NORTHEAST BANCORP /ME/
Form 10-Q
February 14, 2012
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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 December 31, 2011

Commission File Number: 1-14588

Northeast Bancorp

(Exact name of registrant as specified in its charter)

Maine	**01-0425066**
(State or other jurisdiction of	**(I.R.S. Employer**

incorporation or organization)	**Identification No.)**
500 Canal Street, Lewiston, Maine	**04240**
(Address of Principal executive offices)	**(Zip Code)**

(207) 786-3245

Registrant s telephone number, including area code

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subjected to such filing requirements for the past 90 days. Yes x 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 x 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	x

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date. As of February 14, 2012, the registrant had outstanding 3,312,173 shares of voting common stock, $1.00 par value per share and 195,351 shares of non-voting common stock, $1.00 par value per share.

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PART 1- FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

NORTHEAST BANCORP AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

(Unaudited)

(Dollars in thousands, except per share data)

	December 31, 2011	June 30, 2011
Assets		
Cash and due from banks	$ 3,005	$ 3,227
Short-term investments	55,358	80,704
Total cash and cash equivalents	58,363	83,931
Available-for-sale securities, at fair value	139,480	148,962
Loans held for sale	8,189	5,176
Loans		
Residential real estate	98,129	95,417
Commercial real estate	162,999	117,761
Construction	1,280	2,015
Commercial business	19,210	22,225
Consumer	65,441	72,495
Total loans	347,059	309,913
Less: Allowance for loan losses	737	437
Loans, net	346,322	309,476
Premises and equipment, net	9,262	8,271
Acquired assets, net	837	690
Accrued interest receivable	1,761	1,244
Federal Home Loan Bank stock, at cost	4,889	4,889
Federal Reserve Bank stock, at cost	871	871
Intangible assets, net	5,012	13,133
Bank owned life insurance	14,047	13,794
Other assets	5,522	5,956
Total assets	$ 594,555	$ 596,393
Liabilities and Stockholders Equity		
Liabilities		
Deposits		
Demand	$ 43,682	$ 48,215
Savings and interest checking	87,356	89,804
Money market	43,353	48,695
Brokered time deposits	4,905	4,924
Certificates of deposit	221,728	209,480

Total deposits	401,024	401,118
Federal Home Loan Bank advances	43,684	43,922
Structured repurchase agreements	67,089	68,008
Short-term borrowings	1,744	2,515
Junior subordinated debentures issued to affiliated trusts	8,029	7,957
Capital lease obligation	1,994	2,075
Other borrowings	0	2,229
Other liabilities	5,091	3,615
Total liabilities	528,655	531,439
Commitments and contingencies		
Stockholders equity		
Preferred stock, $1.00 par value, 1,000,000 shares authorized; 4,227 shares issued and outstanding at December 31, 2011 and June 30, 2011; liquidation preference of $1,000 per share	4	4
Voting common stock, $1.00 par value, 13,500,000 shares authorized; 3,312,173 issued and outstanding at December 31, 2011 and June 30, 2011, respectively	3,312	3,312
Non-voting common stock, $1.00 par value, 1,500,000 shares authorized 195,351 issued and outstanding at December 31, 2011 and June 30, 2011, respectively	195	195
Warrants to purchase common stock	406	406
Additional paid-in capital	49,982	49,700
Unearned restricted stock	(145)	(163)
Retained earnings	11,846	11,726
Accumulated other comprehensive income (loss)	300	(226)
Total stockholders equity	65,900	64,954
Total liabilities and stockholders equity	$ 594,555	$ 596,393

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

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NORTHEAST BANCORP AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

(Dollars in thousands, except per share data)

	Successor Company (1)			Predecessor Company (2)	
	Three Months Ended December 31, 2011	Six Months Ended December 31, 2011	Three Days Ended December 31, 2010	89 Days Ended December 28, 2010	181 Days Ended December 28, 2010
Interest and dividend income:					
Interest on loans	$ 5,874	$ 11,011	$ 196	$ 5,468	$ 11,210
Interest and dividends on available-for-sale securities	541	1,180	45	1,439	3,111
Dividends on regulatory stock	21	33	0	9	18
Other interest and dividend income	36	83	1	28	39
Total interest and dividend income	6,472	12,307	242	6,944	14,378
Interest expense:					
Deposits	836	1,673	42	1,273	2,796
Federal Home Loan Bank advances	258	516	15	451	918
Structured repurchase agreements	249	497	23	685	1,392
Short-term borrowings	3	8	6	205	376
Junior subordinated debentures issued to affiliated trusts	185	368	6	167	340
Obligation under capital lease agreements	25	51	1	27	55
Total interest expense	1,556	3,113	93	2,808	5,877
Net interest and dividend income before provision for loan losses	4,916	9,194	149	4,136	8,501
Provision for loan losses	134	534	0	453	912
Net interest and dividend income after provision for loan losses	4,782	8,660	149	3,683	7,589
Noninterest income:					
Fees for other services to customers	370	710	14	331	698
Net securities gains	433	380	0	5	17
Gain on sales of residential loans	770	1,426	49	919	1,867
Gain on sale of commercial loan	203	203	0	0	0
Investment commissions	704	1,391	25	625	1,174
Bank-owned life insurance income	126	253	4	123	250
Bargain purchase gain	0	0	14,921	0	0
Other income	86	107	7	153	225

Total noninterest income	2,692	4,470	15,020	2,156	4,231
Noninterest expense:					
Salaries and employee benefits	3,729	7,446	139	2,493	4,949
Occupancy and equipment expense	916	1,765	23	674	1,352
Professional fees	277	692	10	239	509
Data processing fees	289	563	8	273	521
Marketing expense	254	345	4	123	230
FDIC insurance premiums	122	239	5	170	346
Intangible asset amortization	337	673	0	0	0
Merger expense	0	0	3,050	23	94
Other	953	1,807	103	751	1,454
Total noninterest expense	6,877	13,530	3,342	4,746	9,455
Income (loss) from continuing operations before income tax expense (benefit)	597	(400)	11,827	1,093	2,365
Income tax expense (benefit)	179	(224)	(14)	310	698
Net income (loss) from continuing operations	$ 418	$ (176)	$ 11,841	$ 783	$ 1,667

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NORTHEAST BANCORP AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

(Dollars in thousands, except per share data)

(Continued)

	Successor Company (1)			Predecessor Company (2)	
	Three Months Ended December 31, 2011	Six Months Ended December 31, 2011	Three Days Ended December 31, 2010	89 Days Ended December 28, 2010	181 Days Ended December 28, 2010
Discontinued operations:					
Income (loss) from discontinued operations	$ 0	$ 186	$ (10)	$ (23)	$ 94
Gain on sale of discontinued operations	0	1,529	0	105	105
Income tax expense (benefit)	0	592	(4)	29	70
Net income (loss) from discontinued operations	0	1,123	(6)	53	129
Net income	$ 418	$ 947	$ 11,835	$ 836	$ 1,796
Net income available to common stockholders	$ 320	$ 751	$ 11,835	$ 777	$ 1,677
Weighted-average shares outstanding:					
Basic	3,494,498	3,494,498	3,492,498	2,331,332	2,330,197
Diluted	3,511,994	3,494,498	3,588,756	2,358,647	2,354,385
Earnings per common share:					
Basic:					
Income (loss) from continuing operations	$ 0.09	$ (0.11)	$ 3.38	$ 0.31	$ 0.66
Income from discontinued operations	0.00	0.32	0.00	0.02	0.06
Net income	$ 0.09	$ 0.21	$ 3.38	$ 0.33	$ 0.72
Diluted:					
Income (loss) from continuing operations	$ 0.09	$ (0.11)	$ 3.29	$ 0.31	$ 0.66
Income from discontinued operations	0.00	0.32	0.00	0.02	0.05
Net income	$ 0.09	$ 0.21	$ 3.29	$ 0.33	$ 0.71

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

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

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

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NORTHEAST BANCORP AND SUBSIDIARY

Consolidated Statements of Changes in Stockholders Equity

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

(Unaudited)

(Dollars in thousands, except per share data)

	Preferred Stock		Common Stock		Warrants to Purchase Common Stock	Additional Paid-in Capital	Unearned Restricted Stock	Retained Earnings	Accumulated Other Comprehensive Income	Total Stockholders Equity
	Shares	Amount	Shares	Amount						
Predecessor Company (2)										
Balance at June 30, 2010	4,227	$ 4	2,323,832	$ 2,324	$ 133	$ 6,761	$ 0	$ 37,338	$ 4,346	$ 50,906
Net income for 181 days ended December 28, 2010	0	0	0	0	0	0	0	1,796	0	1,796
Other comprehensive loss net of tax:										
Unrealized loss on purchased interest rate caps and swap, net	0	0	0	0	0	0	0	0	(10)	(10)
Unrealized loss on available-for-sale securities, net	0	0	0	0	0	0	0	0	(1,863)	(1,863)
Total comprehensive loss										(77)
Dividends on preferred stock	0	0	0	0	0	0	0	(106)	0	(106)
Dividends on common stock at $0.09 per share	0	0	0	0	0	0	0	(419)	0	(419)
Stock options exercised	0	0	7,500	8	0	54	0	0	0	62
Accretion of preferred stock	0	0	0	0	0	16	0	(16)	0	0
Balance at December 28, 2010	4,227	$ 4	2,331,332	$ 2,332	$ 133	$ 6,831	$ 0	$ 38,593	$ 2,473	$ 50,366
Successor Company (1)										
Balance at December 29, 2010	4,227	$ 4	2,331,332	$ 2,332	$ 406	$ 33,685	$ 0	$ 0	$ 0	$ 36,427
Net income for three days ended December 31, 2010	0	0	0	0	0	0	0	11,835	0	11,835
Other comprehensive income net of tax:										
Unrealized gain on available-for-sale securities, net	0	0	0	0	0	0	0	0	188	188
Total comprehensive income										12,023
Restricted stock award	0	0	13,026	13	0	168	(181)	0	0	0
Voting common stock issued	0	0	965,815	965	0	12,489	0	0	0	13,454
	0	0	195,351	195	0	2,526	0	0	0	2,721

Non-voting common stock issued										
Balance at December 31, 2010	4,227	$ 4	3,505,524	$ 3,505	$ 406	$ 48,868	$ (181)	$ 11,835	$ 188	$ 64,625

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NORTHEAST BANCORP AND SUBSIDIARY

Consolidated Statements of Changes in Stockholders Equity

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

(Unaudited)

(Dollars in thousands, except per share data)

(Continued)

	Preferred Stock		Common Stock		Warrants to Purchase	Additional Paid-in	Unearned Restricted	Retained	Accumulated Other Comprehensive	Total Stockholders
	Shares	Amount	Shares	Amount	Common Stock	Capital	Stock	Earnings	Income	Equity
Successor Company (1)										
Balance at June 30, 2011	4,227	$ 4	3,507,524	$ 3,507	$ 406	$ 49,700	$ (163)	$ 11,726	$ (226)	$ 64,954
Net income	0	0	0	0	0	0	0	947	0	947
Other comprehensive loss, net of tax:										
Unrealized loss on purchased interest rate caps and swap, net	0	0	0	0	0	0	0	0	(123)	(123)
Unrealized gain on available-for-sale securities, net	0	0	0	0	0	0	0	0	649	649
Total comprehensive income										1,473
Dividends on preferred stock	0	0	0	0	0	0	0	(106)	0	(106)
Dividends on common stock at $0.18 per share	0	0	0	0	0	0	0	(631)	0	(631)
Stock-based compensation	0	0	0	0	0	192	18	0	0	210
Accretion of preferred stock	0	0	0	0	0	90	0	(90)	0	0
Balance at December 31, 2011	4,227	$ 4	3,507,524	$ 3,507	$ 406	$ 49,982	$ (145)	$ 11,846	$ 300	$ 65,900

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

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

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

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NORTHEAST BANCORP AND SUBSIDIARY

Consolidated Statements of Cash Flows

(Unaudited)

(Dollars in thousands)

	Successor Company (1)		Predecessor Company (2)
	Six Months Ended December 31, 2011	Three Days Ended December 31, 2010	181 Days Ended December 28, 2010
Cash flows from operating activities:			
Net income	$ 947	$ 11,835	$ 1,796
Adjustments to reconcile net income to net cash (used in) provided by operating activities:			
Provision for loan losses	534	0	912
(Gain) loss on sale or impairment of repossessed collateral, net	(50)	0	91
Accretion of fair value adjustments on loans, net	(1,124)	0	0
Accretion of fair value adjustments on deposits, net	(716)	0	0
Accretion of fair value adjustments on borrowings, net	(1,088)	0	0
Originations of loans held for sale	(72,454)	(1,975)	(96,575)
Net proceeds from sales of loans held for sale	70,867	1,682	104,843
Gain on sales of loans held for sale	(1,426)	(49)	(1,867)
Proceeds from sale of commercial loan	711	0	0
Gain on sale of commercial loan	(203)	0	0
Amortization of intangible assets	742	6	344
Bank-owned life insurance income, net	(253)	(4)	(250)
Depreciation of premises and equipment	604	9	520
Loss (gain) on sale of premises and equipment	2	0	(6)
Net gain on sale of available-for-sale securities	(380)	0	(17)
Deferred income tax benefit	0	0	(313)
Stock-based compensation	210	0	0
Gain on sale of insurance business	(1,529)	0	(104)
Net amortization of securities	843	0	89
Bargain purchase gain	0	(14,921)	0
Changes in other assets and liabilities:			
Interest receivable	(517)	82	121
Decrease in prepaid FDIC assessment	323	0	120
Other assets and liabilities	372	(1,201)	33
Net cash (used in) provided by operating activities	(3,585)	(4,536)	9,737
Cash flows from investing activities:			
Proceeds from sales of available-for-sale securities	49,053	0	173
Purchases of available-for-sale securities	(51,274)	0	(19,001)
Proceeds from maturities and principal payments on available-for-sale securities	12,223	0	26,806
Loan purchases	(51,662)	0	0
Loan originations and principal collections, net	14,141	386	14,292
Purchases of premises and equipment	(1,754)	(90)	(503)
Proceeds from sales of premises and equipment	0	0	36
Proceeds from sales of repossessed collateral	660	0	217
Proceeds from sale of assets of insurance division	9,726	0	147

Net cash (used in) provided by investing activities	(18,887)	296	22,167
Cash flows from financing activities:			
Net increase (decrease) in deposits	622	2,658	(9,580)
Net (decrease) increase in short-term borrowings	(771)	(1,009)	16,875
Dividends paid on preferred stock	(106)	0	(106)
Dividends paid on common stock	(631)	0	(419)
Issuance of common stock	0	16,175	62
Repayment of other borrowings	(2,129)	0	(496)
Repayment of capital lease obligation	(81)	0	(77)
Net cash (used in) provided by financing activities	(3,096)	17,824	6,259
Net (decrease) increase in cash and cash equivalents	(25,568)	13,584	38,163
Cash and cash equivalents, beginning of period	83,931	58,598	20,435
Cash and cash equivalents, end of period	$ 58,363	$ 72,182	$ 58,598
Supplemental schedule of cash flow information:			
Interest paid	$ 4,985	$ 356	$ 5,800
Income taxes paid, net	254	0	846
Supplemental schedule of noncash investing and financing activities:			
Transfer from loans to acquired assets	$ 757	$ 0	$ 124
Transfer from acquired assets to loans	0	0	143

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

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

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

NORTHEAST BANCORP AND SUBSIDIARY

Notes to Unaudited Consolidated Financial Statements

December 31, 2011

1. Basis of Presentation

The accompanying unaudited condensed and consolidated interim financial statements include the accounts of Northeast Bancorp (Northeast or the Company) and its wholly-owned subsidiary, Northeast Bank (the Bank). These financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, the accompanying consolidated financial statements contain all adjustments (consisting principally of normal recurring accruals) considered necessary for a fair presentation of the Company s financial position at December 31, 2011; the results of operations for the three and six-month periods ended December 31, 2011, the three days ended December 31, 2010, and the 89 and 181 days ended December 28, 2010; the changes in stockholders equity for the six-month period ended December 31, 2011, the three days ended December 31, 2010, and the 181 days ended December 28, 2010; the cash flows for the six-month period ended December 31, 2011, the three days ended December 31, 2010, and the 181 days ended December 28, 2010. Operating results for the three and six-month periods ended December 31, 2011 are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2012. For further information, refer to the audited consolidated financial statements and notes thereto for the fiscal year ended June 30, 2011 included in the Company s Annual Report on Form 10-K for the fiscal year ended June 30, 2011 (Fiscal 2011) filed with the Securities and Exchange Commission.

2. Merger Transaction

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

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

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

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

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

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

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

As a result of the transaction, the Company committed to the Board of Governors of the Federal Reserve System (the Federal Reserve) and the Maine Bureau of Financial Institutions (the Bureau), to, among other things, (i) maintain a Tier 1 leverage ratio of at least 10%, (ii) maintain a total risk-based capital ratio of at least 15%, (iii) limit purchased loans to 40% of total loans, (iv) fund 100% of the Company s loans with core deposits, and (v) hold commercial real estate loans (including owner-occupied commercial real estate) to within 300% of total risk-based capital. The Company is currently in compliance with all commitments to the Federal Reserve and the Bureau.

3. Loans, Allowance for Loan Losses and Credit Quality

The composition of the Company s loan portfolio is as follows on the dates indicated. The Company s originated portfolio consists of loans originated before and after the Merger. The Company s purchased portfolio consists of loans acquired subsequent to the Merger through its Loan Acquisition and Servicing Group (LASG).

	December 31, 2011	June 30, 2011
	(Dollars in thousands)	
Loans:		
Originated portfolio:		
Residential real estate	$ 94,556	$ 95,417
Commercial real estate	115,102	117,124
Construction	1,280	2,015
Commercial business	19,210	22,225
Consumer (1)	65,441	72,495
Total originated portfolio	295,589	309,276
Purchased portfolio:		
Commercial real estate	47,897	637
Residential real estate	3,573	0
Total purchased portfolio	51,470	637
Total loans	347,059	309,913
Less: Allowance for loan losses	737	437
Loans, net	$ 346,322	$ 309,476

(1) Consumer loans include home equity loans and lines totaling $45.9 million and $50.1 million at December 31, 2011 and June 30, 2011, respectively.

In the fourth quarter of Fiscal 2011, the Company launched its loan acquisition and servicing business, which operates at the Company s office in Boston, Massachusetts. Through the LASG, the Company purchases loans originated throughout the United States that are secured by commercial real estate, multi-family residential real estate and other business assets. These loans are generally purchased at a discount from the loan s unpaid principal balance from sellers in the financial services industry or government agencies. From the date of inception through December 31, 2011, the LASG had purchased loans with principal balances at acquisition totaling $64.3 million, for an aggregate purchase price of $52.3 million. The Company intends to continue to grow this segment of its loan portfolio, both in absolute terms and as a percentage of its total loan portfolio.

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

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

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

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

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

The following table presents a summary of PCI loans purchased during the six months ended December 31, 2011.

	Commercial Real Estate and Commercial Business
	(Dollars in thousands)
Contractually required payments receivable	$ 10,064
Nonaccretable difference	(2,958)
Cash flows expected to be collected	7,106
Accretable yield	(3,122)
Fair value of loans acquired	$ 3,984

The following table presents a summary of PCI loans acquired through the Merger on December 29, 2010.

	Residential Real Estate and Consumer	Commercial Real Estate and Commercial Business	Total
	(Dollars in thousands)		
Contractually required payments receivable	$ 4,148	$ 4,977	$ 9,125
Nonaccretable difference	(1,282)	(1,893)	(3,175)
Cash flows expected to be collected	2,866	3,084	5,950
Accretable yield	(958)	(344)	(1,302)
Fair value of PCI loans acquired	$ 1,908	$ 2,740	$ 4,648

Changes in the accretable yield related to PCI loans during the three and six months ended December 31, 2011 follow.

	Three Months Ended December 31, 2011		
	Acquired through Merger	Purchased	Total
	(Dollars in thousands)		
Beginning balance	$ 209	$ 2,951	$ 3,160
Accretion	(208)	(488)	(696)
Acquisitions	0	95	95
Reclassifications from nonaccretable difference	361	210	571
Disposals and transfers	(121)	(614)	(735)

End balance	$ 241	$ 2,154	$ 2,395

	Six Months Ended December 31, 2011		
	Acquired through Merger	Purchased	Total
		(Dollars in thousands)	
Beginning balance	$ 373	$ 0	$ 373
Accretion	(372)	(564)	(936)
Acquisitions	0	3,122	3,122
Reclassifications from nonaccretable difference	361	210	571
Disposals and transfers	(121)	(614)	(735)
End balance	$ 241	$ 2,154	$ 2,395

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

	December 31, 2011			June 30, 2011		
	Acquired through Merger	Purchased	Total	Acquired through Merger	Purchased	Total
		(Dollars in thousands)			(Dollars in thousands)	
Unpaid principal balance of PCI loans	$ 4,698	$ 5,844	$ 10,542	$ 7,110	$ 937	$ 8,047
Carrying amount of PCI loans	$ 2,864	$ 3,093	$ 5,957	$ 4,228	$ 637	$ 4,865

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Allowance for Loan Losses

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

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

The general component of the allowance for loan losses is based on historical loss experience adjusted for qualitative factors stratified by the following loan segments: residential real estate (including home equity loans), commercial real estate, commercial business, and consumer. The Company currently considers its loss experience subsequent to the Merger in its quantitative historical loss analysis. The Company does not weight periods used in that analysis to determine the average loss rate in each portfolio segment. Further, the Company considers qualitative information, including certain experience of the Predecessor Company, in determining its average loss factor for purposes of Company s allowance for loan losses. Qualitative factors considered in the Company s analysis include: levels/trends in delinquencies and substandard loans; trends in volumes and terms of loans; effects of changes in risk rating and underwriting standards and other changes in lending policies, procedures and practices; experience/ability/depth of lending management and staff; and national and regional economic trends and conditions. There were no significant changes in the Company s policies or methodology pertaining to the general component of the allowance for loan losses during the three or six months ended December 31, 2011.

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

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

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

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

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

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

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

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

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

The Company periodically may agree to modify the contractual terms of loans. When a loan is modified and a concession is made to a borrower experiencing financial difficulty, the modification is considered a troubled debt restructuring (TDR). The Company considers all loans identified as being modified in a TDR as impaired loans. By policy, the Company does not remove TDRs from impairment classification. There were no loans modified in a TDR during the three or six months ended December 31, 2011. At December 31, 2011, there were no material payment defaults of loans previously modified in a TDR during the preceding six months. At December 31, 2011 and June 30, 2011, TDRs totaled $955 thousand and $1.1 million, respectively.

The following table sets forth activity in the Successor Company s allowance for loan losses by portfolio segment.

Three months ended December 31, 2011:

	Residential Real Estate	Commercial Real Estate	Commercial Business	Purchased (1)	Consumer	Total
			(Dollars in thousands)			
Beginning balance	$ 124	$ 114	$ 418	$ 0	$ 54	$ 710
Provision (benefit)	33	33	(191)	0	259	134
Recoveries	1	0	12	0	13	26
Charge-offs	(33)	0	(8)	0	(92)	(133)
End balance	$ 125	$ 147	$ 231	$ 0	$ 234	$ 737

Six months ended December 31, 2011:

	Residential Real Estate	Commercial Real Estate	Commercial Business	Purchased (1)	Consumer	Total
			(Dollars in thousands)			
Beginning balance	$ 34	$ 147	$ 238	$ 0	$ 18	$ 437

Provision (benefit)	147	24	(33)	0	396	534
Recoveries	1	0	34	0	28	63
Charge-offs	(57)	(24)	(8)	0	(208)	(297)
End balance	$ 125	$ 147	$ 231	$ 0	$ 234	$ 737

(1) Purchased loans included above include commercial real estate, commercial business, and commercial loans secured by residential real estate. The Company separately analyzes loans purchased by the LASG from other segments in determining the allowance for loan losses. There have been no charge-offs or reductions in the cash flow estimates made at the time of loan acquisition in the Company s purchased loan portfolio. As a result, no provision has been made for potential losses related to such loans from inception of the Company s LASG through December 31, 2011.

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The following table sets forth activity in the Predecessor Company s allowance for loan losses. There was no activity in the Successor Company s allowance for loan losses during the three days ended December 31, 2010.

	89 Days Ended December 28, 2010	181 Days Ended December 28, 2010
	(Dollars in thousands)	
Beginning balance	$ 5,862	$ 5,806
Provision	453	912
Recoveries	92	108
	6,407	6,826
Charge-offs	(440)	(859)
End balance	$ 5,967	$ 5,967

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

	December 31, 2011				
	Residential Real Estate	Commercial Real Estate	Commercial Business	Consumer	Total
	(Dollars in thousands)				
Allowance for loan losses:					
Individually evaluated	$ 0	$ 64	$ 224	$ 0	$ 288
Collectively evaluated	125	83	7	234	449
Purchased (1)	0	0	0	0	0
Total	$ 125	$ 147	$ 231	$ 234	$ 737
Loans:					
Individually evaluated	$ 542	$ 2,601	$ 1,119	$ 0	$ 4,262
Collectively evaluated	140,876	112,757	18,091	19,603	291,327
Purchased (1)	3,573	47,897	0	0	51,470
Total	$ 144,991	$ 163,255	$ 19,210	$ 19,603	$ 347,059

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

Individually evaluated	$ 0	$ 1,221	$ 1,922	$ 0	$ 3,143
Collectively evaluated	146,585	116,810	20,303	22,435	306,133
Purchased (1)	0	637	0	0	637
Total	$ 146,585	$ 118,668	$ 22,225	$ 22,435	$ 309,913

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

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

	As of December 31, 2011			For the three months ended December 31, 2011		For the six months ended December 31, 2011	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(Dollars in thousands)			(Dollars in thousands)		(Dollars in thousands)	
Impaired loans without a valuation allowance:							
Residential 1-4 family	$ 542	$ 602	$ 0	$ 271	$ 7	$ 181	$ 8
Commercial real estate	2,414	2,648	0	1,549	37	1,148	58
Commercial business	479	792	0	340	1	578	5
Total	3,435	4,042	0	2,160	45	1,907	71
Impaired loans with a valuation allowance:							
Residential 1-4 family	0	0	0	73	0	49	0
Commercial real estate	187	219	64	268	3	469	3
Commercial business	640	672	224	678	0	741	0
Total	827	891	288	1,019	3	1,259	3
Total impaired loans	$ 4,262	$ 4,933	$ 288	$ 3,179	$ 48	$ 3,166	$ 74

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

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

	December 31, 2011							
	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)							
Residential real estate:								
Residential 1- 4 family	$ 315	$ 704	$ 0	$ 2,787	$ 3,806	$ 90,752	$ 94,556	$ 3,264
Residential 1- 4 family - purchased	0	0	0	0	0	3,573	3,573	0
Home equity	217	32	0	153	402	45,434	45,836	182
Commercial real estate	492	0	0	441	933	114,169	115,102	1,998
Commercial real estate - purchased	0	0	0	0	0	47,897	47,897	0
Construction	0	0	0	0	0	1,280	1,280	0
Commercial business	363	0	0	921	1,284	17,926	19,210	1,119
Consumer	829	371	0	326	1,526	18,077	19,605	329
Total	$ 2,216	$ 1,107	$ 0	$ 4,628	$ 7,951	$ 339,108	$ 347,059	$ 6,892

	June 30, 2011							
	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)							
Residential real estate:								
Residential 1- 4 family	$ 257	$ 1,021	$ 0	$ 1,779	$ 3,057	$ 92,360	$ 95,417	$ 2,195
Home equity	117	0	0	89	206	49,854	50,060	205
Commercial real estate	0	492	0	934	1,426	115,698	117,124	3,601

Commercial real estate - purchased	0	0	0	0	0	637	637	0
Construction	0	0	0	121	121	1,893	2,015	121
Commercial business	4	75	751	416	1,246	20,979	22,225	559
Consumer	566	338	0	508	1,412	21,024	22,435	527
Total	$ 944	$ 1,926	$ 751	$ 3,847	$ 7,468	$ 302,445	$ 309,913	$ 7,208

Credit Quality Indicators

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

Loans rated 1 4: Loans in these categories are considered pass rated loans with low to average risk.

Loans rated 5: Loans in this category are considered special mention. These loans are beginning to show signs of potential weakness and are being closely monitored by management.

Loans rated 6: Loans in this category are considered substandard. Generally, a loan is considered substandard if the current net worth inadequately protects it and the paying capacity of the obligors and/or the collateral pledged. There is a distinct possibility that the Company will sustain some loss if the weakness is not corrected.

Loans rated 7: Loans in this category are considered doubtful. Loans classified as doubtful have all the weaknesses inherent in those classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of current existing facts, highly questionable and improbable.

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Loans rated 8: Loans in this category are considered loss and of such little value that their continuance as loans is not warranted. There were no loans rated 8 at December 31, 2011 or June 30, 2011.

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

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

	December 31, 2011			
	Commercial Real Estate	Commercial Real Estate - Purchased	Commercial Business	Construction
	(Dollars in thousands)			
Loans rated 1- 4	$ 108,612	$ 47,897	$ 17,540	$ 735
Loans rated 5	2,056	0	400	0
Loans rated 6	4,434	0	1,270	0
Loans rated 7	0	0	0	0
	$ 115,102	$ 47,897	$ 19,210	$ 735

	June 30, 2011			
	Commercial Real Estate	Commercial Real Estate - Purchased	Commercial Business	Construction
	(Dollars in thousands)			
Loans rated 1- 4	$ 106,717	$ 637	$ 18,201	$ 2,015
Loans rated 5	3,133	0	1,169	0
Loans rated 6	7,274	0	2,855	0
Loans rated 7	0	0	0	0
	$ 117,124	$ 637	$ 22,225	$ 2,015

4. Securities Available-for-Sale

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

	December 31, 2011		June 30, 2011	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(Dollars in thousands)			
Debt securities issued by U.S. Government-sponsored enterprises	$ 45,845	$ 45,925	$ 48,827	$ 48,737
Mortgage-backed securities issued by government agencies	92,813	93,555	99,637	99,558
Equity securities	0	0	193	216
Trust preferred securities	0	0	466	451

	$ 138,658	$ 139,480	$ 149,123	$ 148,962

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

	December 31, 2011		June 30, 2011	
	Gross Unrealized Gains	Gross Unrealized Losses	Gross Unrealized Gains	Gross Unrealized Losses
	(Dollars in thousands)			
Debt securities issued by U.S. Government-sponsored enterprises	$ 81	$ 1	$ 7	$ 97
Mortgage-backed securities issued by government agencies	743	1	212	291
Equity securities	0	0	23	0
Trust preferred securities	0	0	8	23
	$ 824	$ 2	$ 250	$ 411

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

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Successor Company	Three Months Ended Three Months Ended December 31, 2011	Three Months Ended Six Months Ended December 31, 2011	Three Months Ended Three Days Ended December 31, 2010
		(Dollars in thousands)	
Gross realized gains	$ 433	$ 447	$ 0
Gross realized losses	0	(67)	0
Net security gains	$ 433	$ 380	$ 0

Predecessor Company	Three Months Ended 89 Days Ended December 28, 2010	Three Months Ended 181 Days Ended December 31, 2010	Three Months Ended
	(Dollars in thousands)		
Gross realized gains	$ 5	$ 17	
Gross realized losses	0	0	
Net security gains	$ 5	$ 17	

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.

	Unrealized	Unrealized	Unrealized	Unrealized	Unrealized	Unrealized
	Less than 12 Months		More than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
			(Dollars in thousands)			
December 31, 2011:						
Debt securities issued by U.S. Government-sponsored enterprises	$ 2,999	$ 1	$ 0	$ 0	$ 2,999	$ 1
Mortgage-backed securities issued by government agencies	2,625	1	0	0	2,625	1
	$ 5,624	$ 2	$ 0	$ 0	$ 5,624	$ 2

	Unrealized	Unrealized	Unrealized	Unrealized	Unrealized	Unrealized
	Less than 12 Months		More than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
			(Dollars in thousands)			
June 30, 2011:						
Debt securities issued by U.S. Government-sponsored enterprises	$ 46,130	$ 97	$ 0	$ 0	$ 46,130	$ 97
Mortgage-backed securities issued by government agencies	51,367	291	0	0	51,367	291

Trust preferred securities	174	23	0	0	174	23
	$ 97,671	$ 411	$ 0	$ 0	$ 97,671	$ 411

There were no other-than-temporary impairment losses on securities during the three or six months ended December 31, 2011. There were no other-than-temporary impairment losses on securities for the three days ended December 31, 2010, nor the 89 or 181 days ended December 28, 2010.

At December 31, 2011, the Company had two available-for-sale securities with continuous unrealized losses for less than twelve months, representing aggregate depreciation from amortized cost of less than 1%. At December 31, 2011, all of the Company s available-for-sale securities were issued by either government agencies or government-sponsored enterprises. The decline in fair value of the Company s available-for-sale securities at December 31, 2011 is attributable to changes in interest rates.

The amortized cost and fair values of available-for-sale debt securities by contractual maturity are shown below as of December 31, 2011. 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 after one year through five years	$ 45,845	$ 45,925
Due after five years through ten years	0	0
Due after ten years	0	0
	45,845	45,925
Mortgage-backed securities	92,813	93,555
	$ 138,658	$ 139,480

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5. Stock-Based Compensation

A summary of the stock option activity for the six months ended December 31, 2011 is as follows:

	Shares	Weighted Average Exercise Price
Outstanding at beginning of period	764,549	$ 14.05
Granted	0	0
Exercised	0	0
Forfeited	(8,500)	13.10
Outstanding and at end of period	756,049	$ 14.06
Exercisable	90,898	$ 14.04

The following table summarizes information about stock options outstanding at December 31, 2011.

	Options Outstanding			Options Exercisable		
Weighted Average Exercise Price	Number	Weighted Average Remaining Life	Aggregate Intrinsic Value	Number	Weighted Average Remaining Life	Aggregate Intrinsic Value
$ 13.93	594,039	9.0 years	$ 0	74,698	9.0 years	$ 0
14.52	162,010	9.0 years	0	16,200	9.0 years	0
14.06	756,049	9.0 years	0	90,898	9.0 years	0

At December 31, 2011, all unvested stock options outstanding are expected to vest.

On December 29, 2010, the Company granted 13,026 shares of the Company s restricted stock to a senior executive of the Company. The holder of this award participates fully in the rewards of stock ownership of the Company, including voting rights and dividend rights. This award has been determined to have a fair value of $13.93 per share based on the average price at which the Company s common stock traded on the date of grant. Forty percent of the award will vest on December 29, 2012, and the remainder will vest in three equal annual installments commencing on December 29, 2013. At December 31, 2011, no restricted common shares were vested. All restricted common shares are expected to vest.

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

The estimated amount and timing of future pre-tax stock-based compensation expense to be recognized are as follows for the fiscal years ending June 30:

	January June 2012	2013	2014	2015	2016	2017	Total
	(Dollars in thousands)						
Stock options	$ 192	$ 384	$ 370	$ 351	$ 221	$ 48	$ 1,566
Restricted stock	18	36	36	36	18	0	144
	$ 210	$ 420	$ 406	$ 387	$ 239	$ 48	$ 1,710

At December 31, 2011, the Company had outstanding a warrant to purchase 67,958 shares of common stock issued to the U.S. Department of the Treasury (the Treasury) on December 12, 2008 in connection with the Company s participation in the Troubled Asset Relief Program on December 12, 2008. The warrant has an exercise price of $9.33 per share and expires on December 12, 2018. The warrant is recorded as a permanent component of stockholders equity in accordance with ASC 815, *Derivatives and Hedging*. At December 31, 2011, the intrinsic value of the warrant was $222 thousand.

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6. Discontinued Operations

On August 31, 2011, the Company sold customer lists and certain fixed assets of its wholly-owned subsidiary, Northeast Bank Insurance Group, Inc. (NBIG) to local insurance agencies in two separate transactions. The Varney Agency, Inc. of Bangor, Maine purchased the assets of nine NBIG offices in Anson, Auburn, Augusta, Bethel, Livermore Falls, Scarborough, South Paris, Thomaston and Turner, Maine. The NBIG office in Berwick, Maine, which operates under the name of Spence & Matthews, was acquired by Bradley Scott, previously a member of NBIG s senior management team. The sale gain, net of income taxes, combined with the elimination of customer list and non-compete intangibles increased tangible equity by approximately $8.4 million. The following is a summary of the sale transactions.

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

Operations associated with NBIG for the periods presented have been classified as discontinued operations in the accompanying consolidated statements of income. The Company has eliminated all intercompany transactions in presenting discontinued operations for each period. Insurance commissions associated with NBIG were $965 thousand for the six months ended December, 2011, all of which was recognized in the first quarter of the fiscal year ending June 30, 2012 (Fiscal 2012). Insurance commissions were $37 thousand for the three days ended December 31, 2010 and $1,221 and $2,661 thousand for the 89 and 181 days ended December 28, 2010, respectively. Intangible and fixed assets associated with discontinued operations totaled approximately $7.4 million and $160 thousand, respectively, at June 30, 2011. In connection with the transaction, the Company repaid borrowings associated with NBIG totaling $2.1 million.

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

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7. Earnings Per Share (EPS)

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

	Successor Company			Predecessor Company	
	Three months ended December 31, 2011	Six months ended December 31, 2011	Three days ended December 31, 2010	89 days ended December 28, 2010	181 days ended December 28, 2010
	(Dollars in thousands, except share and per share data)			(Dollars in thousands, except share and per share data)	
Net income (loss) from continuing operations	$ 418	$ (176)	$ 11,841	$ 783	$ 1,667
Preferred stock dividends	(53)	(106)	0	(51)	(104)
Accretion of preferred stock	(45)	(90)	0	(8)	(15)
Net income (loss) from continuing operations available to common shareholders	$ 320	$ (372)	$ 11,841	$ 724	$ 1,548
Undistributed earnings (loss) of continuing operations allocated to participating securities	1	(1)	(44)	0	0
Net income from continuing operations allocated to common shareholders	$ 319	$ (371)	$ 11,797	$ 724	$ 1,548
Net income (loss) from discontinued operations available to common shareholders	$ 0	$ 1,123	$ (6)	$ 53	$ 129
Undistributed earnings (loss) of discontinued operations allocated to participating securities	0	4	0	0	0
Net income (loss) from discontinued operations allocated to common shareholders	$ 0	$ 1,119	$ (6)	$ 53	$ 129
Weighted average shares used in calculation of basic earnings per share	3,494,498	3,494,498	3,492,498	2,331,332	2,330,197
Incremental shares from assumed exercise of dilutive securities	17,496	0	96,258	27,315	24,188
Weighted average shares used in calculation of diluted earnings per share	3,511,994	3,494,498	3,588,756	2,358,647	2,354,385
Earnings per common share:					

Income (loss) from continuing operations	$	0.09	$	(0.11)	$	3.38	$	0.31	$	0.67
Income from discontinued operations		0.00		0.32		0.00		0.02		0.05
Earnings per common share	$	0.09	$	0.21	$	3.38	$	0.33	$	0.72
Diluted earnings per common share:										
Income (loss) from continuing operations	$	0.09	$	(0.11)	$	3.29	$	0.31	$	0.66
Income from discontinued operations		0.00		0.32		0.00		0.02		0.05
Diluted earnings per common share	$	0.09	$	0.21	$	3.29	$	0.33	$	0.71

756,049 stock options were anti-dilutive and excluded from the calculation of dilutive earnings per share for the three and six months ended December 31, 2011. 67,958 shares issuable upon the exercise of the warrant issued to the Treasury were anti-dilutive during the six months ended December 31, 2011 due to the Company s loss from continuing operations.

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8. Fair Value Measurements

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

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

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

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

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

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

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

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

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

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

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

Valuations of impaired loans are determined by reviewing collateral values or through discounted cash flow analyses using a rate commensurate with the risk associated with the estimated cash flows. Assumptions regarding credit risk, cash flows and discount rates are developed using available market information and historical information.

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

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

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

Derivative financial instruments The valuation of the Company s interest rate swaps and caps are determined using widely accepted valuation techniques including discounted cash flow analyses on the expected cash flows of derivatives. These analyses reflect the contractual terms of the derivatives, including the period to maturity, and use observable market-based inputs, including interest rate curves and implied volatilities. The Company incorporates credit valuation adjustments to appropriately reflect both its own nonperformance risk and the respective counterparty s nonperformance risk in the fair value measurements. In adjusting the fair value of its derivative contracts for the effect of nonperformance risk, the Company has considered the impact of netting and any applicable credit enhancements, such as collateral postings. Although the Company has determined that the majority of the inputs used to value its interest rate derivatives fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with its derivatives utilize Level 3 inputs, such as estimates of current credit spreads, to evaluate the likelihood of default by the Company and its counterparties.

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

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

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

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

Assets and liabilities measured at fair value on a recurring basis are summarized below. There were no significant transfers between Levels I, II, and III during the periods presented.

	$45,925	$45,925	$45,925	$45,925
	Fair Value Measurements at Reporting Date Using:			
	Total	Level 1	Level 2	Level 3
	(Dollars in thousands)			
December 31, 2011				
Assets				
Securities available-for-sale				
Debt securities issued by U.S. Government sponsored enterprises	$ 45,925	$ 0	$ 45,925	$ 0
Mortgage-backed securities issued by government agencies	93,555	0	93,555	0
Other assets interest rate caps	10	0	10	0
Liabilities				
Other liabilities - interest rate swap	$ 611	$ 0	$ 0	$ 611

	$48,737	$48,737	$48,737	$48,737
	Fair Value Measurements at Reporting Date Using:			
	Total	Level 1	Level 2	Level 3
	(Dollars in thousands)			
June 30, 2011				
Assets				
Securities available-for-sale				
Debt securities issued by U.S. Government sponsored enterprises	$ 48,737	$ 0	$ 48,737	$ 0
Mortgage-backed securities issued by government agencies	99,558	0	99,558	0

Equity securities	216	216	0	0
Trust preferred securities	451	451	0	0
Other assets interest rate caps	46	0	46	0
Liabilities				
Other liabilities - interest rate swap	$ 503	$ 0	$ 0	$ 503

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The following table shows the change in the fair value of derivative financial instruments measured on a recurring basis using significant unobservable inputs (Level 3).

Successor Company	Three Months Ended Three Months Ended December 31, 2011	Three Months Ended Six Months Ended December 31, 2011	Three Months Ended Three Days Ended December 31, 2010
	(Dollars in thousands)		
Beginning balance	$ 669	$ 503	$ 577
Unrealized gain (loss)	58	(108)	0
Ending balance	$ 611	$ 611	$ 577

Predecessor Company	Three Months Ended 89 Days Ended December 28, 2010	Three Months Ended 181 Days Ended December 28, 2010	Three Months Ended
	(Dollars in thousands)		
Beginning balance	$ 655	$ 413	
Unrealized gain (loss)	(239)	3	
Ending balance	$ 416	$ 416	

Assets measured at fair value on a nonrecurring basis are summarized below. There were no significant transfers between Levels I, II, and III during the periods presented.

	$1,426 Total	$1,426 Level 1	$1,426 Level 2	$1,426 Level 3
		(Dollars in thousands)		
December 31, 2011:				
Impaired loans	$ 539	$ 0	$ 0	$ 539
Repossessed collateral	593	0	0	593

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

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

	December 31, 2011	June 30, 2011

	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
		(Dollars in thousands)		
Financial assets:				
Cash and cash equivalents	$ 58,363	$ 58,363	$ 83,931	$ 83,931
Available-for-sale securities	139,480	139,480	148,962	148,962
Regulatory stock (FHLB and Federal Reserve)	5,760	5,760	5,760	5,760
Loans held for sale	8,189	8,189	5,176	5,209
Loans, net	346,322	357,463	309,476	316,361
Accrued interest receivable	1,761	1,761	1,244	1,244
Other assets interest rate caps	10	10	46	46
Financial liabilities:				
Deposits (with no stated maturity)	174,391	174,391	186,714	186,714
Time deposits	226,633	226,633	214,404	216,767
FHLB advances	43,684	46,089	43,922	45,465
Structured repurchase agreements	67,089	68,367	68,008	69,364
Other borrowings	0	0	2,229	2,280
Short-term borrowings	1,744	1,744	2,515	2,515
Capital lease obligation	1,994	2,289	2,075	2,306
Junior subordinated debentures issued to affiliated trusts	8,029	8,272	7,957	7,979
Other liabilities interest rate swaps	611	611	503	503

9. Derivatives and Hedging Activities

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

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

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

Risk Management Policies Hedging Instruments

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

Interest Rate Risk Management Cash Flow Hedging Instruments

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

The Company purchased two interest rate caps for $325 thousand, which expire on September 30, 2014. The swap agreement provides for the Company to receive payments at a variable rate determined by a specified index (three month LIBOR) in exchange for making payments at a fixed rate.

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

	Interest Rate Caps	Interest Rate Swap
	(Dollars in thousands)	
December 31, 2011:		
Notional amount	$ 6,000	$ 10,000
Weighted average pay rate		4.69%
Weighted average receive rate		2.05%
Strike rate based on three month LIBOR	2.51%	
Weighted average maturity in years	2.75	3.17
Unrealized loss	$ 72	$ 296

	Interest Rate Caps	Interest Rate Swap
	(Dollars in thousands)	
June 30, 2011:		
Notional amount	$ 6,000	$ 10,000

Weighted average pay rate		4.69%
Weighted average receive rate		2.23%
Strike rate based on three month LIBOR	2.51%	
Weighted average maturity in years	3.25	3.67
Unrealized loss	$ 45	$ 137

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

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

December 31, 2011
(Dollars in thousands)

Asset Derivatives	Balance Sheet Location	Fair Value
Interest rate caps	Other assets	$ 10

Liability Derivatives	Balance Sheet Location	Fair Value
Interest rate swap	Other liabilities	$ 611

June 30, 2011
(Dollars in thousands)

Asset Derivatives	Balance Sheet Location	Fair Value
Interest rate caps	Other assets	$ 46

Liability Derivatives	Balance Sheet Location	Fair Value
Interest rate swap	Other liabilities	$ 503

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

The Company currently holds derivative instruments that contain credit-risk related contingent features that are in a net liability position, which require the Company to assign collateral. Collateral required to be maintained at dealer banks by the Company is monitored and adjusted as necessary. At December 31, 2011, the Company had cash totaling $800 thousand in a margin account with the dealer bank associated with its interest rate swap.

10. Other Comprehensive Income (Loss)

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

	$000	$000	$000	$000	$000	$000
Successor Company	Three Months Ended December 31, 2011			Six Months Ended December 31, 2011		
	Pre-tax Amount	Tax Expense (Benefit)	After-tax Amount	Pre-tax Amount	Tax Expense (Benefit)	After-tax Amount
	(Dollars in thousands)			(Dollars in thousands)		
Unrealized holding (losses) gains on available-for-sale securities	$ (273)	$ (93)	$ (180)	$ 1,363	$ 463	$ 900
Less: Realized gains on available-for-sale securities	433	147	286	380	129	251
Unrealized (losses) gains on available-for-sale securities, net	(706)	(240)	(466)	983	334	649
Unrealized gains (losses) on cash flow hedges	34	11	23	(186)	(63)	(123)
Total other comprehensive (loss) income	$ (672)	$ (229)	$ (443)	$ 797	$ 271	$ 526

Three Days Ended December 31, 2010

	Pre-tax Amount	Tax Expense (Benefit)	After-tax Amount
		(Dollars in thousands)	
Unrealized holding gains on available-for-sale securities	$ 285	$ 97	$ 188
Less: Realized gains on available-for-sale securities	0	0	0
Unrealized gains on available-for-sale securities, net	285	97	188
Unrealized gains on cash flow hedges	0	0	0
Total other comprehensive income	$ 285	$ 97	$ 188

Predecessor Company	89 Days Ended December 28, 2010			181 Days Ended December 28, 2010		
	Pre-tax Amount	Tax Expense (Benefit)	After-tax Amount	Pre-tax Amount	Tax Expense (Benefit)	After-tax Amount
		(Dollars in thousands)			(Dollars in thousands)	
Unrealized holding losses on available-for-sale securities	$ (2,503)	$ (851)	$ (1,652)	$ (2,806)	$ (954)	$ (1,852)
Less: Realized gains on available-for-sale securities	5	2	3	17	6	11
Unrealized losses on available-for-sale securities, net	(2,508)	(853)	(1,655)	(2,823)	(960)	(1,863)
Unrealized gains (losses) on cash flow hedges	286	97	189	(16)	(6)	(10)
Total other comprehensive (loss) income	$ (2,222)	$ (756)	$ (1,466)	$ (2,839)	$ (966)	$ (1,873)

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

	December 31, 2011	June 30, 2011
	(Dollars in thousands)	
Unrealized gain (loss) on available-for-sale securities	$ 822	$ (160)
Tax effect	(279)	54
Net-of-tax amount	543	(106)
Unrealized loss on cash flow hedges	(368)	(182)
Tax effect	125	62
Net-of-tax amount	(243)	(120)
Accumulated other comprehensive income (loss)	$ 300	$ (226)

11. Troubled Asset Relief Capital Purchase Program

On December 12, 2008, in connection with the Company s participation in the federal government s Troubled Asset Relief Program (TARP) Capital Purchase Program, the Company issued 4,227 shares of Fixed Rate Cumulative Perpetual Preferred Stock, Series A, liquidation preference $1,000 per share (the Series A Preferred Stock), and a warrant to purchase 67,958 shares of the Company s common stock for an purchase price of $634 thousand (the TARP Warrant) to the U.S. Department of the Treasury (the Treasury).

The Series A Preferred Stock qualifies as Tier 1 capital and pays cumulative dividends at a rate of 5% per annum until December 12, 2013. Thereafter, the dividend rate will increase to 9% per annum. On and after December 12, 2013, the Company may, at its option, redeem shares of Series A Preferred Stock, in whole or in part, at any time and from time to time, for cash at a per share amount equal to the sum of the liquidation preference per share plus any accrued and unpaid dividends. The Series A Preferred Stock may be redeemed, in whole or in part, at any time and from time to time, at the option of the Company, subject to consultation with the Company s primary federal banking regulator, provided that any partial redemption must be for at least 25% of the issue price of the Series A Preferred Stock. Any redemption of a share of Series A Preferred Stock would be at one hundred percent (100%) of its issue price, plus any accrued and unpaid dividends and the Series A Preferred Stock may be redeemed without regard to whether the Company has replaced such funds from any other source, or to any waiting period.

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

12. Recent Accounting Pronouncements

In April 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-02, *Receivables (Topic 310): A Creditors Determination of Whether a Restructuring is a Troubled Debt Restructuring.* For public entities, this update provides guidance and clarification to help creditors in determining whether a creditor has granted a concession and whether a debtor is experiencing financial difficulties for purposes of determining whether a restructuring constitutes a troubled debt restructuring. The amendments in this update are effective for the first interim or annual period beginning on or after June 15, 2011 and should be applied retrospectively to the beginning of the annual period of adoption. The adoption of this guidance did not have a material impact on the consolidated financial statements.

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

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

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

In December 2011, the FASB issued ASU No. 2011-11, *Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities* (ASU 2011-11). The update requires entities to disclose information about offsetting and related arrangements of financial instruments and derivative instruments. The amendments require enhanced disclosures by requiring improved information about financial instruments and derivative instruments that are either (i) offset in accordance with current literature or (2) subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are offset in accordance with current literature. ASU 2011-11 is effective for fiscal years, and interim periods within those years, beginning on or after January 1, 2013. The Company does not anticipate that the adoption of this guidance will have a material impact on the consolidated financial statements.

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

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

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

A Note about Forward Looking Statements

This report contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended, such as statements relating to our financial condition, prospective results of operations, future performance or expectations, plans, objectives, prospects, loan loss allowance adequacy, simulation of changes in interest rates, capital spending 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 terms, or the future or conditional verbs such as will , may , should , could , and would . In addition, the Company may from time to time make such oral or written forward-looking statements in future filings with the Securities and Exchange Commission (including exhibits thereto), in its reports to shareholders, and in other communications made by or with the Company s approval.

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

Financial Statement Presentation

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

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

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

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

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

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

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

Critical Accounting Policies

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

Allowance for Loan Losses

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

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

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

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

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

excluding changes due to interest rate indices. Factors considered by management in determining impairment include payment status, collateral value, and the probability of the collecting scheduled principal and interest payments when due.

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Purchased Loans

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

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

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

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

Business Combination Accounting

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

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

	Predecessor Company	Fair Value Adjustment, net	Successor Company
		(Dollars in thousands)	
Mortgage loans:			
Residential	$ 99,888	$ (37)	$ 99,851
Commercial	118,602	(1,549)	117,053
Construction	9,311	(188)	9,123
Home Equity	52,308	(500)	51,808
	280,109	(2,274)	277,835
Other loans:			
Commercial business	27,529	(1,815)	25,714
Consumer	59,647	(1,455)	58,192

Total	$ 367,285	$ (5,544)	$ 361,741