulty of promptly finding qualified replacement personnel.

If our allowance for loan losses is not sufficient to absorb actual losses or if we are required to increase our allowance, our financial condition and results of operations could be adversely affected.

We are exposed to the risk that our borrowers may default on their obligations. A borrower s default on its obligations under one or more loans of the Bank may result in lost principal and interest income and increased operating expenses as a result of the allocation of management time and resources to the collection and work-out of the loan. In certain situations, where collection efforts are unsuccessful or acceptable work-out arrangements cannot be reached, the Bank may have to write off the loan in whole or in part. In such situations, the Bank may acquire real estate or other assets, if any, that secure the loan through foreclosure or other similar available remedies, and often the amount owed under the defaulted loan exceeds the value of the assets acquired.

We periodically make a determination of an allowance for loan losses based on available information, including, but not limited to, our historical loss experience, the quality of the loan portfolio, certain economic conditions, the value of the underlying collateral,

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expected cash flows from purchased loans, and the level of non-accruing and criticized loans. We rely on our loan quality reviews, our experience and our evaluation of economic conditions, among other factors, in determining the amount of provision required for the allowance for loan losses. Provisions to this allowance result in an expense for the period. If, as a result of general economic conditions, previously incorrect assumptions, or an increase in defaulted loans, we determine that additional increases in the allowance for loan losses are necessary, we will incur additional expenses.

Determining the allowance for loan losses inherently involves a high degree of subjectivity and requires us to make significant estimates of current credit risks and future trends, all of which may undergo material changes. At any time, there are likely to be loans in our portfolio that will result in losses but that have not been identified as nonperforming or potential problem credits. We cannot be sure that we will be able to identify deteriorating credits before they become nonperforming assets or that we will be able to limit losses on those loans that are identified. We have in the past been, and in the future may be, required to increase our allowance for loan losses for any of several reasons. State and federal regulators, in reviewing our loan portfolio as part of a regulatory examination, may request that we increase our allowance for loan losses. Changes in economic conditions affecting borrowers, new information regarding existing loans, identification of additional problem loans and other factors, both within and outside of our control, may require an increase in our allowance for loan losses. In addition, if charge-offs in future periods exceed those estimated in our determination of our allowance for loan losses, we will need additional increases in our allowance for loan losses. Any increases in our allowance for loan losses will result in a decrease in our net income and, possibly, our capital, and could have an adverse effect on our financial condition and results of operations.

A significant portion of loans held in our loan portfolio were originated by third parties, and such loans may not have been subject to the same level of due diligence that Northeast Bank would have conducted had it originated the loans.

At June 30, 2013, 38% of the loans held in our loan portfolio were originated by third parties, and therefore may not have been subject to the same level of due diligence that Northeast Bank would have conducted had it originated the loans. Although the Loan Acquisition and Servicing Group conducts a comprehensive review of all loans that it purchases, loans originated by third parties may lack current financial information and may have incomplete legal documentation and outdated appraisals. As a result, the Loan Acquisition and Servicing Group may not have information with respect to an acquired loan which, if known at the time of acquisition, would have caused it to reduce its bid price or not bid for the loan at all. This may adversely affect our yield on loans or cause us to increase our provision for loan losses.

Our experience with loans held in our loan portfolio that were originated by third parties is limited.

At June 30, 2013, the 38% of the loans held in our loan portfolio that were originated by third parties had been held by us for approximately nine months, calculated on a weighted average basis. Consequently, we have had only a relatively short period of time to evaluate the performance of those loans and the price at which we purchased them. Further experience with these loans may provide us with information that could cause us to increase our provision for loan losses.

Our loan portfolio includes commercial loans, which are generally riskier than other types of loans.

At June 30, 2013, our commercial real estate mortgage and commercial business loan portfolios comprised 68% of total loans. Commercial loans generally carry larger loan balances and involve a higher risk of nonpayment or late payment than residential mortgage loans. These loans, and purchased loans in particular, may lack standardized terms and may include a balloon payment feature. Moreover, some of these loans may be secured by assets located outside of the Community Banking Division s primary market area. The ability of a borrower to make or refinance a balloon payment may be affected by a number of factors, including the financial condition of the borrower, prevailing economic conditions and prevailing interest rates. Repayment of these loans is generally more dependent on the economy and the successful operation of a business. Because of the risks associated with commercial loans, we may experience higher rates of default than if the portfolio were more heavily weighted toward residential mortgage loans. Higher rates of default could have an adverse effect on our financial condition and results of operations.

Environmental liability associated with our lending activities could result in losses.

In the course of business, we may acquire, through foreclosure, properties securing loans we have originated or purchased that are in default. Particularly in commercial real estate lending, there is a risk that hazardous substances could be discovered on these properties. In this event, we might be required to remove these substances from the affected properties at our sole cost and expense. The cost of this removal could substantially exceed the value of affected properties. We may not have adequate remedies against the prior owner or other responsible parties and could find it difficult or impossible to sell the affected properties. These events could have an adverse effect on our financial condition and results of operations.

We are subject to liquidity risk.

Liquidity is the ability to meet cash flow needs on a timely basis at a reasonable cost. Our liquidity is used principally to originate or purchase loans, to repay deposit liabilities and other liabilities when they come due, and to fund operating costs. Customer demand for non-maturity deposits can be difficult to predict. Changes in market interest rates, increased competition within our markets, and other factors may make deposit gathering more difficult. Disruptions in the capital markets or interest rate changes may make the terms of wholesale funding sources which include Federal Home Loan Bank advances, the Federal Reserve s Borrower-in-Custody program, securities sold under repurchase agreements, federal funds purchased and brokered certificates of deposit less favorable and may

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make it difficult to sell securities when needed to provide additional liquidity. As a result, there is a risk that the cost of funding will increase or that we will not have sufficient funds to meet our obligations when they come due.

We are subject to security and operational risks relating to our use of technology.

Communication and information systems are critical to the conduct of our business because we use these systems to manage our customer relationships and process accounting and financial reporting information. Although we have established policies and procedures to prevent or limit the impact of system failures, interruptions and security breaches, there can be no assurance that such events will not occur or that they will be adequately addressed if they do. In addition, any compromise of our security systems could prevent customers from using our website and our online banking services, both of which involve the transmission of confidential information. Although we rely on security and processing systems to provide the security and authentication necessary to securely transmit data, these precautions may not protect our systems from compromises or breaches of security. The occurrence of any failures, interruptions or security breaches of our information systems could damage our reputation, result in the loss of business, subject us to increased regulatory scrutiny or expose us to civil litigation and possible financial liability, including the costs of customer notification and remediation efforts. Any of these occurrences could have an adverse effect on our financial condition and results of operations.

Damage to our reputation could significantly harm our business, including our competitive position and business prospects.

Our ability to attract and retain customers and employees could be adversely affected if our reputation is damaged. Our actual or perceived failure to address various issues could give rise to reputational risk that could cause harm to us and our business prospects. These issues also include, but are not limited to, legal and regulatory requirements; properly maintaining customer and employee personal information; record keeping; money-laundering; sales and trading practices; ethical issues; appropriately addressing potential conflicts of interest; and the proper identification of the legal, reputational, credit, liquidity and market risks inherent in our products. Failure to appropriately address any of these issues could also give rise to additional regulatory restrictions and legal risks, which could, among other consequences, increase the size and number of litigation claims and damages asserted or subject us to enforcement actions, fines and penalties and cause us to incur related costs and expenses.

Internal controls may fail or be circumvented.

Effective controls over financial reporting are necessary to help ensure reliable financial reporting and prevent fraud. Management is responsible for maintaining an effective system of internal control and assessing system effectiveness. Our system of internal control is a process designed to provide reasonable, not absolute, assurance that system objectives are being met. Failure or circumvention of the system of internal control could have an adverse effect on our business, profitability, and financial condition, and could further result in regulatory actions and loss of investor confidence.

Our historical operating results may be of limited use to you in evaluating our historical performance and predicting our future results.

We applied the acquisition method of accounting, as described in Accounting Standards Codification 805, *Business Combinations*, to the merger of FHB Formation LLC with and into Northeast. As a result of application of the acquisition method of accounting to our balance sheet, our financial statements from the periods prior to December 29, 2010, the date that the merger was consummated, are not directly comparable to the financial statements for periods subsequent to December 29, 2010. The lack of comparability arises from the assets and liabilities having new accounting bases as a result of recording them at their fair values as of the transaction date rather than at historical cost basis. In connection with the application of the acquisition method of accounting for the merger, the allowance for loan losses was reduced to zero when the loan portfolio was marked to its then current fair value. In addition, the accretion of fair value adjustments to certain interest-bearing assets and liabilities increased our net income for periods subsequent to the merger. The lack of comparability means that the periods being reported in the fiscal year ended June 30, 2011 in the statements and tables are not the same periods as reported for the fiscal years ended June 30, 2013 and 2012, and, as a result, our historical operating results before December 29, 2010 are of limited relevance in evaluating our historical financial performance subsequent to December 29, 2010 and predicting our future operating results.

Difficult economic conditions, both in the Community Banking Division s primary market area and more generally, could adversely affect our financial condition and results of operations.

Our Community Banking Division primarily serves individuals and businesses located in western and south-central Maine. As a result, a significant portion of our earnings are closely tied to the economy of Maine. In addition, our loan portfolio includes commercial loans acquired by our Loan Acquisition and Servicing Group that are secured by assets located nationwide. Deterioration in the economic conditions of the Community Banking Division s market in Maine, and deterioration of the economy nationally could result in the following consequences:

- loan delinquencies may increase;
- problem assets and foreclosures may increase;
- demand for our products and services may decline;

- collateral for our loans may decline in value, in turn reducing a customer s borrowing power and reducing the value of collateral securing a loan; and

- the net worth and liquidity of loan guarantors may decline, impairing their ability to honor commitments to us.

Our future growth, if any, may require us to raise additional capital, but that capital may not be available when we need it.

As a bank, we are required by regulatory authorities to maintain adequate levels of capital to support our operations. In addition, in conjunction with the regulatory approvals received for the merger with FHB Formation LLC, we committed to maintain a Tier 1 leverage ratio of at least 10% and a total risk-based capital ratio of at least 15%. We may need to raise additional capital to support our operations or our growth, if any. Our ability to raise additional capital will depend, in part, on conditions in the capital markets and our financial performance at that time. Accordingly, we may be unable to raise additional capital, if and when needed, on acceptable terms, or at all. If we cannot raise additional capital when needed, our ability to further expand our operations through internal growth and acquisitions could be materially impaired. In addition, if we decide to raise additional equity capital, investors interests could be diluted. Our failure to meet any applicable regulatory guideline related to our lending activities or any capital requirement otherwise imposed upon us or to satisfy any other regulatory requirement could subject us to certain activity restrictions or to a variety of enforcement remedies available to the regulatory authorities, including limitations on our ability to pay dividends or pursue acquisitions, the issuance by regulatory authorities of a capital directive to increase capital and the termination of deposit insurance by the FDIC.

Risks Associated With the Industry

Competition in the financial services industry is intense and could result in us losing business or experiencing reduced margins.

Our future growth and success will depend on our ability to continue to compete effectively in the Community Banking Division s Maine market, in the markets in which the Loan Acquisition and Servicing Group invests and in the markets in which ableBanking will operate. We face aggressive competition from other domestic and foreign lending institutions and from numerous other providers of financial services. The ability of non-banking financial institutions to provide services previously limited to commercial banks has intensified competition. Because non-banking financial institutions are not subject to the same regulatory restrictions as banks and bank holding companies, they can often operate with greater flexibility and lower cost structures. Securities firms and insurance companies that elect to become financial holding companies may acquire banks and other financial institutions. This may significantly change the competitive environment in which we conduct our business. Some of our competitors have significantly greater financial resources and/or face fewer regulatory constraints. As a result of these various sources of competition, we could lose business to competitors or could be forced to price products and services on less advantageous terms to retain or attract clients, either of which would adversely affect its profitability.

Changes in interest rates could adversely affect our net interest income and profitability.

The majority of our assets and liabilities are monetary in nature. As a result, our earnings and growth are significantly affected by interest rates, which are subject to the influence of economic conditions generally, both domestic and foreign, to events in the capital markets and also to the monetary and fiscal policies of the United States and its agencies, particularly the Federal Reserve. The nature and timing of any changes in such policies or general economic conditions and their effect on us cannot be controlled and are extremely difficult to predict. Changes in interest rates can affect our net interest income as well as the value of our assets and liabilities. Net interest income is the difference between (i) interest income on interest-earning assets, such as loans and securities, and (ii) interest expense on interest-bearing liabilities, such as deposits and borrowings. Changes in market interest rates, changes in the relationships between short-term and long-term market interest rates, or the yield curve, or changes in the relationships between different interest rate indices can affect the interest rates charged on interest-earning assets differently than the interest rates paid on interest-bearing liabilities. This difference could result in an increase in interest expense relative to interest income, and therefore reduce our net interest income. Further, declines in market interest rates may trigger loan prepayments, which in many cases are within our customers discretion, and which in turn may serve to reduce our net interest income if we are unable to lend those funds to other borrowers or invest the funds at the same or higher interest rates.

We operate in a highly regulated industry, and laws and regulations, or changes in them, could limit or restrict our activities and could have an adverse impact in our operations.

We are subject to regulation and supervision by the Federal Reserve, and our banking subsidiary, Northeast Bank, is subject to regulation and supervision by the Federal Reserve, the Maine Bureau of Financial Institutions and the FDIC, as the insurer of Northeast Bank s deposits. Federal and state laws and regulations govern numerous matters, including changes in the ownership or control of banks and bank holding companies, maintenance of adequate capital and the financial condition of a financial institution, permissible types, amounts and terms of extensions of credit and investments, permissible non-banking activities, the level of reserves against deposits and restrictions on dividend payments. The Federal Reserve, the FDIC and the Maine Bureau of Financial Institutions have the power to issue cease and desist orders to prevent or remedy unsafe or unsound practices or violations of law by banks subject

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to their regulation, and the Federal Reserve possesses similar powers with respect to bank holding companies. These and other restrictions limit the manner in which we and Northeast Bank may conduct business and obtain financing.

Because our business is highly regulated, the laws, rules, regulations, and supervisory guidance and policies applicable to us are subject to regular modification and change. It is impossible to predict the competitive impact that any such changes would have on the banking and financial services industry in general or on our business in particular. Such changes may, among other things, increase the cost of doing business, limit permissible activities, or affect the competitive balance between banks and other financial institutions. The Dodd-Frank Act instituted major changes to the banking and financial institutions regulatory regimes in light of the recent performance of and government intervention in the financial services sector. Other changes to statutes, regulations, or regulatory policies, including changes in interpretation or implementation of statutes, regulations, or policies, could affect us in substantial and unpredictable ways. Such changes could subject us to additional costs, limit the types of financial services and products we may offer, and/or increase the ability of non-banks to offer competing financial services and products, among other things. Failure to comply with laws, regulations, or policies could result in sanctions by regulatory agencies, civil money penalties, and/or reputation damage, which could have a material adverse effect on our business, financial condition, and results of operations. See Supervision and Regulation in Item 1, Business.

Additional requirements imposed by the Dodd-Frank Act could adversely affect us.

Current and future legal and regulatory requirements, restrictions, and regulations, including those imposed under the Dodd-Frank Act, may adversely impact our profitability and may have a material and adverse effect on our business, financial condition, and results of operations, may require us to invest significant management attention and resources to evaluate and make any changes required by the legislation and related regulations and may make it more difficult for us to attract and retain qualified executive officers and employees. The Dodd-Frank Act comprehensively reformed the regulation of financial institutions, products and services. Because many aspects of the Dodd-Frank Act are subject to rulemaking and will take effect over several years, it is difficult to forecast the impact that such rulemaking will have on us, our customers or the financial industry. Certain provisions of the Dodd-Frank Act that affect deposit insurance assessments, the payment of interest on demand deposits and interchange fees could increase the costs associated with our banking subsidiaries deposit-generating activities, as well as place limitations on the revenues that those deposits may generate. In addition, the Dodd-Frank Act established the CFPB. The CFPB has the authority to prescribe rules for all depository institutions governing the provision of consumer financial products and services, which may result in rules and regulations that reduce the profitability of such products and services or impose greater costs on the Company and its subsidiaries. The Dodd-Frank Act also established new minimum mortgage underwriting standards for residential mortgages, and the regulatory agencies have focused on the examination and supervision of mortgage lending and servicing activities. The CFPB recently issued a final rule that requires creditors, such as our banking subsidiaries, to make a reasonable good faith determination of a consumer s ability to repay any consumer credit transaction secured by a dwelling. The rule provides creditors with minimum requirements for making such ability-to-repay determinations. See Supervision and Regulation The Dodd-Frank Act in Item 1, Business.

We will become subject to more stringent capital requirements.

The Dodd-Frank Act requires the federal banking agencies to establish minimum leverage and risk-based capital requirements for insured banks and their holding companies. The federal banking agencies issued a joint final rule, or the Final Capital Rule, that implements the Basel III capital standards and establishes the minimum capital levels required under the Dodd-Frank Act. We must comply with the Final Capital Rule by January 1, 2015. The Final Capital Rule establishes a minimum common equity Tier I capital ratio of 6.5% of risk-weighted assets for a well capitalized institution and increases the minimum Tier I capital ratio for a well capitalized institution from 6.0% to 8.0%. Additionally, the Final Capital Rule requires an institution to maintain a 2.5% common equity Tier I capital conservation buffer over the 6.5% minimum risk-based capital requirement to avoid restrictions on the ability to pay dividends, discretionary bonuses, and engage in share repurchases. The Final Capital Rule permanently grandfathers trust preferred securities issued before May 19, 2010, subject to a limit of 25% of Tier I capital. The

Final Capital Rule increases the required capital for certain categories of assets, including high-volatility construction real estate loans and certain exposures related to securitizations; however, the Final Capital Rule retains the current capital treatment of residential mortgages. Under the Final Capital Rule, we may make a one-time, permanent election to continue to exclude accumulated other comprehensive income from capital. If we do not make this election, unrealized gains and losses will be included in the calculation of our regulatory capital. Implementation of these standards, or any other new regulations, may adversely affect our ability to pay dividends, or require us to reduce business levels or raise capital, including in ways that may adversely affect our results of operations or financial condition.

The FDIC s assessment rates could adversely affect our financial condition and results of operations.

The FDIC insures deposits at FDIC-insured depository institutions, such as Northeast Bank, up to applicable limits. As a result of recent economic conditions and the enactment of the Dodd-Frank Act, the FDIC has increased deposit insurance assessment rates. If these increases are insufficient for the deposit insurance fund of the FDIC to meet its funding requirements, there may need to be further special assessments or increases in deposit insurance premiums. We are generally unable to control the amount of premiums that we are required to pay for FDIC insurance. If there are additional bank or financial institution failures, we may be required to pay

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even higher FDIC premiums than the recently increased levels. Any future additional assessments, increases or required prepayments in FDIC insurance premiums may materially adversely affect results of operations, including by reducing our profitability or limiting our ability to pursue certain business opportunities.

Changes in accounting standards can materially impact our financial statements.

Our accounting policies and methods are fundamental to how we record and report our financial condition and results of operations. From time to time, the Financial Accounting Standards Board or regulatory authorities change the financial accounting and reporting standards that govern the preparation of our financial statements. These changes can be hard to predict and can materially impact how we record and report our financial condition and results of operations. In some cases, we could be required to apply a new or revised standard retroactively, resulting in our restating prior period financial statements.

Risks Associated With Our Common Stock

Market volatility has affected and may continue to affect the value of our common stock.

The performance of our common stock has been and may continue to be affected by many factors, including volatility in the credit, mortgage and housing markets, and the markets with respect to financial institutions generally. Government action and changes in government regulations, such as the Dodd-Frank Act, may affect the value of our common stock. More general market fluctuations, industry factors and general economic and political conditions and events, such as economic slowdowns or interest rate changes could also cause the value of our common stock to decrease regardless of our operating results.

Our common stock trading volume may not provide adequate liquidity for investors.

Our voting common stock is listed on the NASDAQ Global Market. The average daily trading volume for Northeast voting common stock is less than the corresponding trading volume for larger financial institutions. Due to this relatively low trading volume, significant sales of Northeast voting common stock, or the expectation of these sales, may place significant downward pressure on the market price of Northeast voting common stock. No assurance can be given that a more active trading market in our common stock will develop in the foreseeable future or can be maintained. There can also be no assurance that the offering will result in a material increase in the float for our common stock, which we define as the aggregate market value of our voting common stock held by shareholders who are not affiliates of Northeast, because our affiliates may purchase shares of voting common stock in the offering.

There is a limited market for and restrictions on the transferability of our non-voting common stock.

Our non-voting common stock is not and will not be listed on any exchange. Additionally, the non-voting common stock can only be transferred in certain limited circumstances set forth in our articles of incorporation. Accordingly, holders of our non-voting common stock may be required to bear the economic consequences of holding such non-voting common stock for an indefinite period of time.

If we defer payments of interest on our outstanding junior subordinated debt securities or if certain defaults relating to those debt securities occur, we will be prohibited from declaring or paying dividends or distributions on, and from making liquidation payments with respect to, our common stock.

As of June 30, 2013, we had outstanding $16.5 million in aggregate principal amount of junior subordinated debt securities issued in connection with the sale of trust preferred securities by affiliates of ours that are statutory business trusts. We have also guaranteed those trust preferred securities. The indenture under which the junior subordinated debt securities were issued, together with the guarantee, prohibits us, subject to limited exceptions, from declaring or paying any dividends or distributions on, or redeeming, repurchasing, acquiring or making any liquidation payments with respect to, any of our capital stock (including the Series A preferred stock and our common stock) at any time when (i) there shall have occurred and be continuing an event of default under the indenture; (ii) we are in default with respect to payment of any obligations under the guarantee; or (iii) we have elected to defer payment of interest on the junior subordinated debt securities. In that regard, we are entitled, at our option but subject to certain conditions, to defer payments of interest on the junior subordinated debt securities from time to time for up to five years.

Events of default under the indenture generally consist of our failure to pay interest on the junior subordinated debt securities under certain circumstances, our failure to pay any principal of or premium on such junior subordinated debt securities when due, our failure to comply with certain covenants under the indenture, and certain events of bankruptcy, insolvency or liquidation relating to us.

As a result of these provisions, if we were to elect to defer payments of interest on the junior subordinated debt securities, or if any of the other events described in clause (i) or (ii) of the first paragraph of this risk factor were to occur, we would be prohibited from declaring or paying any dividends on the Series A preferred stock and our common stock, from redeeming, repurchasing or otherwise acquiring any of the Series A preferred stock or our common stock, and from making any payments to holders of the Series A preferred stock or our common stock in the event of our liquidation, which would likely have a material adverse effect on the market value of our common stock.

We are dependent upon our subsidiaries for dividends, distributions and other payments.

We are a separate and distinct legal entity from Northeast Bank, and depend on dividends, distributions and other payments from Northeast Bank to fund dividend payments on our common stock and to fund all payments on our other obligations. We and Northeast

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Bank are subject to laws that authorize regulatory authorities to block or reduce the flow of funds from Northeast Bank to us. Regulatory action of that kind could impede access to the funds that Northeast needs in order to make payments on its obligations or dividend payments. In addition, if Northeast Bank does not maintain sufficient capital levels or its earnings are not sufficient to make dividend payments to us, we may not be able to make dividend payments to our common and preferred shareholders. Further, our right to participate in a distribution of assets upon a subsidiary s liquidation or reorganization is subject to the prior claims of Northeast Bank s creditors.

We may not be able to pay dividends and, if we pay dividends, we cannot guarantee the amount and frequency of such dividends.

The continued payment of dividends on shares of our common stock will depend upon our debt and equity structure, earnings and financial condition, need for capital in connection with possible future acquisitions, growth and other factors, including economic conditions, regulatory restrictions, and tax considerations. We cannot guarantee that we will pay dividends or, if we pay dividends, the amount and frequency of these dividends.

We may issue additional shares of common or preferred stock in the future, which could dilute a shareholder s ownership of common stock.

Our articles of incorporation authorize our board of directors, generally without shareholder approval, to, among other things, issue additional shares of common or preferred stock. The issuance of any additional shares of common or preferred stock could be dilutive to a shareholder s ownership of our common stock. To the extent that we issue options or warrants to purchase common stock in the future and the options or warrants are exercised, our shareholders may experience further dilution. Holders of shares of our common stock have no preemptive rights that entitle holders to purchase their pro rata share of any offering of shares of any class or series and, therefore, shareholders may not be permitted to invest in future issuances of Northeast common or preferred stock. We are required by federal and state regulatory authorities to maintain adequate levels of capital to support our operations. Accordingly, regulatory requirements and/or deterioration in our asset quality may require us to sell common stock to raise capital under circumstances and at prices that result in substantial dilution.

We may issue debt and equity securities that are senior to our common stock as to distributions and in liquidation, which could negatively affect the value of our common stock.

In the future, we may increase our capital resources by entering into debt or debt-like financing or issuing debt or equity securities, which could include issuances of senior notes, subordinated notes, preferred stock or common stock. In the event of our liquidation, our lenders and holders of its debt or preferred securities would receive a distribution of our available assets before distributions to the holders of Northeast common stock. Our decision to incur debt and issue securities in future offerings will depend on market conditions and other factors beyond our control. We cannot predict or estimate the amount, timing or nature of our future offerings and debt financings. Future offerings could reduce the value of shares of our common stock and dilute a shareholder s interest in Northeast.

Our common stock is not insured by any governmental entity.

Our common stock is not a deposit account or other obligation of any bank and is not insured by the FDIC or any other governmental entity.

Anti-takeover provisions could negatively impact our shareholders.

Federal law imposes restrictions, including regulatory approval requirements, on persons seeking to acquire control over Northeast. Provisions of Maine law and provisions of our articles of incorporation and by-laws could make it more difficult for a third party to acquire control of us or have the effect of discouraging a third party from attempting to acquire control of us. We have a classified board of directors, meaning that approximately one-third of our directors are elected annually. Additionally, our articles of organization authorize our board of directors to issue preferred stock without shareholder approval and such preferred stock could be issued as a defensive measure in response to a takeover proposal. Other provisions that could make it more difficult for a third party to acquire us even if an acquisition might be in the best interest of our shareholders include supermajority voting requirements to remove a director from office without cause; restrictions on shareholders calling a special meeting; a requirement that only directors may fill a board vacancy; and provisions regarding the timing and content of shareholder proposals and nominations.

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Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

At June 30, 2013, the Company conducted its business from its main office in Lewiston, Maine and an office in Boston, Massachusetts. The Company also conducts business from its ten full-service bank branches and six loan production offices located in western and south-central Maine, southern New Hampshire and southeastern Massachusetts.

In addition to its Lewiston, Maine, and Boston, Massachusetts, offices, the Company leases eleven of its other locations. For information regarding the Company s lease commitments, please refer to Lease Obligations under Note 14 of the Notes to the Consolidated Financial Statements in Item 8 of this Annual Report.

Item 3. Legal Proceedings

From time to time, the Company and its subsidiaries are subject to certain legal proceedings and claims in the ordinary course of business. Management presently believes that the ultimate outcome of these proceedings, individually and in the aggregate, will not be material to the Company or its consolidated financial position. The Company establishes reserves for specific legal matters when it determines that the likelihood of an unfavorable outcome is probable and the loss is reasonably estimable. Legal proceedings are subject to inherent uncertainties, and unfavorable rulings could occur that could cause the Company to establish litigation reserves or could have, individually or in the aggregate, a material adverse effect on its business, financial condition, or operating results.

Item 4. Mine Safety Disclosures

Not applicable.

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PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

(a) The Company s voting common stock currently trades on the NASDAQ under the symbol NBN. There is no established public trading market for the Company s non-voting common stock. As of the close of business on September 16, 2013, there were approximately 513 registered shareholders of record.

The following table sets forth the high and low closing sale prices of the Company s voting common stock, as reported on NASDAQ, and quarterly dividends paid on the Company s voting and non-voting common stock during the periods indicated.

Fiscal year ended June 30, 2013	**High**	**Low**	**Div Pd**
Jul 1 Sep 30	$ 9.53	$ 8.40	$ 0.09
Oct 1 Dec 31	9.53	8.93	0.09
Jan 1 Mar 31	10.18	9.08	0.09
Apr 1 Jun 30	10.12	9.23	0.09

Fiscal year ended June 30, 2012	**High**	**Low**	**Div Pd**
Jul 1 Sep 30	$ 14.00	$ 9.45	$ 0.09
Oct 1 Dec 31	14.69	11.18	0.09
Jan 1 Mar 31	14.29	11.60	0.09
Apr 1 Jun 30	11.70	8.00	0.09

On September 16, 2013, the last reported sale price of the Company s voting common stock, as reported on NASDAQ was $10.56. Holders of the Company s voting and non-voting common stock are entitled to receive dividends when and if declared by the Board of Directors out of funds legally available. The amount and timing of future dividends payable on the Company s voting and non-voting common stock will depend on, among other things, the financial condition of the Company, regulatory considerations, and other factors. The Company is a legal entity separate from the Bank, but its revenues are derived primarily from the Bank. Accordingly, the ability of the Company to pay cash dividends on its stock in the future generally will be dependent upon the earnings of the Bank and the Bank s ability to pay dividends to the Company. The payment of dividends by the Bank will depend on a number of factors, including capital requirements, regulatory limitations, the Bank s results of operations and financial condition, tax considerations, and general economic conditions. National banking laws regulate and restrict the ability of the Bank to pay dividends to the Company. See Item 1. Business Supervision and Regulation.

(b) Not applicable.

(c) Issuer Repurchases of Equity Securities.

None.

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Item 6. Selected Financial Data

The following table sets forth our selected financial and operating data on a historical basis. The data set forth below does not purport to be complete. It should be read in conjunction with, and is qualified in its entirety by, the more detailed information, including the Company s Consolidated Financial Statements and related notes, appearing elsewhere herein.

[redacted]						
Selected operations data:						
Interest and dividend income	$ 36,543	$ 27,014	$ 13,304	$ 14,378	$ 31,262	$ 33,766
Interest expense	6,596	6,317	3,207	5,877	13,314	16,718
Net interest income	29,947	20,697	10,097	8,501	17,948	17,048
Provision for loan losses	1,122	946	707	912	1,864	2,100
Noninterest income (3)	11,433	8,565	18,982	4,214	5,701	4,640
Net securities gains (losses)	792	1,111	1,200	17	(18)	268
Noninterest expense (4)	34,685	28,230	17,148	9,455	19,473	18,598
Income before income taxes	6,365	1,197	12,424	2,365	2,294	1,258
Income tax expense (benefit)	1,945	181	(83)	698	782	130
Net income from continuing operations	4,420	1,016	12,507	1,667	1,512	1,128
Net income (loss) from discontinued operations		1,147	45	129	207	(169)
Net income	$ 4,420	$ 2,163	$ 12,552	$ 1,796	$ 1,719	$ 959
Net income available to common stockholders	$ 4,065	$ 1,771	$ 12,355	$ 1,677	$ 1,476	$ 825
Consolidated per share data:						
Earnings:						
Basic:						
Continuing operations	$ 0.39	$ 0.15	$ 3.51	$ 0.66	$ 0.55	$ 0.43
Discontinued operations		0.26	0.01	0.06	0.09	(0.07)
Net income	$ 0.39	$ 0.41	$ 3.52	$ 0.72	$ 0.64	$ 0.36
Diluted:						
Continuing operations	$ 0.39	$ 0.15	$ 3.46	$ 0.66	$ 0.54	$ 0.43
Discontinued operations		0.26	0.01	0.05	0.09	(0.07)

Net income	$ 0.39	$ 0.41	$ 3.47	$ 0.71	$ 0.63	$ 0.36
Cash dividends	$ 0.36	$ 0.36	$ 0.18	$ 0.18	$ 0.36	$ 0.36
Book value	10.89	11.07	17.33	19.79	20.08	18.63
Selected balance sheet data:						
Total assets	$ 670,639	$ 669,196	$ 596,393	$ 627,984	$ 622,607	$ 598,148
Loans	435,376	356,254	309,913	367,284	382,309	393,651
Deposits	484,623	422,188	401,118	374,617	384,197	385,386
Borrowings	64,069	120,859	126,706	199,326	183,025	162,389
Total stockholders equity	113,802	119,139	64,954	50,366	50,906	47,317
Other ratios:						
Return on average assets	0.64%	0.36%	4.09%	0.57%	0.28%	0.16%
Return on average equity	3.79%	3.03%	38.23%	7.03%	3.47%	2.14%
Efficiency ratio	82.25%	92.95%	56.63%	74.26%	82.40%	84.71%
Average equity to average total assets	16.93%	11.90%	10.69%	8.18%	8.10%	7.35%
Common dividend payout ratio	92.25%	71.26%	5.02%	25.02%	56.64%	101.14%
Tier 1 leverage capital ratio	17.78%	19.91%	10.35%	N/A	8.40%	8.12%
Total risk-based capital ratio	27.54%	33.34%	18.99%	N/A	14.09%	13.23%

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

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

(3) Includes primarily fees for deposits, investment brokerage services to customers, and gains on the sale of loans. In the 184 days ended June 30, 2011, the total further includes a bargain purchase gain $15.4 million.

(4) Includes salaries, employee benefits, occupancy and equipment, and other expenses. In the 184 days ended June 30, 2011, the total includes merger expenses totaling $3.2 million.

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Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

Northeast Bancorp (the Company) is a Maine corporation and a bank holding company registered with the Federal Reserve under the Bank Holding Company Act of 1956. The Company also is a registered Maine financial institution holding company. The Federal Reserve is the primary regulator of the Company, and the Company is also subject to regulation and examination by the Superintendent of the Maine Bureau of Financial Institutions. The Company s principal asset is the capital stock of Northeast Bank (the Bank), a Maine state-chartered universal bank. Accordingly, the Company s results of operations are primarily dependent on the results of the operations of the Bank.

The Management s Discussion and Analysis of Financial Condition and Results of Operations, which follows, presents a review of the consolidated operating results of the Company for the fiscal year ended June 30, 2013 (fiscal 2013) and the fiscal year ended June 30, 2012 (fiscal 2012). This discussion and analysis is intended to assist you in understanding the results of our operations and financial condition. You should read this discussion together with your review of the Company s Consolidated Financial Statements and related notes and other statistical information included in this report. Certain amounts in the periods prior to fiscal 2013 have been reclassified to conform to the fiscal 2013 presentation.

Overview

Financial Presentation

On December 29, 2010, the merger (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 our 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 (the Successor Company). In the application of ASC 805 to this transaction, the following was considered:

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

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

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

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

As a result of application of the acquisition method of accounting to Northeast Bancorp after the merger on December 29, 2010, the Company s financial statements from the periods prior to the transaction date are not directly comparable to the financial statements for periods subsequent to the transaction date. To make this distinction, the Company has labeled balances and results of operations prior to the transaction date as Predecessor Company and balances and results of operations for periods subsequent to the transaction date as Successor Company. The lack of comparability arises from the assets and liabilities having new accounting bases as a result of recording them at their fair values as of the transaction date rather than at historical cost basis. To denote this lack of comparability, a heavy black line has been placed between the Successor Company and Predecessor Company columns in the discussion herein.

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In connection with the transaction, as part of the regulatory approval process the Company made certain commitments to the Board of Governors of the Federal Reserve System (the Federal Reserve), the most significant of which are, (i) maintain a Tier 1 leverage ratio of at least 10%, (ii) maintain a total risk-based capital ratio of at least 15%, (iii) limit purchased loans to 40% of total loans, (iv) fund 100% of the Company s loans with core deposits (defined as non-maturity deposits and non-brokered insured time deposits), and (v) hold commercial real estate loans (including owner-occupied commercial real estate) to within 300% of total risk-based capital. On June 28, 2013, the Federal Reserve approved the amendment of the commitment to hold commercial real estate loans to within 300% of total risk-based capital to exclude owner-occupied commercial real estate loans. All other commitments made to the Federal Reserve in connection with the merger remain unchanged. The Company and the Bank are currently in compliance with all commitments to the Federal Reserve. The Company s compliance ratios at June 30, 2013 follow.

Condition	**Ratio at June 30, 2013**
(i) Tier 1 leverage ratio	17.78%
(ii) Total risk-based capital ratio	27.54%
(iii) Ratio of purchased loans to total loans	37.57%
(iv) Ratio of loans to core deposits	92.94%
(v) Ratio of commercial real estate loans to total risk-based capital	159.07%

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

Fiscal 2013 Financial Highlights

The Company s financial and strategic highlights for fiscal 2013 include the following:

- Earned net income of $4.4 million, or $0.39 per diluted share, from continuing operations as compared to $1.0 million, or $0.15 per diluted share, from continuing operations in fiscal 2012.

- Purchased commercial loans totaling $121.3 million, and earned an average yield on the purchased portfolio of 16.0%, a result that includes regularly scheduled interest and accretion, and accelerated accretion and fees recognized on loan payoffs. The Company also monitors the total return on its purchased loan portfolio, a measure that includes gains on sales of purchased loans, as well as interest, scheduled accretion and accelerated accretion and fees. On this basis, the purchased loan portfolio earned a total return of 18.3% for fiscal 2013. An overview of the LASG portfolio for fiscal 2013 follows:

	Purchased	**Originated** **(Dollars in thousands)**	**Total LASG**
Purchased or originated during the year:			
Unpaid principal balance	$ 155,216	$ 37,181	$ 192,397
Net investment basis	121,336	37,208	158,544

Totals as of year end:			
Unpaid principal balance	$ 204,276	$ 38,846	$ 243,122
Net investment basis	166,786	38,879	205,665
Returns during the year:			
Yield	16.04%	9.34%	15.28%
Total Return (1)	18.33%	9.34%	17.32%

(1) The total return on purchased loans represents scheduled accretion, accelerated accretion, gains on asset sales, and other noninterest income recorded during the period divided by the average invested balance, on an annualized basis.

- Increased the Company s deposit base by $62.4 million, principally through $69.0 million of net deposits raised through ableBanking, the Bank s online affinity deposit platform.

- Redeemed TARP preferred stock and warrants totaling $4.3 million.

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Results of Operations Continuing Operations

General

Net income from continuing operations for the year ended June 30, 2013 was $4.4 million, a $3.4 million increase over 2012. Items of significance affecting the Company s earnings included:

- An increase in the net interest margin, which grew to 4.62%, compared to 3.69% for the year ended June 30, 2012, principally due to growth in the Company s purchased loan portfolio. The following table summarizes interest income and related yields recognized on the Company s loans.

	Year Ended June 30, 2013 Average Balance	2013 Interest Income	2013 Yield	2012 Average Balance	2012 Interest Income	2012 Yield
	(Dollars in thousands)					
Community Banking Division	$ 252,199	$ 14,824	5.88%	$ 297,348	$ 18,047	6.07%
LASG:						
Originated	14,906	1,392	9.34%	3,278	308	9.40%
Purchased	117,205	18,801	16.04%	39,022	6,379	16.35%
Total LASG	132,111	20,193	15.28%	42,300	6,687	15.81%
Total	$ 384,310	$ 35,017	9.11%	$ 339,648	$ 24,734	7.28%

The yield on purchased loans was increased by unscheduled loan payoffs, which resulted in immediate recognition of the prepaid loans discount in interest income. The following table details the total return on purchased loans, which includes transactional income of $10.6 million for the year ended June 30, 2013.

	Year Ended June 30, 2013 Income	2013 Return (1)	2012 Income	2012 Return (1)
	(Dollars in thousands)			
Regularly scheduled interest and accretion	$ 11,038	9.35%	$ 3,762	9.64%
Transactional income:				
Gains on loan sales	2,115	1.79%	868	2.22%
Gain on sale of real estate owned	684	0.58%		0.00%
Other noninterest income	36	0.03%		0.00%
Accelerated accretion and loan fees	7,763	6.58%	2,617	6.71%
Total transactional income	10,598	8.98%	3,485	8.93%
Total	$ 21,636	18.33%	$ 7,247	18.57%

(1) The total return on purchased loans represents scheduled accretion, accelerated accretion, gains on asset sales, and other noninterest income recorded during the period divided by the average invested balance, on an annualized basis.

- Net gains on residential mortgage loan sales of $3.0 million, compared to $2.8 million in fiscal 2012.

- Net gains on portfolio loan sales of $2.3 million, compared to $1.1 million in fiscal 2012.

- An increase of $6.5 million in noninterest expense, principally resulting from increased staffing and infrastructure costs necessary to execute the Company s loan purchasing strategy. Further, during fiscal 2013, the Company incurred $1.4 million of nonrecurring expenses related to severance and the settlement of a previously disclosed lawsuit.

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Net Interest Income

The following table sets forth average balance sheets, average yields and costs, and certain other information for the periods indicated:

	Successor Company (1)					
	Year Ended June 30, 2013			Year Ended June 30, 2012		
	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 (3)	$ 131,199	$ 1,138	0.87%	$ 138,708	$ 2,019	1.46%
Loans (4) (5)	384,310	35,017	9.11%	339,648	24,734	7.28%
Regulatory stock	5,398	75	1.39%	5,673	72	1.27%
Short-term investments (6)	127,781	313	0.24%	76,217	189	0.25%
Total interest-earning assets	648,688	36,543	5.63%	560,246	27,014	4.82%
Cash and due from banks	3,065			2,910		
Other non-interest earning assets	37,206			36,803		
Total assets	$ 688,959			$ 599,959		
Liabilities & Stockholders Equity:						
Interest-bearing liabilities:						
NOW accounts	$ 55,763	$ 153	0.27%	$ 55,218	$ 213	0.39%
Money market accounts	63,931	337	0.53%	44,692	175	0.39%
Savings accounts	31,939	44	0.14%	32,799	67	0.20%
Time deposits	280,059	3,564	1.27%	223,782	2,971	1.33%
Total interest-bearing deposits	431,692	4,098	0.95%	356,491	3,426	0.96%
Short-term borrowings (7)	1,472	19	1.29%	1,075	21	1.95%
Borrowed funds	75,633	1,710	2.26%	112,812	2,119	1.87%
Junior subordinated debentures	8,185	769	9.40%	8,028	751	9.35%
Total interest-bearing liabilities	516,982	6,596	1.28%	478,406	6,317	1.32%
Interest-bearing liabilities of discontinued operations (8)				271		
Non-interest bearing liabilities:						
Demand deposits and escrow accounts	49,343			45,933		
Other liabilities	5,982			3,932		
Total liabilities	572,307			528,542		
Stockholders equity	116,652			71,417		
Total liabilities and stockholders equity	$ 688,959			$ 599,959		
Net interest income		$ 29,947			$ 20,697	

Interest rate spread	4.36%	3.50%
Net interest margin (9)	4.62%	3.69%

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

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

(3) Interest income and yield are stated on a fully tax-equivalent basis using a 34% tax rate.

(4) Includes loans held for sale.

(5) Nonaccrual loans are included in the computation of average, but unpaid interest has not been included for purposes of determining interest income.

(6) Short term investments include FHLB overnight deposits and other interest-bearing deposits.

(7) Short term borrowings include securities sold under repurchase agreements and sweep accounts.

(8) The average balance of borrowings associated with discontinued operations has been excluded from interest expense, interest rate spread, and net interest margin.

(9) Net interest margin is calculated as net interest income divided by total interest-earning assets.

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	Successor Company (1) 184 Days Ended June 30, 2011			Predecessor Company (2) 181 Days Ended December 28, 2010		
	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 (3)	$ 143,894	$ 1,642	2.32%	$ 161,894	$ 3,111	3.96%
Loans (4) (5)	337,630	11,544	6.78%	385,286	11,210	5.87%
Regulatory stock	5,550	28	1.00%	5,486	18	0.66%
Short-term investments (6)	75,080	90	0.24%	39,212	39	0.20%
Total interest-earning assets	562,154	13,304	4.71%	591,878	14,378	4.92%
Cash and due from banks	3,432			3,340		
Other non-interest earning assets	43,668			34,724		
Total assets	$ 609,254			$ 629,942		
Liabilities & Stockholders Equity:						
Interest-bearing liabilities:						
NOW accounts	$ 56,386	$ 160	0.56%	$ 53,780	$ 183	0.69%
Money market accounts	52,238	135	0.51%	55,955	213	0.77%
Savings accounts	34,799	67	0.38%	38,303	99	0.52%
Time deposits	207,251	1,303	1.25%	196,318	2,301	2.36%
Total interest-bearing deposits	350,674	1,665	0.94%	344,356	2,796	1.64%
Short-term borrowings (7)	19,764	76	0.76%	53,873	376	1.41%
Borrowed funds	115,798	1,101	1.89%	117,688	2,365	4.05%
Junior subordinated debentures	7,921	365	9.14%	16,496	340	4.16%
Total interest-bearing liabilities	494,157	3,207	1.29%	532,413	5,877	2.23%
Interest-bearing liabilities of discontinued operations (8)	2,134			2,462		
Non-interest bearing liabilities:						
Demand deposits and escrow accounts	43,761			37,941		
Other liabilities	4,075			5,576		
Total liabilities	544,127			578,392		
Stockholders equity	65,127			51,550		
Total liabilities and stockholders equity	$ 609,254			$ 629,942		
Net interest income		$ 10,097			$ 8,501	
Interest rate spread			3.42%			2.69%
Net interest margin (9)			3.58%			2.92%

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

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

(3) Interest income and yield are stated on a fully tax-equivalent basis using a 34% tax rate.

(4) Includes loans held for sale.

(5) Nonaccrual loans are included in the computation of average, but unpaid interest has not been included for purposes of determining interest income.

(6) Short term investments include FHLB overnight deposits and other interest-bearing deposits.

(7) Short term borrowings include securities sold under repurchase agreements and sweep accounts.

(8) The average balance of borrowings associated with discontinued operations has been excluded from interest expense, interest rate spread, and net interest margin.

(9) Net interest margin is calculated as net interest income divided by total interest-earning assets.

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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) changes 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.

	Year Ended June 30, 2013 Compared to the Year Ended June 30, 2012		
	Change Due to Volume	**Change Due to Rate**	**Total Change**
		(Dollars in thousands)	
Interest earning assets:			
Investment securities	$ (104)	$ (777)	$ (881)
Loans	3,529	6,754	10,283
Regulatory stock	(3)	6	3
Short-term investments	128	(4)	124
Total increase in interest income	3,550	5,979	9,529
Interest bearing liabilities:			
Interest bearing deposits	823	(151)	672
Short-term borrowings	6	(8)	(2)
Borrowed funds	(790)	381	(409)
Junior subordinated debentures	14	4	18
Total increase in interest expense	53	226	279
Total increase in net interest and dividend income	$ 3,497	$ 5,753	$ 9,250

A rate/volume comparison of fiscal 2012 and 2011 has not been presented because the successor and predecessor periods in fiscal 2011 are not comparable to fiscal 2012 due to the significant effect of acquisition accounting adjustments.

For the period, the 4.62% net interest margin earned was 93 basis points higher than that earned for the year ended June 30, 2012. The net interest margin improved during fiscal 2013 principally due to increased purchased loan volume, offset in part by a decline in the effect of accretion of Merger-related fair value adjustments and a reduction in the yield earned on investment securities.

The following table summarizes interest income and related yields recognized on the Company s loans.

[redacted]

Community Banking Division	$ 252,199	$ 14,824	5.88%	$ 297,348	$ 18,047	6.07%
LASG:						
Originated	14,906	1,392	9.34%	3,278	308	9.40%
Purchased	117,205	18,801	16.04%	39,022	6,379	16.35%
Total LASG	132,111	20,193	15.28%	42,300	6,687	15.81%

Total	$ 384,310	$ 35,017	9.11%	$ 339,648	$ 24,734	7.28%

The yield on purchased loans was increased by unscheduled loan payoffs, which resulted in immediate recognition of the prepaid loans discount in interest income. The following table details the total return on purchased loans, which includes transactional income of $10.6 million for the year ended June 30, 2013.

Regularly scheduled interest and accretion	$ 11,038	9.35%	$ 3,762	9.64%
Transactional income:				
Gains on loan sales	2,115	1.79%	868	2.22%
Gain on sale of real estate owned	684	0.58%		0.00%
Other noninterest income	36	0.03%		0.00%
Accelerated accretion and loan fees	7,763	6.58%	2,617	6.71%
Total transactional income	10,598	8.98%	3,485	8.93%
Total	$ 21,636	18.33%	$ 7,247	18.57%

(1) The total return on purchased loans represents scheduled accretion, accelerated accretion, gains on asset sales, and other noninterest income recorded during the period divided by the average invested balance, on an annualized basis.

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The following table summarizes the effects of accretion of fair value adjustments on the net interest margin, for the periods indicated:

[redacted]

Interest-earning assets:						
Investment securities	$ 131,199	$ (3)	0.00%	$ 138,708	$ (100)	-0.07%
Loans	384,310	563	0.15%	339,648	713	0.21%
Other interest-earning assets	133,179		0.00%	81,890		0.00%
Total interest-earning assets	$ 648,688	$ 560	0.09%	$ 560,246	$ 613	0.11%
Interest-bearing liabilities:						
Interest-bearing deposits	431,692	989	0.23%	356,491	1,292	0.36%
Short-term borrowings	1,472		0.00%	1,075		0.00%
Borrowed funds	75,633	1,196	1.58%	112,812	2,299	2.04%
Junior subordinated debentures (1)	8,185	6	0.07%	8,028	(2)	-0.02%
Total interest-bearing liabilities	$ 516,982	$ 1,692	0.42%	$ 478,406	$ 3,589	0.75%
Total effect of noncash accretion on:						
Net interest income		$ 2,751			$ 4,202	
Net interest margin		0.42%			0.75%	

(1) Includes the effects of hedge amortization.

The Company s total cost of funds improved to 1.16% in fiscal 2013, down from 1.20% in fiscal 2012, principally due to a 1 basis point decrease in the cost of interest-bearing deposits and a $3.4 million increase in average non-interest bearing deposits.

Provision for Loan Losses

Quarterly, the Company determines the amount of its allowance for loan losses 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 acquired loans accounted for under ASC 310-30, a provision for loan loss is recorded when estimates of future cash flows decrease due to credit deterioration.

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 fiscal year ended June 30, 2013 was $1.1 million. This compares to a provision for loan losses of $946 thousand for the year ended June 30, 2012. At June 30, 2013 and 2012, the allowance for loan losses stood at $1.1 million and $824 thousand, respectively, and the ratio of allowance for loan losses to total loans was 0.26% and 0.23%, respectively. Net charge-offs for the fiscal year ended June 30, 2013 totaled $803 thousand, representing approximately 0.21% of the Company s average portfolio loan balance during the fiscal year. This compares to $559 thousand, or 0.17%, in fiscal 2012, representing an increase of $242 thousand in fiscal 2013, principally due to one commercial business loan relationship.

For additional information on the allowance for loan losses, see Asset Quality.

Noninterest Income

Noninterest income for the fiscal year ended June 30, 2013 totaled $12.2 million, an increase of $2.5 million, or 26.3%, from fiscal 2012. When compared to fiscal 2012, the increase was principally due to the following:

- $2.0 million increase in gains recognized on portfolio loan and real estate owned sales, principally because of purchased loan sales and commercial REO resolutions during fiscal 2013;

- a $248 thousand increase in gains on residential loans originated for sale. During fiscal 2013, the Company expanded mortgage-banking activities into Massachusetts and increased sales volume to $143.2 million from $121.4 million in fiscal 2012;

- a $265 thousand increase in customer fees, due to an increase in commercial loan servicing fees; and

- a $217 thousand increase in BOLI income, due to death benefits received in fiscal 2013.

Noninterest Expense

Noninterest expense for the fiscal year ended June 30, 2013 totaled $34.7 million, an increase of $6.5 million, or 22.9%, from fiscal 2012. When compared to fiscal 2012, the increase was principally due to the following:

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- an increase of $3.6 million in salaries and benefits, reflecting increased staffing associated with the LASG and operational areas supporting the LASG, residential lending, and ableBanking. The Company s employees, on a full-time equivalent basis, totaled 219 at June 30, 2013, compared to 203 at June 30, 2012. The Company also incurred approximately $388 thousand of severance expense in fiscal 2013 associated with the departure of a senior manager and the Bank s decision to exit the investment brokerage business;

- an increase of $940 thousand in occupancy and equipment expense, principally due to increased rent associated with the relocation of the Company s office in Boston, MA, and depreciation of investments in new technology, principally those associated with ableBanking;

- an increase of $358 thousand in marketing expense, principally due to promotional efforts for ableBanking and residential mortgage lending;

- an increase of $660 thousand in loan acquisition and collection expense, principally due an increase of $19.6 million in loan acquisitions in fiscal 2013, as well as the overall size of the purchased loan portfolio which increased by $82.3 million;

- the settlement of a lawsuit in the amount of $1.0 million. The summons and complaint was filed in August of 2011, in connection with a dispute regarding certain deposit account activity occurring in 2005 and 2006.

Income Taxes

Income tax expense for the fiscal year ended June 30, 2013 totaled $1.9 million, representing 30.6% of pretax income. The Company s effective tax rate differed from its statutory federal rate because of affordable housing tax credits totaling $117 thousand and non-taxable BOLI income of $718 thousand.

Income tax expense for the fiscal year ended June 30, 2012 totaled $181 thousand, representing 15.1% of pretax income. The effective tax rate for the period reflects the level of pretax income in relation to nontaxable income, principally BOLI income totaling $501 thousand, and low-income housing tax credits totaling $118 thousand.

Results of Operations Discontinued Operations

Overview

In the first quarter of fiscal 2012, the Company sold intangible assets (principally customer lists) and certain fixed assets of Northeast Bank Insurance Group (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.

Net income from discontinued operations for the fiscal year ended June 30, 2012 was $1.1 million, or $0.26 per diluted share, which includes a pre-tax gain on the sale of NBIG intangibles and certain fixed assets, net of expenses, of $1.6 million. The Company also recorded pre-tax income associated with operations of $186 thousand prior to the asset sale. Income tax expense associated with discontinued operations for the year ended June 30, 2012 was $605 thousand, or 34.5% of pre-tax income.

Financial Condition

Overview

The Company s total assets grew to $670.6 million at June 30, 2013, representing an increase of $1.4 million, or 0.2%, compared to $669.2 million at June 30, 2012. Significant changes in the Company s balance sheet components include:

- loan growth of $79.1 million, or 22.2%, principally due to net growth of $116.1 million in commercial loans purchased or originated by the Bank s LASG, offset by net amortization and payoffs of $37.0 million in the Community Banking Division loan portfolio;

- deposit growth $62.4 million, or 14.8%, primarily due to a $69.0 million increase in deposits raised through ableBanking, the Bank s online affinity deposit platform;

- a $56.8 million decrease in borrowings, to the result of maturing wholesale repurchase agreements and FHLB advances, and

- a $5.3 million, or 4.5%, decrease in stockholders equity, primarily due to the redemption of TARP preferred stock and warrants totaling $4.3 million.

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Cash and Cash Equivalents

Cash and cash equivalents decreased $62.3 million, or 48.6%, to $65.9 million at June 30, 2013 as compared to $128.3 million at June 30, 2012. This decrease occurred as cash was used to fund loan growth.

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Investments Securities

The available-for-sale securities portfolio totaled $121.6 million and $133.3 million at June 30, 2013 and 2012, respectively. The year over year decrease of $11.7 million, or 8.8%, was primarily due to principal amortization of mortgage-backed securities during the year. Mortgage-backed securities and U.S. Government-sponsored enterprise bonds totaling $53.5 million were pledged for outstanding borrowings at June 30, 2013.

At June 30, 2013, the Company s investment portfolio was comprised entirely of U.S. Government-sponsored enterprise bonds and mortgage-backed securities guaranteed by government agencies. Generally, funds retained by the Company as a result of increases in deposits or decreases in loans, to the extent not immediately deployed by the Bank, are invested in securities held in its investment portfolio, which serves as a source of liquidity for the Company. The composition of the Company s securities portfolio at the dates indicated follows.

	June 30, 2013		June 30, 2012		June 30, 2011	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
			(Dollars in thousands)			
U.S. Government agency securities	$ 45,289	$ 45,333	$ 45,824	$ 45,808	$ 48,827	$ 48,737
Agency mortgage-backed securities	78,944	76,264	86,816	87,456	99,637	99,558
Trust preferred securities					466	451
Equity securities					193	216
	$ 124,233	$ 121,597	$ 132,640	$ 133,264	$ 149,123	$ 148,962

The table below sets forth certain information regarding the contractual maturities and weighted average yields of the Company s securities portfolio at June 30, 2013. Actual maturities of mortgage-backed securities will differ from contractual maturities due both to scheduled amortization and prepayments.

	Within One Year		After One Year Through Five Years		After Five Years Through Ten Years		After Ten Years		Total	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
					(Dollars in thousands)					
U.S. Government agency securities	$ 45,332	0.35%	$		$		$		$ 45,332	0.35%
Agency mortgage-backed securities					40,622	0.86%	35,643	1.27%	76,265	1.05%
	$ 45,332	0.35%	$		$ 40,622	0.86%	$ 35,643	1.27%	$ 121,597	0.79%

Management reviews the portfolio of investments on an ongoing basis to determine if there have been any other-than-temporary declines in value. No other-than-temporary impairment expense was recognized during fiscal 2013 or fiscal 2012.

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Loans

Loans, including loans held-for-sale, totaled $444.0 million at June 30, 2013, compared to $366.1 million at June 30, 2012. The increase of $77.9 million, or 21.3%, at June 30, 2013, was principally due to net increases of $83.7 million and $10.1 million in commercial real estate and commercial business loans, respectively, offset by decreases in all other categories. During fiscal 2013, the LASG purchased $121.3 million in loans, consisting principally of commercial real estate loans.

The composition of the Company s loan portfolio (excluding loans held-for-sale) at the dates indicated is as follows:

	Successor Company						Predecessor Company			
	June 30, 2013		June 30, 2012		June 30, 2011		June 30, 2010		June 30, 2009	
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
	(Dollars in thousands)									
Residential real estate	$ 127,829	29.36%	$ 137,571	38.61%	$ 145,477	46.94%	$ 155,613	40.70%	$ 138,900	35.29%
Commercial real estate	264,448	60.74%	180,735	50.74%	117,761	38.00%	121,175	31.70%	120,730	30.67%
Construction	42	0.01%	1,187	0.33%	2,015	0.65%	5,525	1.45%	6,384	1.62%
Commercial business	29,720	6.83%	19,612	5.51%	22,225	7.17%	30,214	7.90%	29,211	7.42%
Consumer and other	13,337	3.06%	17,149	4.81%	22,435	7.24%	69,782	18.25%	98,426	25.00%
Total loans	435,376	100.0%	356,254	100.0%	309,913	100.0%	382,309	100.0%	393,651	100.0%
Less: Allowance for loan losses	1,143		824		437		5,806		5,764	
Loans, net	$ 434,233		$ 355,430		$ 309,476		$ 376,503		$ 387,887	

The Company s loan portfolio (excluding loans held-for-sale) by lending division follows:

	June 30, 2013				June 30, 2012			
	Community Banking Division	LASG	Total	Percent of Total	Community Banking Division	LASG	Total	Percent of Total
	(Dollars in thousands)							
Originated loans:								
Residential real estate	$ 89,584	$ 150	$ 89,734	20.61%	$ 90,793	$ 151	$ 90,944	25.53%
Home equity	35,389		35,389	8.13%	42,696		42,696	11.98%
Commercial real estate	78,915	21,487	100,402	23.06%	97,146	3,050	100,196	28.12%
Construction	42		42	0.01%	1,187		1,187	0.33%
Commercial business	12,444	17,242	29,686	6.82%	17,732	1,880	19,612	5.51%
Consumer	13,337		13,337	3.06%	17,149		17,149	4.81%
Subtotal	229,711	38,879	268,590	61.69%	266,703	5,081	271,784	76.28%
Purchased loans:								
Residential real estate		2,706	2,706	0.62%		3,931	3,931	1.10%

Commercial business		34	34	0.01%				
Commercial real estate		164,046	164,046	37.68%		80,539	80,539	22.62%
Subtotal		166,786	166,786	38.31%		84,470	84,470	23.72%
Total	$ 229,711	$ 205,665	$ 435,376	100.00%	$ 266,703	$ 89,551	$ 356,254	100.00%

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The following table summarizes the scheduled maturity of the Company s loan portfolio at June 30, 2013. Demand loans, loans having no stated repayment schedule, and overdraft loans are reported as being due in less than one year.

	Scheduled Loan Maturities				
	Within One Year	After One Year Through Five Years	After Five Years Through Ten Years	After Ten Years	Total
Mortgages:					
Residential:					
Originated	$ 4,802	$ 13,483	$ 21,989	$ 84,849	$ 125,123
Purchased	565	2,057		84	2,706
Commercial:					
Originated	4,745	26,251	15,937	53,469	100,402
Purchased	12,822	76,624	17,882	60,718	164,046
Construction	42				42
Non-mortgage loans:					
Commercial:					
Originated	18,224	9,083	1,937	442	29,686
Purchased		34			34
Consumer and other	427	2,310	5,030	5,570	13,337
Total loans	$ 41,627	$ 129,842	$ 62,775	$ 205,132	$ 435,376

	Loans Due After One Year, by Interest Rate Type		
	Predetermined rate	Floating or Adjustable (Dollars in thousands)	Total
Mortgages:			
Residential:			
Originated	$ 54,617	$ 65,704	$ 120,321
Purchased	83	2,058	2,141
Commercial:			
Originated	73,346	22,311	95,657
Purchased	56,704	94,520	151,224
Construction			
Non-mortgage loans:			
Commercial:			
Originated	3,955	7,507	11,462
Purchased	5	29	34
Consumer and other	37	12,873	12,910
Total	$ 188,747	$ 205,002	$ 393,749

Of total portfolio loans at June 30, 2013, approximately 46.5% were variable rate products, compared to 56.3% at June 30, 2012. This decrease in the percentage of variable rate products resulted principally from an increase in fixed-rate commercial loans.

Certain purchased loans have been identified as having evidence of credit deterioration since their origination, and it is probable that the Company will not collect all contractually required principal and interest payments. Purchased credit-impaired loans are accounted for using the measurement provisions set forth in ASC 310-30. A nonaccretable difference has been established in accounting for PCI loans to absorb losses of principal and interest. Losses absorbed by the nonaccretable difference do not affect the income statement or the allowance for loan losses.

Other Assets

The cash surrender value of the Company s BOLI assets increased $90 thousand, or 0.6%, to $14.4 million at June 30, 2013, compared to $14.3 million at June 30, 2012. BOLI assets are invested in the general account of three insurance companies and in separate accounts of a fourth insurance company. A general account policy s cash surrender value is supported by the general assets of the insurance company. A separate account policy s cash surrender value is supported by assets segregated from the general assets of the insurance company. Standard and Poor s rated these companies A+ or better at June 30, 2013. Interest earnings, net of mortality costs, increase the cash surrender value. These interest earnings are based on interest rates that reset each year, and are subject to minimum guaranteed rates. These increases in cash surrender value are recognized in other income and are not subject to income taxes. Management considers BOLI an illiquid asset. BOLI represented 11.8% of the Company s total risk-based capital at June 30, 2013.

Intangible assets totaled $3.5 million and $4.5 million at June 30, 2013 and June 30, 2012, respectively. The $943 thousand decrease was the result of core deposit intangible amortization during fiscal 2013.

Deposits

The Company s principal source of funding is its core deposit accounts. At June 30, 2013, core deposits, which the Company defines as non-maturity accounts and certificates of deposit with balances less than $250 thousand, represented 98.3% of total deposits.

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Total deposits increased $62.4 million to $484.6 million as of June 30, 2013 from $422.2 million as of June 30, 2012. The overall increase was achieved through the Bank s online affinity deposit program, which grew CD and money market deposit balances by a total of $69.0 million during fiscal 2013.

The following tables set forth certain information relative to the composition of the Company s average deposit accounts and the weighted average interest rate on each category of deposits for the periods indicated:

	Successor Company					
	Year Ended June 30, 2013			Year Ended June 30, 2012		
	Average Balance	Weighted Average Rate	Percent of Total Average Deposits	Average Balance	Weighted Average Rate	Percent of Total Average Deposits
	(Dollars in thousands)					
Non-interest bearing demand deposits and escrow accounts	$ 49,343	0.00%	10.26%	$ 45,933	0.00%	11.41%
Regular savings	31,939	0.14%	6.64%	32,799	0.20%	8.15%
NOW accounts	55,763	0.27%	11.59%	55,218	0.39%	13.72%
Money market accounts	63,931	0.53%	13.29%	44,692	0.39%	11.11%
Time deposits	280,059	1.27%	58.22%	223,782	1.33%	55.61%
Total average deposits	$ 481,035	0.85%	100.00%	$ 402,424	0.85%	100.00%

[redacted]

Non-interest bearing demand deposits and escrow accounts	$ 43,761	0.00%	11.10%	$ 37,941	0.00%	9.92%
[redacted]						
NOW accounts	56,386	0.56%	14.30%	53,780	0.69%	14.07%
[redacted]						
Time deposits	207,251	1.25%	52.54%	196,318	2.36%	51.35%
[redacted]						

As of June 30, 2013, the aggregate amount of outstanding certificates of deposit in amounts greater than or equal to $100 thousand was approximately $163.4 million. The scheduled maturity of these deposits is set forth below (dollars in thousands).

3 months or less	$ 27,694
Over 3 through 6 months	35,931
Over 6 through 12 months	14,545

Over 12 months		85,269
Total time certificates $100 and over	$	163,439

Borrowings

Short-term borrowings, FHLB advances, Federal Reserve Discount Window Borrower-in-custody advances, wholesale repurchase agreements and junior subordinated debentures have been the Company s sources of funding other than deposits. In fiscal 2013, total borrowings decreased by $56.8 million, or 47.0%, to $64.0 million.

Advances from the FHLB were $28.0 million and $43.5 million at June 30, 2013 and June 30, 2012, respectively, a decrease of $15.4 million, or 35.5%. At June 30, 2013, the Company had pledged investment securities having a fair value of $27.3 million for outstanding FHLB borrowings. In addition, pledges of residential real estate loans, certain commercial real estate loans and certain FHLB deposits free of liens or pledges are required to secure outstanding advances and available additional borrowing capacity from the FHLB. Wholesale repurchase agreements were $25.4 million and $66.2 million at June 30, 2013 and 2012, respectively. At June 30, 2013, the Company had pledged investment securities having a fair value of $27.0 million and cash of $3.2 million for outstanding wholesale repurchase agreements.

Short-term borrowings, consisting of sweep accounts and repurchase agreements, were $625 thousand and $1.2 million at June 30, 2013 and 2012, respectively. At June 30, 2013, sweep accounts were secured by $2.0 million of letters of credit issued by the FHLB and investment securities with a fair value of $3.0 million.

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The table below sets forth certain information about the Company s short-term borrowings for the periods indicated:

[redacted]						
Balance at period end	$	625	0.00%	$	1,209	2.00%
[redacted]						
Maximum outstanding at any period		2,707			1,836	

	Successor Company 184 Days Ended June 30, 2011			Predecessor Company 181 Days Ended December 28, 2010		
		Amount	Weighted Average Rate		Amount	Weighted Average Rate
	(Dollars in thousands)					
Balance at period end	$	2,515	1.52%	$	62,737	1.13%
Average outstanding during period		19,764	0.76%		53,873	1.41%
Maximum outstanding at any period		62,034			62,737	

There were no balances outstanding at June 30, 2013 and 2012, respectively, for advances under the Federal Reserve Discount Window Borrower-in-custody program. The available credit under the program was $80 thousand and $369 thousand at June 30, 2013 and June 30, 2012, respectively.

The Company had junior subordinated debentures issued to affiliated trusts totaling $8.3 million and $8.1 million at June 30, 2013 and 2012, respectively. See Capital below for more information on our junior subordinated debentures and affiliated trusts.

Asset Quality

Allowance for Loan Losses

The allowance for loan losses is maintained at a level that management considers adequate to provide for probable loan losses based upon evaluation of known and inherent risks in the loan portfolio. The allowance is increased by providing for loan losses through a charge to expense and by recoveries of loans previously charged-off and is reduced by loans being charged-off.

The allowance 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 legacy loans based on estimates of deteriorated credit quality post-Merger.

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As of June 30, 2013, the allowance for loan losses totaled $1.1 million, or 0.26% of total loans, as compared to $824 thousand, or 0.23% of total loans, at June 30, 2012. The year over year increase in the Company s allowance for losses was principally the result of loan originations and an increase in troubled debt restructurings. The following table sets forth activity in Company s allowance for loan losses for the periods indicated.

	Successor Company			Predecessor Company		
	Year Ended June 30, 2013	Year Ended June 30, 2012	184 Days Ended June 30, 2011	181 Days Ended Dec. 28, 2010	Year Ended June 30, 2010	Year Ended June 30, 2009
	(Dollars in thousands)					
Allowance at beginning of period	$ 824	$ 437	$	$ 5,806	$ 5,764	$ 5,656
Loans charged-off during the period:						
Residential real estate	369	248	42	61	237	271
Commercial real estate	135	26	27	281	412	257
Commercial business	203	17	21	145	509	285
Consumer and other	148	352				