

NORTHEAST BANCORP /ME/
Form 10-Q
November 12, 2014
[Table of Contents](#)

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2014

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)

(207) 786-3245

Registrant's telephone number, including area code

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

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller Reporting Company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. As of October 31, 2014, the registrant had outstanding 9,349,587 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.

Table of Contents

<u>Part I.</u>	<u>Financial Information</u>	
	<u>Item 1.</u>	<u>Financial Statements (unaudited)</u> <u>Consolidated Balance Sheets</u> <u>September 30, 2014 and June 30, 2014</u>
		<u>Consolidated Statements of Income</u> <u>Three Months Ended September 30, 2014 and 2013</u>
		<u>Consolidated Statements of Comprehensive Income</u> <u>Three Months Ended September 30, 2014 and 2013</u>
		<u>Consolidated Statements of Changes in Shareholders' Equity</u> <u>Three Months Ended September 30, 2014 and 2013</u>
		<u>Consolidated Statements of Cash Flows</u> <u>Three Months Ended September 30, 2014 and 2013</u>
		<u>Notes to Consolidated Financial Statements</u>
	<u>Item 2.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>
	<u>Item 3.</u>	<u>Quantitative and Qualitative Disclosure about Market Risk</u>
	<u>Item 4.</u>	<u>Controls and Procedures</u>
<u>Part II.</u>	<u>Other Information</u>	
	<u>Item 1.</u>	<u>Legal Proceedings</u>
	<u>Item 1A.</u>	<u>Risk Factors</u>
	<u>Item 2.</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>
	<u>Item 3.</u>	<u>Defaults Upon Senior Securities</u>
	<u>Item 4.</u>	<u>Mine Safety Disclosures</u>
	<u>Item 5.</u>	<u>Other Information</u>
	<u>Item 6.</u>	<u>Exhibits</u>

Table of Contents

PART 1- FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

NORTHEAST BANCORP AND SUBSIDIARY**CONSOLIDATED BALANCE SHEETS**

(Unaudited)

(Dollars in thousands, except share data)

	September 30, 2014	June 30, 2014
Assets		
Cash and due from banks	\$ 2,313	\$ 3,372
Short-term investments	81,217	78,887
Total cash and cash equivalents	83,530	82,259
Available-for-sale securities, at fair value	110,347	113,881
Loans held for sale	9,069	11,945
Loans	541,799	516,416
Less: Allowance for loan losses	1,539	1,367
Loans, net	540,260	515,049
Premises and equipment, net	8,780	9,135
Real estate owned and other repossessed collateral, net	2,115	1,991
Federal Home Loan Bank stock, at cost	4,102	4,102
Intangible assets, net	2,632	2,798
Bank owned life insurance	14,945	14,836
Other assets	6,511	5,935
Total assets	\$ 782,291	\$ 761,931
Liabilities and Shareholders Equity		
Liabilities		
Deposits:		
Demand	\$ 52,698	\$ 50,140
Savings and interest checking	96,814	98,340
Money market	103,054	83,901
Time	341,229	341,948
Total deposits	593,795	574,329
Federal Home Loan Bank advances	42,773	42,824
Wholesale repurchase agreements	10,158	10,199
Short-term borrowings	3,804	2,984
Junior subordinated debentures issued to affiliated trusts	8,485	8,440

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

Capital lease obligation	1,511	1,558
Other liabilities	8,523	9,531
Total liabilities	669,049	649,865
Commitments and contingencies		
Shareholders' equity		
Preferred stock, \$1.00 par value, 1,000,000 shares authorized; no shares issued and outstanding at September 30, 2014 and June 30, 2014		
Voting common stock, \$1.00 par value, 25,000,000 shares authorized; 9,367,071 and 9,260,331 shares issued and outstanding at September 30, 2014 and June 30, 2014, respectively	9,367	9,260
Non-voting common stock, \$1.00 par value, 3,000,000 shares authorized; 880,963 shares issued and outstanding at September 30, 2014 and June 30, 2014	881	881
Additional paid-in capital	90,809	90,914
Retained earnings	13,836	12,294
Accumulated other comprehensive loss	(1,651)	(1,283)
Total shareholders' equity	113,242	112,066
Total liabilities and shareholders' equity	\$ 782,291	\$ 761,931

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

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

(Unaudited)

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

Interest and dividend income:			
Interest on loans	\$	10,922	\$ 8,457
Interest on available-for-sale securities		244	282
Other interest and dividend income		66	52
Total interest and dividend income		11,232	8,791
Interest expense:			
Deposits		1,130	1,047
Federal Home Loan Bank advances		323	323
Wholesale repurchase agreements		73	95
Short-term borrowings		9	5
Junior subordinated debentures issued to affiliated trusts		206	192
Obligation under capital lease agreements		20	22
Total interest expense		1,761	1,684
Net interest and dividend income before provision for loan losses		9,471	7,107
Provision for loan losses		320	77
Net interest income after provision for loan losses		9,151	7,030
Noninterest income:			
Fees for other services to customers		394	439
Gain on sales of loans held for sale		584	539
Gain on sales of portfolio loans		80	216
Loss recognized on real estate owned and other repossessed collateral, net		(23)	(38)
Bank-owned life insurance income		109	118
Other noninterest income		10	14
Total noninterest income		1,154	1,288
Noninterest expense:			
Salaries and employee benefits		4,533	4,612
Occupancy and equipment expense		1,202	1,327
Professional fees		308	376
Data processing fees		345	277
Marketing expense		69	36
Loan acquisition and collection expense		274	473
FDIC insurance premiums		124	110
Intangible asset amortization		166	210
Legal settlement recovery			(250)
Other noninterest expense		716	681
Total noninterest expense		7,737	7,852
Income from continuing operations before income tax expense		2,568	466
Income tax expense		924	156
Net income from continuing operations		1,644	310
Income from discontinued operations before income tax expense			15
Income tax expense			5
Net income from discontinued operations			10

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

Net income	\$	1,644	\$	320
Net income available to common shareholders	\$	1,644	\$	320
Weighted-average shares outstanding:				
Basic		10,180,038		10,440,513
Diluted		10,180,038		10,440,513
Earnings per common share:				
Basic:				
Income from continuing operations	\$	0.16	\$	0.03
Income from discontinued operations		0.00		0.00
Net Income	\$	0.16	\$	0.03
Diluted:				
Income from continuing operations	\$	0.16	\$	0.03
Income from discontinued operations		0.00		0.00
Net Income	\$	0.16	\$	0.03
Cash dividends declared per common share	\$	0.01	\$	0.09

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

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

(Unaudited)

(Dollars in thousands)

Net income	\$	1,644	\$	320
Other comprehensive income (loss), before tax:				
Available-for-sale securities:				
Change in net unrealized gain or loss on available-for-sale securities		(275)		517
Reclassification adjustment for net gains included in net income				
Total available-for-sale securities		(275)		517
Derivatives and hedging activities:				
Change in accumulated loss on effective cash flow hedges		(272)		19
Reclassification adjustments for net gains included in net income		(9)		(19)
Total derivatives and hedging activities		(281)		
Total other comprehensive income (loss), before tax		(556)		517
Income tax expense (benefit) related to other comprehensive (loss) income		(188)		176
Other comprehensive income (loss), net of tax		(368)		341
Total comprehensive income	\$	1,276	\$	661

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

Table of Contents**NORTHEAST BANCORP AND SUBSIDIARY****CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY**

(Unaudited)

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

	Preferred Stock		Voting Common Stock		Non-voting Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders Equity
	Shares	Amount	Shares	Amount	Shares	Amount				
Balance at June 30, 2013		\$ 9,565,680	\$ 9,566	880,963	\$ 881	\$ 92,745	\$ 12,524	\$ (1,914)	\$ 113,802	
Net income							320		320	
Other comprehensive income, net of tax								341	341	
Dividends on common stock at \$0.09 per share							(940)		(940)	
Stock-based compensation						323			323	
Forfeiture of restricted common stock		(13,093)	(13)			13				
Balance at September 30, 2013		\$ 9,552,587	\$ 9,553	880,963	\$ 881	\$ 93,081	\$ 11,904	\$ (1,573)	\$ 113,846	
Balance at June 30, 2014		\$ 9,260,331	\$ 9,260	880,963	\$ 881	\$ 90,914	\$ 12,294	\$ (1,283)	\$ 112,066	
Net income							1,644		1,644	
Other comprehensive income, net of tax								(368)	(368)	
Common stock repurchased		(14,400)	(14)			(120)			(134)	
Dividends on common stock at \$0.01 per share							(102)		(102)	
Stock-based compensation						136			136	
Issuance of restricted common stock		128,000	128			(128)				
Forfeiture of restricted common stock		(6,860)	(7)			7				
Balance at September 30, 2014		\$ 9,367,071	\$ 9,367	880,963	\$ 881	\$ 90,809	\$ 13,836	\$ (1,651)	\$ 113,242	

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

Table of Contents**NORTHEAST BANCORP AND SUBSIDIARY****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Unaudited)

(Dollars in thousands)

Operating activities:			
Net income		\$ 1,644	\$ 320
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses		320	77
(Gain) loss on sale and impairment of real estate owned and other repossessed collateral, net		(5)	102
Accretion of fair value adjustments on loans, net		(3,097)	(1,317)
Accretion of fair value adjustments on deposits, net		(64)	(201)
Accretion of fair value adjustments on borrowings, net		(47)	(67)
Originations of loans held for sale		(27,676)	(27,433)
Net proceeds from sales of loans held for sale		31,136	31,148
Gain on sales of loans held for sale		(584)	(539)
Gain on sales of portfolio loans		(80)	(216)
Amortization of intangible assets		166	210
Bank-owned life insurance income, net		(109)	(118)
Depreciation of premises and equipment		432	522
Loss (gain) on sale of premises and equipment		28	(1)
Stock-based compensation		136	323
Amortization of securities, net		262	335
Changes in other assets and liabilities:			
Other assets		(364)	(497)
Other liabilities		(1,284)	387
Net cash provided by operating activities		814	3,035
Investing activities:			
Purchases of available-for-sale securities			(3,004)
Proceeds from maturities and principal payments on available-for-sale securities		2,994	6,576
Loan purchases		(13,167)	(16,348)
Proceeds from sales of portfolio loans		793	205
Loan originations and principal collections, net		(10,213)	(31,961)
Purchases of premises and equipment		(105)	(284)
Proceeds from sales of premises and equipment			11
Proceeds from sales of real estate owned and other repossessed collateral		88	150
Net cash used in investing activities		(19,610)	(44,655)
Financing activities:			
Net increase in deposits		19,530	47,676
Net increase in short-term borrowings		820	1,345
Repurchase of common stock		(134)	
Dividends paid on common stock		(102)	(940)
Proceeds from FHLB advances			15,000
Repayment of wholesale repurchase agreements			(10,000)
Repayment of capital lease obligation		(47)	(44)
Net cash provided by financing activities		20,067	53,037
Net increase in cash and cash equivalents		1,271	11,417

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

Cash and cash equivalents, beginning of period		82,259		65,934
Cash and cash equivalents, end of period	\$	83,530	\$	77,351
Supplemental schedule of noncash investing and financing activities:				
Transfers from loans to real estate owned and other repossessed collateral	\$	209	\$	1,531
Transfers from real estate owned and other repossessed collateral to loans				

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

Table of Contents

NORTHEAST BANCORP AND SUBSIDIARY

Notes to Unaudited Consolidated Financial Statements

September 30, 2014

1. Basis of Presentation

The accompanying unaudited condensed and consolidated interim financial statements include the accounts of Northeast Bancorp (Northeast) or the Company) and its wholly-owned subsidiary, Northeast Bank (the Bank).

These financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, the accompanying consolidated financial statements contain all adjustments (consisting principally of normal recurring accruals) considered necessary for a fair presentation of the Company s financial position, results of operations, and cash flows for the interim periods presented. These financial statements and notes should be read in conjunction with the audited consolidated financial statements and notes thereto for the fiscal year ended June 30, 2014 (Fiscal 2014) included in the Company s Annual Report on Form 10-K filed with the Securities and Exchange Commission.

2. Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)* (ASU 2014-09). ASU 2014-09 implements a common revenue standard that clarifies the principles for recognizing revenue. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve that core principle, an entity should apply the following steps: (i) identify the contract(s) with a customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract and (v) recognize revenue when (or as) the entity satisfies a performance obligation. ASU 2014-09 is effective January 1, 2017 and is not expected to have a significant impact on the Company s financial statements.

In June 2014, the FASB issued ASU 2014-11, *Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures* (ASU 2014-11). ASU 2014-11 requires that repurchase-to-maturity transactions be accounted for as secured borrowings consistent with the accounting for other repurchase agreements. In addition, ASU 2014-11 requires separate accounting for repurchase financings, which entails the transfer of a financial asset executed contemporaneously with a repurchase agreement with the same counterparty. ASU 2014-11 requires entities to disclose certain information about transfers accounted for as sales in transactions that are economically similar to repurchase agreements. In addition, ASU 2014-11 requires disclosures related to collateral, remaining contractual tenor and of the potential risks associated with repurchase agreements, securities lending transactions and repurchase-to-maturity transactions. ASU 2014-11 is effective January 1, 2015 and is not expected to have a significant impact on the Company s financial statements.

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

In August 2014, the FASB issued ASU 2014-14, *Receivables - Troubled Debt Restructurings by Creditors (Subtopic 310-40): Classification of Certain Government-Guaranteed Mortgage Loans upon Foreclosure* (ASU 2014-14). ASU 2014-14 affects creditors that hold government-guaranteed mortgage loans, including those guaranteed by the Federal Housing Administration (FHA) of the U.S. Department of Housing and Urban Development (HUD), and the U.S. Department of Veterans Affairs (VA). The update requires that, upon foreclosure, a guaranteed mortgage loan be derecognized and a separate other receivable be recognized when specific criteria are met. ASU 2014-14 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2014. The adoption of this guidance is not expected to have a significant impact on the Company's financial statements.

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

The following presents a summary of the amortized cost, gross unrealized holding gains and losses and fair value of securities available for sale.

	September 30, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
U.S. Government agency securities	\$ 48,359	\$ 15	\$ (23)	\$ 48,351
Agency mortgage-backed securities	63,544	0	(1,548)	61,996
	\$ 111,903	\$ 15	\$ (1,571)	\$ 110,347

	June 30, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
U.S. Government agency securities	\$ 48,415	\$ 31	\$ (28)	\$ 48,418
Agency mortgage-backed securities	66,744	3	(1,284)	65,463
	\$ 115,159	\$ 34	\$ (1,312)	\$ 113,881

When securities are sold, the adjusted cost of the specific security sold is used to compute the gain or loss on sale. There were no securities sold during the three months ended September 30, 2014 or 2013. At September 30, 2014, investment securities with a fair value of approximately \$32.3 million were pledged as collateral to secure outstanding borrowings.

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

	September 30, 2014					
	Less than 12 Months		More than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
(Dollars in thousands)						
U.S. Government agency securities	\$ 27,111	\$ (23)	\$	\$	\$ 27,111	\$ (23)
Agency mortgage-backed securities	2,510	(6)	59,486	(1,542)	61,996	(1,548)
	\$ 29,621	\$ (29)	\$ 59,486	\$ (1,542)	\$ 89,107	\$ (1,571)

	June 30, 2014					
	Less than 12 Months		More than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses

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

(Dollars in thousands)

U.S. Government agency securities	\$	24,141	\$	(28)	\$		\$	24,141	\$	(28)
Agency mortgage-backed securities					62,734	(1,284)	62,734	(1,284)		
	\$	24,141	\$	(28)	\$	62,734	\$	(1,284)	\$	86,875
									\$	(1,312)

There was no other-than-temporary impairment losses on securities during the three months ended September 30, 2014 or 2013.

At September 30, 2014, the Company had twenty-one securities in a continuous loss position for greater than twelve months. At September 30, 2014, all of the Company's available-for-sale securities were issued or guaranteed by either government agencies or government-sponsored enterprises. The decline in fair value of the Company's available-for-sale securities at September 30, 2014 is attributable to changes in interest rates.

Management of the Company, in addition to considering current trends and economic conditions that may affect the quality of individual securities within the Company's investment portfolio, also considers the Company's ability and intent to hold such securities to maturity or recovery of cost. Management does not believe any of the Company's available-for-sale securities are other-than-temporarily impaired at September 30, 2014.

Table of Contents

The amortized cost and fair values of available-for-sale debt securities by contractual maturity are shown below as of September 30, 2014. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost		Fair Value
	(Dollars in thousands)		
Due within one year	\$ 3,002	\$	3,009
Due after one year through five years	45,357		45,342
Due after five years through ten years	31,904		31,393
Due after ten years	31,640		30,603
	\$ 111,903	\$	110,347

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

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

Loans purchased by the Company are accounted for under ASC 310-30, *Receivables - Loans and Debt Securities Acquired with Deteriorated Credit Quality* (ASC 310-30). At acquisition, the effective interest rate is determined based on the discount rate that equates the present value of the Company's estimate of cash flows with the purchase price of the loan. Prepayments are not assumed in determining a purchased loan's effective interest rate and income accretion. The application of ASC 310-30 limits the yield that may be accreted on the purchased loan, or the accretible yield, to the excess of the Company's estimate, at acquisition, of the expected undiscounted principal, interest, and other cash flows over the Company's initial investment in the loan. The excess of contractually required payments receivable over the cash flows expected to be collected on the loan represents the purchased loan's nonaccretible difference. Subsequent improvements in expected cash flows of loans with nonaccretible differences result in a prospective increase to the loan's effective yield through a reclassification of some, or all, of the nonaccretible difference to accretible yield. The effect of subsequent credit-related declines in expected cash flows of purchased loans are recorded through a specific allocation in the allowance for loan losses.

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

In cases where a borrower experiences financial difficulties and the Company makes certain concessionary modifications to contractual terms, the loan is classified as a troubled debt restructuring (TDR), and therefore by definition is an impaired loan. Concessionary modifications may include adjustments to interest rates, extensions of maturity, and other actions intended to minimize economic loss and avoid foreclosure or repossession of collateral. For loans accounted for under ASC 310-30, the Company evaluates whether it has granted a concession by comparing the restructured debt terms to the expected cash flows at acquisition plus any additional cash flows expected to be collected arising from changes in estimate after acquisition. As a result, if an ASC 310-30 loan is modified to be consistent with, or better than, the Company's expectations at acquisition, the loan would not qualify as a TDR. Nonaccrual loans that are restructured generally remain on nonaccrual status for a minimum period of six months to demonstrate that the borrower can meet the restructured terms. If the restructured loan is on accrual status prior to being modified, it is reviewed to determine if the modified loan should remain on accrual status. If the borrower's ability to meet the revised payment schedule is not reasonably assured, the loan is classified as a nonaccrual loan. With limited exceptions, loans classified as TDRs remain classified as such until the loan is paid off.

The composition of the Company's loan portfolio is as follows on the dates indicated.

	September 30, 2014			June 30, 2014	
Originated	Purchased	Total	Originated	Purchased	Total
(Dollars in thousands)					

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

Residential real estate	\$	114,414	\$	2,729	\$	117,143	\$	116,972	\$	3,687	\$	120,659
Home equity		26,818				26,818		27,975				27,975
Commercial real estate		108,709		202,922		311,631		116,617		199,481		316,098
Commercial business		76,663		277		76,940		41,518		282		41,800
Consumer		9,267				9,267		9,884				9,884
Total loans	\$	335,871	\$	205,928	\$	541,799	\$	312,966	\$	203,450	\$	516,416

Table of Contents

Allowance for Loan Losses and Impaired Loans

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. For residential and consumer loans, a charge-off is recorded no later than the point at which a loan is 180 days past due if the loan balance exceeds the fair value of the collateral, less costs to sell. For commercial loans, a charge-off is recorded on a case-by-case basis when all or a portion of the loan is deemed to be uncollectible. Subsequent recoveries, if any, are credited to the allowance.

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

Residential real estate: All loans in this segment are collateralized by residential real estate and repayment is primarily dependent on the credit quality of the individual borrower. The overall health of the economy, particularly unemployment rates and housing prices, has a significant effect on the credit quality in this segment. For purposes of the Company's allowance for loan loss calculation, home equity loans and lines of credit are included in residential real estate.

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

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

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

Purchased: Loans in this segment are typically secured by commercial real estate, multi-family residential real estate, or business assets and have been acquired by the Bank's Loan Acquisition and Servicing Group (LASG). Loans acquired by the LASG are, with limited exceptions, performing loans at the date of purchase. Loans in this segment acquired with specific material credit deterioration since origination are identified as purchased credit-impaired. Repayment of loans in this segment is largely dependent on cash flow from the successful operation of the property, in the case of non-owner occupied property, or operating business, in the case of owner-occupied property. Loan performance may be adversely affected by factors affecting the general economy or conditions specific to the real estate market, such as geographic location or

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

The general component of the allowance for loan losses is based on historical loss experience adjusted for qualitative factors stratified by loan segment. The Company does not weight periods used in that analysis to determine the average loss rate in each portfolio segment. This historical loss factor is adjusted for the following qualitative factors:

- Levels and trends in delinquencies and nonperforming loans

- Trends in the volume and nature of loans

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

- Trends in portfolio concentration

- National and local economic trends and conditions

- Effects of changes or trends in internal risk ratings

- Other effects resulting from trends in the valuation of underlying collateral

There were no significant changes in the Company's policies or methodology pertaining to the general component of the allowance for loan losses during the three months ended September 30, 2014 or 2013.

The allocated component of the allowance for loan losses relates to loans that are classified as impaired. Impairment is measured on a loan-by-loan basis for commercial business and commercial real estate loans by either the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent. An allowance is established when the discounted cash flows or collateral value of the impaired loan is lower than the carrying value of that loan. Large

Table of Contents

groups of smaller-balance homogeneous loans, such as consumer and residential real estate loans are collectively evaluated for impairment based on the group's historical loss experience adjusted for qualitative factors. Accordingly, the Company does not separately identify individual consumer and residential loans for individual impairment and disclosure. However, all TDRs are individually reviewed for impairment.

For all portfolio segments, except loans accounted for under ASC 310-30, a loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. For the purchased loan segment, a loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to realize cash flows as estimated at acquisition. For loans accounted for under ASC 310-30 for which cash flows can reasonably be estimated, loan impairment is measured based on the decrease in expected cash flows from those estimated at acquisition, excluding changes due to changes in interest rate indices and other non-credit related factors, discounted at the loan's effective rate assumed at acquisition. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting the scheduled principal and interest payments when due.

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

Table of Contents

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

	Three Months Ended September 30, 2014						
	Residential Real Estate	Commercial Real Estate	Commercial Business	Consumer	Purchased	Unallocated	Total
	(Dollars in thousands)						
Beginning balance	\$ 580	\$ 358	\$ 48	\$ 79	\$ 267	\$ 35	\$ 1,367
Provision	358	(18)	1	(35)	4	10	320
Recoveries	5			10			15
Charge-offs	(160)			(3)			(163)
Ending balance	\$ 783	\$ 340	\$ 49	\$ 51	\$ 271	\$ 45	\$ 1,539

	Three Months Ended September 30, 2013						
	Residential Real Estate	Commercial Real Estate	Commercial Business	Consumer	Purchased	Unallocated	Total
	(Dollars in thousands)						
Beginning balance	\$ 594	\$ 173	\$ 70	\$ 189	\$ 76	\$ 41	\$ 1,143
Provision	115	(10)	(26)	(53)	25	26	77
Recoveries	6		6	18			30
Charge-offs	(20)			(6)			(26)
Ending balance	\$ 695	\$ 163	\$ 50	\$ 148	\$ 101	\$ 67	\$ 1,224

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

	September 30, 2014						
	Residential Real Estate	Commercial Real Estate	Commercial Business	Consumer	Purchased	Unallocated	Total
	(Dollars in thousands)						
Allowance for loan losses:							
Individually evaluated	\$ 389	\$ 86	\$ 4	\$ 232	\$ 711		\$ 711
Collectively evaluated	394	254	49	47	45		789
ASC 310-30					39		39
Total	\$ 783	\$ 340	\$ 49	\$ 51	\$ 271	\$ 45	\$ 1,539
Loans:							
Individually evaluated	\$ 3,501	\$ 2,294	\$ 221	\$ 6,274	\$ 12,290		\$ 12,290
Collectively evaluated	137,731	106,415	76,663	9,046	329,855		329,855
ASC 310-30					199,654		199,654
Total	\$ 141,232	\$ 108,709	\$ 76,663	\$ 9,267	\$ 205,928	\$ 541,799	\$ 541,799

	June 30, 2014						
	Residential Real Estate	Commercial Real Estate	Commercial Business	Consumer	Purchased	Unallocated	Total
	(Dollars in thousands)						
Allowance for loan losses:							
Individually evaluated	\$ 190	\$ 84	\$ 6	\$ 166	\$ 446		\$ 446
Collectively evaluated	390	274	48	73	820		820

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

ASC 310-30						101			101					
Total	\$	580	\$	358	\$	48	\$	79	\$	267	\$	35	\$	1,367
Loans:														
Individually evaluated	\$	2,314	\$	2,549	\$		\$	240	\$	4,747	\$		\$	9,850
Collectively evaluated		142,633		114,068		41,518		9,644						307,863
ASC 310-30										198,703				198,703
Total	\$	144,947	\$	116,617	\$	41,518	\$	9,844	\$	203,450	\$		\$	516,416

Table of Contents

The following table sets forth information regarding impaired loans. Loans accounted for under ASC 310-30 that have performed based on cash flow and accretible yield expectations determined at date of acquisition are not considered impaired assets and have been excluded from the tables below.

	At September 30, 2014			At June 30, 2014		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
(Dollars in thousands)						
Impaired loans without a valuation allowance:						
Originated:						
Residential real estate	\$ 1,396	\$ 1,468	\$	\$ 1,005	\$ 1,081	\$
Consumer	191	195		200	205	
Commercial real estate	808	814		1,368	1,371	
Commercial business		11				
Purchased:						
Commercial real estate	5,018	7,193		2,857	4,148	
Total	7,413	9,681		5,430	6,805	
Impaired loans with a valuation allowance:						
Originated:						
Residential real estate	2,105	2,036	389	1,309	1,278	190
Consumer	30	31	4	40	47	6
Commercial real estate	1,486	1,468	86	1,181	1,187	84
Commercial business						
Purchased:						
Commercial real estate	1,256	1,745	232	1,890	2,215	166
Total	4,877	5,280	711	4,420	4,727	446
Total impaired loans	\$ 12,290	\$ 14,961	\$ 711	\$ 9,850	\$ 11,532	\$ 446

	Three Months Ended September 30,			
	2014		2013	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
(Dollars in thousands)				
Impaired loans without a valuation allowance:				
Originated:				
Residential real estate	\$ 1,201	\$ 17	\$ 1,061	\$ 6
Consumer	196	3	84	1
Commercial real estate	1,088	7	439	7
Commercial business		1	63	3
Purchased:				
Commercial real estate	3,938	75	1,637	7
Total	6,423	103	3,284	24
Impaired loans with a valuation allowance:				
Originated:				
Residential real estate	1,707	28	1,393	18
Consumer	35	1	91	1
Commercial real estate	1,334	20	1,121	26
Commercial business			54	
Purchased:				

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

Commercial real estate	1,573	3	200	2
Total	4,649	52	2,859	47
Total impaired loans	\$ 11,072	\$ 155	\$ 6,143	\$ 71

Table of Contents

Credit Quality

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

Loans rated 1 - 6: Loans in these categories are considered pass rated loans. Loans in categories 1-5 are considered to have low to average risk. Loans rated 6 are considered marginally acceptable business credits and have more than average risk.

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

Loans rated 8: Loans in this category are considered substandard. Loans classified as substandard are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified have a well-defined weakness or weaknesses that jeopardize the orderly liquidation of the debt.

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

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

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

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

Loans rated 1- 6	\$	102,725	\$	76,427	\$	11,686	\$	191,367	\$	382,207

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

Loans rated 7	4,783	42	1,014	9,815	15,654
Loans rated 8	1,201	194	665	4,746	6,806
Loans rated 9					
Loans rated 10					
	\$ 108,709	\$ 76,663	\$ 13,365	\$ 205,928	\$ 404,667

Loans rated 1- 6	\$ 110,044	\$ 41,271	\$ 11,941	\$ 189,986	\$ 353,242
Loans rated 7	4,880	46	940	8,619	14,485
Loans rated 8	1,693	201	670	4,845	7,409
Loans rated 9					
Loans rated 10					
	\$ 116,617	\$ 41,518	\$ 13,551	\$ 203,450	\$ 375,136

(1) Certain of the Company's loans made for commercial purposes, but secured by residential collateral, are rated under the Company's risk-rating system.

Table of ContentsPast Due and Nonaccrual Loans

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

	September 30, 2014							
	30-59 Days	60-89 Days	Past Due 90 Days or More-Still Accruing	Past Due 90 Days or More- Nonaccrual	Total Past Due	Total Current	Total Loans	Non- Accrual Loans
(Dollars in thousands)								
Originated portfolio:								
Residential real estate	\$ 427	\$ 508	\$	\$ 1,306	\$ 2,241	\$ 112,173	\$ 114,414	\$ 2,105
Home equity				11	11	26,807	26,818	28
Commercial real estate	733			432	1,165	107,544	108,709	721
Commercial business						76,663	76,663	
Consumer	308	83		57	448	8,819	9,267	145
Total originated portfolio	1,468	591		1,806	3,865	332,006	335,871	2,999
Purchased portfolio:								
Residential real estate						2,729	2,729	
Commercial business						277	277	
Commercial real estate		289		3,437	3,726	199,196	202,922	4,287
Total purchased portfolio		289		3,437	3,726	202,202	205,928	4,287
Total loans	\$ 1,468	\$ 880	\$	\$ 5,243	\$ 7,591	\$ 534,207	\$ 541,799	\$ 7,286

	June 30, 2014							
	30-59 Days	60-89 Days	Past Due 90 Days or More-Still Accruing	Past Due 90 Days or More- Nonaccrual	Total Past Due	Total Current	Total Loans	Non- Accrual Loans
(Dollars in thousands)								
Originated portfolio:								
Residential real estate	\$ 222	\$ 728	\$	\$ 1,573	\$ 2,523	\$ 114,449	\$ 116,972	\$ 1,743
Home equity	109	7		120	236	27,739	27,975	160
Commercial real estate	126	136		629	891	115,726	116,617	1,162
Commercial business						41,518	41,518	5
Consumer	188	24		49	261	9,623	9,884	139
Total originated portfolio	645	895		2,371	3,911	309,055	312,966	3,209
Purchased portfolio:								
Residential real estate						3,687	3,687	
Commercial business						282	282	
Commercial real estate				1,995	1,995	197,486	199,481	4,116
Total purchased portfolio				1,995	1,995	201,455	203,450	4,116
Total loans	\$ 645	\$ 895	\$	\$ 4,366	\$ 5,906	\$ 510,510	\$ 516,416	\$ 7,325

Troubled Debt Restructurings

The following table shows the Company's post-modification balance of TDRs by type of modification.

	Three Months Ended September 30,			
	2014		2013	
	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
	(Dollars in thousands)			
Extended maturity	2	\$ 234	1	\$ 14
Adjusted interest rate			1	82
Rate and maturity	4	246		
Principal deferment	1	461	2	341
Court ordered concession	4	85		
	11	\$ 1,026	4	\$ 437

Table of Contents

The following table shows loans modified in a TDR and the change in the recorded investment subsequent to the modifications occurring.

	Three Months Ended September 30,					
	Number of Contracts	2014 Recorded Investment Pre-Modification	Recorded Investment Post-Modification	Number of Contracts	2013 Recorded Investment Pre-Modification	Recorded Investment Post-Modification
Originated portfolio:						
Residential real estate	9	\$ 823	\$ 823		\$	\$
Home equity				1	14	14
Commercial real estate	1	200	200	1	323	323
Commercial business				1	18	18
Consumer	1	3	3	1	82	82
Total originated portfolio	11	1,026	1,026	4	437	437
Purchased portfolio:						
Residential real estate						
Commercial real estate						
Total purchased portfolio						
Total	11	\$ 1,026	\$ 1,026	4	\$ 437	\$ 437

The Company considers TDRs past due 90 days or more to be in payment default. Two loans modified in a TDR in the last twelve months defaulted during the three months ended September 30, 2014; the recorded investment of such loans was \$48 thousand. As of September 30, 2014, there were no further commitments to lend associated with loans modified in a TDR.

ASC 310-30 Loans

The following table presents a summary of loans accounted for under ASC 310-30 that were acquired by the Company during the period indicated.

Three Months Ended September 30, 2014 (Dollars in thousands)	
Contractually required payments receivable	\$ 21,108
Nonaccretable difference	(304)
Cash flows expected to be collected	20,804
Accretable yield	(7,960)
Fair value of loans acquired	\$ 12,844

Certain of the loans accounted for under ASC 310-30 that were acquired by the Company are not accounted for using the income recognition model because the Company cannot reasonably estimate cash flows expected to be collected. The carrying amounts of such loans are as follows.

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

As of and for the three
months ended
September 30, 2014

Loans acquired during the period	\$	322
Loans at end of period		4,287

The following table summarizes the activity in the accretable yield for loans accounted for under ASC 310-30.

Three Months Ended September 30, 2014
(Dollars in thousands)

Beginning balance	\$	109,040
Acquisitions		7,960
Accretion		(4,443)
Reclassifications to (from) accretable yield		10
Disposals and other changes		(4,215)
End balance	\$	108,352

The following table provides information related to the unpaid principal balance and carrying amounts of ASC 310-30 loans.

	September 30, 2014	June 30, 2014
	(Dollars in thousands)	
Unpaid principal balance	\$ 241,675	\$ 239,376
Carrying amount	\$ 203,640	\$ 201,171

Table of Contents**5. Earnings Per Share (EPS)**

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

	Three Months Ended September 30,	
	2014	2013
	(Dollars in thousands, except share and per share data)	
Net income	\$ 1,644	\$ 320
Net income from continuing operations available to common shareholders	\$ 1,644	\$ 320
Weighted average shares used in calculation of basic earnings per share	10,180,038	10,440,513
Incremental shares from assumed exercise of dilutive securities		
Weighted average shares used in calculation of diluted earnings per share	10,180,038	10,440,513
Earnings per common share:		
Income from continuing operations	\$ 0.16	\$ 0.03
Income from discontinued operations	0.00	0.00
Earnings per common share	\$ 0.16	\$ 0.03
Diluted earnings per common share:		
Income from continuing operations	\$ 0.16	\$ 0.03
Income from discontinued operations	0.00	0.00
Diluted earnings per common share	\$ 0.16	\$ 0.03

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

	Three Months Ended September 30,	
	2014	2013
Stock options	1,082,121	1,166,804
Warrants	1,082,121	1,166,804

6. Fair Value Measurements

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. The Company uses prices and inputs that are current as of the measurement date, including during periods of market dislocation. In periods of market dislocation, the observability of prices and inputs may be reduced for many instruments. This condition could cause an instrument to be reclassified from one

level to another. When market assumptions are not readily available, the Company's own assumptions are set to reflect those that market participants would use in pricing the asset or liability at the measurement date. If there has been a significant decrease in the volume and level of activity for the asset or liability, regardless of the valuation technique(s) used, the objective of a fair value measurement remains the same.

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

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

Level 2 Valuations based on significant observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

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

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

Table of Contents

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

Transfers - There were no transfers of assets and liabilities measured at fair value on a recurring or nonrecurring basis during the current period.

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

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

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

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

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

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

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

Fair Value of other Financial Instruments:

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

FHLB stock - The carrying value of FHLB stock approximates fair value based on redemption provisions of the FHLB.

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

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

Interest receivable - The fair value of this financial instrument approximates the book value as this financial instrument has a short maturity. It is the Company's policy to stop accruing interest on loans past due by more than 90 days. Therefore, this financial instrument has been adjusted for estimated credit loss.

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

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

Table of Contents

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

Table of Contents

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

	Total	September 30, 2014		Level 3
		Level 1	Level 2	
(Dollars in thousands)				
<u>Assets</u>				
Securities available-for-sale:				
U.S. Government agency securities	\$ 48,351	\$	\$ 48,351	\$
Agency mortgage-backed securities	61,996		61,996	
Other assets interest rate caps				
<u>Liabilities</u>				
Other liabilities interest rate swaps	\$ 985	\$	\$ 985	\$

	Total	June 30, 2014		Level 3
		Level 1	Level 2	
(Dollars in thousands)				
<u>Assets</u>				
Securities available-for-sale:				
U.S. Government agency securities	\$ 48,418	\$	\$ 48,418	\$
Agency mortgage-backed securities	65,463		65,463	
Other assets interest rate caps				
<u>Liabilities</u>				
Other liabilities interest rate swap	\$ 714	\$	\$ 714	\$

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

	Total	September 30, 2014		Level 3
		Level 1	Level 2	
(Dollars in thousands)				
Collateral dependent impaired loans	\$ 1,359	\$	\$	\$ 1,359
Real estate owned and other repossessed collateral	2,115			2,115

	Total	June 30, 2014		Level 3
		Level 1	Level 2	
(Dollars in thousands)				
Collateral dependent impaired loans	\$ 1,467	\$	\$	\$ 1,467
Real estate owned and other repossessed collateral	1,991			1,991

Table of Contents

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

	Carrying Amount	Fair Value Measurements at September 30, 2014			
		Total	Level 1	Level 2	Level 3
Financial assets:					
Cash and cash equivalents	\$ 83,530	\$ 83,530	\$ 83,530	\$	\$
Available-for-sale securities	110,347	110,347		110,347	
Federal Home Loan Bank stock	4,102	4,102		4,102	
Loans held for sale	9,069	9,079		9,079	
Loans, net	541,799	538,558			538,558
Accrued interest receivable	1,077	1,077		1,077	
Financial liabilities:					
Deposits	593,795	594,048		594,200	
FHLB advances	42,773	43,616		43,616	
Wholesale repurchase agreements	10,158	10,384		10,384	
Short-term borrowings	3,804	3,804		3,804	
Capital lease obligation	1,511	1,626		1,626	
Subordinated debentures	8,485	7,984			7,984
Interest rate swaps	985	985		985	

	Carrying Amount	Fair Value Measurements at June 30, 2014			
		Total	Level 1	Level 2	Level 3
Financial assets:					
Cash and cash equivalents	\$ 82,259	\$ 82,259	\$ 82,259	\$	\$
Available-for-sale securities	113,881	113,881		113,881	
Federal Home Loan Bank stock	4,102	4,102		4,102	
Loans held for sale	11,945	11,945		11,945	
Loans, net	515,049	522,154			522,154
Accrued interest receivable	1,216	1,216		1,216	
Interest rate caps					
Financial liabilities:					
Deposits	574,329	574,868		574,868	
FHLB advances	42,824	43,843		43,843	
Wholesale repurchase agreements	10,199	10,484		10,484	
Short-term borrowings	2,984	2,984		2,984	
Capital lease obligation	1,558	1,701		1,701	
Subordinated debentures	8,440	7,858			7,858
Interest rate swaps	714	714		714	

7. Derivatives and Hedging Activities

The Company has stand-alone derivative financial instruments in the form of interest rate caps that derive their value from a fee paid and are adjusted to fair value based on index and strike rate, and swap agreements that derive their value from the underlying interest rate. These transactions involve both credit and market risk. The notional amounts are amounts on which calculations, payments and the value of the

derivative are based. Notional amounts do not represent direct credit exposures. Direct credit exposure arises in the event of nonperformance by the counterparties to these agreements, and is limited to the net difference between the calculated amounts to be received and paid, if any. Such differences, which represent the fair value of the derivative instruments, are reflected on the Company's balance sheet as derivative assets and derivative liabilities. The Company seeks to manage the credit risk of its financial contracts through credit approvals, limits and monitoring procedures, and does not expect any counterparties to fail to meet their obligations.

The Company currently holds derivative instruments that contain credit-risk related features that are in a net liability position, which may require that collateral be assigned to dealer banks. At September 30, 2014, the Company had posted cash collateral totaling \$2.3 million with dealer banks related to derivative instruments in a net liability position.

The Company does not offset fair value amounts recognized for derivative instruments. The Company does not net the amount recognized for the right to reclaim cash collateral against the obligation to return cash collateral arising from derivative instruments executed with the same counterparty under a master netting arrangement.

Risk Management Policies - Derivative Instruments

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

Interest Rate Risk Management - Cash Flow Hedging Instruments

The Company uses variable rate debt as a source of funds for use in the Company's lending and investment activities and other general business purposes. These debt obligations expose the Company to variability in interest payments due to changes in interest rates. If interest rates increase, interest expense increases. Conversely, if interest rates decrease, interest expense decreases. Management believes

Table of Contents

it is prudent to limit the variability of a portion of its interest payments and, therefore, generally hedges a portion of its variable-rate interest payments.

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

Interest rate swaps:										
	Notional Amount	Inception Date	Termination Date	Index	Receive Rate	Pay Rate	Strike Rate	Unrealized Loss	Fair Value	Balance Sheet Location
\$	10,000	February 2010	February 2015	3 Mo. LIBOR	2.12%	4.69%	n/a	\$ (315)	\$ (355)	Other Liabilities
	5,000	July 2013	July 2033	3 Mo. LIBOR	0.23%	3.38%	n/a	(283)	(283)	Other Assets
	5,000	July 2013	July 2028	3 Mo. LIBOR	0.23%	3.23%	n/a	(231)	(231)	Other Liabilities
	5,000	July 2013	July 2023	3 Mo. LIBOR	0.23%	2.77%	n/a	(116)	(116)	Other Liabilities
\$	25,000							\$ (945)	\$ (985)	

Interest rate swaps:										
	Notional Amount	Inception Date	Termination Date	Index	Receive Rate	Pay Rate	Strike Rate	Unrealized Loss	Fair Value	Balance Sheet Location
June 30, 2014 (Dollars in thousands)										
\$	10,000	February 2010	February 2015	3 Mo. LIBOR	2.12%	4.69%	n/a	\$ (99)	\$ (165)	Other Liabilities
	5,000	July 2013	July 2033	3 Mo. LIBOR	0.23%	3.38%	n/a	(216)	(216)	Other Liabilities
	5,000	July 2013	July 2028	3 Mo. LIBOR	0.23%	3.23%	n/a	(200)	(200)	Other Liabilities
	5,000	July 2013	July 2023	3 Mo. LIBOR	0.23%	2.77%	n/a	(133)	(133)	Other Liabilities
Interest rate caps:										
\$	6,000	September 2009	September 2014	3 Mo. LIBOR	n/a	n/a	2.51%	(16)		Other Assets
\$	31,000							\$ (664)	\$ (714)	

During the three months ended September 30, 2014 and 2013, no interest rate cap or swap agreements were terminated prior to maturity. Changes in the fair value of interest rate caps and swaps designated as hedging instruments of the variability of cash flows associated with variable rate debt are reported in other comprehensive income. These amounts subsequently are reclassified into interest expense as a yield adjustment in the same period in which the related interest on the debt affects earnings. Risk management results for the three months ended September 30, 2014 and 2013 related to the balance sheet hedging of variable rate debt indicates that the hedges were effective. The Company had no fair value hedges at September 30, 2014.

During the periods presented, amounts recognized in income related to hedge ineffectiveness resulted from amortization of the non-zero fair value associated with the Company's single interest rate swap held at the time of the merger with FHB Formation LLC in December 2010.

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

During the periods presented, amounts recognized in income related to amounts excluded from effectiveness testing resulted from amortization of the acquisition price of interest rate caps. The table below presents amounts recognized in income related to both hedge ineffectiveness and amounts excluded from effectiveness testing.

	Three Months Ended September 30,			
	2014		2013	
	(Dollars in thousands)			
Interest income (expense):				
Interest rate caps	\$	(16)	\$	(6)
Interest rate swap		25		25
Total	\$	9	\$	19

The Company expects to record interest income of \$40 thousand related to interest rate swap ineffectiveness in the next twelve months. The Company's outstanding interest rate caps expired on September 30, 2014.

Table of Contents**8. Other Comprehensive Income**

The components of other comprehensive income (loss) follow.

	Three Months Ended September 30,					
	Pre-tax Amount	2014 Tax Expense (Benefit)	After-tax Amount	Pre-tax Amount	2013 Tax Expense (Benefit)	After-tax Amount
	(Dollars in thousands)					
Change in net unrealized gain or loss on available-for-sale securities	\$ (275)	\$ (93)	\$ (182)	\$ 517	\$ 176	\$ 341
Reclassification adjustment for net gains included in net income						
Total available-for-sale securities	(275)	\$ (93)	\$ (182)	517	176	341
Change in accumulated gain or loss on effective cash flow hedges	(272)	(92)	(180)	19	6	13
Reclassification adjustment for net gains included in net income	(9)	(3)	(6)	(19)	(6)	(13)
Total derivatives and hedging activities	(281)	(95)	(186)			
Total other comprehensive income (loss)	\$ (556)	\$ (188)	\$ (368)	\$ 517	\$ 176	\$ 341

Accumulated other comprehensive loss is comprised of the following.

	September 30, 2014	June 30, 2014
	(Dollars in thousands)	
Unrealized loss on available-for-sale securities	\$ (1,553)	\$ (1,278)
Tax effect	527	434
Net-of-tax amount	(1,026)	(844)
Unrealized loss on cash flow hedges	(945)	(664)
Tax effect	320	225
Net-of-tax amount	(625)	(439)
Accumulated other comprehensive loss	\$ (1,651)	\$ (1,283)

Table of Contents**9. Commitments and Contingencies**Commitments

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets. The contract amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

Financial instruments with contract amounts which represent credit risk are as follows:

	September 30, 2014	June 30, 2014
	(Dollars in thousands)	
Commitments to originate loans	\$ 16,139	\$ 14,282
Unused lines of credit	34,651	34,657
Standby letters of credit	166	166

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the counter party. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment, and income-producing commercial properties. The Company has recorded an allowance for possible losses on commitments and unfunded loans totaling \$30 thousand recorded in other liabilities at both September 30, 2014 and June 30, 2014.

Contingencies

The Company and its subsidiary are parties to litigation and claims arising in the normal course of business. Management believes that the liabilities, if any, arising from such litigation and claims will not be material to the Company's consolidated financial position or results of operations.

10. Discontinued Operations

The Company concluded all investment brokerage activities in the second quarter of Fiscal 2014. Accordingly, operations associated with these activities have been classified as discontinued operations in the accompanying consolidated statements of income. The following summarizes the operations of the Company's investment brokerage division for the three months ended September 30, 2013.

Noninterest income:		
Investment commissions	\$	675
Other noninterest income		
Total noninterest income		675
Noninterest expense:		
Salaries and employee benefits		532
Occupancy and equipment expense		40
Data processing fees		57
Marketing expense		8
Other noninterest expense		23
Total noninterest expense		660
Income (loss) before tax		15
Income tax expense (benefit)		5
Net income (loss)	\$	10

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

The following discussion should be read in conjunction with the consolidated financial statements, notes and tables included in Northeast

Table of Contents

Bancorp's Annual Report on Form 10-K for the fiscal year ended June 30, 2014, filed with the Securities and Exchange Commission.

A Note about Forward Looking Statements

This report contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended, such as statements relating to the Company's financial condition, prospective results of operations, future performance or expectations, plans, objectives, prospects, loan loss allowance adequacy, simulation of changes in interest rates, capital spending and finance sources and revenue sources. These statements relate to expectations concerning matters that are not historical facts. Accordingly, statements that are based on management's projections, estimates, assumptions, and judgments constitute forward-looking statements. These forward-looking statements, which are based on various assumptions (some of which are beyond the Company's control), may be identified by reference to a future period or periods, or by the use of forward-looking terminology such as believe, expect, estimate, anticipate, continue, plan, approximately, intend, objective, goal, project, or other similar terms or variations thereof, or the future or conditional verbs such as will, may, should, could, and would. Although the Company believes that these forward-looking statements are based on reasonable estimates and assumptions, they are not guarantees of future performance and are subject to known and unknown risks, uncertainties, contingencies, and other factors. Accordingly, the Company cannot give you any assurance that its expectations will, in fact, occur or that its estimates or assumptions will be correct. The Company cautions you that actual results could differ materially from those expressed or implied by such forward-looking statements as a result of, among other factors, changes in interest rates and real estate values; competitive pressures from other financial institutions; the effects of continuing weakness in general economic conditions on a national basis or in the local markets in which the Company operates, including changes which adversely affect borrowers' ability to service and repay the Company's loans; changes in loan defaults and charge-off rates; changes in the value of securities and other assets, adequacy of loan loss reserves, or deposit levels necessitating increased borrowing to fund loans and investments; changes in government regulation; the risk that the Company may not be successful in the implementation of its business strategy; the risk of compromises or breaches to our security systems; the risk that intangibles recorded in the Company's financial statements will become impaired; changes in assumptions used in making such forward-looking statements; and the other risks and uncertainties detailed in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2014 as updated in the Company's Quarterly Reports on Form 10-Q and other filings submitted to the Securities and Exchange Commission. These forward-looking statements speak only as of the date of this report and the Company does not undertake any obligation to update or revise any of these forward-looking statements to reflect events or circumstances occurring after the date of this report or to reflect the occurrence of unanticipated events.

Description of Business and Strategy

Business Overview

Northeast Bancorp (we, our, us, Northeast or the Company), incorporated under Maine law in 1987, is a bank holding company registered with the Board of Governors of the Federal Reserve System (the Federal Reserve). 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. The Company's primary subsidiary and principal asset is its wholly-owned banking subsidiary, Northeast Bank (the Bank or Northeast Bank), a Maine state-chartered bank originally organized in 1872. As an FDIC-insured Maine-chartered bank, the Bank is subject to regulation and supervision by the Maine Bureau of Financial Institutions (the Bureau) and the FDIC.

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

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

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. The Company's compliance ratios at September 30, 2014 follow.

Table of Contents

Condition	Ratios at September 30, 2014
(i) Tier 1 leverage ratio	15.89%
(ii) Total risk-based capital ratio	22.97%
(iii) Ratio of purchased loans to total loans	37.38%
(iv) Ratio of loans to core deposits	92.80%
(v) Ratio of commercial real estate loans to total risk-based capital	167.57%

As of September 30, 2014, the Company, on a consolidated basis, had total assets of \$782.3 million, total deposits of \$593.8 million, and shareholders' equity of \$113.2 million. The Company gathers retail deposits through its banking offices in Maine and its online affinity deposit program, ableBanking; originates loans through the Bank's Community Banking Division; and purchases and originates commercial loans through the Bank's Loan Acquisition and Servicing Group (LASG).

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 our national commercial loan portfolio. The Company purchases performing commercial real estate loans, on a nationwide basis, typically at a discount from their outstanding principal balances, producing yields higher than those normally achieved on our originated loan portfolio. These loans are purchased 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, we have also originated commercial real estate and commercial business loans on a nationwide basis. We expect national originations to become an area of increasing focus for the Company, and in particular the origination of loans guaranteed by the Small Business Administration (SBA). As of September 30, 2014, the Company serviced SBA loans with an unpaid principal balance of \$51.9 million, of which \$36.2 million was held by third parties.

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 deposit program, ableBanking, a division of Northeast Bank, 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 allows us to attract and retain core deposits in support of balance sheet growth, and to continue to generate new commercial and residential mortgage loans.

Critical Accounting Policies

Critical accounting policies are those that involve significant judgments and assessments by management, and which could potentially result in materially different results under different assumptions and conditions. The reader is encouraged to review each of the policies included in Form 10-K for the year ended June 30, 2014 to gain a better understanding of how Northeast's financial performance is measured and reported. There has been no material change in critical accounting policies during the three months ended September 30, 2014.

Table of Contents

Overview

Net income from continuing operations was \$1.6 million for the quarter ended September 30, 2014, compared to \$310 thousand for the quarter ended September 30, 2013. Net income available to common shareholders was \$1.6 million, or \$0.16 per diluted common share, for the quarter ended September 30, 2014, compared to \$320 thousand, or \$0.03 per diluted common share, for the quarter ended September 30, 2013. The current quarter included \$52 thousand of expenses related to severance, and excluding these items, which the Company considers to be non-core, net operating earnings were \$1.7 million, or \$0.17 per diluted common share.

Net interest income before provision increased by \$2.4 million, or 33.3%, to \$9.5 million for the quarter ended September 30, 2014, compared to the quarter ended September 30, 2013, primarily due to higher transactional interest income from purchased loan payoffs and the positive effect of balance sheet growth. This result is evident in the net interest margin, which increased to 5.18% for the quarter ended September 30, 2014, compared to 4.24% for the quarter ended September 30, 2013.

Noninterest income decreased by \$134 thousand for the quarter ended September 30, 2014, compared to the quarter ended September 30, 2013, primarily due to a \$136 thousand reduction in gains realized on sales of purchased loans.

Noninterest expense decreased by \$115 thousand for the quarter, measured against the quarter ended September 30, 2013. Comparing the two quarters, variances of significance are:

- Salaries and employee benefits decreased by \$79 thousand, principally due to reductions in severance and overall employee head count, offset in part by higher incentive compensation expense;
- Occupancy and equipment costs declined by \$125 thousand, the result of a reduction in software maintenance and depreciation expense following the conversion of the Bank's core systems platform to an outsourced model in May 2014. The decrease in equipment expense was offset in part by higher conversion-related data processing fees, which increased by \$68 thousand;
- Professional fees, which tend to fluctuate from quarter to quarter, were lower by \$68 thousand;
- Loan expense decreased by \$199 thousand, mainly due to lower loan acquisition and work-out expenses as well as a \$78 thousand recovery of work-out expenses previously incurred;
- A \$250 thousand insurance recovery was recognized in the quarter ended September 30, 2013.

Financial Condition

Overview

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

Total assets increased by \$20.4 million, or 2.7%, to \$782.3 million at September 30, 2014, compared to June 30, 2014. The principal components of the change in the balance sheet were as follows:

- The loan portfolio excluding loans held for sale grew by \$25.4 million, or 4.9%, compared to June 30, 2014, principally due to net growth of \$33.4 million in commercial loans purchased or originated by LASG, offset by an \$8.0 million decrease in the Bank's Community Banking Division loan portfolio.

New loans generated by the LASG aggregated \$53.5 million for the quarter, consisting of \$13.2 million in purchases, at an average price of 81.7%, and \$40.3 million of originations, the latter total including \$36.0 million of loans to broker dealers secured by marketable securities. Residential and consumer loan production sold in the secondary market totaled \$30.8 million for the quarter.

As has been discussed in the Company's prior SEC filings, the Company made certain commitments to the Board of Governors of the Federal Reserve System in connection with the merger of FHB Formation LLC with and into the Company in December 2010. The Company's loan purchase and commercial real estate loan availability under these conditions follow.

Basis for Regulatory Condition	Condition	Purchased Loan Capacity at September 30, 2014 (Dollars in millions)	
Total Loans	Purchased loans may not exceed 40% of total loans	\$	24.0
Regulatory Capital	Commercial real estate loans may not exceed 300% of total risk-based capital	\$	162.5

Table of Contents

An overview of the LASG portfolio follows.

	Three Months Ended September 30,					
	Purchased	2014 Originated	Total LASG	Purchased	2013 Originated	Total LASG
(Dollars in thousands)						
Purchased or originated during the period:						
Unpaid principal balance	\$ 16,117	\$ 40,358	\$ 56,475	\$ 18,331	\$ 26,426	\$ 44,757
Net investment basis	13,167	40,353	53,520	16,348	26,426	42,774
Totals as of period end:						
Unpaid principal balance	\$ 244,910	\$ 108,534	\$ 353,444	\$ 214,159	\$ 63,588	\$ 277,747
Net investment basis	205,928	108,497	314,425	177,412	63,618	241,030
Returns during the period:						
Yield	12.76%	6.45%	10.93%	10.16%	5.71%	9.21%
Total Return (1)	12.75%	6.88%	11.05%	10.62%	5.71%	9.57%

(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.

- Deposits increased by \$19.5 million, or 3.4%, for the quarter, attributable primarily to growth in non-maturity accounts, which increased by \$20.2 million, or 8.7%, for the three months ended September 30, 2014. This growth was centered mainly in money market accounts attracted through the Bank's online-only ableBanking division.

Assets*Cash, Short-term Investments and Securities*

Cash and short-term investments were \$83.5 million as of September 30, 2014, an increase of \$1.3 million, or 1.6%, from \$82.3 million at June 30, 2014.

Available-for-sale securities, consisting of securities issued by government agencies and government-sponsored enterprises, totaled \$110.3 million as of September 30, 2014. At September 30, 2014, securities with a fair value of \$32.3 million were pledged for outstanding borrowings.

Loans

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

Total loans, excluding loans held for sale, amounted to \$541.8 million as of September 30, 2014, an increase of \$25.4 million, or 4.9%, from \$516.4 million as of June 30, 2014. The increase consisted of net growth in loans purchased or originated by the LASG of \$33.4 million and net decrease in loans originated by the Community Banking Division of \$8.0 million. The composition of the Company's loan portfolio follows.

	September 30, 2014		Total	Percent of Total
	Community Banking Division	LASG (Dollars in thousands)		
Originated loans:				
Residential real estate	\$ 114,103	\$ 310	\$ 114,413	21.12%
Home equity	26,818		26,818	4.95%
Commercial real estate: non-owner occupied	44,571	27,541	72,112	15.26%
Commercial real estate: owner occupied	23,400	13,020	36,420	3.91%
Construction	179		179	0.90%
Commercial business	9,037	67,626	76,663	14.15%
Consumer	9,267		9,267	1.71%
Subtotal	227,375	108,497	335,872	61.99%
Purchased loans:				
Residential real estate		2,729	2,729	0.50%
Commercial business		277	277	0.05%
Commercial real estate: non-owner occupied		167,512	167,512	30.92%
Commercial real estate: owner occupied		35,409	35,409	6.54%
Subtotal		205,927	205,927	38.01%
Total	\$ 227,375	\$ 314,424	\$ 541,799	100.00%

Table of Contents

	June 30, 2014			
	Community Banking Division	LASG (Dollars in thousands)	Total	Percent of Total
Originated loans:				
Residential real estate	\$ 116,660	\$ 312	\$ 116,972	22.66%
Home equity	27,975		27,975	5.42%
Commercial real estate: non-owner occupied	46,191	33,969	80,160	15.52%
Commercial real estate: owner occupied	24,519	11,907	36,426	7.05%
Construction	31		31	0.01%
Commercial business	10,145	31,373	41,518	8.04%
Consumer	9,884		9,884	1.91%
Subtotal	235,405	77,561	312,966	60.61%
Purchased loans:				
Residential real estate		3,687	3,687	0.71%
Commercial business		282	282	0.05%
Commercial real estate: non-owner occupied		133,581	133,581	25.87%
Commercial real estate: owner occupied		65,900	65,900	12.76%
Subtotal		203,450	203,450	39.39%
Total	\$ 235,405	\$ 281,011	\$ 516,416	100.00%

Classification of Assets

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

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

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

Table of Contents

The following table details the Company's nonperforming assets and other credit quality indicators as of September 30, 2014 and June 30, 2014. Management believes that, based on their carrying amounts, nonperforming assets are well secured based on the estimated fair value of underlying collateral.

Non-Performing Assets at September 30, 2014					
	Community Banking Division		LASG		Total
	(Dollars in thousands)				
Loans:					
Residential real estate	\$	1,939	\$	171	\$ 2,110
Home equity		28			28
Commercial real estate		716		4,287	5,003
Construction					
Commercial business					
Consumer		145			145
Subtotal		2,828		4,458	7,286
Real estate owned and other repossessed collateral		2,115			2,115
Total	\$	4,943	\$	4,458	\$ 9,401
Ratio of nonperforming loans to total loans					1.34%
Ratio of nonperforming assets to total assets					1.20%
Ratio of loans past due to total loans					1.40%
Nonperforming loans that are current				\$	1,492
Commercial loans risk rated substandard or worse				\$	1,398
Troubled debt restructurings:					
On accrual status				\$	5,573
On nonaccrual status				\$	1,478

Non-Performing Assets at June 30, 2014					
	Community Banking Division		LASG		Total
	(Dollars in thousands)				
Loans:					
Residential real estate	\$	1,572	\$	171	\$ 1,743
Home equity		160			160
Commercial real estate		1,162		4,116	5,278
Construction					
Commercial business		5			5
Consumer		139			139
Subtotal		3,038		4,287	7,325
Real estate owned and other repossessed collateral		1,991			1,991
Total	\$	5,029	\$	4,287	\$ 9,316
Ratio of nonperforming loans to total loans					1.42%
Ratio of nonperforming assets to total assets					1.22%
Ratio of loans past due to total loans					1.14%
Nonperforming loans that are current				\$	651
Commercial loans risk rated substandard or worse				\$	1,894
Troubled debt restructurings:					

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

On accrual status	\$	4,057
Nonaccrual status	\$	2,117

Table of Contents*Allowance for Loan Losses*

In connection with the application of the acquisition method of accounting for the merger on December 29, 2010, the allowance for loan losses was reduced to zero when the loan portfolio was marked to its then current fair value. Since that date, the Company has provided for an allowance for loan losses as new loans are originated or in the event that credit exposure in the pre-merger loan portfolio or other acquired loans exceeds the exposure estimated when initial fair values were determined.

The Company's allowance for loan losses was \$1.5 million as of September 30, 2014, which represents an increase of \$172 thousand from \$1.4 million as of June 30, 2014. The increase during the period was principally due to increases in reserves necessary for specific reserves and general allowances on newly originated loans.

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

	September 30, 2014	June 30, 2014	September 30, 2013
Allowance for loan losses to nonperforming loans	21.12%	18.66%	22.18%
Allowance for loan losses to total loans	0.28%	0.26%	0.25%
Last twelve months of net-charge offs to average loans	0.09%	0.06%	0.10%

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

Other Assets

The cash surrender value of the Company's bank-owned life insurance (BOLI) assets increased \$109 thousand, or 0.7%, to \$14.9 million at September 30, 2014, compared to \$14.8 million at June 30, 2014. Increases in cash surrender value are recognized in other income and are not subject to income taxes. Borrowing on, or surrendering, a policy may subject the Company to income tax expense on the increase in cash surrender value. For these reasons, management considers BOLI an illiquid asset. BOLI represented 12.2% of the Company's total risk-based capital at September 30, 2014.

Intangible assets totaled \$2.6 million and \$2.8 million at September 30, 2014 and June 30, 2014, respectively. The \$166 thousand decrease was the result of core deposit intangible asset amortization during the period.

Deposits, Borrowed Funds, Capital Resources and Liquidity

Deposits

The Company's principal source of funding is its core deposit accounts. At September 30, 2014, non-maturity accounts and certificates of deposit with balances less than \$250 thousand represented 99.7% of total deposits.

Total deposits increased \$19.5 million to \$593.8 million as of September 30, 2014 from \$574.3 million as of June 30, 2014. The increase, which funded growth in the Company's loan portfolio, was centered mainly in money market accounts attracted through the ableBanking division. The composition of total deposits at September 30, 2014 and June 30, 2014 follows.

	September 30, 2014		June 30, 2014		Percent of Total
	Amount	Percent of Total	Amount	Percent of Total	
	(Dollars in thousands)				
Demand deposits	\$ 52,698	8.87%	\$ 50,140	8.73%	
NOW accounts	62,852	10.58%	63,648	11.08%	
Regular and other savings	33,962	5.72%	34,692	6.04%	
Money market deposits	103,054	17.36%	83,901	14.61%	
Total non-certificate accounts	252,566	42.53%	232,381	40.46%	
Term certificates less than \$250 thousand	339,410	57.16%	339,616	59.13%	
Term certificates of \$250 thousand or more	1,819	0.31%	2,332	0.41%	
Total certificate accounts	341,229	57.47%	341,948	59.54%	
Total deposits	\$ 593,795	100.00%	\$ 574,329	100.00%	

Table of Contents*Borrowed Funds*

Advances from the FHLB were \$42.8 million at September 30, 2014 and June 30, 2014. In conjunction with the aforementioned FHLB advances, the Company entered into interest rate swaps with a weighted average pay rate and term of 3.13% and 15 years, respectively. The interest rate swaps have been designated as cash flow hedges of the variability of cash flows associated with the variable rate debt.

At September 30, 2014, the Company had pledged investment securities with a fair value of \$18.3 million, as well as certain residential real estate loans, commercial real estate loans, and FHLB deposits free of liens or pledges to secure outstanding advances and available additional borrowing capacity.

Wholesale repurchase agreements were \$10.2 million at September 30, 2014 and June 30, 2014. At September 30, 2014, the Company had pledged investment securities with a fair value of \$14.0 million as collateral for outstanding wholesale repurchase agreements.

Short-term borrowings, consisting of sweep accounts and repurchase agreements, were \$3.8 million and \$3.0 million as of September 30, 2014 and June 30, 2014, respectively.

Liquidity

The following table is a summary of the unused borrowing capacity of the Company at September 30, 2014, in addition to traditional retail deposit products (dollars in thousands).

Brokered time deposits	\$	195,573	Subject to policy limitation of 25% of total assets
Federal Home Loan Bank of Boston		88,181	Subject to eligible and qualified collateral
Federal Reserve Discount Window Borrower-in-Custody		1,430	Subject to the pledge of indirect auto loans
Total unused borrowing capacity		285,184	
Unencumbered investment securities		76,640	
Total sources of liquidity	\$	361,824	

Retail deposits and other core deposit sources including deposit listing services are used by the Company to manage its overall liquidity position. While the Company typically does not seek wholesale funding such as brokered deposits, the ability to raise them remains an important part of its liquidity contingency planning. While management closely monitors and forecasts the Company's liquidity position, it is affected by asset growth, deposit withdrawals and other contractual obligations and commitments. The accuracy of management's forecast assumptions may increase or decrease the Company's overall available liquidity.

At September 30, 2014, the Company had \$361.8 million of immediately accessible liquidity, defined as additional cash that could be raised within seven days through collateralized borrowings, brokered deposits or security sales. This position represented 46.3% of total assets. The

Company also had \$83.5 million of cash and cash equivalents at September 30, 2014.

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

Capital

The carrying amount and unpaid principal balance of junior subordinated debentures totaled \$8.5 million and \$16.5 million, respectively, as of September 30, 2014. This debt represents qualifying Tier 1 capital for the Company, up to a maximum of 25% of total Tier 1 capital. At September 30, 2014, the carrying amounts of the junior subordinated notes, net of the Company's \$496 thousand investment in the affiliated trusts, qualified as Tier 1 capital.

At September 30, 2014, shareholders' equity was \$113.2 million, an increase of \$1.2 million, or 1.1%, from June 30, 2014. Book value per outstanding common share was \$11.05 at September 30, 2014 and at June 30, 2014. Tier 1 capital to total average assets of the Company was 15.89% as of September 30, 2014 and 15.90% at June 30, 2014.

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 FDIC has adopted a statement of policy regarding the capital adequacy of state-chartered banks and promulgated 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

Table of Contents

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 FDIC 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.

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 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 for adequately capitalized institutions equal to 2.5% of total risk weight assets, or face restrictions on capital distributions and executive bonuses. 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.

The Bank and the Company are subject to capital commitments with the Federal Reserve and the Bureau that require higher minimum capital ratios. These commitments require that the Company and the Bank (i) maintain a Tier 1 leverage ratio of at least 10%; and (ii) maintain a total risk-based capital ratio of at least 15%. The Bank and the Company were in compliance with these commitments at September 30, 2014.

Table of Contents

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

	Actual		Minimum Capital Requirements		Minimum To Be Well Capitalized Under Prompt Correction Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
September 30, 2014:						
Total capital to risk weighted assets:						
Company	\$ 122,688	22.97%	\$ 42,733	≥8.0%	\$ N/A	N/A
Bank	105,067	19.57%	42,940	≥8.0%	53,675	≥10.0%
Tier 1 capital to risk weighted assets:						
Company	121,119	22.67%	21,366	≥4.0%	N/A	N/A
Bank	101,309	18.87%	21,470	≥4.0%	32,205	≥6.0%
Tier 1 capital to average assets:						
Company	121,119	15.89%	30,485	≥4.0%	N/A	N/A
Bank	101,309	13.31%	30,450	≥4.0%	38,063	≥5.0%
June 30, 2014:						
Total capital to risk weighted assets:						
Company	\$ 120,818	23.69%	\$ 40,808	≥8.0%	\$ N/A	N/A
Bank	103,160	20.12%	41,027	≥8.0%	51,284	≥10.0%
Tier 1 capital to risk weighted assets:						
Company	119,421	23.41%	20,404	≥4.0%	N/A	N/A
Bank	99,256	19.35%	20,514	≥4.0%	30,771	≥6.0%
Tier 1 capital to average assets:						
Company	119,421	15.90%	30,049	≥4.0%	N/A	N/A
Bank	99,256	13.22%	30,028	≥4.0%	37,536	≥5.0%

Off-balance Sheet Financial Instruments

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

See Part I. Item I. Notes to Unaudited Consolidated Financial Statements Note 9: Commitments and Contingencies for further discussion.

Table of ContentsResults of Operations*General*

Net income increased by \$1.3 million to \$1.6 million for the quarter ended September 30, 2014, compared to \$320 thousand for the quarter ended September 30, 2013. Pre-tax income for the quarter ended September 30, 2014 included \$52 thousand of expenses related to severance. When compared to the prior year, increases in net income the three months ended September 30, 2014 resulted principally from higher transactional income on purchased loans and the positive effect of balance sheet growth.

The following table details the total return on purchased loans, which includes transactional interest income of \$2.0 million for the quarter ended September 30, 2014, an increase of \$1.3 million from the quarter ended September 30, 2013. Including the loss or gain on the sales of purchased loans during the two quarters, the total transactional income increased by \$1.1 million for the quarter ended September 30, 2014, compared to the quarter ended September 30, 2013.

	Three Months Ended September 30,			
	2014		2013	
	Income	Return (1)	Income	Return (1)
	(Dollars in thousands)			
Regularly scheduled interest and accretion	\$ 4,497	8.80%	\$ 3,739	8.54%
Transactional income:				
(Loss) gain on loan sales	(4)	-0.01%	216	0.49%
Gain on sale of real estate owned		0.00%		0.00%
Other noninterest income		0.00%		0.00%
Accelerated accretion and loan fees	2,025	3.96%	696	1.59%
Total transactional income	2,021	3.95%	912	2.08%
Total	\$ 6,518	12.75%	\$ 4,651	10.62%

(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 Interest Income

Net interest income before provision for loan losses increased by \$2.4 million, or 33.3%, to \$9.5 million for the quarter ended September 30, 2014 compared to the quarter ended September 30, 2013, primarily due to higher transactional interest income from purchased loan payoffs and the positive effect of balance sheet growth. When compared to the quarter ended September 30, 2013, transactional interest income increased \$1.3 million, having a 94 basis point effect on the net interest margin, which increased to 5.18% from 4.24%. The following table summarizes interest income and related yields recognized on the loan portfolios.

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

	Three Months Ended September 30,					
	Average Balance	2014 Interest Income	Yield	Average Balance	2013 Interest Income	Yield
	(Dollars in thousands)					
Community Banking Division	\$ 241,165	\$ 3,062	5.04%	\$ 242,700	\$ 3,342	5.46%
LASG:						
Originated	82,335	1,338	6.45%	47,208	680	5.71%
Purchased	202,856	6,522	12.76%	173,167	4,435	10.16%
Total LASG	285,191	7,860	10.93%	220,375	5,115	9.21%
Total	\$ 526,356	\$ 10,922	8.23%	\$ 463,075	\$ 8,457	7.25%

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

Table of Contents

In the quarter ended September 30, 2014, net interest income was negatively affected by a lower level of noncash accretion of fair value adjustments resulting from the merger than in the comparable 2013 quarter. The effect of such accretion will continue to diminish as financial instruments held at the merger mature or prepay. The following table summarizes the effects of such accretion.

	Three Months Ended September 30,					
	Average Balance	2014 Income (Expense)	Effect on Yield / Rate	Average Balance	2013 Income (Expense)	Effect on Yield / Rate
(Dollars in thousands)						
Interest-earning assets:						
Investment securities	\$ 112,250	\$	0.00%	\$ 119,298	\$	0.00%
Loans	526,356	77	0.06%	463,075	36	0.03%
Other interest-earning assets	86,864		0.00%	83,129		0.00%
Total interest-earning assets	\$ 725,470	\$ 77	0.04%	\$ 665,502	\$ 36	0.02%
Interest-bearing liabilities:						
Interest-bearing deposits	524,631	64	0.05%	463,128	201	0.17%
Short-term borrowings	3,320		0.00%	2,278		0.00%
Borrowed funds	52,979	92	0.69%	59,986	108	0.71%
Junior subordinated debentures	8,461		0.00%	8,288	(1)	-0.05%
Total interest-bearing liabilities	\$ 589,391	\$ 156	0.11%	\$ 533,680	\$ 308	0.23%
Total effect of noncash accretion on:						
Net interest income		\$ 233			\$ 344	
Net interest margin		0.13%			0.21%	

The Company's interest rate spread and net interest margin increased by 96 basis points and 94 basis points, respectively, for the quarter ended September 30, 2014 compared to the quarter ended September 30, 2013. These increases were principally the result of the aforementioned increases in transactional income and loan volume. The following table sets forth the average balance sheets, interest income and interest expense, and average yields and costs for the three months ended September 30, 2014 and 2013.

	Three Months Ended September 30,					
	Average Balance	2014 Interest Income/Expense	Average Yield/Rate	Average Balance	2013 Interest Income/Expense	Average Yield/Rate
(Dollars in thousands)						
Assets:						
Interest-earning assets:						
Investment securities	\$ 112,250	\$ 244	0.86%	\$ 119,298	\$ 282	0.94%
Loans (1) (2)	526,356	10,922	8.23%	463,075	8,457	7.25%
Regulatory stock	4,102	15	1.45%	5,721	4	0.28%
Short-term investments (3)	82,762	51	0.24%	77,408	48	0.25%
Total interest-earning assets	725,470	11,232	6.14%	665,502	8,791	5.24%
Cash and due from banks	2,712			3,037		
Other non-interest earning assets	34,736			34,012		
Total assets	\$ 762,918			\$ 702,551		
Liabilities & Shareholders' Equity:						
Interest-bearing liabilities:						
NOW accounts	\$ 63,608	\$ 41	0.26%	\$ 59,124	\$ 40	0.27%

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

Money market accounts	86,294	110	0.51%	85,688	112	0.52%
Savings accounts	34,361	11	0.13%	33,926	12	0.14%
Time deposits	340,368	968	1.13%	284,390	883	1.23%
Total interest-bearing deposits	524,631	1,130	0.85%	463,128	1,047	0.90%
Short-term borrowings	3,320	9	1.08%	2,278	5	0.87%
Borrowed funds	52,979	416	3.12%	59,986	440	2.91%
Junior subordinated debentures	8,461	206	9.66%	8,288	192	9.19%
Total interest-bearing liabilities	589,391	1,761	1.19%	533,680	1,684	1.25%
Non-interest bearing liabilities:						
Demand deposits and escrow accounts	53,245			50,391		
Other liabilities	7,891			5,561		
Total liabilities	650,527			589,632		
Shareholders' equity	112,391			112,919		
Total liabilities and shareholders equity	\$ 762,918			\$ 702,551		
Net interest income		\$ 9,471			\$ 7,107	
Interest rate spread			4.95%			3.99%
Net interest margin (4)			5.18%			4.24%

(1) Includes loans held for sale.

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

Table of Contents

- (3) Short term investments include FHLB overnight deposits and other interest-bearing deposits.
- (4) Net interest margin is calculated as net interest income divided by total interest-earning assets.

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

	Three Months Ended September 30, 2014		
	Compared to the Three Months Ended September 30, 2013		
	Change Due to Volume	Change Due to Rate	Total Change
	(Dollars in thousands)		
Interest earning assets:			
Investments securities	\$ (16)	\$ (22)	\$ (38)
Loans	1,235	1,230	2,465
Regulatory stock	(1)	12	11
Short-term investments	3		3
Total increase (decrease) in interest income	1,221	1,220	2,441
Interest bearing liabilities:			
Interest bearing deposits	166	(83)	83
Short-term borrowings	3	1	4
Borrowed funds	(53)	29	(24)
Junior subordinated debentures	4	10	14
Total (decrease) increase in interest expense	120	(43)	77
Total increase (decrease) in net interest income	\$ 1,101	\$ 1,263	\$ 2,364

Provision for Loan Losses

Quarterly, the Company determines the amount of the allowance for loan losses that is appropriate to provide for losses inherent in the Company's loan portfolios, with the provision for loan losses determined by the net change in the allowance for loan losses. For loans acquired with deteriorated credit quality, a provision for loan a loss is recorded when estimates of future cash flows are lower than had been previously expected. See Part I. Item I. Notes to Unaudited Consolidated Financial Statements Note 4: Loans, Allowance for Loan losses and Credit Quality for further discussion.

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

The provision for loan losses for the three months ended September 30, 2014 and 2013 was \$320 thousand and \$77 thousand, respectively. The increase in the Company's loan loss provision resulted principally from increases in impairment allowances on two commercial real estate loans.

Noninterest Income

Noninterest income decreased by \$134 thousand for the current quarter, compared to the quarter ended September 30, 2013, principally due to a \$136 thousand reduction in gains realized on sales of purchased loans.

Noninterest Expense

Noninterest expense decreased by \$115 thousand for the quarter, measured against the quarter ended September 30, 2013. Comparing the two quarters, variances of significance are:

- Salaries and employee benefits decreased by \$79 thousand, principally due to reductions in severance and overall employee head count, offset in part by higher incentive compensation expense;
- Occupancy and equipment costs declined by \$125 thousand, the result of a reduction in software maintenance and depreciation expense following the conversion of the Bank's core systems platform to an outsourced model in May 2014. The decrease in equipment expense was offset in part by higher conversion-related data processing fees, which increased by \$88 thousand;
- Professional fees, which tend to fluctuate from quarter to quarter, were lower by \$68 thousand;
- Loan expense decreased by \$199 thousand, mainly due to lower loan acquisition and work-out expenses as well as a \$78 thousand recovery of work-out expenses previously incurred;
- A \$250 thousand insurance recovery was recognized in the quarter ended September 30, 2013.

Table of Contents

Income Taxes

The Company's income tax expense was \$924 thousand, or an effective rate of 36.0%, for the quarter ended September 30, 2014, as compared to \$161 thousand, or an effective rate of 33.5%, for the quarter ended September 30, 2013. The increase in the Company's effective tax rate was principally due to increased state income taxes resulting from changes in state apportionment.

Table of Contents

Item 3. Quantitative and Qualitative Disclosure about Market Risk

Not required for smaller reporting companies.

Item 4. Controls and Procedures

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

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

Based on this evaluation of the Company s disclosure controls and procedures, the Chief Executive Officer and Chief Financial Officer have concluded that these disclosure controls and procedures were effective as of September 30, 2014.

There were no changes in the Company s internal controls over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) that occurred during the quarter ended September 30, 2014 that have materially affected, or is reasonably likely to materially affect, the Company s internal controls over financial reporting.

PART II OTHER INFORMATION

Item 1. Legal Proceedings

None.

Item 1A. Risk Factors

Not required for smaller reporting companies.

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

On April 23, 2014, the Company announced that its Board of Directors authorized the Company to purchase up to 870,000 shares of its common stock, representing 8.3% of the Company's outstanding common shares and approximately \$8.4 million based on the Company's closing stock price on April 22, 2014. Such purchases will be made in open market or in privately negotiated transactions from time to time and in such amounts as market conditions warrant. The timing and actual number of shares repurchased will depend on a variety of factors including price, corporate and regulatory requirements, market conditions, and other corporate liquidity requirements and priorities. The stock repurchase program may be suspended or terminated at any time without prior notice, and will expire on April 23, 2016.

The following table sets forth information with respect to purchases made by us of our common stock during the quarter ended September 30, 2014.

Period		Total Number of Shares Purchased (1)	Average Price Per share	Total Number of Shares Purchased as Part of Publicly Announced Programs	Maximum Number of Shares that May Yet Be Purchased Under the Program
Jul. 1	Jul. 31	2,100	\$ 9.23	293,300	576,700
Aug. 1	Aug. 31	12,300	\$ 9.34	305,600	564,400
Sep. 1	Sep. 30			305,600	564,400

(1) Based on trade date, not settlement date

Table of Contents

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Table of Contents

Item 6. Exhibits

Exhibits No.	Description
31.1	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Rule 13a-14(a)). *
31.2	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Rule 13a-14(a)). *
32.1	Certificate of the Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Rule 13a-14(b)). **
32.2	Certificate of the Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Rule 13a-14(b)). **
101	The following materials from Northeast Bancorp's Quarterly Report on Form 10-Q for the quarter ended September 30, 2014 formatted in XBRL: (i) Consolidated Balance Sheets at September 30, 2014 and June 30, 2014; (ii) Consolidated Statements of Income for the three months ended September 30, 2014 and 2013; (iii) Consolidated Statements of Comprehensive Income for the three months ended September 30, 2014 and 2013; (iv) Consolidated Statements of Changes in Shareholders' Equity for the three months ended September 30, 2014 and 2013; (v) Consolidated Statements of Cash Flows for the three months ended September 30, 2014 and 2013; and (v) Notes to Unaudited Consolidated Financial Statements.

* Filed herewith

** Furnished herewith

Table of Contents

SIGNATURES

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

Date: November 12, 2014

NORTHEAST BANCORP

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

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

Table of Contents

NORTHEAST BANCORP

Index to Exhibits

Exhibits

No.	Description
31.1	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Rule 13a-14(a)). *
31.2	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Rule 13a-14(a)). *
32.1	Certificate of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Rule 13a-14(b)). **
32.2	Certificate of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Rule 13a-14(b)). **
101	The following materials from Northeast Bancorp's Quarterly Report on Form 10-Q for the quarter ended September 30, 2014 formatted in XBRL: (i) Consolidated Balance Sheets at September 30, 2014 and June 30, 2014; (ii) Consolidated Statements of Income for the three months ended September 30, 2014 and 2013; (iii) Consolidated Statements of Comprehensive Income for the three months ended September 30, 2014 and 2013; (iv) Consolidated Statements of Changes in Shareholders Equity for the three months ended September 30, 2014 and 2013; (v) Consolidated Statements of Cash Flows for the three months ended September 30, 2014 and 2013; and (v) Notes to Unaudited Consolidated Financial Statements.

* Filed herewith

** Furnished herewith