NORTHEAST BANCORP /ME/
Form 10-K
September 27, 2011
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United States

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended June 30, 2011

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from to

Commission file number (1-14588)

NORTHEAST BANCORP

(Exact name of registrant as specified in its charter)

Maine	**01-0425066**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

500 Canal Street, Lewiston, Maine	**04240**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code:

(207) 786-3245

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

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

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

None

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

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

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

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

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

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

Large Accelerated Filer ¨	Accelerated filer ¨
Non-accelerated filer ¨	Smaller Reporting Company þ

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

The aggregate market value of the registrant s voting and non-voting common stock held by non-affiliates, computed by reference to the last reported sales price of the registrant s voting common stock on the NASDAQ Global Market on December 31, 2010 was approximately $37,471,755. For this computation, the registrant has excluded the market value of shares of voting and non-voting common stock reported as beneficially owned by executive officers and directors of the registrant; such exclusion shall not be deemed to constitute an admission that any such person is an affiliate of the registrant.

As of September 23, 2011, 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.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s proxy statement for the 2011 Annual Meeting of Shareholders to be held on November 18, 2011 are incorporated by reference in Items 10, 11, 12, 13 and 14 of Part III of this Annual Report on Form 10-K. The registrant intends to file such proxy statement with the Securities and Exchange Commission not later than 120 days after the end of its fiscal year ended June 30, 2011.

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A Note About Forward-Looking Statements

This report contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended, such as statements relating to our financial condition, prospective results of operations, future performance or expectations, plans, objectives, prospects, loan loss allowance adequacy, simulation of changes in interest rates, capital spending, finance sources and revenue sources. These statements relate to expectations concerning matters that are not historical facts. Accordingly, statements that are based on management s projections, estimates, assumptions, and judgments constitute forward-looking statements. These forward looking statements, which are based on various assumptions (some of which are beyond the Company s control), may be identified by reference to a future period or periods, or by the use of forward-looking terminology such as believe , expect , estimate , anticipate , continue , plan , approximately , intend , objective , goal , project , or other similar terms or variations on those terms, or the conditional verbs such as will , may , should , could , and would . In addition, the Company may from time to time make such oral or written forward-looking statements in future filings with the Securities and Exchange Commission (including exhibits thereto), in its reports to shareholders, and in other communications made by or with the approval of the Company.

Such forward-looking statements reflect our current views and expectations based largely on information currently available to our management, and on our current expectations, assumptions, plans, estimates, judgments, and projections about our business and our industry, and they involve inherent risks and uncertainties. Although the Company believes that these forward-looking statements are based on reasonable estimates and assumptions, they are not guarantees of future performance and are subject to known and unknown risks, uncertainties, contingencies, and other factors. Accordingly, the Company cannot give you any assurance that our expectations will in fact occur or that our estimates or assumptions will be correct. The Company cautions you that actual results could differ materially from those expressed or implied by such forward-looking statements as a result of, among other factors, 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 Act; the risk that intangibles recorded in the Company s financial statements will become impaired; and changes in assumptions used in making such forward-looking statements. These forward-looking statements speak only as of the date of this report and the Company does not undertake any obligation to update or revise any of these forward-looking statements to reflect events or circumstances occurring after the date of this report or to reflect the occurrence of unanticipated events.

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PART I

Item 1. Business
Overview and Strategy

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

On December 29, 2010, the merger of the Company and FHB Formation LLC (FHB), a Delaware limited liability company (the Merger) was consummated. FHB is the entity through which a group of independent accredited investors (Investors) purchased 937,933 shares of the Company s outstanding common stock and 1,161,166 shares of newly-issued voting and non-voting common stock, at a price equal to $13.93 per share. As a result of this transaction, $16.2 million of new capital was contributed to the Company and the Investors collectively own approximately 60% of the outstanding common shares of the Company. We have applied the acquisition method of accounting, as described in Accounting Standards Codification (ASC) 805, *Business Combinations,* to this transaction, which represents an acquisition by FHB of Northeast, with Northeast as the surviving company.

Northeast, through the Bank, and third party affiliations, provides a broad range of financial services to individuals and companies in western and south-central Maine and southeastern New Hampshire. Although historically the Bank had been primarily a residential mortgage lender, over the last decade the Bank has expanded its commercial loan business, increased its line of financial products and services, and expanded its market area.

With the additional capital provided as a result of the Merger, the Company is in the process of augmenting the traditional community banking strategy with two new business initiatives:

- A Loan Acquisition and Servicing Group (LASG), to purchase performing commercial loans for the Bank s portfolio and to service commercial loans for third parties. In the second half of the fiscal year ended June 30, 2011 (Fiscal 2011), the LASG made significant investments in staffing and infrastructure to build its purchasing and servicing capabilities, and launched loan purchasing activities in the fourth quarter of Fiscal 2011.

- An Online Deposit Program, to provide a new source of core deposit funding for the Bank. This program is currently under development, and is expected to begin operation in the second half of the fiscal year ending June 30, 2012 (Fiscal 2012).

The Merger required the approval of the Bureau and the Federal Reserve. Those approvals contain certain commitments by the Company, including the following:

The Federal Reserve requires that the Company and the Bank:

- maintain a leverage ratio (Tier 1) of at least 10%;

- maintain a total risk-based capital ratio of at least 15%;

limit purchased loans to 40% of total loans;

fund 100% of loans with core deposits;

- hold commercial real estate loans (including owner-occupied commercial real estate) to within 300% of total risk-based capital, and

- amend the articles of incorporation to address certain technical concerns.

The Bureau requires that, for a two-year period, Northeast receive the prior approval of the Bureau for any material deviation from the business plan. The Bureau s approval includes other conditions on capital ratios and loan purchasing that are either the same as or less stringent than those of the Federal Reserve.

The Company and the Bank are currently in compliance with all commitments to the Federal Reserve and Bureau.

As of June 30, 2011, the Company, on a consolidated basis, had total assets of approximately $596 million, total deposits of approximately $401 million, and stockholders equity of approximately $65 million. The Company conducts business from its headquarters in Lewiston Maine, an office in Boston Massachusetts, as well as through its 10 banking branches, As of June 30, 2011, the Company also operated four loan production offices, one financial center and 10 insurance agency offices. In August of 2011, the Company sold the customer lists and certain other assets of its insurance agency division. Refer to Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations Business Strategy for additional information on the sale of insurance assets in August 2011.

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

Market Area and Competition

The Bank is headquartered in Lewiston, Maine with full service branches in Auburn, Augusta, Bethel, Brunswick, Buckfield, Harrison, Lewiston, Poland, Portland, and South Paris, Maine. The Bank s investment brokerage division has an office in Falmouth, Maine from which investment, life insurance and financial planning products and services are offered. The Bank s mortgage loan originators are in most of our branches and in four loan production offices in Bangor, Brunswick, Alfred and Portsmouth, New Hampshire. The Company s primary market area, which covers the western and south central regions of the State of Maine, is characterized by a diverse economy that has experienced an economic decline in recent years. In the fourth quarter of Fiscal 2011, the Bank launched its Loan Acquisition and Servicing Group from its recently-opened office in Boston, Massachusetts. The LASG has a nationwide scope in its loan purchasing and servicing activities.

We encounter intense competition in our market areas in making loans, purchasing loans, attracting deposits, and selling other customer products and services. In one or more aspects of our business, we compete with other savings banks, commercial banks, credit unions, mutual funds, insurance companies, brokerage and investment banking companies, finance companies, and other financial intermediaries operating in Maine and nationwide. Many of our primary competitors, including those affiliated with large bank holding companies or other larger financial-based institutions, have substantially greater resources, larger established customer bases, higher lending limits, extensive branch networks, numerous ATMs and greater advertising and marketing budgets. They may also offer services that we do not currently provide.

Lending Activities

General

The Bank s gross loan portfolio, including loans held for sale, aggregated $315.1 million at June 30, 2011, representing 52.8% of total assets at that date. The principal lending activities of the Bank are the purchase and origination of mortgages for the purpose of financing or re-financing commercial and one-to four-family residential properties. Currently, the majority of the properties securing the mortgage loan portfolio are located in

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the State of Maine. In the future, as the Bank also pursues nationwide commercial loan purchasing opportunities, loan collateral may increasingly be located throughout the country. Interest rates and origination fees charged on loans originated by the Bank are generally competitive with other financial institutions and other mortgage originators in its general market area. Purchased commercial loans are typically acquired at a discount from their outstanding principal balances, producing yields higher than those normally achievable on the Bank s originated commercial loans.

In conjunction with the regulatory approvals received for the Merger of the Company with FHB, the Company has committed to fund 100% of its loan portfolio with core deposits. At June 30, 2011, deposits qualifying as core totaled $372.8 million, which exceeded the amount required to fund the outstanding loan portfolio on that date by $57.7 million. For additional information, see Sources of Funds Deposits below.

Commercial Real Estate Lending Originated Loans

The Bank originates both multi-family and commercial real estate loans. At June 30, 2011, originated commercial real estate loans totaled $117.8 million or 37.4% of total loans. Multi-family and commercial property loans generally are made in amounts up to 80% of the lesser of the appraised value or the purchase price of the property. Although the largest multi-family or commercial loan in our portfolio at June 30, 2011 was $3,826,000, most of these loans have balances under $500,000.

The Bank s permanent commercial real estate loans are secured by improved property such as office buildings, medical facilities, retail centers, warehouses, apartment buildings, condominiums and other types of buildings, which are located in its primary market area. Multi-family and commercial real estate loans generally have interest rates that adjust every 3 to 5 years, typically indexed to Federal Home Loan Bank (FHLB) or Wall Street Journal prime rates of interest. Mortgage loan maturities have terms up to 20 years.

Loans secured by multi-family and commercial real estate generally are larger and involve greater risks than one-to four-family residential mortgage loans. Because payments on loans secured by multi-family and commercial properties often are dependent on successful operation or management of the properties, repayment of such loans may be subject to a greater extent to adverse conditions in the real estate market or the economy. We seek to minimize these risks in a variety of ways, including limiting the size of our multi-family and commercial real estate loans. In determining whether to originate multi-family or commercial real estate loans, we also consider such factors as the financial condition of the borrower and the debt service coverage of the property. The Company intends to continue to make multi-family and commercial real estate loans as market demand and economic conditions permit.

Commercial Business Lending Originated Loans

The Bank offers a variety of commercial business loan services, including term loans, lines of credit and equipment and receivables financing. A broad range of short-to-medium term commercial business loans are made available to businesses for working capital (including the support of inventory and receivables), business expansion (including acquisitions of real estate and improvements), and the purchase of machinery and equipment. Equipment loans are typically originated on a one-year line of credit basis or on a fixed-term basis ranging from one to five years.

The purpose of a particular loan generally determines its structure. At June 30, 2011, commercial business loans outstanding totaled $22.2 million or 7.1% of total loans.

The Bank s commercial business loans are generally underwritten on the basis of the borrower s ability to make repayment from the cash flow of its business. Such loans generally are collateralized by business assets, such as accounts receivable, equipment, and inventory, and are typically supported by personal guarantees. As a general practice, the Bank takes as collateral a security interest in any available real estate, equipment, or other business assets, although such loans may be made on an uncollateralized basis. Collateralized working capital loans are primarily secured by short-term assets whereas term loans are primarily secured by long-term assets.

The availability of funds for the repayment of a commercial business loan may be substantially dependent on the success of the business itself, which in turn may be affected by adverse changes in the economy. Further, collateral securing such loans may depreciate in value over time, may be difficult to appraise and to liquidate, and may fluctuate in value.

Commercial Lending Purchased Loans

The Bank s loan purchasing business consists primarily of acquiring loans at a discount from their outstanding principal balances. These loans are generally secured by commercial real estate, (including multi-family residential real estate), one-to-four family residential real estate or business assets and are purchased from sellers nationwide in the financial services industry or government agencies. Loan purchasing activities were launched in the fourth quarter of Fiscal 2011, and balances outstanding totaled $637 thousand at June 30, 2011. The Bank intends to grow this segment of its loan portfolio, both in absolute terms and as a percentage of its total loan portfolio. Future growth, if achieved, must remain within the bounds of the regulatory commitments the Company entered into in conjunction with the Merger. Those commitments include the following requirements with respect to purchased loans:(i) limit purchased loans to 40% of total loans, and (ii) hold commercial real estate loans (including owner-occupied commercial real estate) to within 300% of total risk-based capital. At June 30, 2011, the Company s commercial real estate loans were 199% of total risk-based capital.

Residential Lending

A significant component of the Bank s lending activities consists of the origination of single-family residential mortgage loans collateralized by owner-occupied property, most of which is located in its community banking market area. At June 30, 2011, residential loans outstanding, including loans held for sale, totaled $150.7 million or 47.8% of total loans. The Bank offers a variety of mortgage loan products, with most originations centered in adjustable rate mortgages (ARMs) or fixed rate 15 or 30 year monthly payment mortgage loans. Originated ARMs are typically held in portfolio, while most fixed rate loans are sold into the secondary market. The Bank also offers home equity loans and home equity lines of credit.

In its residential mortgage loan originations, the Bank lends up to a maximum loan-to-value ratio of 95.0% on mortgage loans secured by owner-occupied property, with the condition that private mortgage insurance is required for loans with a loan-to-value ratio in excess of 80.0%. Title insurance, hazard insurance and, if appropriate, flood insurance are required for all properties securing real estate loans made by the Bank. A licensed appraiser appraises all properties securing residential first mortgage loans.

The Bank s adjustable rate mortgages are typically offered with rate adjustments tied to the weekly average rate of one-, three- or five-year U.S. Treasury securities with specified minimum and maximum interest rate adjustments. The interest rates on a majority of these mortgages are adjusted yearly with limitations on upward adjustments of 2% per adjustment period and 6% over the life of the loan. The Bank generally charges a higher interest rate if the property is not owner-occupied.

It has been the Bank s experience that the proportions of fixed-rate and adjustable-rate loan originations depend in large part on the interest rate environment. As interest rates fall, there is generally a reduced demand for variable rate mortgages and, as interest rates rise, that demand typically increases. Although the contractual loan payment period for single-family residential real estate loans is generally for a 15-to 30-year period, such loans often remain outstanding for significantly shorter periods than their contractual terms. The Bank generally does not charge a penalty for prepayment of mortgage loans.

The Bank s home equity loans and lines-of-credit are secured by second mortgages on one-to-four-family owner occupied properties, and are made in amounts such that the combined first and second mortgage balances do not

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exceed 80.0% of the value of the property serving as collateral. The lines-of-credit are available to be drawn upon for 10 years, at the end of which time they become term loans amortized over a term of between five and twenty years. Interest rates on home equity lines normally adjust based on the Wall Street Journal prime rate of interest.

We have adopted written, non-discriminatory underwriting standards for use in the underwriting and review of every loan considered for origination or purchase. These underwriting standards are reviewed and approved annually by our board of directors. Our underwriting standards for fixed rate residential mortgage loans generally conform to standards established by Fannie Mae (FNMA) and the Federal Home Loan Mortgage Corporation (the FHLMC). A loan application is obtained or reviewed by the Bank s underwriters to determine the borrower s ability to repay, and confirmation of the more significant information is obtained through credit reports, financial statements, and employment and other verifications.

Consumer Loans

Consumer loans made by the Bank include loans collateralized by automobiles, recreational vehicles, and boats, second mortgages, home improvement loans, mobile home loans, personal loans (collateralized and uncollateralized) and deposit account collateralized loans. At June 30, 2011, consumer loans outstanding aggregated $22.4 million, or 7.1% of total loans. The Bank s consumer loan portfolio consists primarily of loans to individuals for various consumer purposes, but includes some business purpose loans, primarily loans collateralized by small trucks and automobiles, which are payable on an installment basis. Most of these loans are for terms of up to 60 months and, although generally collateralized by liens on various personal assets of the borrower, they may be originated without collateral. Consumer loans are made at fixed and variable interest rates and may be made based on up to a seven-year amortization schedule.

The Bank s consumer lending activities have decreased in the past several years, due to its decision to exit the indirect consumer lending business in 2008, and the sale of a significant portion of its remaining indirect portfolio in Fiscal 2011.

Construction Loans

The Bank originates residential construction loans to finance the construction of single-family dwellings. At June 30, 2011, construction loans outstanding totaled $2.0 million or 0.6% of total loans. Most residential construction loans are made to individuals who intend to erect owner-occupied housing on a purchased parcel of real estate. The Bank s construction loans to individuals typically range in size from $100,000 to $400,000. Construction loans also are made to contractors to erect single-family dwellings for resale. Construction loans are generally offered on the same basis as other residential real estate loans, except that a larger percentage down payment is typically required.

The Bank also may make residential construction loans to real estate developers for the acquisition, development and construction of residential subdivisions, though over the past several years the Bank has limited its reliance on this type of loan. Such loans may involve additional risk attributable to the fact that funds will be advanced to fund the project under construction, which is of uncertain value prior to completion, and because it is relatively difficult to evaluate accurately the total amount of funds required to complete a project.

The Bank finances the construction of individual, owner-occupied houses on the basis of written underwriting and construction loan management guidelines. Construction loans are structured either to be converted to permanent loans with the Bank at the end of the construction phase or to be paid off upon receiving financing from another financial institution. Construction loans on residential properties are generally made in amounts up to 80% of appraised value. Construction loans to developers generally have terms of up to 12 months. Loan proceeds on builders projects are disbursed in increments as construction progresses and as inspections warrant. The maximum loan amount for construction loans is based on the lesser of the current appraisal value or the purchase price for the property.

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Loans collateralized by multi-family residential real estate and subdivisions generally are larger than loans collateralized by single-family, owner-occupied housing and also generally involve a greater degree of risk. Payments on these loans depend on the results of operations and management of the properties, which may be affected by adverse conditions in the real estate market or the economy.

Loan Origination Activities

Loan originations are derived from a number of sources. Residential loan originations may be generated through real estate broker referrals, mortgage loan brokers, direct solicitation by the Bank s loan officers, present depositors and borrowers, builders, attorneys, walk-in customers and, in some instances, other lenders. Loan applications, whether originated through the Bank or through mortgage brokers, are underwritten and closed based on the same standards, which generally meet underwriting guidelines of the Federal Home Loan Mortgage Corporation (the FHLMC). Consumer and commercial loan originations emanate from many of the same sources. The legal lending limit of the Bank, as of June 30, 2011, was approximately $13.7 million.

The underwriting procedures for originated loans followed by the Bank conform to regulatory specifications and are designed to assess the borrower s ability to make principal and interest payments and the value of any assets or property serving as collateral for the loan. Generally, as part of the process, a bank loan officer meets with each applicant to obtain the appropriate employment and financial information as well as any other required loan information. Upon receipt of the borrower s completed loan application, the Bank then obtains reports with respect to the borrower s credit record, and orders and reviews an appraisal of any collateral for the loan (prepared for the Bank through an independent appraiser). The loan information supplied by the borrower is independently verified. Loan officers or other loan production personnel in a position to directly benefit monetarily through loan solicitation fees from individual loan transactions do not have approval authority. Once a loan application has been completed and all information has been obtained and verified, the loan request is submitted to a final review process. As part of the loan approval process, all uncollateralized loans of more than $25,000 and all new collateralized loans of more than $500,000 require pre-approval by the Bank s management credit committee.

Loan applicants are notified promptly of the decision of the Bank by telephone and a letter. If the loan is approved, the commitment letter specifies the terms and conditions of the proposed loan, including the amount of the loan, interest rate, amortization term, a brief description of the required collateral and required insurance coverage. Prior to closing any long-term loan, the borrower must provide proof of fire and casualty insurance on the property serving as collateral, which insurance must be maintained during the full term of the loan. Title insurance is required on loans collateralized by real property. Interest rates on committed loans are normally locked in at the time of application for a 30- to 45-day period.

Loan Purchasing Activities

The Bank launched its new business initiative, commercial loan purchasing, through the LASG in the fourth quarter of Fiscal 2011. Although the outstanding balance of commercial purchased loans was less than 1% of total loans at June 30, 2011, the Company s strategy is to grow this portfolio significantly in future years.

The LASG loan purchasing strategy involves the acquisition of commercial loans, typically secured by real estate or other business assets located throughout the country. LASG management closely monitors the economic and other conditions of the states in which the collateral securing its loan portfolio is located, and regularly reviews the geographic diversity of the purchased commercial loan portfolio. This strategy enables the Bank to reduce the credit and collateral risks of its total purchased commercial loan portfolio and to take advantage of selective real estate markets.

Prior to acquiring a loan or portfolio of loans, the LASG conducts a comprehensive review and evaluation of the loan or loans to be acquired in accordance with the Bank s credit policy for purchased loans. This review includes an analysis of information provided by the seller, including credit and collateral files, a review and

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valuation of the underlying collateral and a review, where applicable, of the adequacy of the income generated by the property to repay the loan. The LASG staff includes credit analysts, real estate analysts, servicing specialists and legal counsel.

The estimated value of the real property collateralizing the loan is determined by the LASG s in-house real estate group, which considers, among other factors, the type of property, its condition and location and its highest and best use in its marketplace. In many cases, real estate brokers and/or appraisers with specific knowledge of the local real estate market are also consulted. For larger loans, members of the LASG typically visit the real property collateralizing the loan, conduct a site inspection and conduct an internal rental analysis of similar commercial properties in the local area. The LASG analyzes the current and likely future cash flows generated by the collateral to repay the loan. Also considered are minimum debt service coverage ratios, consisting of the ratio of net operating income to total principal and interest payments. New tax and title searches may also be obtained to verify the status of any prior liens on the collateral. In most cases, third-party environmental specialists review available information with respect to each property collateralizing a loan to assess potential environmental risk.

In order to determine the amount that the Bank is willing to bid to acquire individual loans or loan pools, the LASG considers, among other factors:

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

In addition to the factors listed above, the LASG also considers the amount it may realize through collection efforts or foreclosure and sale of the collateral, net of expenses, and the length of time and costs required to complete the collection or foreclosure process in the event a loan becomes non-performing or is non-performing at the time of purchase. Under the Bank s credit policy for purchased commercial loans, all bids are subject to the approval of the Bank s management credit committee.

Brokerage and Investment Advisory Services

The Bank s investment brokerage division, Northeast Financial Services (Northeast Financial), offers an array of investment and financial planning products and services from its principal office in Falmouth, Maine and through the Bank s branch network. Working in partnership with *Commonwealth Financial Network, a registered investment adviser*, Northeast Financial s 13 registered representatives offer customers a broad range of investment products including stocks, bonds, mutual funds, fixed annuities, retirement planning, business planning and life insurance.

Investment Activities

The Company s securities portfolio and short-term investments provide and maintain liquidity, assist in managing the interest rate sensitivity of the balance sheet, provide collateral for various Bank obligations, and provide incremental spread income to the extent achievable while minimizing credit risk and interest rate risk. Individual investment decisions are made based on the credit quality of the investment, liquidity requirements, potential returns, cash flow targets, and consistency with the Bank s asset/liability management objectives.

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Sources of Funds

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

Deposits

Consumer and commercial deposits are currently gathered principally from the Bank s primary market area through the offering of a variety of deposit accounts with a range of interest rates and other terms, which are designed to meet customer financial needs. The Federal Deposit Insurance Corporation (FDIC) insures deposits up to certain limits (generally, $250,000 per depositor). Additionally, in January 2011, the FDIC issued final rules to provide separate temporary coverage for noninterest-bearing transaction accounts and Lawyer Trust Accounts (IOLTAs). The final rule provides that all funds held in noninterest-bearing transaction accounts are fully insured, without limit, and that this unlimited coverage is separate from, and in addition to, the coverage provided to depositors with respect to other accounts held at the Bank. This temporary coverage will expire December 31, 2012.

The Bank relies primarily on competitive pricing of its deposit products, customer service and long-standing relationships with customers to attract and retain deposits through its ten branch office locations. Additional deposit services provided to customers are ATMs, telephone banking, Internet banking, Internet bill payment, remote deposit capture and cash management. Interest rates on deposits are based upon factors that include prevailing loan demand, deposit maturities, alternative costs of funds, interest rates offered by competing financial institutions and other financial service firms, and general economic conditions.

The Company committed, in conjunction with the regulatory approvals received for the Merger, to fund 100% of its loan portfolio with core deposits. Core deposits, for purposes of this commitment, are defined as non-maturity deposits and non-brokered insured time deposits. At June 30, 2011, deposits qualifying as core totaled $372.8 million, which exceeds the amount required to fund the outstanding loan portfolio on that date by $57.7 million. Our objective is to raise additional core deposit funding, in order to pay-off borrowed funds as those funds mature and to fund attractive lending opportunities, as they arise. To that end, we are building the capability to offer an online savings deposit program and expect to pilot that program in the second half of Fiscal 2012.

Borrowings

Northeast Bank is a member of the Federal Home Loan Bank of Boston (FHLBB), which provides a central credit facility primarily for member institutions. In the past, the Bank has borrowed from the FHLBB, primarily to fund asset growth, and on occasion to meet short-term liquidity needs. Our current funding strategy emphasizes increasing core deposits, but we may continue to use FHLBB borrowings to provide short-term liquidity or as an integral component of the Bank s overall interest rate risk management process. FHLBB advances are secured by a blanket security agreement which requires the Bank to maintain as collateral certain qualifying assets, chiefly securities and one-to-four-family residential mortgage loans.

Additional wholesale funding sources are available through securities sold under agreements to repurchase, the Federal Reserve Bank (FRB) and deposit brokers. While the Company currently does not seek to raise incremental funding through these sources, they remain an important part of our liquidity contingency planning.

Other Subsidiaries

The Bank has one active non-bank subsidiary, Northeast Bank Insurance Group, Inc., which supports the Bank s insurance agencies. At June 30, 2011, investment in this subsidiary constituted 1.70% of the Company s total assets.

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

Employees

As of June 30, 2011, the Company employed 226 full-time and 21 part-time employees. The Company s employees are not represented by any collective bargaining unit. The Company believes that its relations with its employees are good.

Supervision and Regulation

The banking industry is extensively regulated under both federal and state law. This regulatory framework is intended primarily to protect depositors and the federal deposit insurance funds, and not to protect shareholders. The following discussion summarizes certain aspects of the regulatory framework applicable to the Company and Bank. To the extent that the following information describes statutory and regulatory provisions, it is qualified in its entirety by reference to the particular statutory and regulatory provisions.

Financial Regulatory Reform Legislation

Dodd-Frank Act. On July 21, 2010, the President signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), which comprehensively reforms the regulation of financial institutions, products and services. Many of the provisions of the Dodd-Frank Act noted in this section are also discussed in other sections below. Furthermore, many of the provisions of the Dodd-Frank Act require study or rulemaking by Federal agencies, a process which will take months and years to fully implement.

Among other things, the Dodd-Frank Act provides for new capital standards that eliminate the treatment of trust preferred securities as Tier 1 capital. Existing trust preferred securities are grandfathered for banking entities with less than $15 billion of assets, such as the Company. The Dodd-Frank Act permanently raises deposit insurance levels to $250,000, retroactive to January 1, 2008, and provides unlimited deposit insurance coverage for transaction accounts through December 31, 2012. Pursuant to modifications under the Dodd-Frank Act, deposit insurance assessments will be calculated based on an insured depository institution s assets rather than its insured deposits and the minimum reserve ratio of the FDIC s Deposit Insurance Fund will be raised to 1.35%. The payment of interest on business demand deposit accounts is permitted by the Dodd-Frank Act. The Dodd-Frank Act authorizes the Federal Reserve to regulate interchange fees for debit card transactions and establishes new minimum mortgage underwriting standards for residential mortgages. Further, the Dodd-Frank Act bars banking organizations, such as the Company, from engaging in proprietary trading and from sponsoring and investing in hedge funds and private equity funds, except as permitted under certain limited circumstances. The Dodd-Frank Act empowers the newly established Financial Stability Oversight Council to designate certain activities as posing a risk to the U.S. financial system and to recommend new or heightened standards and safeguards for financial institutions engaging in such activities.

Under the Dodd Frank Act, the Federal Reserve may directly examine the subsidiaries of the Company, including the Bank. Further, the Dodd-Frank Act establishes the Office of Financial Research which has the power to require reports from financial services companies such as the Company. The Dodd-Frank Act also establishes the Bureau of Consumer Financial Protection (CFPB) as an independent bureau of the Federal Reserve. The CFPB has the exclusive authority to prescribe rules governing the provision of consumer financial products and services, which in the case of the Bank will be enforced by the Federal Reserve.

The Dodd-Frank Act grants the U.S. Securities and Exchange Commission (the SEC) express authority to adopt rules granting proxy access for shareholder nominees, and grants shareholders a non-binding vote on executive compensation and golden parachute payments. Pursuant to modifications of the proxy rules under the

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Dodd-Frank Act, the Company will be required to disclose the relationship between executive pay and financial performance, the ratio of the median pay of all employees to the pay of the chief executive officer, and employee and director hedging activities. The Dodd-Frank Act also requires that stock exchanges change their listing rules to require that each member of a listed company s compensation committee be independent and be granted the authority and funding to retain independent advisors and to prohibit the listing of any security of an issuer that does not adopt policies governing the claw back of excess executive compensation based on inaccurate financial statements.

Other Proposals. Other legislative and regulatory proposals regarding changes in banking, the regulation of banks and other financial institutions, and public companies generally, are regularly considered by the executive branch of the Federal government, Congress and various state governments, including Maine, and state and federal regulatory authorities. It cannot be predicted what additional legislative and/or regulatory proposals, if any, will be considered in the future, whether any such proposals will be adopted or, if adopted, how any such proposals would affect the Company and the Bank.

Bank Holding Company Regulation

General. As a bank holding company registered under the Bank Holding Company Act of 1956 (the BHCA), the Company is subject to the regulation and supervision of, and inspection by, the Federal Reserve, its primary regulator. The Company also is registered as a Maine financial institution holding company under Maine law and is subject to regulation and examination by the Bureau. The Company is required to file reports with, and provide other information regarding its business operations and those of its subsidiaries to, the Federal Reserve and the Superintendent.

The BHCA prohibits a bank holding company, with certain limited exceptions, from (i) acquiring or retaining direct or indirect ownership or control of more than 5% of the outstanding voting stock of any company which is not a bank or bank holding company, or (ii) engaging directly or indirectly in activities other than those of banking, managing or controlling banks, or performing services for its subsidiaries unless such non-banking business is determined by the Federal Reserve to be so closely related to banking or managing or controlling banks as to be properly incident thereto. Generally, permissible activities for bank holding companies include, among other things, factoring accounts receivable, acquiring and servicing loans, leasing personal property, performing certain data processing services, acting as an agent or broker in selling credit life insurance and certain other types of insurance in connection with credit transactions, and conducting certain insurance underwriting activities. The BHCA does not place geographic limits on permissible non-bank activities of bank holding companies. In making determinations of what non-banking activities are permissible, the Federal Reserve is required to weigh the expected benefit to the public, such as greater convenience, increased competition or gains in efficiency, against the possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest or unsound banking practices. Generally, bank holding companies, such as the Company, are required to obtain prior approval of the Federal Reserve to engage in any new activity not previously approved by the Federal Reserve. Further, despite prior approval, the Federal Reserve reserves the power to order any bank holding company or its subsidiaries to terminate any activity when the Federal Reserve has reasonable grounds to believe that continuation of such activity constitutes a serious risk to the financial soundness, safety, or stability of the bank holding company or any of its bank subsidiaries.

Gramm-Leach Bliley Act. The Gramm-Leach-Bliley Act (the GLB Act), which amended the BHCA, significantly relaxed previously existing restrictions on the activities of bank holding companies and their subsidiaries by:

- allowing bank holding companies that qualify as a financial holding company to engage in a substantially broader range of activities that are financial in nature;
- allowing insurers and other financial service companies to acquire banks;
- removing various restrictions that apply to bank holding company ownership of securities firms and mutual fund advisory companies; and

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establishing the overall regulatory structure applicable to bank holding companies that also engage in insurance and securities operations.

Under the GLB Act, an eligible bank holding company may elect to be a financial holding company and thereafter engage in a range of activities that are financial in nature and that are not permissible for bank holding companies. These activities may be conducted either directly or through a subsidiary, and include activities such as insurance underwriting, securities underwriting and dealing and making merchant banking investments in commercial and financial companies. A financial holding company also may engage in any activity that the Federal Reserve determines by rule or order to be financial in nature, incidental to such financial activity, or complementary to a financial activity and does not pose a substantial risk to the safety and soundness of an institution or the financial system generally. In addition to these activities, a financial holding company may engage in those activities permissible for a bank holding company.

In order for a bank holding company to be eligible for financial holding company status, each of its subsidiary insured depository institutions must be well-capitalized and well-managed and have at least a satisfactory rating on its most recent Community Reinvestment Act of 1977 (CRA) review. A bank holding company seeking to become a financial holding company must file a declaration with the Federal Reserve that it elects to become a financial holding company. If, after becoming a financial holding company, any of the insured depository institution subsidiaries should fail to continue to meet these requirements, the financial holding company would be prohibited from engaging in activities not permissible for bank holding companies unless it was able to return to compliance within a specified period of time.

Although the Bank, our sole banking subsidiary, meets the capital, management, and CRA requirements, the Company has not made a declaration to elect to become a financial holding company and at this time has no plans to do so.

Banking Acquisitions. The BHCA requires, among other things, the prior approval of the Federal Reserve in any case where a bank holding company proposes to (i) acquire direct or indirect ownership or control of more than 5% of the outstanding voting stock of any bank or bank holding company (unless it already owns a majority of such voting shares), (ii) acquire all or substantially all of the assets of another bank or bank holding company, or (iii) merge or consolidate with any other bank holding company. The Federal Reserve will not approve any acquisition, merger, or consolidation that would result in a monopoly, or that would have a substantially anti-competitive effect, unless the anti-competitive impact of the proposed transaction is clearly outweighed by a greater public interest in meeting the convenience and needs of the community to be served. The Federal Reserve also is required to consider the financial and managerial resources and future prospects of the holding companies and banks, the projected capital adequacy on a post-acquisition basis, and the acquiring institution s performance under the CRA. Under the Dodd-Frank Act, the Federal Reserve must also consider the effect of a proposed transaction on the financial stability of the United States.

In addition, Maine law requires the prior approval of the Superintendent for (i) the acquisition of more than 5% of the voting shares of a Maine financial institution or any financial institution holding company that controls a Maine financial institution, or (ii) the acquisition by a Maine financial institution holding company of more than 5% of a financial institution or a financial institution holding company domiciled outside the State of Maine.

Source of Strength. Under the Dodd-Frank Act, the Company is required to act as a source of financial strength for the Bank in the event of the financial distress of the Bank. This provision codifies the longstanding policy of the Federal Reserve. The Federal bank regulatory agencies must still issue regulations to implement the source of strength provisions of the Dodd-Frank Act. In addition, any capital loans by a bank holding company to any of its subsidiary banks are subordinate to the payment of deposits and to certain other indebtedness of such subsidiary banks. In the event of a bank holding company s bankruptcy, any commitment by the bank holding company to a Federal bank regulatory agency to maintain the capital of a subsidiary bank will be assumed by the bankruptcy trustee and entitled to a priority of payment.

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Safety and Soundness. There are a number of obligations and restrictions imposed on bank holding companies and their depository institution subsidiaries by law and regulatory policy that are designed to minimize potential loss to the depositors of such depository institutions and the FDIC insurance funds in the event of a depository institution default. For example, under the Federal Deposit Insurance Company Improvement Act of 1991 (FDICIA), to avoid receivership of an insured depository institution subsidiary, a bank holding company is required to guarantee the compliance of any insured depository institution subsidiary that may become undercapitalized with the terms of any capital restoration plan filed by such subsidiary with its appropriate Federal bank regulatory agency up to the lesser of (i) an amount equal to 5% of the institution s total assets at the time the institution became undercapitalized or (ii) the amount that is necessary (or would have been necessary) to bring the institution into compliance with all applicable capital standards as of the time the institution fails to comply with such capital restoration plan. See Capital Adequacy Guidelines Classification of Banking Institutions and Enforcement, Policies and Actions .

Under the Federal Deposit Insurance Act, as amended (FDIA), the Federal bank regulatory agencies have adopted guidelines prescribing safety and soundness standards. These guidelines establish general standards relating to internal controls and information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth and compensation, fees and benefits. In general, the guidelines require, among other things, appropriate systems and practices to identify and manage the risk and exposures specified in the guidelines.

Bank Regulation

General. The Bank is a Maine state-chartered banking corporation and a member of the Federal Reserve System and, as such, is subject to the supervision, examination, and regulation by the Bureau and the Federal Reserve.

As a state-chartered commercial bank, the Bank is subject to the applicable provisions of Maine law and the regulations adopted by the Bureau. The Federal Reserve and the Bureau regularly examine the operations of the Bank and are given authority to approve or disapprove mergers, consolidations, the establishment of branches and similar corporate actions. The Bank is subject to federal and state regulatory requirements relating to its activities and operations including with respect to capital, permissible activities, reserves, investments, lending authority, the issuance of securities, payment of dividends, transactions with affiliated parties and borrowing. Federal and state banking regulators also have the power to prevent the continuance or development of unsafe or unsound banking practices or other violations of law.

Deposit Insurance. The Bank s deposits are insured by the Deposit Insurance Fund (DIF) of the FDIC, up to the federally insured limit of $250,000 per depositor. In addition, as noted above, under the Dodd-Frank Act certain noninterest-bearing transaction accounts are fully insured regardless of the dollar amount beginning December 31, 2010 and ending December 31, 2012. This additional deposit insurance coverage replaced the FDIC s Transaction Account Guarantee Program, which expired on December 31, 2010.

FDIA, as amended by the Federal Deposit Insurance Reform Act and the Dodd-Frank Act, requires the FDIC to set a ratio of deposit insurance reserves to estimated insured deposits the designated reserve ratio (the DRR) of at least 1.35%. The FDIC utilizes a risk-based assessment system that imposes insurance premiums based upon a risk matrix that takes into account a bank s capital level and supervisory rating. On February 27, 2009, the FDIC introduced three possible adjustments to an institution s initial base assessment rate: (1) a decrease of up to five basis points for long-term unsecured debt, including senior unsecured debt (other than debt guaranteed under the Temporary Liquidity Guarantee Program) and subordinated debt and, for small institutions, a portion of Tier 1 capital; (2) an increase not to exceed 50 percent of an institution s assessment rate before the increase for secured liabilities in excess of 25 percent of domestic deposits; and (3) for non-Risk Category I institutions, an increase not to exceed 10 basis points for brokered deposits in excess of 10 percent of domestic deposits.

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On November 9, 2010, the FDIC proposed to change its assessment base from total domestic deposits to average total assets minus average tangible equity, which is defined as Tier 1 capital, as required in the Dodd-Frank Act. The new assessment formula became effective on April 1, 2011, and was used to calculate the June 30, 2011 assessment. The FDIC plans to raise the same expected revenue under the new base as under the current assessment base. Since the new base is larger than the current base, the proposal would lower the assessment rate schedule to maintain revenue neutrality. Assessment rates would be reduced to a range of 2 1/2 to 9 basis points on the broader assessment base for banks in the lowest risk category (well capitalized and CAMELS 1 or 2) up to 30 to 45 basis points for banks in the highest risk category.

In November 2009, the FDIC issued a final rule that mandated that insured depository institutions prepay their quarterly risk-based assessments to the FDIC for the fourth quarter of 2009 and for all of 2010, 2011 and 2012 on December 31, 2009. Institutions recorded the entire amount of its prepayment as a prepaid expense. The prepaid assessments bear a zero percent risk weight for risk-based capital purposes. As of December 31, 2009, and for each quarter thereafter, the Bank will record an expense for its regular quarterly assessment for the quarter and a corresponding credit to the prepaid assessment until the asset is exhausted. The FDIC will not refund or collect additional prepaid assessments because of a decrease or growth in deposits over the next three years. However, should the prepaid assessment not be exhausted after collection of the amount due on June 30, 2013, the remaining amount of the prepayment will be returned to the institution. The timing of any refund of the prepaid assessment will not be affected by the change in the deposit insurance assessment calculation discussed above.

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

Loans to Insiders. The Bank also is subject to certain restrictions imposed by federal and state banking regulatory agencies on extensions of credit to executive officers, directors, principal shareholders or any related interest of such persons. Sections 22(g) and 22(h) of the Federal Reserve Act, as amended, and Regulation O, promulgated by the Federal Reserve, provide that extensions of credit to such insiders (a) must be made on substantially the same terms, including interest rates and collateral as, and follow credit underwriting procedures that are not less stringent than those prevailing at the time for, comparable transactions with persons not covered above and who are not employees, (b) must not involve more than the normal risk of repayment or present other unfavorable features, and (c) may not exceed certain limitations on the amount of credit extended to such persons, individually and in the aggregate, which limits are based, in part, on the amount of the Bank s capital. The Dodd-Frank Act explicitly provides that an extension of credit to an insider includes credit exposure to such insider arising from a derivatives transaction, repurchase agreement, reverse repurchase agreement, securities lending transaction or securities borrowing transaction.

Additionally, the Dodd-Frank Act requires that asset sale transactions with insiders must be on market terms, and if the transaction represents more than 10% of the capital and surplus of the bank, be approved by a majority of the uninterested directors of the bank. The Bank also is subject to certain lending limits and restrictions on overdrafts to such persons and extensions of credit in excess of certain limits must be approved by the board of directors of the Bank. A violation of these restrictions may result in the assessment of substantial civil monetary penalties on the Bank or any officer, director, employee, agent or other person participating in the conduct of the affairs of the Bank or the imposition of a cease and desist order.

Bank Subsidiaries Activities. The powers of Maine-chartered banks, such as the Bank, include provisions designed to provide such banks with competitive equity to the powers of national banks. In addition, the GLB Act permits state banks to engage in activities that are permissible for subsidiaries of financial holding companies to the extent such activities are permitted under applicable state law. The GLB Act also expressly preserves the ability of state banks, such as the Bank, to retain all existing subsidiaries. In order to form a financial subsidiary, a state bank must be well capitalized. State banks with financial subsidiaries will be subject to certain capital deduction, risk management, and affiliate transaction rules. In this regard, Federal Reserve rules provide that state bank subsidiaries that engage only in activities that the bank could engage in directly will not be deemed to be a financial subsidiary.

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Capital Adequacy Guidelines

Minimum Capital Requirements. The Company and the Bank are required to comply with capital adequacy standards established by the Federal Reserve. There are two basic measures of capital adequacy for bank holding companies that have been promulgated by the Federal Reserve: a risk-based measure and a leverage measure.

The risk-based capital standards are designed to make regulatory capital requirements more sensitive to differences in credit and market risk profile among banks and bank holding companies, to account for off-balance sheet exposure and to lessen disincentives for holding liquid assets. Under these standards, assets and off-balance sheet items are assigned to broad risk categories, each with appropriate weights. The resulting capital ratios represent capital as a percentage of total risk-weighted assets and off-balance sheet items. In addition, the Federal bank regulatory agencies may from time to time require that a banking organization maintain capital above the minimum limits, whether because of its financial condition or actual or anticipated growth. Federal Reserve policy also provides that banking organizations generally, and in particular those that are experiencing substantial internal growth or actively making acquisitions, are expected to maintain capital positions that are substantially in excess of the minimum supervisory levels, without significant reliance on intangible assets.

The Federal Reserve risk-based guidelines define a three-tier capital framework. Tier 1 capital generally consists of the sum of common stockholders equity, perpetual preferred stock and trust preferred securities (both subject to certain limitations and, in the case of the latter, to specific limitations on the kind and amount of such securities which may be included as Tier 1 capital and certain additional restrictions described below), and minority interests in the equity accounts of consolidated subsidiaries, less goodwill and other non-qualifying intangible assets. Tier 2 capital generally consists of hybrid capital instruments, perpetual debt and mandatory convertible debt securities; perpetual preferred stock and trust preferred securities, to the extent it is not eligible to be included as Tier 1 capital; term subordinated debt and intermediate-term preferred stock; and, subject to limitations, general allowances for loan losses. The sum of Tier 1 and Tier 2 capital less certain required deductions, such as investments in unconsolidated banking or finance subsidiaries, represents qualifying total capital. Risk-based capital ratios are calculated by dividing Tier 1 and total capital, respectively, by risk-weighted assets. Assets and off-balance sheet credit equivalents are assigned to one of four categories of risk-weights, based primarily on relative credit risk. The minimum Tier 1 risk-based capital ratio is 4% and the minimum total risk-based capital ratio is 8%.

Pursuant to Section 171 of the Dodd-Frank Act (more commonly known as the Collins Amendment), the capital requirements generally applicable to insured depository institutions will serve as a floor for any capital requirements the Federal Reserve may establish for the Company as a bank holding company. As a result, hybrid securities, including trust preferred securities, issued on or after May 19, 2010 are not eligible to be included in Tier 1 capital and instead may be included only in Tier 2 capital. The Company has not issued any trust preferred securities since May 19, 2010. However, as the Company had total consolidated assets of less than $15 billion as of December 31, 2009, its hybrid securities, including its trust preferred securities, issued before May 19, 2010 will remain eligible to be included in Tier 1 capital to the same extent as before the enactment of the Collins Amendment. The Collins Amendment also specifies that the Federal Reserve may not establish risk-based capital requirements for bank holding companies that are quantitatively lower than the risk-based capital requirements in effect for insured depository institutions as of July 21, 2010.

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

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may establish for bank holding companies, such as the Company. The Collins Amendment also specifies that the Federal Reserve may not establish leverage capital requirements for bank holding companies that are quantitatively lower than the leverage capital requirements in effect for insured depository institutions as of July 21, 2010.

The Company s merger with FHB Formation on December 29, 2010 required the approval of the Maine Bureau of Financial Institutions and the Federal Reserve. Those approvals contain certain commitments by the Company, including the following:

The Federal Reserve requires that the Company and the Bank:

- maintain a leverage ratio (Tier 1) of at least 10%;
- maintain a total risk-based capital ratio of at least 15%;
- limit purchased loans to 40% of total loans;
- fund 100% of loans with core deposits;
- hold commercial real estate loans (including owner-occupied commercial real estate) to within 300% of total risk-based capital, and
- amend the articles of incorporation to address certain technical concerns.

The Bureau requires that, for a two-year period, Northeast receive the prior approval of the Bureau for any material deviation from the business plan. The Bureau s approval includes other conditions on capital ratios and loan purchasing that are either the same as or less stringent than those of the Federal Reserve.

The Company and the Bank are currently in compliance with all commitments to the Federal Reserve and Bureau. At June 30, 2011, the Company s consolidated Tier 1 Capital ratio was 10.35% and its Total Capital ratio was 18.99%.

Federal bank regulatory agencies also have adopted regulations that require regulators to take into consideration concentrations of credit risk and risks from non-traditional activities, as well as an institution s ability to manage those risks, when determining the adequacy of an institution s capital. Other factors taken into consideration include: interest rate exposure; liquidity, funding and market risk; the quality and level of earnings; the quality of loans and investments; the effectiveness of loan and investment policies; and management s overall ability to monitor and control financial and operational risks, including concentrations of credit and non-traditional activities. This evaluation is made as part of the institution s regular safety and soundness examination. Further, each Federal banking agency prescribes standards for depository institution holding companies relating to internal controls, information systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation, maximum rates of classified assets to capital, minimum earnings sufficient to absorb losses and other standards as they deem appropriate. In addition, pursuant to the requirements of FDICIA, Federal bank regulatory agencies all have adopted regulations requiring regulators to consider interest rate risk (when interest rate sensitivity of an institution s assets does not match its liabilities or its off-balance sheet position) in the evaluation of a bank s capital adequacy.

Classification of Banking Institutions. Among other things, FDICIA provides Federal bank regulatory agencies with broad powers to take prompt corrective action with respect to depository institutions that do not meet minimum capital requirements. The extent of those powers depends upon whether the institutions in question are well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, critically undercapitalized. A depository institution s classification will depend upon where its capital levels are in relation to various relevant capital measures, which include a risk-based capital measure and a leverage ratio capital measure, and certain other factors.

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The Federal bank regulatory agencies have adopted regulations establishing relevant capital measures and relevant capital levels. Under these regulations, a bank will be considered:

	Total Risk Based Capital Ratio	Tier 1 Risk-Based Capital Ratio	Leverage Ratio	Other
Well Capitalized:	10% or greater	6% or greater	5% or greater	Not subject to any order or written directive to meet and maintain a specific capital level for any capital measure
Adequately Capitalized	8% or greater	4% or greater	4% or greater (3% in the case of a bank with a composite CAMEL rating of 1)	
Undercapitalized	less than 8%	less than 4%	less than 4% ((3% in the case of a bank with a composite CAMEL rating of 1)	
Significantly Undercapitalized	less than 6%	less than 3%	less than 3%	
Critically Undercapitalized				Ratio of tangible equity to total assets is less than or equal to 2%

Under certain circumstances, a depository institution s primary Federal bank regulatory agency may use its authority to reclassify a well classified bank as adequately capitalized or subject an adequately capitalized or undercapitalized institution to supervisory actions applicable to the next lower capital category if it determines that the bank is in an unsafe or unsound condition or deems the bank to be engaged in an unsafe or unsound practice and not have corrected the deficiency. The banking agencies are permitted to establish individual minimum capital requirements exceeding the general requirements described above. Generally, failing to maintain the status of well capitalized or adequately capitalized subjects a depository institution to restrictions and limitations on its business that become progressively more severe as capital levels decrease. At June 30, 2011, the Bank met the definition of a well capitalized institution.

Prompt Corrective Regulatory Action. Federal banking regulators are required to take prompt corrective action if an insured depository institution fails to satisfy certain minimum capital requirements and other measures deemed appropriate by the Federal bank regulatory agencies. See Capital Adequacy Guidelines and Enforcement Policies and Actions. Failure to meet the capital adequacy guidelines could subject a banking institution to capital raising requirements. A bank is prohibited from making any capital distribution (including the payment of a dividend) or paying a management fee to its holding company if the bank would thereafter be undercapitalized . Limitations exist for undercapitalized depository institutions regarding, among other things, asset growth, acquisitions, branching, new lines of business, acceptance of brokered deposits and borrowings from the Federal Reserve System. These institutions also are required to submit a capital instruction plan that includes a guarantee from the institution s holding company. See Bank Holding Company Regulation Source of Strength; Safety and Soundness . A significantly undercapitalized depository

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institution may be subject to a number of requirements and restrictions, including orders to sell a sufficient quantity of voting stock to become adequately capitalized, requirements to reduce total assets and cessation of receipt of deposits from correspondent banks. The appointment of a receiver or conservator may be required for critically undercapitalized institutions.

Basel Committee on Banking Supervision Capital Proposals. The Company has not elected, and does not expect to elect, to calculate its risk-based capital requirements under the Internal-Ratings Based and Advanced Measurement Approaches (commonly referred to as the advanced approaches or Basel II) proposed by the Basel Committee on Banking Supervision (the Basel Committee), as implemented in the U.S. by the Federal bank regulatory agencies. In connection with Basel II, the Federal bank regulatory agencies also issued, in 2008, a joint notice of proposed rulemaking that sought comment on implementation in the United States of certain aspects of the standardized approach of the international Basel II Accord (the Standardized Approach Proposal). However, the Federal bank regulatory agencies have delayed finalizing the Standardized Approach Proposal until they can determine how best to eliminate its reliance on credit ratings, as required by Section 939A of the Dodd-Frank Act. Regardless, the Company does not currently expect to calculate its capital ratios in accordance with the Standardized Approach Proposal**.**

In response to the recent financial crisis, the Basel Committee released additional recommended revisions to existing capital rules throughout the world. These proposed revisions are intended to protect financial stability and promote sustainable economic growth by setting out higher and better capital requirements, better risk coverage, the introduction of a global leverage ratio, measures to promote the build up of capital that can be drawn down in periods of stress, and the introduction of two global liquidity standards (collectively, Basel III). The Federal Reserve has not yet adopted Basel III, and there remains considerable uncertainty regarding the timing for adoption and implementation of Basel III in the United States. If and when the Federal Reserve does implement Basel III, it may be with some modifications or adjustments. Accordingly, the Company is not yet in a position to determine the effect of Basel III on its capital requirements.

Dividend Restrictions

The Company is a legal entity separate and distinct from the Bank. The primary source of revenues and funds of the Company, including funds to pay dividends to our shareholders, have been and will likely continue to be from dividends, if any, paid to us by the Bank. There are statutory and regulatory limitations on the payment of dividends by the Bank to the Company as well as by the Company to its shareholders. As to the payment of dividends, the Bank is subject to the laws and regulations of the State of Maine and to the regulations of the Federal Reserve.

If, in the opinion of the applicable Federal bank regulatory agency, a depository institution or holding company under its jurisdiction is engaged in or is about to engage in an unsafe or unsound practice (which, depending on the financial condition of the depository institution or holding company, could include the payment of dividends), such authority may require, after notice and hearing (except in the case of an emergency proceeding where there is no notice or hearing), that such institution or holding company cease and desist from such practice. The Federal bank regulatory agencies have indicated that paying dividends that deplete a depository institution s or holding company s capital base to an inadequate level would be such an unsafe and unsound banking practice. Moreover, under FDICIA, an insured institution may not pay a dividend if payment would cause it to become undercapitalized or if it already is undercapitalized. See Capital Adequacy Guidelines Prompt Corrective Regulatory Action . Moreover, the Federal Reserve and the FDIC have issued policy statements which provide that bank holding companies and insured depository institutions generally should only pay dividends out of current operating earnings.

Enforcement Policies and Actions

The Federal Reserve and the Bureau have primary regulatory enforcement responsibility over the Company and the Bank. This enforcement authority includes, among other things, the ability to assess civil money penalties, to

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issue cease-and-desist or removal orders, to initiate injunctive actions against banking organizations and affiliated parties, and, in extreme cases, to terminate deposit insurance. In general, these enforcement actions may be initiated for violations of laws and regulations and unsafe or unsound practices. Other actions or inactions may provide the basis for enforcement action, including misleading or untimely reports filed with the Federal bank regulatory agencies. Current law generally requires public disclosure of final enforcement actions.

Transactions with Affiliates

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

Interstate Banking and Branching

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, as amended (the Interstate Banking Act), generally permits well capitalized bank holding companies to acquire banks in any state, and preempts all state laws restricting the ownership by a bank holding company of banks in more than one state. The Interstate Banking Act also permits a bank to merge with an out-of-state bank and convert any offices into branches of the resulting bank if both states have not opted out of interstate branching; and permits a bank to acquire branches from an out-of-state bank if the law of the state where the branches are located permits the interstate branch acquisition. Under the Dodd-Frank Act, a bank holding company or bank must be well capitalized and well managed to engage in an interstate acquisition. Bank holding companies and banks are required to obtain prior Federal Reserve approval to acquire more than 5% of a class of voting securities, or substantially all of the assets, of a bank holding company, bank or savings association. The Interstate Banking Act and the Dodd-Frank Act permit banks to establish and operate *de novo* interstate branches to the same extent a bank chartered by the host state may establish branches.

Maine law expressly authorizes interstate banking combinations that are approved by the Bureau and do not result in deposit concentrations exceeding 30% of the total deposits of the State of Maine (unless such limitation is waived by the Bureau). Further, interstate branch acquisitions and the establishment of *de novo* branches also are authorized under Maine law.

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Community Reinvestment Act

Bank holding companies and their subsidiary banks are subject to the provisions of the CRA and the regulations promulgated thereunder by the appropriate Federal bank regulatory agency. Under the terms of the CRA, the Bank has a continuing and affirmative obligation consistent with its safe and sound operation to help meet the credit needs of its entire community, including low and moderate income neighborhoods. The CRA does not establish specific lending requirements or programs for financial institutions nor does it limit an institution s discretion to develop the types of products and services that it believes are best suited to its particular community, consistent with the CRA. The CRA requires each appropriate Federal bank regulatory agency, in connection with its examination of a subsidiary depository institution, to assess such institution s record of meeting the credit needs of its community and to take such record into account in its evaluation of certain applications by that institution. The CRA also requires all institutions to make public disclosure of their CRA ratings. Further, such assessment also is part of the Federal Reserve s consideration of applications to acquire, merge or consolidate with, or assume the liabilities of, another banking institution or its holding company, or to open or relocate a branch office. In the case of a bank holding company applying for approval to acquire a bank or a bank holding company, the Federal Reserve will assess the record of each subsidiary bank of the applicant bank holding company in considering the application. An institution s CRA rating is based on its actual performance in meeting community needs. Current CRA regulations for large banks primarily rely on objective criteria of the performance of institutions under three key assessment tests:: (a) a lending test, which evaluates the institution s record of making loans in its service areas; (b) an investment test, which evaluates the institution s record of investing in community development projects, affordable housing, and programs benefiting low or moderate income individuals and businesses; and (c) a service test, which evaluates the institution s delivery of services through its branches, ATMs, and other offices. For smaller banks, current CRA regulations primarily evaluate the performance of institutions under two key assessment tests: a lending test and a community development test. the Bank received a satisfactory CRA rating in its most recent examination.

Consumer Protection Laws

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

Interchange Fees

Pursuant to the Dodd-Frank Act, the Federal Reserve has issued a final rule governing the interchange fees charged on debit cards. The rule caps the fee a bank may charge on a debit card transaction and shifts such interchange fees from a percentage of the transaction amount to a per transaction fee. The rule is effective October 1, 2011. Although the rule does not directly apply to institutions with less than $10 billion in assets, market forces may result in debit card issuers of all sizes adopting fees that comply with this rule. If adopted by the Bank, the rule would indirectly result in a significant decrease in the fee income that the Bank earns from debit cards.

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Mortgage Reform

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

Privacy and Customer Information Security

The Federal bank regulatory agencies have adopted guidelines for establishing standards for safeguarding nonpublic personal information about customers that implement provisions of the GLB Act, which establishes a comprehensive framework to permit affiliations among commercial banks, insurance companies, securities firms, and other financial service providers by revising and expanding the BHCA framework. The GLB Act requires financial institutions to implement policies and procedures regarding the disclosure of nonpublic personal information about consumers to nonaffiliated third parties. In general, the GLB Act requires financial institutions to explain to consumers their policies and procedures regarding the disclosure of such nonpublic personal information, and, unless otherwise required or permitted by law, financial institutions are prohibited from disclosing such information except as provided in their policies and procedures.

Additionally, the Information Security Guidelines established by the GLB Act require each financial institution, under the supervision and ongoing oversight of its board of directors or an appropriate committee of the board, to develop, implement and maintain a comprehensive written information security program designed to ensure the security and confidentiality of customer information, to protect against anticipated threats or hazards to the security or integrity of such information; and to protect against unauthorized access to or use of such information that could result in substantial harm or inconvenience to any customer. The Federal banking regulators have issued guidance for banks on response programs for unauthorized access to customer information. This guidance, among other things, requires notice to be sent to customers whose sensitive information has been compromised if unauthorized use of this information is reasonably possible. Most states have enacted legislation concerning breaches of data security and Congress continues to consider federal legislation that would require that notice be sent to consumers of a data security breach. The Federal bank regulatory agencies have also jointly issued final rules and guidelines implementing certain provisions of the FACT Act that (a) require the Bank to develop and implement a written Identity Theft Prevention Program to detect, prevent, and mitigate identity theft in connection with the opening of certain accounts or certain existing accounts; (b) require credit and debit card issuers, such as the Bank, to assess the validity of notifications of changes of address under certain circumstances; and (c) provide guidance regarding reasonable policies and procedures that a user of consumer reports, such as the Bank, must employ when a consumer reporting agency sends the user a notice of address discrepancy.

Anti-Money Laundering and the Bank Secrecy Act

Under the Bank Secrecy Act (BSA), a financial institution is required to have systems in place to detect certain transactions, based on the size and nature of the transaction. Financial institutions are generally required to report to the United States Treasury any cash transactions involving more than $10,000. In addition, financial institutions are required to file suspicious activity reports for transactions that involve more than $5,000 and which the financial institution knows, suspects or has reason to suspect involves illegal funds, is designed to evade the requirements of the BSA or has no lawful purpose. The Uniting and Strengthening America by

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Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the USA PATRIOT Act), which amended the BSA, is designed to deny terrorists and others the ability to obtain anonymous access to the U.S. financial system. The USA PATRIOT Act has significant implications for financial institutions and businesses of other types involved in the transfer of money. The USA PATRIOT Act, together with the implementing regulations of various Federal regulatory agencies, has caused financial institutions, such as the Bank, to adopt and implement additional policies or amend existing policies and procedures with respect to, among other things, anti-money laundering compliance, suspicious activity, currency transaction reporting, customer identity verification and customer risk analysis. In evaluating an application under Section 3 of the BHCA to acquire a bank or an application under the Bank Merger Act to merge banks or affect a purchase of assets and assumption of deposits and other liabilities, the applicable Federal bank regulatory agency must consider the anti-money laundering compliance record of both the applicant and the target.

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

Bank Securities Activities. With respect to bank securities activities, the GLB Act amended the Federal securities laws to eliminate the blanket exceptions that banks traditionally have had from the definition of broker, dealer, and investment adviser under the Securities Exchange Act of 1934 (the Exchange Act). The GLB Act provided 11 exceptions from the definition of broker in Section 3(a)(4) of the Exchange Act that permit banks to effect securities transaction under certain conditions without registering as broker-dealers with the SEC. Regulation R, which was issued jointly by the SEC and the Federal Reserve, implements certain of these exceptions.

Sarbanes-Oxley Act

The Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley Act) implemented a broad range of corporate governance and accounting measures, executive compensation disclosure requirements, and enhanced and timely disclosure obligations for corporate information, all of which are designed to ensure that the stockholders of corporate America are treated fairly and have full and accurate information about the public companies in which they invest. All companies that file periodic reports with the SEC are affected by the Sarbanes-Oxley Act.

Specifically, the Sarbanes-Oxley Act and various regulations promulgated thereunder, established among other things:

- the creation of an independent accounting oversight board to oversee the audit of public companies and auditors who perform such audits;
- auditor independence provisions which restrict non-audit services that independent accountants may provide to their audit clients;
- additional responsibilities for financial statements for the chief executive officer and chief financial officer of the reporting entity;
- a prohibition on personal loans to directors and officers, except certain loans made by financial institutions on non-preferential terms and in compliance with other bank regulatory requirements;

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additional corporate governance and responsibility measures which (a) require the chief executive officer and chief financial officer to certify financial statements and to forfeit salary and bonuses in certain situations, and (b) protect whistleblowers and informants;

enhance independence and expertise requirements of members of audit committees;

expansion of the audit committee s authority and responsibility by requiring that the audit committee (a) have direct control of the outside auditor, (b) be able to hire and fire the auditor, and (c) approve all non-audit services;

mandatory disclosure by analysts of potential conflicts of interest; and

enhanced penalties for fraud and other violations.

On September 11, 2007, the Company changed its listing from the American Stock Exchange to the NASDAQ Stock Exchange. Both exchanges have adopted corporate governance rules that have been approved by the SEC.

Federal Home Loan Bank System

The Bank is a member of the Federal Home Loan Bank of Boston (FHLBB), which is one of the regional Federal Home Loan Banks comprising the Federal Home Loan Bank System. Each Federal Home Loan Bank serves as a central credit facility primarily for its member institutions. The Bank, as a member of the FHLB, is required to acquire and hold shares of capital stock in the FHLB. While the required percentage of stock ownership is subject to change by the FHLBB, the Bank is in compliance with this requirement with an investment in FHLBB stock at June 30, 2011 of $4.9 million. The Bank receives dividends on its FHLBB stock. The FHLBB has recently declared dividends equal to an annual yield of approximately the daily average three-month LIBOR yield for the quarter for which the dividend has been declared. As of June 30, 2011, the Bank had $43.9 million in outstanding FHLB advances. Any advances from the FHLBB must be secured by specified types of collateral, and long-term advances may be obtained only for the purpose of providing funds for residential housing finance.

ITEM 1A. Risk Factors

An investment in our common stock involves certain risks inherent to our business. The material risks and uncertainties that management believes affect the Company are described below. To understand these risks and to evaluate an investment in our common stock, you should read this entire report, including the following risk factors.

If any of the potential events described in these risk factors actually occur, the Company s financial condition and results of operations could be materially and adversely affected. If this were to happen, the value of the Company s common stock could decline significantly.

The Company may not be successful in the implementation of its post-Merger business strategy.

The Company s business strategy following the Merger was revised to include building a Loan Acquisition and Servicing Group and growing deposits with an online affinity savings program. The Company s ability to develop and offer new products and services depends on whether the Company can hire and retain enough suitably experienced and talented employees, identify enough suitable customers and successfully build the systems and obtain the other resources necessary for creating the new product and service offerings. The Company may not be able to do so, or, identifying suitable employees and customers and building the systems and obtain the other resources necessary may be more expensive, or take longer, than the Company expects. There can be no assurance that our business strategy following the Merger will be accretive to earnings within a reasonable period of time.

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Continued economic weakness or further weakening could adversely affect the Company s financial condition and results of operations.

The Company continues to operate in a challenging and uncertain economic environment that includes generally uncertain national and local conditions. Within Maine, the unemployment rate has improved slightly over the past few years, to 7.7% from a high of 8.4% in 2009, but remains high by historic standards. Residential loan sales were down 18% in the first 6 months of 2011 from the comparable 2010 period, while Maine home values have remained relatively stable over the past year. A worsening of these conditions would likely exacerbate the adverse effects of these difficult market conditions on Northeast and others in the financial services industry. In particular, Northeast faces the following risks in connection with these events:

- Continued asset valuation declines and an increase in the number of borrowers unable to repay their loans in accordance with their original terms. Increased delinquencies, coupled with decreases in the value of the collateral securing loans, could result in increased credit losses.

- A decrease in demand for our loans and other products and services offered by us, which would result in a decrease in revenues.

- Higher FDIC assessments may be required if market developments significantly deplete the insurance fund of the FDIC and reduce the ratio of reserves to insured deposits.

Recent market volatility has affected and may continue to affect the value of the Company s common stock.

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

The Company s participation in the Capital Purchase Program, which includes restrictions on the ability to pay dividends or repurchase outstanding common stock and restrictions on executive compensation, may act to depress the market value of Northeast s common stock, potentially restrict its operational flexibility and hinder its ability to attract and retain well qualified executives.

Pursuant to its participation in the Capital Purchase Program, the Company s ability to declare or pay dividends on any of Northeast s shares of common stock is limited to $0.09 per share per quarter. The Company is unable to declare or pay dividends on shares of common stock if in arrears on the payment of dividends on its Series A preferred stock. In addition, the Treasury s approval generally is required for Northeast to make any stock repurchase (other than purchases of Series A preferred stock or shares of common stock in connection with the administration of any employee benefit plan in the ordinary course of business and consistent with past practice) unless all of the Series A preferred stock has been redeemed or transferred by Treasury to unaffiliated third parties. In addition, outstanding shares of common stock may not be repurchased if Northeast is in arrears on the payment of Series A preferred stock dividends. The restriction on the Company s ability to pay dividends may depress the market price for shares of its common stock.

In addition, the Company must comply with the executive compensation and corporate governance standards imposed by ARRA for as long as Treasury holds any securities acquired from Northeast pursuant to the Capital Purchase Program or upon exercise of the warrant held by Treasury. In addition, the restrictions on the Company s ability to compensate senior executives as compared to executive compensation at companies that did not participate in the Capital Purchase Program may limit the Company s ability to recruit and retain senior executives. Treasury s ability to change the terms, rules or requirements of the Capital Purchase Program could adversely affect the Company s financial condition and results of operations.

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The outstanding Series A preferred stock could decrease net income and earnings per share, and the warrant issued to Treasury may be dilutive to holders of the Company s common stock.

The sale of the Series A preferred stock to Treasury increased the number of outstanding shares of common stock on a fully-diluted basis. In addition, the Series A preferred stock carries a preferred dividend. The dividends declared on the Series A preferred stock will reduce the net income available to holders of the Company s common stock and earnings per share. In addition, the ownership interest of the existing holders of Northeast s common stock will be diluted to the extent that Treasury exercises the warrant it acquired in connection with Northeast s participation in the Capital Purchase Program.

If the Company is are unable to redeem the outstanding Series A preferred stock, the annual dividend rate will increase substantially.

If Northeast is unable to redeem the outstanding Series A preferred stock prior to December 12, 2013, the annual dividend rate would increase from 5.0% to 9.0%. Depending on the Company s financial condition at the time, such an increase in the annual dividend rate on the Series A preferred stock could have a material negative effect on liquidity and results of operations.

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

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

Adverse events in Maine, where the Company s business is currently concentrated, could adversely impact its results and future growth.

The Company s business, the location of its branches, the primary source of repayment for its small business loans and the real estate collateralizing its commercial real estate loans and its home equity loans are primarily concentrated in Maine. Unlike larger national or other regional banks that are more geographically diversified, the Company s business and earnings are closely tied to general business and economic conditions, particularly the economy of Maine. As a result, Northeast is exposed to geographic risks and adverse changes in laws and regulations in Maine would have a greater negative impact on Northeast s revenues, financial condition and business than similar institutions in markets outside of Maine.

The Company is dependent upon its employees.

The Company s success is dependent, in large measure, upon its ability to attract and retain key people. There exists significant competition for those with the experience and skills required to conduct many of the Company s business activities. There is no assurance that the Company will continue to attract or retain such personnel.

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Northeast is a holding company and depends on its subsidiary for dividends, distributions and other payments.

Northeast is a separate and distinct legal entity from its banking subsidiary and depends on dividends, distributions and other payments from the Bank to fund dividend payments on Northeast s common stock and to fund all payments on its other obligations. Northeast and the Bank are subject to laws that authorize regulatory authorities to block or reduce the flow of funds from the Bank to Northeast. Regulatory action of that kind could impede access to the funds that Northeast needs in order to make payments on its obligations or dividend payments. In addition, if the Bank s earnings are not sufficient to make dividend payments to Northeast while maintaining adequate capital levels, Northeast may not be able to make dividend payments to its common and preferred shareholders. Further, Northeast s right to participate in a distribution of assets upon a subsidiary s liquidation or reorganization is subject to the prior claims of the Bank s creditors.

The Company may not be able to pay dividends and, if the Company pays dividends, the Company cannot guarantee the amount and frequency of such dividends.

In addition to the restrictions on the ability to declare or pay dividends imposed by the terms of the Series A preferred stock, the continued payment of dividends on shares of the Company s common stock will also depend upon the Company s debt and equity structure, earnings and financial condition, need for capital in connection with possible future acquisitions, growth and other factors, including economic conditions, regulatory restrictions, and tax considerations. The Company cannot guarantee that it will pay dividends or, if it pays dividends, the amount and frequency of these dividends.

The Company s loan portfolio is subject to credit risk and achievement of the Company s goal to increase its portfolio of purchased commercial loans will increase its exposure to credit risk.

Northeast is exposed to the risk that its borrowers may default on their obligations. Credit risk arises through the extension of loans, certain securities, letters of credit and financial guarantees. Although credit personnel analyze the creditworthiness of individual borrowers and limits are established for the total credit exposure to any one borrower, such limits may not have the effect of adequately limiting our credit exposure.

Further, the Bank s commercial mortgage and commercial business loan portfolios, which currently comprise 44.4% of total loans, are expected to grow as a result of the activities of the newly-launched Loan Acquisition and Servicing Group (LASG). Commercial loans normally return higher interest yields, but also generally carry larger loan balances and involve a higher risk of nonpayment or late payment than residential mortgage loans. These loans, and purchased loans in particular, may lack standardized terms and may include a balloon payment feature. The ability of a borrower to make or refinance a balloon payment may be affected by a number of factors, including the financial condition of the borrower, prevailing economic conditions and prevailing interest rates. Repayment of these loans is generally more dependent on the economy and the successful operation of a business.

Because of the risks associated with commercial loans, the Company may experience higher rates of default than if the portfolio were more heavily weighted toward residential mortgage loans. Higher rates of default could have an adverse effect on the Company s operating results and financial condition.

An increase in the Company s allowance for loan losses will result in reduced earnings.

As a lender, the Company is exposed to the risk that its customers will be unable to repay their loans according to their terms and that any collateral securing the payment of their loans will not be sufficient to assure full repayment. The Company evaluates the collectability of its loan portfolio and provides an allowance for loan losses that the Company believes is adequate based upon various factors. Many of these factors are difficult to predict or estimate accurately, particularly in a changing economic environment. The process of determining the estimated losses inherent in the Company s loan portfolio requires subjective and complex judgments and the level of uncertainty concerning economic conditions may adversely affect its ability to estimate the incurred losses in its loan portfolio. If the Company s evaluation is incorrect and borrower defaults cause losses exceeding the portion of the allowance for loan losses allocated to those loans, the Company s earnings could be significantly and adversely affected. The Company may experience losses in its loan portfolios or perceive adverse trends that require it to significantly increase its allowance for loan losses in the future, which would reduce future earnings.

Changes in interest rates could adversely affect the Company s net interest income and profitability.

The majority of the Company s assets and liabilities are monetary in nature. As a result, the earnings and growth of the Company are significantly affected by interest rates, which are subject to the influence of economic conditions generally, both domestic and foreign, to events in the capital markets and also to the monetary and fiscal policies of the United States and its agencies, particularly the Federal Reserve. The nature and timing of any changes in such policies or general economic conditions and their effect on the Company cannot be controlled and are extremely difficult to predict. Changes in interest rates can impact the Company s net interest income as well as the valuation of the Company s assets and liabilities.

Banking is an industry that depends, to a large extent, on its net interest income. Net interest income is the difference between (1) interest income on interest-earning assets, such as loans, and (2) interest expense on interest-bearing liabilities, such as deposits. Changes in interest rates can have differing effects on the Company s net interest income. In particular, changes in market interest rates, changes in the relationships between short-term and long-term market interest rates, or the yield curve, or changes in the relationships between different interest rate indices can affect the interest rates charged on interest-earning assets differently than the interest rates paid on interest-bearing liabilities. This difference could result in an increase in interest expense relative to interest income and therefore reduce the Company s net interest income. Further, declines in market interest rates may trigger loan prepayments, which in many cases are within the Company s customers discretion, which in turn may serve to reduce net interest income if the Company is unable to lend those funds to other borrowers or invest the funds at the same or higher interest rates.

While the Company has attempted to structure its asset and liability management strategies to mitigate the impact on net interest income of changes in market interest rates, the Company cannot provide assurances that it will be successful in doing so.

The Company is subject to liquidity risk.

Liquidity is the ability to meet cash flow needs on a timely basis at a reasonable cost. The Company s liquidity is used principally to originate or purchase loans, to repay deposit liabilities and other liabilities when they come due, and to fund operating costs. Changes in market interest rates, increased competition within its markets, and other factors may make deposit gathering more difficult. Disruptions in the capital markets or interest rate changes may make the terms of wholesale funding sources less favorable and may make it difficult to sell securities when needed to provide additional liquidity. As a result, there is a risk that the cost of funding will increase or that the Company will not have sufficient funds to meet its obligations when they come due.

The Company monitors its liquidity closely. Overnight investments and the unencumbered portion of its securities portfolio can be used as a source of liquidity. Wholesale funding sources include FHLB advances, the Federal Reserve s Borrower-in-Custody program, securities sold under repurchase agreements, federal funds purchased and brokered CDs. An additional source of liquidity, should it be needed, is the sale or securitization of loans.

The Company committed, in conjunction with the regulatory approvals received for the Merger, to fund 100% of its loans with core deposits. Core deposits, for purposes of this commitment, are defined as non-maturity deposits and non-brokered insured time deposits. At June 30, 2011, the ratio of the Company s loans to core deposits

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stood at 84.2%, providing room within the commitment constraint to grow the loan portfolio by approximately $58 million as of that date. However, should a one-to-one ratio of loans to core deposits be achieved, the ability to grow loans further will be dependent on the Company s ability to raise additional core deposit funding. To the extent the Company s ability to gather core deposits is constrained by market forces or for any other reason, our ability to achieve loan growth would be similarly constrained, which in turn could have an adverse effect on the Company s operating results.

Monetary policies and regulations of the Federal Reserve System could adversely affect our business, financial condition and results of operations.

The commercial banking business is affected not only by legislation, regulatory policies, and general economic conditions, but also by the monetary policy of the Federal Reserve. Changes in the discount rate on member bank borrowing, availability of borrowing at the discount window, open market operations, the imposition of changes in reserve requirements against member banks deposits and assets of foreign branches and the imposition of and changes in reserve requirements against certain borrowings by banks and their affiliates are some of the instruments of monetary policy available to the Federal Reserve. These monetary policies are used in varying combinations to influence overall growth and distributions of credit, bank loans, investments and deposits. Their use also affects interest rates charged on loans or paid on deposits. The monetary policies of the Federal Reserve have had a significant effect on the operating results of commercial banks and are expected to do so in the future. The monetary policies of these agencies are influenced by various factors, including inflation, unemployment, short-term and long-term changes in the international trade balance and in the fiscal policies of the United States Government. Future monetary policies cannot be predicted and the effect of such policies on the business, financial condition and results of operations of Northeast Bank may be adverse.

Regulators may restrict distributions or require divestiture if Northeast s subsidiaries are undercapitalized.

If an FDIC-insured depository institution, such as the Bank, fails to meet certain capital standards or requirements (such institution being referred to as an undercapitalized institution), the appropriate regulatory agency would be required by law to take one or more of certain specific actions with respect to such institution (for example, the regulatory agency may require the institution to issue new shares, merge with another depository institution, restrict the interest rates it pays on deposits, restrict its asset growth, terminate certain activities, have a new election for its board of directors, dismiss certain directors or officers, divest of certain subsidiaries and/or take any other action that will better resolve the problems of the institution in a manner that will minimize the long-term loss to the FDIC) in the event the undercapitalized institution failed to submit an acceptable capital restoration plan or failed to implement such plan. If Northeast were to control an undercapitalized institution, then the Federal Reserve would be required by law to take one or more of such actions if (i) Northeast and any other company that controls the undercapitalized institution did not agree to guarantee the capital restoration plan for such undercapitalized institution or (ii) the institution was significantly undercapitalized as defined in regulations issued by the appropriate regulatory agency. In either case, the appropriate regulatory agency may (a) prohibit Northeast from making any capital distribution without the prior approval of such regulatory agency; (b) require Northeast to divest companies that are controlled by Northeast and that are in danger of becoming insolvent and pose a significant risk to the undercapitalized institution; and (c) require Northeast to divest the undercapitalized institution.

The Company faces operational risk.

The Company is exposed to many types of operational risk, including the risk of fraud, unauthorized transactions, inadvertent errors, faulty systems, legal risk and reputational risk, among others. Threats to information systems and customer information in particular have become more widespread. Key areas of operational risk to which the Company is exposed include:

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

Breaches of security or systems failures could have an adverse effect on the Company business: Communication and information systems are critical to the conduct of the Company s business, since the Company uses such systems to manage the Company s customer relationships and process accounting and financial reporting information. While the Company has established policies and procedures to prevent or limit the impact of system failures, interruptions and security breaches, there can be no assurance that such events will not occur or that they will be adequately addressed if they do. In addition, any compromise of the Company s security systems could prevent customers from using its web site and its online banking services, both of which involve the transmission of confidential information. Although the Company relies on commonly used security and processing systems to provide the security and authentication necessary to securely transmit data, these precautions may not protect the Company s systems from compromises or breaches of security. The occurrence of any failures, interruptions or security breaches of the Company s information systems could damage the Company s reputation, result in the loss of business, subject the Company to increased regulatory scrutiny or expose the Company to civil litigation and possible financial liability. Any of these occurrences could have a material adverse effect on the Company s business, profitability and financial condition.

Negative public opinion could damage the Company s reputation: Negative public opinion could result from the Company s actual or alleged conduct in any number of activities, including lending practices, the failure of any product or service sold by Northeast to meet its clients expectations or applicable regulatory requirements, corporate governance and acquisitions, or from actions taken by government regulators and community organizations in response to those activities. Negative public opinion can adversely affect the Company s ability to keep, attract and/or retain clients and can expose the Company to litigation and regulatory action. Actual or alleged conduct by one of Northeast s businesses can result in negative public opinion about the Company s other businesses. Reputational damage could adversely affect the Company s business and revenues.

The Company s future growth, if any, may require the Company to raise additional capital in the future, but that capital may not be available when it is needed.

Northeast is required by regulatory authorities to maintain adequate levels of capital to support its operations. The Company may need to raise additional capital to support its operations or its growth, if any. The Company s ability to raise additional capital will depend, in part, on conditions in the capital markets and the Company s financial performance at that time, both of which are outside Northeast s control. Accordingly, the Company may be unable to raise additional capital, if and when needed, on acceptable terms, or at all. If the Company cannot raise additional capital when needed, our ability to further expand its operations through internal growth and acquisitions could be materially impaired. In addition, if the Company decides to raise additional equity capital, Investors interests could be diluted.

The Company operates in a highly regulated environment and may be adversely affected by changes in laws and regulations, or the manner in which they are applied.

The Company is subject to extensive regulation, supervision and examination by the Federal Reserve Board, the Maine Superintendent and by the FDIC, as insurer of the Bank s deposits. Such regulation and supervision govern the activities in which Northeast may engage and are intended primarily for the protection of the insurance fund and the depositors and borrowers of the Bank. Regulatory authorities have extensive discretion in their supervisory and enforcement activities, including the imposition of restrictions on operations, the classification of Northeast s assets and the determination of the level of allowance for loan losses. Any change in such regulation and oversight, whether in the form of regulatory policy, regulations, legislation or supervisory action, may have a material impact on operations.

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Changes in accounting standards can materially impact Northeast s financial statements.

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

Changes and interpretations of tax laws and regulations may adversely impact Northeast s financial statements.

Local, state or federal tax authorities may interpret tax laws and regulations differently than Northeast and challenge tax positions that it has taken on its tax returns. This may result in the disallowance of deductions or differences in the timing of deductions and result in the payment of additional taxes, interest or penalties that could materially affect the Company s performance.

Unpredictable catastrophic events could have a material adverse effect on the Company.

The occurrence of catastrophic events such as hurricanes, pandemic disease, windstorms, floods, severe winter weather or other catastrophes could adversely affect the Company s business and, in turn, its financial condition or results of operations. This may result in a significant number of employees that are unavailable to perform critical operating functions at either their regular worksite or the disaster recovery worksite. Unpredictable natural and other disasters could have an adverse effect on the Company in that such events could materially disrupt its operations or the ability or willingness of its customers to access the financial services offered by Northeast Bank.

Item1 B. Unresolved Staff Comments

None.

Item 2. Properties

The principal executive and administrative offices of the Company and the Bank are located at 500 Canal Street, Lewiston, Maine (Headquarters Building). In 2005, the Bank entered into a 15-year lease with respect to the Headquarters Building, and the Company moved its principal executive and administrative offices to this four story building located in downtown Lewiston. The Company leases the entire building, a total of 27,000 square feet. For the first ten years of the lease, the annual rent expense is approximately $264,000. In addition to executive and administrative offices, this building also houses our operations, loan processing and underwriting, loan servicing, accounting, human resources and commercial lending departments. The Company also opened a 500 square foot branch office in this building.

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In addition to the branch office located in our Headquarters Building, we have nine banking branches and ten insurance agency offices located in the State of Maine as set forth below.

Branch Locations	Ownership
232 Center Street, Auburn	Lease (1)
235 Western Avenue, Augusta	Fee Simple
11 Main Street, Bethel	Fee Simple
168 Maine Street, Brunswick	Fee Simple
2 Depot Street, Buckfield	Fee Simple
46 Main Street, Harrison	Fee Simple
500 Canal Street, Lewiston	Lease (2)
1399 Maine Street, Poland	Lease (3)
77 Middle Street, Portland	Lease (4)
235 Main Street, South Paris	Fee Simple
Insurance Agency Locations	
59 Main Street, Anson, Maine	Fee Simple
232 Center Street, Auburn, Maine*	Lease (1)
235 Western Avenue, Augusta, Maine*	Fee Simple
4 Sullivan Square, Berwick, Maine	Fee Simple
11 Main Street, Bethel, Maine*	Fee Simple
28 Main Street, Livermore Falls, Maine	Lease (5)
423 U. S. Route 1, Scarborough, Maine	Lease (6)
235 Main Street, South Paris, Maine*	Fee Simple
472 Main Street, Thomaston, Maine	Lease (7)
10 Snell Hill Road, Turner, Maine	Fee Simple

* Each of these insurance agency locations are situated in an existing bank branch location at the address indicated.
(1) Lease term is ten years and expires May 1, 2016.
(2) Lease term is 15 years and expires July 15, 2020.
(3) Lease term is 15 years but with notice can be terminated in 10 years, and expires January 1, 2025.
(4) Lease term is five years and expires September 30, 2012.
(5) Lease is a tenant at will.
(6) Lease term is five years and expires November 15, 2015.
(7) Lease is a tenant at will.

The Bank s investment division leases space at 202 US Route One, Falmouth, Maine, which has a term of five years and expires August 31, 2012. The Company s Boston Massachusetts business development office leases space at 800 Boylston Street, Boston MA for a term of two years, expiring on December 31, 2012. In addition, the Bank has purchased land in Windham, Maine.

Item 3. Legal Proceedings

In the ordinary course of business, the Company is involved in various threatened and pending legal proceedings. A legal proceeding that arose subsequent to June 30, 2011 is described below:

In August 2011, the Bank received a summons and complaint in **TSM Properties, LLC v. Northeast Bank and Daniel G. Thompson**, Docket No. CV-11-337, Cumberland County Superior Court in Maine. This action was instituted on August 19, 2011 and arises in connection with disputed transfers of money by TSM Properties manager (Mr. Thompson) to other accounts from TSM Properties account with the Bank. TSM Properties has asserted claims against Mr. Thompson and also against the Bank. Damages sought include $2,247,239 and additional unspecified amounts. The case is in its initial stages, and the Bank intends to vigorously defend against these claims.

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While it is not feasible to predict or determine the outcome of these proceedings, the Company believes that the outcome of such proceedings will not have a material adverse effect on the results of operations or financial position of the Company.

Item 4. (Removed and Reserved)

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PART II

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

(a) The Company s voting common stock currently trades on the NASDAQ under the symbol NBN. There is no established public trading market for the Company s non-voting common stock. As of the close of business on September 1, 2011, there were approximately 436 shareholders of record.

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

Fiscal year ended June 30, 2011	High	Low	Div Pd
Jul 1 Sep 30	$ 13.25	$ 12.00	$ .090
Oct 1 Dec 31	17.80	12.25	.090
Jan 1 Mar 31	16.50	14.50	.090
Apr 1 Jun 30	15.29	13.50	.090

Fiscal year ended June 30, 2010	High	Low	Div Pd
Jul 1 Sep 30	$ 10.00	$ 7.66	$ .090
Oct 1 Dec 31	9.71	8.42	.090
Jan 1 Mar 31	15.28	8.50	.090
Apr 1 Jun 30	15.14	12.00	.090

On September 23, 2011, the last reported sale price of the Company s voting common stock, as reported on NASDAQ was $13.27. Holders of the Company s voting and non-voting common stock are entitled to receive dividends when and if declared by the Board of Directors out of funds legally available therefor. The amount and timing of future dividends payable on the Company s voting and non-voting common stock will depend on, among other things, the financial condition of the Company, regulatory considerations, and other factors. The Company is a legal entity separate from the Bank, but its revenues are derived primarily from the Bank. Accordingly, the ability of the Company to pay cash dividends on its stock in the future generally will be dependent upon the earnings of the Bank and the Bank s ability to pay dividends to the Company. The payment of dividends by the Bank will depend on a number of factors, including capital requirements, regulatory limitations, the Bank s results of operations and financial condition, tax considerations, and general economic conditions. National banking laws regulate and restrict the ability of the Bank to pay dividends to the Company. See Item 1. Business Supervision and Regulation .

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The following graph compares the performance of the Company s voting common stock (or for periods prior to the Merger, the Company s common stock) (assuming reinvestment of dividends) with the total return for companies within the S&P 500 Index and the Philadelphia KBW Bank Index. The calculation of total cumulative return assumes a $100 investment was made at market close on June 30, 2006.

The following table provides information about the Company s voting common stock that may be issued upon the exercise of stock options under the Company s equity compensation plans in effect as of June 30, 2011.

	Equity Compensation Plans		
	(a)	(b)	(c)
Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plan (excluding securities referenced in column (a))
Equity compensation plan approved by security holders (1)	764,549	$ 14.05	40,979
Equity compensation plan not approved by security holders	0	$ 0.00	0

(1) Includes information related to the Northeast Bancorp Stock Option and Incentive Plan Stock Option Plan approved by the shareholders in 2010 (the 2010 Plan). The 2010 Plan provide for a proportionate adjustment to the number of shares reserved for issuance in the event of any stock dividend, stock split, combination, recapitalization, or similar event.

(b) None.

(c) Issuer Repurchases of Equity Securities.

None.

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Item 6. Selected Financial Data

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

	Successor Company	Predecessor Company				
	184 Days Ended June 30, 2011	181 Days Ended Dec. 28, 2010	Twelve Months Ended June 30, 2010	Twelve Months Ended June 30, 2009	Twelve Months Ended June 30, 2008	Twelve Months Ended June 30, 2007
	(Dollars in thousands except for Per Share Data)					
Selected operations data:						
Interest income	$ 13,304	$ 14,378	$ 31,262	$ 33,766	$ 35,398	$ 35,682
Interest expense	3,261	5,952	13,513	16,980	21,051	20,097
Net interest income	10,043	8,426	17,749	16,786	14,347	15,585
Provision for loan losses	707	912	1,864	2,100	836	989
Other operating income (1)	21,758	6,980	12,164	10,505	10,510	7,903
Net securities gains	1,200	17	(18)	268	293	42
Other operating expenses (2)	19,802	11,947	25,417	24,461	21,855	20,075
Income before income taxes	12,492	2,564	2,614	998	2,459	2,466
Income tax (benefit) expense	(60)	768	895	39	528	579
Net income	$ 12,552	$ 1,796	$ 1,719	$ 959	$ 1,931	$ 1,887
Net income available to common stockholders	$ 12,355	$ 1,677	$ 1,476	$ 825	$ 1,931	$ 1,887
Consolidated per share data:						
Net income:						
Basic	$ 3.52	$ 0.72	$ 0.64	$ 0.36	$ 0.82	$ 0.77
Diluted	$ 3.47	$ 0.71	$ 0.63	$ 0.36	$ 0.82	$ 0.76
Cash dividends	$ 0.18	$ 0.18	$ 0.36	$ 0.36	$ 0.36	$ 0.36
Selected balance sheet data:						
Total assets	$ 596,393	$ 627,984	$ 622,194	$ 598,148	$ 598,274	$ 556,801
Loans receivable	309,913	367,284	382,309	393,651	409,194	425,571
Deposits	401,118	374,617	384,197	385,386	363,374	364,554
Borrowings	126,706	199,326	183,025	162,389	186,830	147,564
Total stockholders equity	64,954	50,366	50,906	47,317	40,273	40,850
Other ratios:						
Return on average assets	4.09%	0.57%	0.28%	0.16%	0.33%	0.34%
Return on average equity	38.23%	6.94%	3.47%	2.14%	4.63%	4.59%
Average equity to average total assets	10.69%	8.18%	8.10%	7.35%	7.23%	7.37%
Common dividend payout ratio	5.03%	23.36%	56.64%	101.14%	44.10%	46.77%

(1) Includes primarily fees for deposits, investment brokerage and trust services to customers, insurance commission revenue and gains on the sale of loans. In the 184-day period ended June 30, 2011, the total further includes a $15.4 million bargain purchase gain.

(2) Includes salaries, employee benefits, occupancy, equipment and other expenses. In the 184-day period ended June 30, 2011, the total further includes merger related expenses totaling $3.2 million.

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

The Management s Discussion and Analysis of Financial Condition and Results of Operations, which follows, presents a review of the consolidated operating results of Northeast Bancorp, Inc. (the Company) for the 184-day period ended June 30, 2011, the 181-day period ended December 28, 2010 and the fiscal years ended June 30, 2010 and 2009. This discussion and analysis is intended to assist you in understanding the results of our operations and financial condition. You should read this discussion together with your review of the Company s Consolidated Financial Statements and related notes and other statistical information included in this report. Certain amounts in the periods prior to 2011 have been reclassified to conform to the 2011 presentation.

Financial Presentation

On December 29, 2010, the merger (Merger) of the Company and FHB Formation LLC (FHB) was consummated. FHB is the entity through which a group of independent accredited investors (the Investors) purchased 937,933 shares of the Company s outstanding common stock and 1,161,166 shares of newly-issued voting and non-voting common stock, at a price equal to $13.93 per share. As a result of this transaction, $16.2 million of new capital was contributed to the Company, and the Investors collectively own approximately 60% of the outstanding common shares of the Company. We have applied the acquisition method of accounting, as described in Accounting Standards Codification (ASC) 805, *Business Combinations*, to this transaction, which represents an acquisition by FHB of Northeast, with Northeast as the surviving company.

As a result of application of the acquisition method of accounting to the Company s balance sheet, the Company s financial statements from the periods prior to the transaction date are not directly comparable to the financial statements for periods subsequent to the transaction date. To make this distinction, we have 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. In addition, the lack of comparability means that the periods being reported in the fiscal year ending June 30, 2011 in the statements and tables are not the same periods as reported for the fiscal year ended June 30, 2010.

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 represents management s estimate of probable losses inherent in the loan portfolio. This accounting policy is considered critical due to the high degree of judgment involved, the subjectivity of the underlying assumptions used, and the potential for changes in the economic environment that could result in material changes in the amount of the allowance for loan losses considered necessary. The allowance is evaluated on a regular basis by management and is based on a periodic review of the collectability of the loans in light of historical delinquency and credit loss experience, together with analyses that reflect current trends for delinquent, non-performing and classified loans, the nature and size of the loan portfolio, adverse situations that may affect borrowers ability to repay, the estimated value of any underlying collateral and prevailing economic conditions. For a further discussion of the allowance for loan losses, please refer to Asset Quality below.

Intangible Assets

Northeast considers accounting for its intangible assets to be critical because significant judgment is exercised in performing periodic valuations of these assets, which consist of customer list and non-compete agreement

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intangibles arising from insurance agency acquisitions, and a core deposit intangible arising from the recent merger with FHB. These assets are being amortized over their estimated useful lives and evaluated for potential impairment on an annual basis as of each June 30th, or more frequently if events or circumstances indicate a potential for impairment. If impairment is detected, the carrying value of an intangible is reduced through a charge to earnings. The evaluation of our intangible assets involves estimations of discount rates and the timing of projected future cash flows, which are subject to change with changes in economic conditions and other factors. Such changes in the assumptions used to evaluate an intangible asset affect its value and could have a material adverse impact on Northeast s results of operations.

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. We consider our accounting policies related to these fair value measurements to be critical because they are important to the portrayal of our financial condition and results subsequent to the merger transaction with FHB, and they require our subjective and complex judgment as a result of the need to make estimates about the effects of matters that are inherently uncertain. Our 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.

In connection with a business combination, ASC 310-30, *Receivables Loans and Debt Securities Acquired with Deteriorated Credit Quality* provides the GAAP guidance for accounting for loans that have experienced a deterioration in credit quality from origination to acquisition for which it is probable that the acquirer will be unable to collect all contractually required payments receivable, including both principal and interest. Loans purchased with evidence of credit deterioration since origination and for which it is probable that all contractually required payments will not be collected are considered to be impaired. In the assessment of credit quality deterioration, the Company must make numerous assumptions, interpretations and judgments using internal and third-party credit quality information to determine whether it is probable that the Company will be able to collect all contractually required payments. This is a point in time assessment and inherently subjective due to the nature of the available information and judgment involved.

This discussion has highlighted those accounting policies that management considers to be critical, however all accounting policies are important, and therefore the reader is encouraged to review each of the policies included in Note 1 to the Consolidated Financial Statements to gain a better understanding of how Northeast s financial performance is measured and reported.

General

Northeast Bancorp is a Maine corporation and a bank holding company registered with the Federal Reserve Bank of Boston (FRB) under the Bank Holding Company Act of 1956. The Company also is a registered Maine financial institution holding company. The FRB is the primary regulator of the Company, and the Company is also subject to regulation and examination by the Superintendent of the Maine Bureau of Financial Institutions. We conduct business from our headquarters in Lewiston, Maine and, as of June 30, 2011, from 10 banking offices, one financial center, 10 insurance agency offices and three loan production offices located in western and south-central Maine, one mortgage loan production offices in Portsmouth, New Hampshire, and one business development office located in Boston Massachusetts. At June 30, 2011, we had consolidated assets of $596.4 million and consolidated stockholders equity of $65.0 million.

Northeast Bancorp s principal asset is the capital stock of Northeast Bank (the Bank), a Maine state-chartered universal bank. Accordingly, the Company s results of operations are primarily dependent on the results of the operations of the Bank. In addition to the Bank s ten branch offices, its investment brokerage division offers investment, insurance and financial planning products and services from its main office in Falmouth Maine as well as through the Bank s branch offices. In the fiscal year ended June 30, 2011 (Fiscal 2011), the Bank s wholly-owned subsidiary, Northeast Bank Insurance Group, Inc. (NBIG), offered personal and commercial property and casualty insurance products through 10 insurance agency offices. As described in more detail below, effective September 1, 2011, NBIG sold its customer lists and certain other assets to local agencies in two separate transactions that netted $9.7 million in total sales proceeds.

Business Strategy

Northeast, through the Bank and third party affiliations, provides a broad range of financial services to individuals and companies in western and south-central Maine and southeastern New Hampshire. Our traditional community banking strategy consists of attracting deposits from the general public and applying those funds to originate or acquire residential mortgage loans, commercial loans, commercial real estate loans and consumer loans. While lending is our primary investment activity, we also invest in mortgage-backed securities and securities issued by United States Government-sponsored enterprises, which serve as a source of liquidity for the Company. We also emphasize the generation of noninterest income through gains earned on the sale of residential mortgage loans in the secondary market, and by providing financial planning and investment brokerage services to customers.

While in prior years, we have emphasized the sale of property and casualty insurance products through the Bank s insurance agency subsidiary, Northeast Bank Insurance Group, Inc., effective September 1, 2011, we sold the customer lists and certain other assets of NBIG in two transactions to two Maine-based insurance agencies. NBIG s insurance agency office in Berwick was sold to Brad Scott, a former senior manager of NBIG and will operate under the name Spence & Matthews. The agency offices in Southern, Western and Central Maine were sold to the Varney Agency, Inc. of Bangor Maine. The aggregate sale price of these assets was $9.7 million, which after expenses and taxes had the effect of increasing the Company s tangible equity by approximately $8.4 million. We intend to develop programs to refer Bank customers with insurance needs to Spence & Matthews and the Varney Agency, and as such, NBIG is expected to continue operations in order to facilitate any such referrals.

With the additional capital provided as a result of the Merger and the sale of NBIG assets, the Company is in the process of augmenting its traditional community banking strategy with two new business initiatives:

1. A Loan Acquisition and Servicing Group (LASG), to purchase performing commercial loans for portfolio and to service commercial loans for third parties. In the second half of Fiscal 2011, the LASG made significant investments in staffing and infrastructure to build its purchasing and servicing capabilities, and launched loan purchasing activities in the fourth quarter of Fiscal 2011.

2. An Online Deposit Program, to provide a new source of core deposit funding for the Bank. This program is currently under development, and is expected to begin operation in the second half of Fiscal 2012.

Economic Conditions

We believe that our market area in Maine has generally witnessed an economic decline and a decrease in residential and commercial real estate values starting in 2009 and continuing to the present. Most recently, the Maine unemployment rate has improved slightly, to 7.7% from a high of 8.4% in 2009, but remains high by historic standards. Residential real estate values have been relatively stable over the past year, but home sales across the state are down 10% over the past 12 months, and are off 18% in the first 6 months of 2011, compared to the first half of 2010. The economy and real estate markets in our market areas will continue to be significant determinants of the quality of our assets in future periods and our results of operations, liquidity and financial condition. We believe future economic activity will depend significantly on consumer confidence, consumer spending, the value of real estate in our markets and business expenditures for new capital equipment, all of which are tied to strong employment.

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Results of Operations

Comparison of 184 Days Ended June 30, 2011, 181 Days Ended December 28, 2010 and Fiscal Year Ended June 30, 2010

Overview

Successor Company

For the 184 days ended June 30, 2011, we reported net income of $12.6 million, or $3.47 per diluted share. The significant factors affecting the Company s net income for the 184 days ended June 30, 2011 were:

- Merger related activity, including a bargain purchase gain of $15.4 million included in noninterest income, and merger related expenses of $3.2 million included in noninterest expense.

- An increase in net interest income due to the application of acquisition accounting. The fair values of deposits, FHLB advances, and structured repurchase agreements were higher than their recorded amounts. The resulting premiums are being amortized against interest expense, reducing it to an amount lower than the nominal interest rate for these deposits and borrowed funds.

- Net securities gains of $1.2 million realized from a restructuring of the investment portfolio.

- Increases in noninterest expense that included increases in staffing and occupancy costs for the new senior management team and two new business lines, the Loan Acquisition and Servicing Group and Online Deposit Program.

- An increase in intangible amortization expense resulting from a new $6.3 million core deposit intangible asset recorded in connection with the Merger, and a merger-related increase of $964 thousand in the insurance agency customer list intangible. The amortization of these intangibles is based on accelerated methods.

Predecessor Company

For the 181 days ended December 28, 2010, we reported net income of $1.8 million, or $0.71 per diluted share. The significant factors affecting the Company s net income for the 181 days ended December 28, 2010 were:

- A 28 basis point reduction in the net interest margin, compared to Fiscal 2010, due in part to a significant increase in cash on the balance sheet, which rose to $55.5 million as of the merger date, the result of loan pay-downs and mortgage-backed securities amortization. This produced a negative interest spread between the interest earned on cash balances and interest paid on deposits and borrowings.

- Gains on the sales of residential loans in the secondary market of $1.9 million, which exceeded the $1.3 million earned for the twelve months ended June 30, 2010, due to increased refinance activity.

- The sale of the customer list and certain fixed assets of our insurance agency office in Jackman, Maine for a gain of $105 thousand.

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Net Interest Income

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

	Successor Company	Predecessor Company	
	184 Days Ended June 30, 2011	181 Days Ended December 28, 2010	Twelve Months Ended June 30, 2010