

NORTHEAST BANCORP /ME/
Form 10-Q
May 08, 2014
[Table of Contents](#)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2014

Commission File Number: 1-14588

Northeast Bancorp

(Exact name of registrant as specified in its charter)

Maine
(State or other jurisdiction of incorporation or organization)

01-0425066
(I.R.S. Employer Identification No.)

500 Canal Street, Lewiston, Maine
(Address of Principal executive offices)

04240
(Zip Code)

(207) 786-3245

Registrant's telephone number, including area code

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

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller Reporting Company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. As of April 30, 2014 the registrant had outstanding 9,550,031 shares of voting common stock, \$1.00 par value per share and 880,963 shares of non-voting common stock, \$1.00 par value per share.

Table of Contents

Part I. Financial Information

Item 1.

Financial Statements (unaudited)
Consolidated Balance Sheets
March 31, 2014 and June 30, 2013

Consolidated Statements of Income
Three Months Ended March 31, 2014 and 2013
Nine Months Ended March 31, 2014 and 2013

Consolidated Statements of Comprehensive Income
Three Months Ended March 31, 2014 and 2013
Nine Months Ended March 31, 2014 and 2013

Consolidated Statements of Changes in Stockholders' Equity
Nine Months Ended March 31, 2014 and 2013

Consolidated Statements of Cash Flows
Nine Months Ended March 31, 2014 and 2013

Notes to Consolidated Financial Statements

Item 2.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Item 3.

Quantitative and Qualitative Disclosure about Market Risk

Item 4.

Controls and Procedures

Part II. Other Information

Item 1.

Legal Proceedings

Item 1A.

Risk Factors

Item 2.

Unregistered Sales of Equity Securities and Use of Proceeds

Item 3.

Defaults Upon Senior Securities

Item 4.

Mine Safety Disclosures

Item 5.

Other Information

Item 6.

Exhibits

Table of Contents

PART 1- FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

NORTHEAST BANCORP AND SUBSIDIARY**CONSOLIDATED BALANCE SHEETS**

(Unaudited)

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

	March 31, 2014	June 30, 2013
Assets		
Cash and due from banks	\$ 2,677	\$ 3,238
Short-term investments	71,686	62,696
Total cash and cash equivalents	74,363	65,934
Available-for-sale securities, at fair value	112,732	121,597
Loans held for sale	9,827	8,594
Loans		
Commercial real estate	299,898	264,448
Residential real estate	153,972	127,829
Construction		42
Commercial and industrial	49,554	29,720
Consumer	10,828	13,337
Total loans	514,252	435,376
Less: Allowance for loan losses	1,345	1,143
Loans, net	512,907	434,233
Premises and equipment, net	9,211	10,075
Real estate owned and other possessed collateral, net	2,000	2,134
Federal Home Loan Bank and Federal Reserve Bank stock, at cost	5,721	5,721
Intangible assets, net	2,962	3,544
Bank owned life insurance	14,726	14,385
Other assets	6,444	4,422
Total assets	\$ 750,893	\$ 670,639
Liabilities and Stockholders Equity		
Deposits		
Demand	\$ 43,294	\$ 46,425
Savings and interest checking	100,961	90,970
Money market	86,735	84,416
Time	332,320	262,812
Total deposits	563,310	484,623
Federal Home Loan Bank advances	42,878	28,040
Wholesale repurchase agreements	10,240	25,397
Short-term borrowings	2,585	625
Junior subordinated debentures issued to affiliated trusts	8,396	8,268
Capital lease obligation	1,604	1,739

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

Other liabilities	7,872	8,145
Total liabilities	636,885	556,837
Commitments and contingencies		
Stockholders' equity		
Preferred stock, \$1.00 par value, 1,000,000 shares authorized; no shares issued and outstanding at March 31, 2014 and June 30, 2013		
Voting common stock, \$1.00 par value, 25,000,000 shares authorized; 9,551,531 and 9,565,680 shares issued and outstanding at March 31, 2014 and June 30, 2013, respectively	9,552	9,566
Non-voting common stock, \$1.00 par value, 3,000,000 shares authorized; 880,963 shares issued and outstanding at March 31, 2014 and June 30, 2013	881	881
Additional paid-in capital	93,371	92,745
Retained earnings	11,856	12,524
Accumulated other comprehensive loss	(1,652)	(1,914)
Total stockholders' equity	114,008	113,802
Total liabilities and stockholders' equity	\$ 750,893	\$ 670,639

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

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

(Unaudited)

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

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2014	2013	2014	2013
Interest and dividend income:				
Interest on loans	\$ 8,403	\$ 9,601	\$ 27,142	\$ 25,209
Interest on available-for-sale securities	253	234	797	929
Other interest and dividend income	61	85	208	283
Total interest and dividend income	8,717	9,920	28,147	26,421
Interest expense:				
Deposits	1,022	1,084	3,048	3,090
Federal Home Loan Bank advances	324	232	975	750
Wholesale repurchase agreements	93	135	285	515
Short-term borrowings	6	4	17	15
Junior subordinated debentures issued to affiliated trusts	140	190	525	574
Obligation under capital lease agreements	20	22	63	69
Total interest expense	1,605	1,667	4,913	5,013
Net interest and dividend income before provision for loan losses	7,112	8,253	23,234	21,408
Provision for loan losses	180	346	407	821
Net interest and dividend income after provision for loan losses	6,932	7,907	22,827	20,587
Noninterest income:				
Fees for other services to customers	385	430	1,246	1,202
Net securities gains				792
Gain on sales of loans held for sale	265	625	1,145	2,295
Gain on sales of portfolio loans	373	1,228	603	2,226
Gain recognized on real estate owned and other repossessed collateral, net	165	230	50	681
Bank-owned life insurance income	108	118	342	599
Other noninterest income	12	12	46	68
Total noninterest income	1,308	2,643	3,432	7,863
Noninterest expense:				
Salaries and employee benefits	3,759	4,687	12,624	12,170
Occupancy and equipment expense	1,450	1,218	4,075	3,341
Professional fees	366	388	1,115	1,210
Data processing fees	257	239	770	671
Marketing expense	86	249	225	678
Loan acquisition and collection expense	440	352	1,203	1,285
FDIC insurance premiums	127	125	354	364
Intangible asset amortization	162	205	582	735
Legal settlement recovery			(250)	

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

Other noninterest expense	869	665	2,284	2,034
Total noninterest expense	7,516	8,128	22,982	22,488
Income from continuing operations before				
income tax expense	724	2,422	3,277	5,962
Income tax expense	287	792	1,119	1,913
Net Income from continuing operations	437	1,630	2,158	4,049
Income (loss) from discontinued operations				
before income tax expense (benefit)		55	(12)	253
Income tax expense (benefit)		19	(4)	87
Net income (loss) from discontinued operations		36	(8)	166
Net income	\$ 437	\$ 1,666	\$ 2,150	\$ 4,215
Net income available to common stockholders	\$ 437	\$ 1,666	\$ 2,150	\$ 3,860
Weighted-average shares outstanding:				
Basic	10,432,494	10,425,576	10,435,300	10,397,280
Diluted	10,432,494	10,425,576	10,435,300	10,397,280
Earnings per common share:				
Basic:				
Income from continuing operations	\$ 0.04	\$ 0.16	\$ 0.21	\$ 0.35
Income from discontinued operations	0.00	0.00	0.00	0.02
Net Income	\$ 0.04	\$ 0.16	\$ 0.21	\$ 0.37
Diluted:				
Income from continuing operations	\$ 0.04	\$ 0.16	\$ 0.21	\$ 0.35
Income from discontinued operations	0.00	0.00	0.00	0.02
Net Income	\$ 0.04	\$ 0.16	\$ 0.21	\$ 0.37
Cash dividends declared per common share	\$ 0.09	\$ 0.09	\$ 0.27	\$ 0.27

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

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

(Unaudited)

(Dollars in thousands)

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2014	2013	2014	2013
Net income	\$ 437	\$ 1,666	\$ 2,150	\$ 4,215
Other comprehensive income (loss), before tax:				
Available-for-sale securities:				
Change in net unrealized gain or loss on available-for-sale securities	579	(164)	449	(318)
Reclassification adjustment for net gains included in net income				(792)
Total available-for-sale securities	579	(164)	449	(1,110)
Derivatives and hedging activities:				
Change in accumulated loss on effective cash flow hedges	(528)	62	56	127
Reclassification adjustments for net gains included in net income	(72)	(17)	(108)	(54)
Total derivatives and hedging activities	(600)	45	(52)	73
Total other comprehensive (loss) income, before tax	(21)	(119)	397	(1,037)
Income tax (benefit) expense related to other comprehensive (loss) income	(7)	(40)	135	(353)
Other comprehensive (loss) income, net of tax	(14)	(79)	262	(684)
Comprehensive income	\$ 423	\$ 1,587	\$ 2,412	\$ 3,531

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

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

(Unaudited)

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

	Preferred Stock		Voting Common Stock		Non-voting Common Stock		Additional	Retained	Accumulated Other Comprehensive	Total
	Shares	Amount	Shares	Amount	Shares	Amount	Paid-in Capital	Earnings	Income (Loss)	Stockholders Equity
Balance at June 30, 2012	4,227	\$ 4	9,307,127	\$ 9,307	1,076,314	\$ 1,076	\$ 96,359	\$ 12,235	\$ 158	\$ 119,139
Net income								4,215		4,215
Other comprehensive loss, net of tax									(684)	(684)
Conversion of non-voting common stock to voting common stock			195,351	195	(195,351)	(195)				
Dividends on preferred stock								(113)		(113)
Dividends on common stock at \$0.27 per share								(2,809)		(2,809)
Offering costs							(59)			(59)
Stock-based compensation							374			374
Issuance of restricted common stock			63,202	64			(64)			
Redemption of preferred stock and warrants	(4,227)	(4)					(4,322)			(4,326)
Accretion of preferred stock							268	(268)		
Balance at March 31, 2013		\$ 9,565,680	\$ 9,566	880,963	\$ 881	\$ 92,556	\$ 13,260	\$ (526)	\$	\$ 115,737
Balance at June 30, 2013		\$ 9,565,680	\$ 9,566	880,963	\$ 881	\$ 92,745	\$ 12,524	\$ (1,914)	\$	\$ 113,802
Net income								2,150		2,150
Other comprehensive income, net of tax									262	262
Dividends on common stock at \$0.27 per share								(2,818)		(2,818)
Stock-based compensation							612			612
Forfeiture of restricted common stock			(14,149)	(14)			14			
Balance at March 31, 2014		\$ 9,551,531	\$ 9,552	880,963	\$ 881	\$ 93,371	\$ 11,856	\$ (1,652)	\$	\$ 114,008

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

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

(Unaudited)

(Dollars in thousands)

	Nine Months Ended March 31,	
	2014	2013
Operating activities:		
Net income	\$ 2,150	\$ 4,215
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Provision for loan losses	407	821
Gain on sale and impairment of real estate owned and other repossessed collateral, net	(50)	(681)
Accretion of fair value adjustments on loans, net	(5,048)	(6,805)
Accretion of fair value adjustments on deposits, net	(489)	(758)
Accretion of fair value adjustments on borrowings, net	(191)	(877)
Originations of loans held for sale	(62,911)	(106,770)
Net proceeds from sales of loans held for sale	62,823	111,179
Gain on sales of loans held for sale	(1,145)	(2,295)
Gain on sales of portfolio loans	(603)	(2,226)
Amortization of intangible assets	582	735
Bank-owned life insurance income, net	(342)	(599)
Depreciation of premises and equipment	1,540	1,283
Loss on disposal of premises and equipment	16	
Net gain on sale of available-for-sale securities		(792)
Stock-based compensation	612	374
Amortization of securities, net	972	1,253
Changes in other assets and liabilities:		
Other assets	(1,978)	1,828
Other liabilities	(460)	737
Net cash (used in) provided by operating activities	(4,115)	622
Investing activities:		
Proceeds from sales of available-for-sale securities		159,579
Purchases of available-for-sale securities	(42,340)	(167,294)
Proceeds from maturities and principal payments on available-for-sale securities	50,682	10,858
Loan purchases	(46,267)	(75,227)
Loan originations and principal collections, net	(33,757)	49,759
Purchases of premises and equipment	(703)	(2,361)
Proceeds from sales of premises and equipment	11	
Proceeds from sales of real estate owned and other repossessed collateral	1,160	2,758
Proceeds from life insurance benefits		628
Proceeds from redemption of regulatory stock		352
Proceeds from sales of portfolio loans	5,575	6,749
Net cash used in investing activities	(65,639)	(14,199)
Financing activities:		
Net increase in deposits	79,176	84,156
Net increase in short-term borrowings	1,960	1,151
Dividends paid on preferred stock		(113)
Dividends paid on common stock	(2,818)	(2,809)

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

Proceeds from (repayment of) FHLB advances	15,000	(10,000)
Stock offering costs		(59)
Repayment of wholesale repurchase agreements	(15,000)	(40,000)
Redemption of preferred stock and warrants		(4,326)
Repayment of capital lease obligation	(135)	(128)
Net cash provided by financing activities	78,183	27,872
Net decrease in cash and cash equivalents	8,429	14,295
Cash and cash equivalents, beginning of period	65,934	128,274
Cash and cash equivalents, end of period	\$ 74,363	\$ 142,569
Supplemental schedule of noncash investing and financing activities:		
Transfers from loans to real estate owned and other repossessed collateral	\$ 2,174	\$ 4,066
Transfers from real estate owned and other repossessed collateral to loans	1,155	1,055
Transfers from premises and equipment to real estate owned and other repossessed collateral		270

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

Table of Contents

NORTHEAST BANCORP AND SUBSIDIARY

Notes to Unaudited Consolidated Financial Statements

March 31, 2014

1. Basis of Presentation

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

These financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, the accompanying consolidated financial statements contain all adjustments (consisting principally of normal recurring accruals) considered necessary for a fair presentation of the Company s financial position, results of operations, and cash flows for the interim periods presented. These financial statements and notes should be read in conjunction with the audited consolidated financial statements and notes thereto for the fiscal year ended June 30, 2013 (Fiscal 2013) included in the Company s Annual Report on Form 10-K filed with the Securities and Exchange Commission.

2. Recent Accounting Pronouncements

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

In January 2013, the FASB issued ASU No. 2013-01, *Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities* (ASU 2013-01). The amendments clarify that the scope of Update 2011-11 applies to derivatives accounted for in accordance with Topic 815, *Derivatives and Hedging*, including bifurcated embedded derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions that are either offset in accordance with Section 210-20-45 or Section 815-10-45 or subject to an enforceable master netting arrangement or similar agreement. The new standards are effective for annual periods beginning January 1, 2013 and for interim periods within those annual periods. Retrospective application is required. The adoption of this guidance did not have a material impact on the consolidated financial statements.

In July 2013, the FASB issued ASU No. 2013-10, *Derivatives and Hedging (Topic 815): Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes* (ASU 2013-30). The amendments in ASU 2013-30

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

permit the Fed Funds Effective Swap Rate (OIS) to be used as a U.S. benchmark interest rate for hedge accounting purposes under Topic 815, in addition to UST and LIBOR. The amendments also remove the restriction on using different benchmark rates for similar hedges. The amendments are effective prospectively for qualifying new or redesignated hedging relationships entered into on or after July 17, 2013. ASU 2013-30 may impact the accounting for interest rate hedging relationships entered into after July 17, 2013.

In January 2014, the FASB issued ASU No. 2014-04, *Receivables (Topic 310): Troubled Debt Restructurings by Creditors* (ASU 2014-04). The amendments clarify that when an in substance repossession or foreclosure occurs, a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (i) the amount of foreclosed residential real estate property held by the creditor and (ii) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments ASU 2014-04 are effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. An entity can elect to adopt the amendments in ASU 2014-04 using either a modified retrospective transition method or a prospective transition method. Under the modified retrospective transition method, an entity should apply the amendments by means of a cumulative-effect adjustment to residential consumer mortgage loans and foreclosed residential real estate properties existing as of the beginning of the annual period for which the amendments are effective. The Company does not expect ASU 2014-04 to have material impact on the consolidated financial statements.

In April 2014, the FASB issued ASU No. 2014-08, *Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity* (ASU 2014-08). Under

Table of Contents

ASU 2014-08, only disposals that represent a strategic shift that has (or will have) a major effect on the entity's results and operations would qualify as discontinued operations. In addition, ASU 2014-08 (1) expands the disclosure requirements for disposals that meet the definition of a discontinued operation, (2) requires entities to disclose information about disposals of individually significant components, and (3) updates the current definition of discontinued operations. The amendments are effective prospectively within annual periods beginning on or after December 15, 2014. The Company does not expect ASU 2014-08 to have a material impact on the consolidated financial statements.

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

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

	Amortized Cost	March 31, 2014		Fair Value
		Gross Unrealized Gains	Gross Unrealized Losses	
(Dollars in thousands)				
U.S. Government agency securities	\$ 45,327	\$ 11	\$ (47)	\$ 45,291
Agency mortgage-backed securities	69,592		(2,151)	67,441
	\$ 114,919	\$ 11	\$ (2,198)	\$ 112,732

	Amortized Cost	June 30, 2013		Fair Value
		Gross Unrealized Gains	Gross Unrealized Losses	
(Dollars in thousands)				
U.S. Government agency securities	\$ 45,289	\$ 44	\$	\$ 45,333
Agency mortgage-backed securities	78,944		(2,680)	76,264
	\$ 124,233	\$ 44	\$ (2,680)	\$ 121,597

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

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2014	2013	2014	2013
(Dollars in thousands)				
Gross realized gains	\$	\$	\$	\$ 831
Gross realized losses				(39)
Net security gains	\$	\$	\$	\$ 792

At March 31, 2014, investment securities with a fair value of approximately \$30.0 million were pledged as collateral to secure outstanding borrowings.

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

	Less than 12 Months		March 31, 2014		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
(Dollars in thousands)						
	\$ 33,273	\$ (47)	\$	\$	\$ 33,273	\$ (47)

U.S. Government agency securities							
Agency mortgage-backed securities	32,147	(654)	35,294	(1,497)	67,441	(2,151)	
	\$ 65,420	\$ (701)	\$ 35,294	\$ (1,497)	\$ 100,714	\$ (2,198)	

	Less than 12 Months		June 30, 2013 More than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Government agency securities	\$	\$	\$	\$	\$	\$
Agency mortgage-backed securities	76,264	(2,680)			76,264	(2,680)
	\$ 76,264	\$ (2,680)	\$	\$	\$ 76,264	\$ (2,680)

(Dollars in thousands)

There were no other-than-temporary impairment losses on securities during the three and nine months ended March 31, 2014 or 2013.

At March 31, 2014, the Company had eleven securities in a continuous loss position for greater than twelve months. At March 31, 2014, all of the Company's available-for-sale securities were issued or guaranteed by either government agencies or government-sponsored enterprises. The decline in fair value of the Company's available-for-sale securities at March 31, 2014 is attributable to changes in interest rates.

Management of the Company, in addition to considering current trends and economic conditions that may affect the quality of individual securities within the Company's investment portfolio, also considers the Company's ability and intent to hold such securities to maturity or recovery of cost. Management does not believe any of the Company's available-for-sale securities are other-than-temporarily impaired at March 31, 2014.

Table of Contents

The amortized cost and fair values of available-for-sale debt securities by contractual maturity are shown below as of March 31, 2014. Actual maturities may differ from contractual maturities because borrowers may have the right to prepay obligations without penalties.

	Amortized Cost		Fair Value
	(Dollars in thousands)		
Due within one year	\$ 3,004	\$	3,005
Due after one year through five years	42,323		42,286
Due after five years through ten years	35,719		35,045
Due after ten years	33,873		32,396
	\$ 114,919	\$	112,732

Table of Contents

4. Loans, Allowance for Loan Losses and Credit Quality

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

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

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

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

The composition of the Company's loan portfolio follows.

Originated	March 31, 2014 Purchased	Total	Originated	June 30, 2013 Purchased	Total
(Dollars in thousands)					

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

Residential real estate	\$	121,155	\$	3,740	\$	124,895	\$	89,734	\$	2,706	\$	92,440
Home equity		29,077				29,077		35,389				35,389
Commercial real estate		118,684		181,214		299,898		100,402		164,046		264,448
Construction								42				42
Commercial business		49,549		5		49,554		29,686		34		29,720
Consumer		10,828				10,828		13,337				13,337
Total loans	\$	329,293	\$	184,959	\$	514,252	\$	268,590	\$	166,786	\$	435,376

Table of Contents

Allowance for Loan Losses and Impaired Loans

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

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

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

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

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

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

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

property type.

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

- Levels and trends in delinquencies and nonperforming loans

- Trends in the volume and nature of loans

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

- Trends in portfolio concentration

- National and local economic trends and conditions

- Effects of changes or trends in internal risk ratings

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

There were no significant changes in the Company's policies or methodology pertaining to the general component of the allowance for loan losses during the three and nine months ended March 31, 2014 or 2013.

The allocated component of the allowance for loan losses relates to loans that are classified as impaired. Impairment is measured on a loan-by-loan basis for commercial business and commercial real estate loans by either the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent. An allowance is established when the discounted cash flows or collateral value of the impaired loan is lower than the carrying value of that loan. Large groups of smaller-balance homogeneous loans, such as consumer and residential real estate loans are collectively evaluated for impairment based on the group's historical loss experience adjusted for qualitative factors. Accordingly, the Company does not

Table of Contents

separately identify individual consumer and residential loans for individual impairment and disclosure. However, all TDRs are individually reviewed for impairment.

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

Table of Contents

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

	Three Months Ended March 31, 2014							Total
	Residential	Commercial	Commercial	Consumer	Purchased	Unallocated		
	Real Estate	Real Estate	Business					
	(Dollars in thousands)							
Beginning balance	\$ 649	\$ 321	\$ 52	\$ 112	\$ 207	\$ 9	\$ 1,350	
Provision	151		41	25	(28)	(9)	180	
Recoveries	1	1	1	5			8	
Charge-offs	(123)		(43)	(27)			(193)	
Ending balance	\$ 678	\$ 322	\$ 51	\$ 115	\$ 179	\$	\$ 1,345	

	Three Months Ended March 31, 2013							Total
	Residential	Commercial	Commercial	Consumer	Purchased	Unallocated		
	Real Estate	Real Estate	Business					
	(Dollars in thousands)							
Beginning balance	\$ 492	\$ 102	\$ 47	\$ 234	\$ 47	\$	\$ 875	
Provision	186	117		(4)	47		346	
Recoveries	2	5		5			12	
Charge-offs	(102)	(43)		(8)	(47)		(200)	
Ending balance	\$ 578	\$ 181	\$ 47	\$ 227	\$	\$	\$ 1,033	

	Nine Months Ended March 31, 2014							Total
	Residential	Commercial	Commercial	Consumer	Purchased	Unallocated		
	Real Estate	Real Estate	Business					
	(Dollars in thousands)							
Beginning balance	\$ 594	\$ 173	\$ 70	\$ 189	\$ 76	\$ 41	\$ 1,143	
Provision	233	148	17	(53)	103	(41)	407	
Recoveries	7	1	7	36			51	
Charge-offs	(156)		(43)	(57)			(256)	
Ending balance	\$ 678	\$ 322	\$ 51	\$ 115	\$ 179	\$	\$ 1,345	

	Nine Months Ended March 31, 2013							Total
	Residential	Commercial	Commercial	Consumer	Purchased	Unallocated		
	Real Estate	Real Estate	Business					
	(Dollars in thousands)							
Beginning balance	\$ 214	\$ 93	\$ 292	\$ 225	\$ 47	\$	\$ 824	
Provision	598	126	(42)	92	47		821	
Recoveries	3	5		12			20	
Charge-offs	(237)	(43)	(203)	(102)	(47)		(632)	
Ending balance	\$ 578	\$ 181	\$ 47	\$ 227	\$	\$	\$ 1,033	

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

Table of Contents

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

	March 31, 2014						
	Residential Real Estate	Commercial Real Estate	Commercial Business	Consumer	Purchased	Unallocated	Total
	(Dollars in thousands)						
Allowance for loan losses:							
Individually evaluated	\$ 221	98		6	139		464
Collectively evaluated	457	224	51	109			841
ASC 310-30					40		40
Total	\$ 678	\$ 322	\$ 51	\$ 115	\$ 179	\$	\$ 1,345
Loans:							
Individually evaluated	\$ 2,379	\$ 2,259	\$ 65	\$ 221	\$ 5,657	\$	\$ 10,581
Collectively evaluated	147,853	116,425	49,484	10,607			324,369
ASC 310-30					179,302		179,302
Total	\$ 150,232	\$ 118,684	\$ 49,549	\$ 10,828	\$ 184,959	\$	\$ 514,252

	June 30, 2013						
	Residential Real Estate	Commercial Real Estate	Commercial Business	Consumer	Purchased	Unallocated	Total
	(Dollars in thousands)						
Allowance for loan losses:							
Individually evaluated	\$ 235	\$ 85	\$ 63	\$ 23	\$ 65	\$	\$ 471
Collectively evaluated	359	88	7	166		41	661
ASC 310-30					11		11
Total	\$ 594	\$ 173	\$ 70	\$ 189	\$ 76	\$ 41	\$ 1,143
Loans:							
Individually evaluated	\$ 2,626	\$ 1,558	\$ 110	\$ 149	\$ 1,129	\$	\$ 5,572
Collectively evaluated	122,497	98,886	29,576	13,188			264,147
ASC 310-30					165,657		165,657
Total	\$ 125,123	\$ 100,444	\$ 29,686	\$ 13,337	\$ 166,786	\$	\$ 435,376

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

March 31, 2014
Unpaid

June 30, 2013
Unpaid

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

	Recorded Investment	Principal Balance	Related Allowance (Dollars in thousands)	Recorded Investment	Principal Balance	Related Allowance
Impaired loans without a valuation allowance:						
Originated:						
Residential real estate	\$ 1,227	\$ 1,253	\$	\$ 1,158	\$ 1,225	\$
Consumer	181	187		88	93	
Commercial real estate	1,280	1,280		434	479	
Commercial business	65	103		47	101	
Purchased:						
Commercial real estate	3,743	5,896		928	1,279	
Total	6,496	8,719		2,655	3,177	
Impaired loans with a valuation allowance:						
Originated:						
Residential real estate	1,152	1,134	221	1,468	1,420	235
Consumer	40	40	6	61	61	23
Commercial real estate	979	1,013	98	1,124	1,131	85
Commercial business				63	98	63
Purchased:						
Commercial real estate	1,914	2,225	139	201	276	65
Total	4,085	4,412	464	2,917	2,986	471
Total impaired loans	\$ 10,581	\$ 13,131	\$ 464	\$ 5,572	\$ 6,163	\$ 471

Table of Contents

The following tables set forth information regarding interest income recognized on impaired loans.

	2014		Three Months Ended March 31,		2013	
	Average Recorded Investment		Interest Income Recognized	Average Recorded Investment		Interest Income Recognized
(Dollars in thousands)						
Impaired loans without a valuation allowance:						
Originated:						
Residential real estate	\$ 1,032		\$ 16	\$ 1,097		\$ 18
Consumer	146		3	82		1
Commercial real estate	832		13	1,375		22
Commercial business	65		2	68		
Purchased:						
Commercial real estate	3,532		23			
Total	5,607		57	2,622		41
Impaired loans with a valuation allowance:						
Originated:						
Residential real estate	1,262		13	1,459		19
Consumer	77			71		1
Commercial real estate	1,117		14	762		3
Commercial business	22			44		
Purchased:						
Commercial real estate	1,925		10			
Total	4,403		37	2,336		23
Total impaired loans	\$ 10,010		\$ 94	\$ 4,958		\$ 64

	2014		Nine Months Ended March 31,		2013	
	Average Recorded Investment		Interest Income Recognized	Average Recorded Investment		Interest Income Recognized
(Dollars in thousands)						
Impaired loans without a valuation allowance:						
Originated:						
Residential real estate	\$ 1,047		\$ 30	\$ 825		\$ 31
Consumer	115		5	52		3
Commercial real estate	635		27	1,370		61
Commercial business	64		8	169		3
Purchased:						
Commercial real estate	2,584		71	264		
Total	4,445		141	2,680		98
Impaired loans with a valuation allowance:						
Originated:						
Residential real estate	1,327		50	940		45
Consumer	84		3	54		3
Commercial real estate	1,119		59	656		16
Commercial business	38		1	221		
Purchased:						
Commercial real estate	1,062		58			
Total	3,630		171	1,871		64

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

Total impaired loans	\$	8,075	\$	312	\$	4,551	\$	162
----------------------	----	-------	----	-----	----	-------	----	-----

Table of Contents

Credit Quality

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

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

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

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

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

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

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

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

	March 31, 2014					
	Commercial Real Estate	Originated Portfolio			Purchased Portfolio	Total
		Construction	Commercial Business	Residential(1)		
	(Dollars in thousands)					
Loans rated 1- 6	\$ 107,003	\$	\$ 49,272	\$ 11,859	\$ 169,507	\$ 337,641

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

Loans rated 7	8,720	42	763	8,282	17,807
Loans rated 8	2,961	235	657	7,170	11,023
Loans rated 9					
Loans rated 10					
	\$ 118,684	\$ 49,549	\$ 13,279	\$ 184,959	\$ 366,471

June 30, 2013

	Originated Portfolio				Purchased Portfolio	Total
	Commercial Real Estate	Construction	Commercial Business	Residential(1)		
Loans rated 1- 6	\$ 95,834	\$ 42	\$ 29,340	\$ 13,110	\$ 161,965	\$ 300,291
Loans rated 7	3,537		82	638	3,226	7,483
Loans rated 8	1,031		264	527	1,595	3,417
Loans rated 9						
Loans rated 10						
	\$ 100,402	\$ 42	\$ 29,686	\$ 14,275	\$ 166,786	\$ 311,191

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

Table of ContentsPast Due and Nonaccrual Loans

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

	March 31, 2014							
	30-59 Days	60-89 Days	Past Due 90 Days or More-Still Accruing	Past Due 90 Days or More- Nonaccrual	Total Past Due	Total Current	Total Loans	Non- Accrual Loans
(Dollars in thousands)								
Originated portfolio:								
Residential real estate	\$ 788	\$ 89	\$	\$ 1,468	\$ 2,345	\$ 118,810	\$ 121,155	\$ 1,678
Home equity	18			194	212	28,865	29,077	214
Commercial real estate	371			657	1,028	117,656	118,684	798
Construction								
Commercial business						49,549	49,549	
Consumer	202	82		90	374	10,454	10,828	152
Total originated portfolio	1,379	171		2,409	3,959	325,334	329,293	2,842
Purchased portfolio:								
Residential real estate						3,740	3,740	
Commercial business						5	5	
Commercial real estate	383	81		2,987	3,451	177,763	181,214	4,582
Total purchased portfolio	383	81		2,987	3,451	181,508	184,959	4,582
Total loans	\$ 1,762	\$ 252	\$	\$ 5,396	\$ 7,410	\$ 506,842	\$ 514,252	\$ 7,424

	June 30, 2013							
	30-59 Days	60-89 Days	Past Due 90 Days or More-Still Accruing	Past Due 90 Days or More- Nonaccrual	Total Past Due	Total Current	Total Loans	Non- Accrual Loans
(Dollars in thousands)								
Originated portfolio:								
Residential real estate	\$ 278	\$ 408	\$	\$ 1,965	\$ 2,651	\$ 87,083	\$ 89,734	\$ 2,346
Home equity	53	47		253	353	35,036	35,389	334
Commercial real estate	91	326		98	515	99,887	100,402	473
Construction								
Commercial business				44	44	29,642	29,686	110
Consumer	193	77		117	387	12,950	13,337	136
Total originated portfolio	615	858		2,477	3,950	264,640	268,590	3,399
Purchased portfolio:								
Residential real estate						2,706	2,706	
Commercial business						34	34	
Commercial real estate		2,210		1,135	3,345	160,701	164,046	1,457
Total purchased portfolio		2,210		1,135	3,345	163,441	166,786	1,457

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

Total loans	\$	615	\$	3,068	\$	3,612	\$	7,295	\$	428,081	\$	435,376	\$	4,856
-------------	----	-----	----	-------	----	-------	----	-------	----	---------	----	---------	----	-------

Table of Contents

Troubled Debt Restructurings

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

	Three Months Ended March 31,				Nine Months Ended March 31,			
	2014		2013		2014		2013	
	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
(Dollars in thousands)								
Extended maturity	1	\$ 305	2	\$ 84	5	\$ 2,082	3	\$ 326
Adjusted interest rate	1	36	3	84	2	118	3	84
Rate and maturity	2	65	1	50	2	65	8	733
Principal deferment			2	73	2	341	2	73
Court ordered concession	1	41	1	80	1	41	2	116
Other	2	171			2	171		
	7	\$ 618	9	\$ 371	14	\$ 2,818	18	\$ 1,332

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

Originated portfolio:								
Residential real estate								
	4	\$ 164	\$ 164	5	\$ 228	\$ 228		
Home equity	1	8	8	2	84	84		
Commercial real estate								
	1	141	141	1	103	50		
Commercial business								
Consumer				1	8	8		
Total originated portfolio	6	313	313	9	423	370		
Purchased portfolio:								
Residential real estate								
Commercial real estate								
	1	305	305					
Total purchased portfolio	1	305	305					
Total	7	\$ 618	\$ 618	9	\$ 423	\$ 370		

Originated portfolio:										
Residential real estate										
	4	\$	164	\$	164	9	\$	903	\$	903
Home equity	2		22		22	4		362		362
Commercial real estate										
	2		464		464	1		103		50
Commercial business										
	1		18		18					
Consumer	2		121		121	4		16		16
Total originated portfolio	11		789		789	18		1,384		1,331
Purchased portfolio:										
Residential real estate										
Commercial real estate										
	3		1,990		2,029					
Total purchased portfolio	3		1,990		2,029					
Total	14	\$	2,779	\$	2,818	18	\$	1,384	\$	1,331

The following table shows the loans that have been modified during the past twelve months which have subsequently defaulted during the periods indicated. The Company considers a loan to have defaulted when it reaches 90 days past due.

	Three Months Ended March 31,				Nine Months Ended March 31,			
	2014		2013		2014		2013	
	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
	(Dollars in thousands)							
Residential	2	\$ 94		\$	3	\$ 163		\$
Home equity			1	36			1	36
Consumer					1	10		
	2	\$ 94	1	\$ 36	4	\$ 173	1	\$ 36

As of March 31, 2014, there were no further commitments to lend associated with loans modified in a TDR.

Table of ContentsASC 310-30 Loans

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

	Three Months Ended March 31, 2014	Nine Months Ended March 31, 2014
	(Dollars in thousands)	
Contractually required payments receivable	\$ 27,024	\$ 70,106
Nonaccretable difference	(376)	(969)
Cash flows expected to be collected	26,648	69,137
Accretable yield	(10,348)	(22,870)
Fair value of loans acquired	\$ 16,300	\$ 46,267

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

	Three Months Ended March 31, 2014	Nine Months Ended March 31, 2014
	(Dollars in thousands)	
Beginning balance	\$ 104,117	\$ 108,251
Acquisitions	10,348	22,870
Accretion	(3,816)	(11,452)
Reclassifications to accretable yield	83	846
Disposals and other	(4,079)	(13,862)
End balance	\$ 106,653	\$ 106,653

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

	March 31, 2014	June 30, 2013
	(Dollars in thousands)	
Unpaid principal balance	\$ 218,328	\$ 203,755
Carrying amount	\$ 182,654	\$ 166,506

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

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

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2014	2013	2014	2013
	(Dollars in thousands, except share and per share data)			
Net income	\$ 437	\$ 1,666	\$ 2,150	\$ 4,215
Preferred stock dividends and accretion				(355)
Net income available to common shareholders	\$ 437	\$ 1,666	\$ 2,150	\$ 3,860
Weighted average shares used in calculation of basic EPS	10,432,494	10,425,576	10,435,300	10,397,280
Incremental shares from assumed exercise of dilutive securities				
Weighted average shares used in calculation of diluted EPS	10,432,494	10,425,576	10,435,300	10,397,280
Earnings per common share:				
Income from continuing operations	\$ 0.04	\$ 0.16	\$ 0.21	\$ 0.35
Income from discontinued operations	0.00	0.00	0.00	0.02
Earnings per common share	\$ 0.04	\$ 0.16	\$ 0.21	\$ 0.37
Diluted earnings per common share:				
Income from continuing operations	\$ 0.04	\$ 0.16	\$ 0.21	\$ 0.35
Income from discontinued operations	0.00	0.00	0.00	0.02
Diluted earnings per common share	\$ 0.04	\$ 0.16	\$ 0.21	\$ 0.37

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

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2014	2013	2014	2013
Stock options	1,143,329	1,074,687	1,148,777	900,514
Warrants				40,775
	1,143,329	1,074,687	1,148,777	941,289

Table of Contents

6. Fair Value Measurements

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Table of Contents

Fair Value of other Financial Instruments:

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

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

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

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

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

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

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

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

Table of Contents

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

	Total	March 31, 2014		Level 3
		Level 1	Level 2	
(Dollars in thousands)				
<u>Assets</u>				
Securities available-for-sale:				
U.S. Government agency securities	\$ 45,291	\$	\$ 45,291	\$
Agency mortgage-backed securities	67,441		67,441	
Other assets interest rate caps				
<u>Liabilities</u>				
Other liabilities interest rate swaps	\$ 333	\$	\$ 333	\$

	Total	June 30, 2013		Level 3
		Level 1	Level 2	
(Dollars in thousands)				
<u>Assets</u>				
Securities available-for-sale:				
U.S. Government agency securities	\$ 45,333	\$	\$ 45,333	\$
Agency mortgage-backed securities	76,264		76,264	
Other assets interest rate caps				
<u>Liabilities</u>				
Other liabilities interest rate swaps	\$ 389	\$	\$ 389	\$

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

	Total	March 31, 2014		Level 3
		Level 1	Level 2	
(Dollars in thousands)				
Collateral dependent impaired loans	\$ 1,361	\$	\$	\$ 1,361
Real estate owned and other repossessed collateral	2,000			2,000

	Total	June 30, 2013		Level 3
		Level 1	Level 2	
(Dollars in thousands)				
Collateral dependent impaired loans	\$ 894	\$	\$	\$ 894
Real estate owned and other repossessed collateral	2,134			2,134

Table of Contents

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

	Carrying Amount	Total	Fair Value Measurements at March 31, 2014		
			Level 1 (Dollars in thousands)	Level 2	Level 3
Financial assets:					
Cash and cash equivalents	\$ 74,363	\$ 74,363	\$ 74,363	\$	\$
Available-for-sale securities	112,732	112,732		112,732	
Regulatory stock	5,721	5,721		5,721	
Loans held for sale	9,827	9,838		9,838	
Loans, net	512,907	518,901			518,901
Accrued interest receivable	1,302	1,302		1,302	
Interest rate caps					
Financial liabilities:					
Deposits	563,310	527,447		527,447	
FHLB advances	42,878	43,981		43,981	
Wholesale repurchase agreements	10,240	10,581		10,581	
Short-term borrowings	2,585	2,585		2,585	
Capital lease obligation	1,604	1,751		1,751	
Subordinated debentures	8,396	7,583			7,583
Interest rate swaps	333	333		333	

Financial assets:					
Cash and cash equivalents	\$ 65,934	\$ 65,934	\$ 65,934	\$	\$
Available-for-sale securities	121,597	121,597		121,597	
Regulatory stock	5,721	5,721		5,721	
Loans held for sale	8,594	8,602		8,602	
Loans, net	434,233	444,988			444,988
Accrued interest receivable	1,396	1,396		1,396	
Interest rate caps					
Financial liabilities:					
Deposits	484,623	449,857		449,857	
FHLB advances	28,040	29,404		29,404	
Wholesale repurchase agreements	25,397	26,092		26,092	
Short-term borrowings	625	625		625	
Capital lease obligation	1,739	1,926		1,926	
Subordinated debentures	8,268	7,594			7,594
Interest rate swaps	389	389		389	

7. Derivatives and Hedging Activities

The Company has stand-alone derivative financial instruments in the form of interest rate caps that derive their value from a fee paid and are adjusted to fair value based on index and strike rate, and swap agreements that derive their value from the underlying interest rate. These

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

The Company currently holds derivative instruments that contain credit-risk related features that are in a net liability position, which may require that collateral be assigned to dealer banks. At March 31, 2014, the Company had posted cash collateral totaling \$1.0 million with dealer banks related to derivative instruments in a net liability position.

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

Risk Management Policies - Derivative Instruments

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

Interest Rate Risk Management - Cash Flow Hedging Instruments

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

Table of Contents

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

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

Notional Amount	Inception Date	Termination Date	March 31, 2014		Strike Rate	Unrealized Loss	Fair Value	Balance Sheet Location	
			Index	Receive Rate Pay Rate (Dollars in thousands)					
<i>Interest rate swaps:</i>									
\$ 10,000	February 2010	February 2015	3 Mo. LIBOR	2.13%	4.69%	n/a	\$ (192)	\$ (226)	Other Liabilities
5,000	July 2013	July 2033	3 Mo. LIBOR	0.24%	3.38%	n/a	(30)	(30)	Other Liabilities
5,000	July 2013	July 2028	3 Mo. LIBOR	0.24%	3.23%	n/a	(46)	(46)	Other Liabilities
5,000	July 2013	July 2023	3 Mo. LIBOR	0.24%	2.77%	n/a	(31)	(31)	Other Liabilities
<i>Interest rate caps:</i>									
6,000	September 2009	September 2014	3 Mo. LIBOR	n/a	n/a	2.51%	(20)		Other Assets
\$ 31,000							\$ (319)	\$ (333)	

Notional Amount	Inception Date	Termination Date	June 30, 2013		Strike Rate	Unrealized Loss	Fair Value	Balance Sheet Location	
			Index	Receive Rate Pay Rate (Dollars in thousands)					
<i>Interest rate swaps:</i>									
\$ 10,000	February 2010	February 2015	3 Mo. LIBOR	2.16%	4.69%	n/a	\$ (223)	\$ (389)	Other Liabilities
<i>Interest rate caps:</i>									
6,000	September 2009	September 2014	3 Mo. LIBOR	n/a	n/a	2.51%	(40)		Other Assets
\$ 16,000							\$ (263)	\$ (389)	

During the three and nine months ended March 31, 2014 and 2013, no interest rate cap or swap agreements were terminated prior to maturity. Changes in the fair value of interest rate caps and swaps designated as hedging instruments of the variability of cash flows associated with variable rate debt are reported in other comprehensive income. These amounts subsequently are reclassified into interest expense as a yield adjustment in the same period in which the related interest on the debt affects earnings. Risk management results for the three and nine months ended March 31, 2014 and 2013 related to the balance sheet hedging of variable rate debt indicates that the hedges were effective.

During the periods presented, amounts recognized in income related to hedge ineffectiveness resulted from amortization of the non-zero fair value associated with the Company's single interest rate swap held at the time of the merger with FHB Formation LLC in December 2010. During the periods presented, amounts recognized in income related to amounts excluded from effectiveness testing resulted from amortization of the acquisition price of interest rate caps. The table below presents amounts recognized in income related to both hedge ineffectiveness and amounts excluded from effectiveness testing.

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

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2014	2013	2014	2013
	(Dollars in thousands)			
Interest income (expense):				
Interest rate caps	\$ (8)	\$ (8)	\$ (22)	\$ (22)
Interest rate swap	80	25	130	76
Total	\$ 72	\$ 17	\$ 108	\$ 54

The Company expects to record interest income of \$90 thousand related to interest rate swap ineffectiveness in the next twelve months. The Company expects to record interest expense of \$18 thousand related to its purchased interest rate caps in the next twelve months.

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

The components of other comprehensive income (loss) follow.

	Three Months Ended March 31,					
	Pre-tax Amount	2014 Tax Expense (Benefit)	After-tax Amount	Pre-tax Amount	2013 Tax Expense (Benefit)	After-tax Amount
	(Dollars in thousands)					
Change in net unrealized gain or loss on available-for-sale securities	\$ 579	\$ 196	\$ 383	\$ (164)	\$ (55)	\$ (109)
Reclassification adjustment for net gains included in net income						
Total available-for-sale securities	579	196	383	(164)	(55)	(109)
Change in accumulated loss on effective cash flow hedges	(528)	(178)	(350)	62	21	41
Reclassification adjustment for net gains included in net income	(72)	(25)	(47)	(17)	(6)	(11)
Total derivatives and hedging activities	(600)	(203)	(397)	45	15	30
Total other comprehensive loss	\$ (21)	\$ (7)	\$ (14)	\$ (119)	\$ (40)	\$ (79)

	Nine Months Ended March 31,					
	Pre-tax Amount	2014 Tax Expense (Benefit)	After-tax Amount	Pre-tax Amount	2013 Tax Expense (Benefit)	After-tax Amount
	(Dollars in thousands)					
Change in net unrealized gain or loss on available-for-sale securities	\$ 449	\$ 152	\$ 297	\$ (318)	\$ (108)	\$ (210)
Reclassification adjustment for net gains included in net income				(792)	(270)	(522)
Total available-for-sale securities	449	152	297	(1,110)	(378)	(732)
Change in accumulated loss on effective cash flow hedges	56	20	36	127	43	84
Reclassification adjustment for net gains included in net income	(108)	(37)	(71)	(54)	(18)	(36)
Total derivatives and hedging activities	(52)	(17)	(35)	73	25	48
Total other comprehensive income (loss)	\$ 397	\$ 135	\$ 262	\$ (1,037)	\$ (353)	\$ (684)

Accumulated other comprehensive loss is comprised of the following.

	March 31, 2014	June 30, 2013
	(Dollars in thousands)	
Unrealized loss on available-for-sale securities	\$ (2,187)	\$ (2,636)
Tax effect	744	896
Net-of-tax amount	(1,443)	(1,740)
Unrealized loss on cash flow hedges	(319)	(263)
Tax effect	110	89
Net-of-tax amount	(209)	(174)
Accumulated other comprehensive loss	\$ (1,652)	\$ (1,914)

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

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

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

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

	March 31, 2014	June 30, 2013
	(Dollars in thousands)	
Commitments to originate loans	\$ 23,810	\$ 13,349
Unused lines of credit	36,340	30,809
Standby letters of credit	166	420

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

Contingencies

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

Table of Contents**10. Discontinued Operations**

The Company concluded all investment brokerage activities in the second quarter of fiscal 2014. Accordingly, operations associated with these activities have been classified as discontinued operations in the accompanying consolidated statements of income. The following summarizes the operations of the Company's investment brokerage division for the three and nine months ended March 31, 2014 and 2013.

	Three Months Ended March 31,		Nine Months Ended March 31,				
	2014	2013	2014	2013			
	(Dollars in thousands)						
Noninterest income:							
Investment commissions	\$	\$	758	\$	971	\$	2,232
Other noninterest income							
Total noninterest income			758	971		2,232	
Noninterest expense:							
Salaries and employee benefits			575	793		1,562	
Occupancy and equipment expense			40	60		142	
Data processing fees			67	82		187	
Marketing expense				8		10	
Other noninterest expense			21	40		78	
Total noninterest expense			703	983		1,979	
Income (loss) before tax			55	(12)		253	
Income tax expense (benefit)			19	(4)		87	
Net income (loss)	\$	\$	36	\$	(8)	\$	166

11. Subsequent Events

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

Table of Contents

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

The following discussion should be read in conjunction with the consolidated financial statements, notes and tables included in Northeast Bancorp's Annual Report on Form 10-K for the fiscal year ended June 30, 2013, filed with the Securities and Exchange Commission.

A Note about Forward Looking Statements

This report contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended, such as statements relating to the Company's financial condition, prospective results of operations, future performance or expectations, plans, objectives, prospects, loan loss allowance adequacy, simulation of changes in interest rates, capital spending and finance sources and revenue sources. These statements relate to expectations concerning matters that are not historical facts. Accordingly, statements that are based on management's projections, estimates, assumptions, and judgments constitute forward-looking statements. These forward-looking statements, which are based on various assumptions (some of which are beyond the Company's control), may be identified by reference to a future period or periods, or by the use of forward-looking terminology such as believe, expect, estimate, anticipate, continue, plan, approximately, intend, objective, goal, project, or other similar terms or variations thereof, or the future or conditional verbs such as will, may, should, could, and would. Although the Company believes that these forward-looking statements are based on reasonable estimates and assumptions, they are not guarantees of future performance and are subject to known and unknown risks, uncertainties, contingencies, and other factors. Accordingly, the Company cannot give you any assurance that its expectations will, in fact, occur or that its estimates or assumptions will be correct. The Company cautions you that actual results could differ materially from those expressed or implied by such forward-looking statements as a result of, among other factors, changes in interest rates and real estate values; competitive pressures from other financial institutions; the effects of continuing weakness in general economic conditions on a national basis or in the local markets in which the Company operates, including changes which adversely affect borrowers' ability to service and repay the Company's loans; changes in loan defaults and charge-off rates; changes in the value of securities and other assets, adequacy of loan loss reserves, or deposit levels necessitating increased borrowing to fund loans and investments; changes in government regulation; the risk that the Company may not be successful in the implementation of its business strategy; the risk that intangibles recorded in the Company's financial statements will become impaired; changes in assumptions used in making such forward-looking statements; and the other risks and uncertainties detailed in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2013 as updated in the Company's Quarterly Reports on Form 10-Q and other filings submitted to the Securities and Exchange Commission. These forward-looking statements speak only as of the date of this report and the Company does not undertake any obligation to update or revise any of these forward-looking statements to reflect events or circumstances occurring after the date of this report or to reflect the occurrence of unanticipated events.

Description of Business and Strategy

Business Overview

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

On December 29, 2010, the merger of the Company and FHB Formation LLC, a Delaware limited liability company (FHB), was consummated. As a result of the merger, the surviving company received a capital contribution of \$16.2 million (in addition to the approximately \$13.1 million in cash consideration paid to former shareholders), and the former members of FHB collectively acquired approximately 60% of the Company's outstanding common stock. The Company applied the acquisition method of accounting, as described in Accounting Standards Codification (ASC) 805, *Business Combinations* (ASC 805) to the merger, which represents an acquisition by FHB of Northeast, with Northeast as the surviving company.

In connection with the transaction, as part of the regulatory approval process, the Company and the Bank made certain commitments to the Federal Reserve, the most significant of which are (i) to maintain a Tier 1 leverage ratio of at least 10%, (ii) to maintain a total risk-based capital ratio of at least 15%, (iii) to limit purchased loans to 40% of total loans, (iv) to fund 100% of the Company's loans with core deposits (defined as non-maturity deposits and non-brokered insured time deposits), and (v) to hold commercial real estate loans (including owner-occupied commercial real estate) to within 300% of total risk-based capital. On June 28, 2013, the Federal Reserve approved the amendment of the commitment to hold commercial real estate loans to within 300% of total risk-based capital to exclude owner-occupied commercial real estate loans. All other commitments made to the Federal Reserve in connection with the merger remain unchanged. The Company and the Bank are currently in compliance with all commitments to the Federal Reserve. The Company's compliance ratios at March 31, 2014 follow.

Table of Contents

Condition	Ratios at March 31, 2014
(i) Tier 1 leverage ratio	16.28%
(ii) Total risk-based capital ratio	24.21%
(iii) Ratio of purchased loans to total loans	35.29%
(iv) Ratio of loans to core deposits	93.18%
(v) Ratio of commercial real estate loans to total risk-based capital	175.10%

As of March 31, 2014, the Company, on a consolidated basis, had total assets of \$750.9 million, total deposits of \$563.3 million, and stockholders' equity of \$114.0 million. The Company gathers retail deposits through its banking offices in Maine and its online affinity deposit program, ableBanking; originates loans through the Bank's Community Banking Division; and purchases and originates commercial loans through the Bank's Loan Acquisition and Servicing Group (LASG). The Community Banking Division, with ten full-service branches and six loan production offices, operates from the Bank's headquarters in Lewiston, Maine. The Company operates ableBanking and the LASG from its offices in Boston, Massachusetts.

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

Strategy

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

Measured growth of the commercial loan portfolio. The LASG purchases performing commercial real estate loans, on a nationwide basis, typically at a discount from their outstanding principal balances, producing yields higher than those normally achieved on our originated loan portfolio. Loans are purchased on a nationwide basis from a variety of sources, including banks, insurance companies, investment funds and government agencies, either directly or indirectly through a broker. This group also originates, on a nationwide basis, commercial real estate and commercial business loans.

Focus on core deposits. The Company offers a full line of deposit products to customers in the Community Banking Division's market area through its ten-branch network. In June 2012, we launched our online affinity deposit program, ableBanking, a division of Northeast Bank, as an additional channel through which to raise core deposits to fund the Company's asset strategy. We also raise deposits through deposit listing services, which offer the ability to attract longer term funding than can typically be obtained through retail channels.

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

Critical Accounting Policies

Critical accounting policies are those that involve significant judgments and assessments by management, and which could potentially result in materially different results under different assumptions and conditions. The reader is encouraged to review each of the policies included in Form 10-K for the year ended June 30, 2013 to gain a better understanding of how Northeast's financial performance is measured and reported. There has been no material change in critical accounting policies during the nine months ended March 31, 2014.

Table of Contents

Overview

Net income from continuing operations was \$437 thousand for the quarter ended March 31, 2014, compared to \$1.6 million for the quarter ended March 31, 2013. Net income from continuing operations for the nine months ended March 31, 2014 was \$2.2 million, compared to \$4.0 million for the nine months ended March 31, 2013.

Net income available to common stockholders was \$437 thousand, or \$0.04 per diluted common share, for the quarter ended March 31, 2014, compared to \$1.7 million, or \$0.16 per diluted common share, for the quarter ended March 31, 2013. For the nine months ended March 31, 2014, net income available to common stockholders was \$2.2 million, or \$0.21 per diluted common share, compared to \$3.9 million, or \$0.37 per diluted common share, for the nine months ended March 31, 2013.

Net interest income before provision decreased by \$1.1 million, or 13.8%, to \$7.1 million for the quarter ended March 31, 2014 compared to the quarter ended March 31, 2013, primarily due to lower transactional interest income from purchased loan payoffs. This result is evident in the net interest margin, which decreased by 99 basis points to 4.08% for the quarter ended March 31, 2014, compared to 5.07% for the quarter ended March 31, 2013.

Noninterest income decreased by \$1.3 million for the quarter ended March 31, 2014, compared to the quarter ended March 31, 2013, principally due to the following:

- A decrease of \$855 thousand in gain on sales of portfolio loans, due to a lower volume of purchased loan sales in the quarter ended March 31, 2014.
- A decrease of \$360 thousand in gain on sales of loans held for sale, principally a volume-related difference due to a significant decline in residential loan refinance activity. The Company sold \$15.3 million of residential loans in the quarter ended March 31, 2014, compared to \$33.3 million in the quarter ended March 31, 2013.
- A decrease of \$65 thousand in net gains on the disposition of other real estate owned.
- A decrease of \$45 thousand in fee income, primarily due to a decrease in transactional deposit account activity.

Noninterest expense decreased by \$612 thousand for the quarter ended March 31, 2014, compared to the quarter ended March 31, 2013, principally due to the following:

- A decrease of \$928 thousand in salaries and employee benefits, principally related to incentive compensation.
- An increase of \$232 thousand in occupancy and equipment expense, primarily due to increased rent and utilities expense, depreciation, and software expenses.

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

- A decrease of \$163 thousand in marketing expense, mainly due to a reduction in deposit marketing in fiscal 2014.
- An increase of \$88 thousand in loan acquisition and collection expenses due, in part, to an increase of \$5.0 million in loan purchases in the quarter ended March 31, 2014 when compared to the quarter ended March 31, 2013.
- An increase of \$204 thousand in other noninterest expense, principally due to non-capital expenditures associated with the Company's upcoming core banking software system conversion.

Financial Condition

Overview

Total assets increased by \$80.3 million, or 12.0%, to \$750.9 million at March 31, 2014, compared to June 30, 2013. The principal components of the change in the balance sheet were as follows:

- The loan portfolio grew by \$78.9 million, or 18.1%, compared to June 30, 2013, principally due to net growth of \$68.0 million in commercial loans purchased or originated by the LASG and \$10.9 million of net growth in loans originated by the Bank's Community Banking Division. As has been discussed in the Company's prior SEC filings, the Company made certain commitments to the Federal Reserve in connection with the merger of FHB with and into the Company in December 2010. The Company's loan purchase capacity under these conditions follow.

Basis for Regulatory Condition	Condition	Purchased Loan Capacity at March 31, 2014 (Dollars in millions)	
Total Loans	Purchased loans may not exceed 40% of total loans	\$	41.1
Regulatory Capital	Commercial real estate loans may not exceed 300% of total risk-based capital	\$	153.6

Table of Contents

An overview of the LASG portfolio follows.

			Three Months Ended March 31,				Total LASG
	Purchased	2014 Originated	Total LASG	Purchased	2013 Originated	Total LASG	
(Dollars in thousands)							
Loans purchased or originated during the period:							
Unpaid principal balance	\$ 19,050	\$ 11,158	\$ 30,208	\$ 13,971	\$ 2,800	\$ 16,771	
Net investment basis	16,300	11,158	27,458	11,340	2,827	14,167	
Loan returns during the period:							
Yield	9.51%	5.13%	8.11%	17.76%	9.43%	16.84%	
Total Return (1)	10.39%	5.13%	8.71%	22.02%	9.43%	20.64%	
			Nine Months Ended March 31,				Total LASG
	Purchased	2014 Originated	Total LASG	Purchased	2013 Originated	Total LASG	
(Dollars in thousands)							
Loans purchased or originated during the period:							
Unpaid principal balance	\$ 53,044	\$ 54,722	\$ 107,766	\$ 103,539	\$ 15,625	\$ 119,164	
Net investment basis	46,267	54,722	100,989	75,553	15,652	91,205	
Loan returns during the period:							
Yield	11.17%	5.27%	9.55%	15.52%	9.55%	14.89%	
Total Return (1)	11.60%	5.27%	9.87%	18.66%	9.55%	17.70%	
Total loans as of period end:							
Unpaid principal balance	\$ 221,597	\$ 88,700	\$ 310,297	\$ 166,360	\$ 17,871	\$ 184,231	
Net investment basis	184,959	88,724	273,683	130,502	17,904	148,406	

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

- Deposits and borrowings increased by \$78.7 million and \$1.6 million, respectively, from June 30, 2013. Growth in each was tied to the Company's strategy for funding its loan growth which, through the third quarter of fiscal 2014, included a component of duration-matched funding for residential mortgages.

Assets

Cash, Short-term Investments and Securities

Cash and short-term investments were \$74.4 million as of March 31, 2014, an increase of \$8.4 million, or 12.8%, from \$65.9 million at June 30, 2013.

Available-for-sale securities, consisting of securities issued by government agencies and government-sponsored enterprises, totaled \$112.7 million as of March 31, 2014. At March 31, 2014, securities with a fair value of \$30.0 million were pledged for outstanding borrowings.

Table of Contents*Loans*

Total loans, excluding loans held for sale, amounted to \$514.3 million as of March 31, 2014, an increase of \$78.9 million, or 18.1%, from \$435.4 million as of June 30, 2013. The increase consisted of net growth in loans purchased or originated by the LASG of \$68.0 million and net growth in loans originated by the Community Banking Division of \$10.9 million. The composition of the Company's loan portfolio follows.

	March 31, 2014			
	Community Banking Division	LASG (Dollars in thousands)	Total	Percent of Total
Originated loans:				
Residential real estate	\$ 121,005	\$ 150	\$ 121,155	23.56%
Home equity	29,077		29,077	5.65%
Commercial real estate: non-owner occupied	46,523	39,716	86,239	16.77%
Commercial real estate: owner occupied	22,970	9,475	32,445	6.31%
Construction				0.00%
Commercial business	10,166	39,383	49,549	9.64%
Consumer	10,828		10,828	2.10%
Subtotal	240,569	88,724	329,293	64.03%
Purchased loans:				
Residential real estate		3,740	3,740	0.73%
Commercial business		5	5	0.00%
Commercial real estate: non-owner occupied		129,038	129,038	25.09%
Commercial real estate: owner occupied		52,176	52,176	10.15%
Subtotal		184,959	184,959	35.97%
Total	\$ 240,569	\$ 273,683	\$ 514,252	100.00%

	June 30, 2013			
	Community Banking Division	LASG (Dollars in thousands)	Total	Percent of Total
Originated loans:				
Residential real estate	\$ 89,584	\$ 150	\$ 89,734	20.61%
Home equity	35,389		35,389	8.13%
Commercial real estate: non-owner occupied	48,428	18,126	66,554	15.29%
Commercial real estate: owner occupied	30,487	3,361	33,848	7.77%
Construction	42		42	0.01%
Commercial business	12,444	17,242	29,686	6.82%
Consumer	13,337		13,337	3.06%
Subtotal	229,711	38,879	268,590	61.69%
Purchased loans:				
Residential real estate		2,706	2,706	0.62%
Commercial business		34	34	0.01%
Commercial real estate: non-owner occupied		125,496	125,496	28.83%

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

Commercial real estate: owner occupied			38,550		38,550	8.85%	
Subtotal			166,786		166,786	38.31%	
Total	\$	229,711	\$	205,665	\$	435,376	100.00%

Classification of Assets

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

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

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

Table of Contents

The following table details the Company's nonperforming assets and other credit quality indicators as of March 31, 2014 and June 30, 2013. The net increase in nonperforming assets during the nine months ended March 31, 2014 was principally due to four purchased loan relationships. Management believes that, based on their carrying amounts, these nonperforming assets are well secured based on the estimated fair value of underlying collateral.

Non-Performing Assets at March 31, 2014				
	Community Banking Division	LASG (Dollars in thousands)		Total
Loans:				
Residential real estate	\$ 1,528	\$ 150		\$ 1,678
Home equity	214			214
Commercial real estate	798	4,582		5,380
Construction				
Commercial business				
Consumer	152			152
Subtotal	2,692	4,732		7,424
Real estate owned and other repossessed collateral	2,000			2,000
Total	\$ 4,692	\$ 4,732		\$ 9,424
Ratio of nonperforming loans to total loans				1.44%
Ratio of nonperforming assets to total assets				1.28%
Ratio of loans past due to total loans				1.44%
Nonperforming loans that are current			\$ 1,923	
Loans risk rated substandard or worse			\$ 11,023	
Troubled debt restructurings:				
On accrual status			\$ 4,160	
On nonaccrual status			\$ 2,189	

Non-Performing Assets at June 30, 2013				
	Community Banking Division	LASG (Dollars in thousands)		Total
Loans:				
Residential real estate	\$ 2,346	\$	\$	2,346
Home equity	334			334
Commercial real estate	473	1,457		1,930
Construction				
Commercial business	110			110
Consumer	136			136
Subtotal	3,399	1,457		4,856
Real estate owned and other repossessed collateral	2,134			2,134
Total	\$ 5,533	\$ 1,457		\$ 6,990
Ratio of nonperforming loans to total loans				1.12%
Ratio of nonperforming assets to total assets				1.04%
Ratio of loans past due to total loans				1.68%
Nonperforming loans that are current			\$ 887	
Loans risk rated substandard or worse			\$ 3,417	
Troubled debt restructurings:				
On accrual status			\$ 2,632	
Nonaccrual status			\$ 1,110	

Table of Contents*Allowance for Loan Losses*

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

The Company's allowance for loan losses was \$1.3 million as of March 31, 2014, which represents an increase of \$202 thousand from \$1.1 million as of June 30, 2013. The increase during the period was principally due to increases in reserves necessary for specific reserves on troubled debt restructurings and general allowances on newly originated loans.

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

	March 31, 2014	June 30, 2013	March 31, 2013
Allowance for loan losses to nonperforming loans	18.12%	23.54%	19.15%
Allowance for loan losses to total loans	0.26%	0.26%	0.27%
Last twelve months of net-charge offs to average loans	0.09%	0.21%	0.23%

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

Other Assets

The cash surrender value of the Company's bank-owned life insurance (BOLI) assets increased \$341 thousand, or 2.4%, to \$14.7 million at March 31, 2014, compared to \$14.4 million at June 30, 2013. Increases in cash surrender value are recognized in other income and are not subject to income taxes. Borrowing on, or surrendering a policy, may subject the Company to income tax expense on the increase in cash surrender value. For these reasons, management considers BOLI an illiquid asset. BOLI represented 11.9% of the Company's total risk-based capital at March 31, 2014.

Intangible assets totaled \$3.0 million and \$3.5 million at March 31, 2014 and June 30, 2013, respectively. The \$582 thousand decrease was the result of core deposit intangible asset amortization during the period.

Deposits, Borrowed Funds, Capital Resources and Liquidity

Deposits

The Company's principal source of funding is its core deposit accounts. At March 31, 2014, non-maturity accounts and certificates of deposit with balances less than \$250 thousand represented 99.6% of total deposits.

Total deposits increased \$78.7 million to \$563.3 million as of March 31, 2014 from \$484.6 million as of June 30, 2013. The increase, which funded growth in the Company's loan portfolio, was principally from term deposits raised through deposit listing services, which has provided the Bank with longer term funding than can typically be attracted through retail channels. At March 31, 2014, the Bank had \$138.6 million of such deposit funding, with a weighted-average original term of 3.0 years. The composition of total deposits at March 31, 2014 and June 30, 2013 follows.

	March 31, 2014		June 30, 2013	
	Amount	Percent of Total (Dollars in thousands)	Amount	Percent of Total
Demand deposits	\$ 43,294	7.69%	\$ 46,425	9.58%
NOW accounts	64,966	11.53%	57,334	11.83%
Regular and other savings	35,995	6.39%	33,636	6.94%
Money market deposits	86,735	15.40%	84,416	17.42%
Total non-certificate accounts	230,990	41.01%	221,811	45.77%
Term certificates less than \$250 thousand	329,988	58.58%	254,384	52.49%
Term certificates of \$250 thousand or more	2,332	0.41%	8,428	1.74%
Total certificate accounts	332,320	58.99%	262,812	54.23%
Total deposits	\$ 563,310	100.00%	\$ 484,623	100.00%

Table of Contents*Borrowed Funds*

Advances from the FHLB were \$42.9 million and \$28.0 million at March 31, 2014 and June 30, 2013, respectively; the increase the result of \$15.0 million of new advances during the period used to fund a portion of the Company's residential loan growth. In conjunction with the aforementioned FHLB advances, the Company entered into interest rate swaps with a weighted average pay rate and term of 3.13% and 15 years, respectively. The interest rate swaps have been designated as cash flow hedges of the variability of cash flows associated with the variable rate debt.

At March 31, 2014, the Company had pledged investment securities with a fair value of \$18.2 million, as well as certain residential real estate loans, commercial real estate loans, and FHLB deposits free of liens or pledges to secure outstanding advances and available additional borrowing capacity.

Wholesale repurchase agreements were \$10.2 million and \$25.4 million at March 31, 2014 and June 30, 2013, respectively. During the nine months ended March 31, 2014, the Company repaid at maturity wholesale repurchase agreements totaling \$15.0 million. At March 31, 2014, the Company had pledged investment securities with a fair value of \$11.8 million as collateral for outstanding wholesale repurchase agreements.

Short-term borrowings, consisting of sweep accounts and repurchase agreements, were \$2.6 million and \$625 thousand as of March 31, 2014 and June 30, 2013, respectively.

Liquidity

The following table is a summary of the liquidity the Company had the ability to access as of March 31, 2014, in addition to traditional retail deposit products (dollars in thousands).

Brokered time deposits	\$	187,723	Subject to policy limitation of 25% of total assets
Federal Home Loan Bank of Boston		94,172	Based on eligible and qualified collateral
Federal Reserve Discount Window			
Borrower-in-Custody		10	Based on the pledge of indirect auto loans
Total unused borrowing capacity		281,905	
Unencumbered investment securities		82,769	
Total sources of liquidity	\$	364,674	

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

At March 31, 2014, the Company had \$364.7 million of immediately accessible liquidity, defined as additional cash that could be raised within seven days through collateralized borrowings, brokered deposits or security sales. This position represented 48.6% of total assets. The Company also had \$74.4 million of cash and cash equivalents at March 31, 2014.

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

Capital

The carrying amount and unpaid principal balance of junior subordinated debentures totaled \$8.4 million and \$16.5 million, respectively, as of March 31, 2014. This debt represents qualifying Tier 1 capital for the Company, up to a maximum of 25% of total Tier 1 capital. At March 31, 2014, the carrying amounts of the junior subordinated notes, net of the Company's \$496 thousand investment in the affiliated trusts, qualified as Tier 1 capital.

At March 31, 2014, stockholders' equity was \$114.0 million, an increase of \$206 thousand compared to June 30, 2013. Book value per outstanding common share was \$10.93 at March 31, 2014 and \$10.89 at June 30, 2013. Tier 1 capital to total average assets of the Company was 16.28% as of March 31, 2014 and 17.78% at June 30, 2013.

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

Table of Contents

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

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

The Basel Committee on Banking Supervision has also released new capital requirements, known as Basel III, setting forth higher capital requirements, enhanced risk coverage, a global leverage ratio, provisions for counter-cyclical capital, and liquidity standards. On July 2, 2013, the Federal Reserve, along with the other federal banking agencies, issued a final rule (the Final Capital Rule) implementing the Basel III capital standards and establishing the minimum capital requirements for banks and bank holding companies required under the Dodd-Frank Act. The majority of the provisions of the Final Capital Rule apply to bank holding companies and banks with consolidated assets of \$500 million or more, such as the Company and the Bank. The Final Capital Rule establishes a new capital risk-based capital ratio, a minimum common equity Tier 1 capital ratio of 6.5% of risk-weighted assets to be a well capitalized institution, and increase the minimum total Tier 1 capital ratio to be a well capitalized institution from 6.0% to 8.0%. Additionally, the Final Capital Rule requires that an institution establish a capital conservation buffer of common equity Tier 1 capital in an amount above the minimum risk-based capital requirements for adequately capitalized institutions equal to 2.5% of total risk weight assets, or face restrictions on capital distributions and executive bonuses. The Final Capital Rule increases the required capital for certain categories of assets, including higher-risk construction real estate loans and certain exposures related to securitizations. Under the Final Capital Rule, the Company may make a one-time, permanent election to continue to exclude accumulated other comprehensive income from capital. If the Company does not make this election, unrealized gains and losses would be included in the calculation of its regulatory capital.

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

The Bank and the Company are subject to capital commitments with the Federal Reserve and the Bureau that require higher minimum capital ratios. These commitments require that the Company and the Bank (i) maintain a Tier 1 leverage ratio of at least 10%; and (ii) maintain a total risk-based capital ratio of at least 15%. The Bank and the Company were in compliance with these commitments at March 31, 2014.

Table of Contents

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

	Actual		Minimum Capital Requirements		Minimum To Be Well Capitalized Under Prompt Correction Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
March 31, 2014:						
Total capital to risk weighted assets:						
Company	\$ 122,945	24.21%	\$ 40,631	≥8.0%	\$ N/A	N/A
Bank	102,257	20.13%	40,648	≥8.0%	50,811	≥10.0%
Tier 1 capital to risk weighted assets:						
Company	121,590	23.94%	20,316	≥4.0%	N/A	N/A
Bank	98,238	19.33%	20,324	≥4.0%	30,486	≥6.0%
Tier 1 capital to average assets:						
Company	121,590	16.28%	29,878	≥4.0%	N/A	N/A
Bank	98,238	13.22%	29,733	≥4.0%	37,166	≥5.0%
June 30, 2013:						
Total capital to risk weighted assets:						
Company	\$ 122,291	27.54%	\$ 35,520	≥8.0%	\$ N/A	N/A
Bank	99,527	22.30%	35,709	≥8.0%	44,637	≥10.0%
Tier 1 capital to risk weighted assets:						
Company	121,148	27.29%	17,760	≥4.0%	N/A	N/A
Bank	95,485	21.39%	17,855	≥4.0%	26,782	≥6.0%
Tier 1 capital to average assets:						
Company	121,148	17.78%	27,255	≥4.0%	N/A	N/A
Bank	95,485	14.08%	27,121	≥4.0%	33,902	≥5.0%

Off-balance Sheet Financial Instruments

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

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

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

Table of ContentsResults of Operations – Continuing Operations*General*

Net income decreased by \$1.2 million to \$437 thousand for the quarter ended March 31, 2014, compared to \$1.6 million for the quarter ended March 31, 2013. Net income decreased by \$1.9 million to \$2.2 million for the nine months ended March 31, 2014, compared to \$4.0 million for the nine months ended March 31, 2013. When compared to the prior year, decreases in net income for both the three and nine months ended March 31, 2014 resulted principally from lower transactional income on purchased loans and lower gains on sales of residential mortgages. Further, in the nine months ended March 31, 2013, the Company recognized \$792 thousand on the sale of investment securities; there were no such sales in the nine months ended March 31, 2014.

The following table details the total return on purchased loans, which includes transactional income of \$689 thousand for the quarter ended March 31, 2014, a decrease of \$3.4 million from the quarter ended March 31, 2013. Transactional income for the nine months ended March 31, 2014 was \$3.7 million, a decrease of \$4.1 million from the nine months ended March 31, 2013, principally due to lower than average purchased loan payoffs and sales in first and third quarters of fiscal 2014.

	Total Return on Purchased Loans Three Months Ended March 31,			
	2014		2013	
	Income	Return (1)	Income	Return (1)
	(Dollars in thousands)			
Regularly scheduled interest and accretion	\$ 3,880	8.83%	\$ 3,043	9.40%
Transactional income:				
Gains on loan sales	349	0.79%	1,218	3.76%
Gain on sale of real estate owned	56	0.13%	211	0.65%
Other noninterest income		0.00%		0.00%
Accelerated accretion and loan fees	284	0.65%	2,653	8.20%
Total transactional income	689	1.57%	4,082	12.61%
Total	\$ 4,569	10.39%	\$ 7,125	22.02%

	Nine Months Ended March 31,			
	2014		2013	
	Income	Return (1)	Income	Return (1)
	(Dollars in thousands)			
Regularly scheduled interest and accretion	\$ 11,632	8.80%	\$ 7,813	9.35%
Transactional income:				
Gains on loan sales	576	0.44%	2,035	2.44%
Gain on sale of real estate owned	56	0.04%	684	0.82%
Other noninterest income		0.00%	36	0.04%
Accelerated accretion and loan fees	3,079	2.33%	5,017	6.01%
Total transactional income	3,711	2.81%	7,772	9.30%
Total	\$ 15,343	11.60%	\$ 15,585	18.66%

Net Interest Income*Three Months Ended March 31, 2014 and 2013*

Net interest income before provision for loan losses decreased by \$1.1 million, or 13.8%, to \$7.1 million for the quarter ended March 31, 2014 compared to the quarter ended March 31, 2013, primarily due to lower transactional interest income from purchased loan payoffs. When compared to the quarter ended March 31, 2013, transactional interest income decreased nearly \$2.4 million, having a 136 basis point effect on the net interest margin, which declined to 4.08% from 5.07%. The following table summarizes interest income and related yields recognized on the loan portfolios.

Community Banking										
Division	\$	249,962	\$	3,183	5.16%	\$	244,397	\$	3,529	5.86%
LASG:										
Originated traditional		57,534		1,008	7.11%		16,167		376	9.43%
Originated securities										
loans		25,992		48	0.75%					0.00%
Purchased		177,559		4,164	9.51%		130,045		5,696	17.76%
Total LASG		261,085		5,220	8.11%		146,212		6,072	16.84%
Total	\$	511,047	\$	8,403	6.67%	\$	390,609	\$	9,601	9.97%

Table of Contents

In the quarter ended March 31, 2014, net interest income was negatively affected by a lower level of noncash accretion of fair value adjustments resulting from the 2010 merger than in the quarter ended March 31, 2013. The effect of such accretion will continue to diminish as financial instruments held at the merger mature or prepay. The following table summarizes the effects of such accretion.

	Average Balance	2014 Income (Expense)	Effect on Yield / Rate	Average Balance	2013 Income (Expense)	Effect on Yield / Rate
	Three Months Ended March 31, (Dollars in thousands)					
Interest-earning assets:						
Investment securities	\$ 114,925	\$	0.00%	\$ 131,006	\$	0.00%
Loans	511,047	53	0.04%	390,609	66	0.07%
Other interest-earning assets	81,227		0.00%	138,416		0.00%
Total interest-earning assets	\$ 707,199	\$ 53	0.03%	\$ 660,031	\$ 66	0.04%
Interest-bearing liabilities:						
Interest-bearing deposits	508,917	74	0.06%	455,700	221	0.20%
Short-term borrowings	2,192		0.00%	1,889		0.00%
Borrowed funds	59,399	104	0.71%	64,212	216	1.36%
Junior subordinated debentures	8,374		0.00%	8,205		0.00%
Total interest-bearing liabilities	\$ 578,882	\$ 178	0.12%	\$ 530,006	\$ 437	0.33%
Total effect of noncash accretion on:						
Net interest income		\$ 231			\$ 503	
Net interest margin		0.13%			0.31%	

Table of Contents

The Company's interest rate spread and net interest margin decreased by 95 basis points and 99 basis points, respectively, for the quarter ended March 31, 2014 compared to the quarter ended March 31, 2013. These decreases were principally the result of the aforementioned decreases in transactional income in the purchased loan portfolio. The following sets forth the average balance sheets, interest income and interest expense, and average yields and costs for the three months ended March 31, 2014 and 2013.

	Three Months Ended March 31,					
	Average Balance	2014 Interest Income/Expense	Average Yield/Rate	Average Balance	2013 Interest Income/Expense	Average Yield/Rate
(Dollars in thousands)						
Assets:						
Interest-earning assets:						
Investment securities	\$ 114,925	\$ 253	0.89%	\$ 131,006	\$ 234	0.72%
Loans (1) (2)	511,047	8,403	6.67%	390,609	9,601	9.97%
Regulatory stock	5,721	16	1.13%	5,391	4	0.30%
Short-term investments (3)	75,506	45	0.24%	133,025	81	0.25%
Total interest-earning assets	707,199	8,717	5.00%	660,031	9,920	6.10%
Cash and due from banks	2,833			3,184		
Other non-interest earning assets	37,366			36,694		
Total assets	\$ 747,398			\$ 699,909		
Liabilities & Stockholders Equity:						
Interest-bearing liabilities:						
NOW accounts	\$ 61,028	\$ 40	0.27%	\$ 55,068	\$ 36	0.27%
Money market accounts	87,352	112	0.52%	70,613	102	0.59%
Savings accounts	35,032	12	0.14%	32,464	11	0.14%
Time deposits	325,505	858	1.07%	297,555	935	1.27%
Total interest-bearing deposits	508,917	1,022	0.81%	455,700	1,084	0.96%
Short-term borrowings	2,192	6	1.11%	1,889	4	0.86%
Borrowed funds	59,399	437	2.98%	64,212	389	2.46%
Junior subordinated debentures	8,374	140	6.78%	8,205	190	9.39%
Total interest-bearing liabilities	578,882	1,605	1.12%	530,006	1,667	1.28%
Non-interest bearing liabilities:						
Demand deposits and escrow accounts	48,361			48,426		
Other liabilities	5,920			5,921		
Total liabilities	633,163			584,353		
Stockholders equity	114,235			115,556		
Total liabilities and stockholders equity	\$ 747,398			\$ 699,909		
Net interest income		\$ 7,112			\$ 8,253	
Interest rate spread			3.87%			4.82%
Net interest margin (4)			4.08%			5.07%

(1) Includes loans held for sale.

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

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

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

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

	Three Months Ended March 31, 2014 compared to 2013		
	Change Due to Volume	Change Due to Rate	Total Change
	(Dollars in thousands)		
Interest earning assets:			
Investment securities	\$ (31)	\$ 50	\$ 19
Loans	2,487	(3,685)	(1,198)
Regulatory stock		12	12
Short-term investments	(34)	(2)	(36)
Total interest-earning assets	2,422	(3,625)	(1,203)
Interest-bearing liabilities:			
Interest-bearing deposits	110	(172)	(62)
Short-term borrowings	1	1	2
Borrowed funds	(31)	79	48
Junior subordinated debentures	4	(54)	(50)
Total interest-bearing liabilities	84	(146)	(62)
Total change in net interest income	\$ 2,338	\$ (3,479)	\$ (1,141)

Table of Contents*Nine Months Ended March 31, 2014 and 2013*

Net interest income before provision for the nine months ended March 31, 2014 and 2013 was \$23.2 million and \$21.4 million, respectively. The increase of \$1.8 million was largely attributable to growth in the LASG loan portfolio, which earned a yield of 9.55% for the nine months ended March 31, 2014 on an average outstanding balance of \$241.7 million. The following table summarizes interest income and related yields recognized on the Company's loans for the nine months ended March 31, 2014 and 2013.

	Nine Months Ended March 31,					
	Average Balance	2014 Interest Income	Yield	Average Balance	2013 Interest Income	Yield
Community Banking Division	\$ 246,539	\$ 9,809	5.30%	\$ 257,760	\$ 11,449	5.92%
LASG:						
Originated traditional loans	44,631	2,513	7.50%	12,974	930	9.55%
Originated securities	21,638	109	0.67%			0.00%
Purchased	175,383	14,711	11.17%	110,151	12,830	15.52%
Total LASG	241,652	17,333	9.55%	123,125	13,760	14.89%
Total	\$ 488,191	\$ 27,142	7.41%	\$ 380,885	\$ 25,209	8.82%

In the nine months ended March 31, 2014, net interest income was negatively affected by a lower level of noncash accretion of fair value adjustments resulting from the 2010 merger than in the nine months ended March 31, 2013. The effect of such accretion will continue to diminish as financial instruments held at the merger mature or prepay. The following table summarizes the effects of such accretion.

	Nine Months Ended March 31,					
	Average Balance	2014 Income (Expense)	Effect on Yield / Rate	Average Balance	2013 Income (Expense)	Effect on Yield / Rate
Interest-earning assets:						
Investment securities	\$ 117,053	\$	0.00%	\$ 132,835	\$ (3)	0.00%
Loans	488,191	136	0.04%	380,885	443	0.15%
Other interest-earning assets	83,055		0.00%	136,437		0.00%
Total interest-earning assets	\$ 688,299	\$ 136	0.03%	\$ 650,157	\$ 440	0.09%
Interest-bearing liabilities:						
Interest-bearing deposits	486,707	489	0.13%	427,125	758	0.24%
Short-term borrowings	2,290		0.00%	1,397		0.00%
Borrowed funds	59,778	319	0.71%	81,183	999	1.64%
Junior subordinated debentures	8,331		0.00%	8,164		0.00%
Total interest-bearing liabilities	\$ 557,106	\$ 808	0.19%	\$ 517,869	\$ 1,757	0.45%
Total effect of noncash accretion on:						
Net interest income		\$ 944			\$ 2,197	

Net interest margin

0.18%

0.45%

Table of Contents

The Company's interest rate spread and net interest margin increased by 15 basis points and 11 basis points, respectively, for the nine months ended March 31, 2014 compared to the nine months ended March 31, 2013. These increases were principally the result of the aforementioned increase in loan volume. The following sets forth the average balance sheets, interest income and interest expense, and average yields and costs for the nine months ended March 31, 2014 and 2013.

	Nine Months Ended March 31,					
	Average Balance	2014 Interest Income/Expense	Average Yield/Rate	Average Balance	2013 Interest Income/Expense	Average Yield/Rate
Assets:						
Interest-earning assets:						
Investment securities	\$ 117,053	\$ 797	0.91%	\$ 132,835	\$ 929	0.93%
Loans (1) (2)	488,191	27,142	7.41%	380,885	25,209	8.82%
Regulatory stock	5,721	68	1.58%	5,446	42	1.03%
Short-term investments (3)	77,334	140	0.24%	130,991	241	0.25%
Total interest-earning assets	688,299	28,147	5.45%	650,157	26,421	5.41%
Cash and due from banks	2,975			3,094		
Other non-interest earning assets	35,855			37,571		
Total assets	\$ 727,129			\$ 690,822		
Liabilities & Stockholders Equity:						
Interest-bearing liabilities:						
NOW accounts	\$ 59,703	\$ 120	0.27%	\$ 55,468	\$ 116	0.28%
Money market accounts	86,421	338	0.52%	56,739	221	0.52%
Savings accounts	34,160	35	0.14%	31,631	32	0.13%
Time deposits	306,423	2,555	1.11%	283,287	2,721	1.28%
Total interest-bearing deposits	486,707	3,048	0.83%	427,125	3,090	0.96%
Short-term borrowings	2,290	17	0.99%	1,397	15	1.43%
Borrowed funds	59,778	1,323	2.95%	81,183	1,334	2.19%
Junior subordinated debentures	8,331	525	8.39%	8,164	574	9.37%
Total interest-bearing liabilities	557,106	4,913	1.17%	517,869	5,013	1.29%
Non-interest bearing liabilities:						
Demand deposits and escrow accounts	50,662			50,192		
Other liabilities	5,718			5,636		
Total liabilities	613,486			573,697		
Stockholders equity	113,643			117,125		
Total liabilities and stockholders equity	\$ 727,129			\$ 690,822		
Net interest income		\$ 23,234			\$ 21,408	
Interest rate spread			4.27%			4.12%
Net interest margin (4)			4.50%			4.39%

(1) Includes loans held for sale.

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

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

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

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

Interest earning assets:					
Investment securities	\$	(108)	\$	(24)	\$ (132)
Loans		6,377		(4,444)	1,933
Regulatory stock		2		24	26
Short-term investments		(97)		(4)	(101)
Total interest-earning assets		6,174		(4,448)	1,726
Interest-bearing liabilities:					
Interest-bearing deposits		336		(378)	(42)
Short-term borrowings		8		(6)	2
Borrowed funds		(405)		394	(11)
Junior subordinated debentures		12		(61)	(49)
Total interest-bearing liabilities		(49)		(51)	(100)
Total change in net interest income	\$	6,223	\$	(4,397)	\$ 1,826

Table of Contents

Provision for Loan Losses

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

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

Three Months Ended March 31, 2014 and 2013

The provision for loan losses for the quarter ended March 31, 2014 and 2013 was \$180 thousand and \$346 thousand, respectively. The decrease in the Company's loan loss provision resulted principally from favorable charge-off trends in the originated loan portfolio.

Nine Months Ended March 31, 2014 and 2013

The provision for loan losses for the nine months ended March 31, 2014 and 2013 was \$407 thousand and \$821 thousand, respectively. The decrease in the Company's loan loss provision resulted from favorable charge-off trends in the originated loan portfolio. Net charge-offs for the nine months ended March 31, 2014 decreased by \$405 thousand from the nine months ended March 31, 2013, principally due to the partial charge-off of one commercial business loan relationship in the first quarter of fiscal 2013.

Noninterest Income

Three Months Ended March 31, 2014 and 2013

Noninterest income decreased by \$1.3 million for the quarter ended March 31, 2014, compared to the quarter ended March 31, 2013, principally due to the following:

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

- A decrease of \$855 thousand in gain on sales of portfolio loans, due to a lower volume of purchased loan sales during the quarter ended March 31, 2014.
- A decrease of \$360 thousand in gain on sales of loans held for sale, principally a volume-related difference related to a significant decline in residential loan refinance activity. The Company sold \$15.3 million of residential loans in the quarter ended March 31, 2014, compared to \$33.3 million in the quarter ended March 31, 2013.
- A decrease of \$65 thousand in net gains on the disposition of other real estate owned.
- A decrease of \$45 thousand in fee income, primarily due to a decrease in transactional deposit account activity.

Nine Months Ended March 31, 2014 and 2013

Noninterest income decreased by \$4.4 million for the nine months ended March 31, 2014, compared to the nine months ended March 31, 2013, principally due to the following:

- A decrease of \$792 thousand in security gains. In the first quarter of fiscal 2013, the Company sold a substantial portion of its available-for-sale investment portfolio and reinvested the sales proceeds in similar securities at lower market yields. There were no security sales in the nine months ended March 31, 2014.
- A decrease of \$1.2 million on sales of held for sale loans, a volume related difference resulting from an increased proportion of residential mortgages held in portfolio and a significant decline in residential loan refinance activity.
- A decrease of \$1.6 million in gains on sales of portfolio loans, principally due to lower volume of purchased loan sales during the nine months ended March 31, 2014.
- A decrease of \$631 thousand in gains on real estate owned, principally due to the favorable resolution of real estate previously securing purchased loans during the nine months ended March 31, 2013.
- A decrease of \$257 thousand in bank-owned life insurance income. In the second quarter of fiscal 2013, the Company received \$235 thousand in life insurance death benefits.

Table of Contents

Noninterest Expense

Three Months Ended March 31, 2014 and 2013

Noninterest expense decreased by \$612 thousand for the current quarter, compared to the quarter ended March 31, 2013. Changes of significance when comparing the current quarter to the quarter ended March 31, 2013 are:

- A decrease of \$928 thousand in salaries and employee benefits, principally related to a decline in incentive compensation.
- An increase of \$232 thousand in occupancy and equipment expense, due to increased rent and utilities expense, depreciation, and software expenses.
- A decrease of \$163 thousand in marketing expense, primarily due to a reduction in deposit marketing in fiscal 2014.
- An increase of \$88 thousand in loan acquisition and collection expenses due, in part, to an increase of \$5.0 million in loan purchases in the quarter ended March 31, 2014 when compared to the quarter ended March 31, 2013.
- An increase of \$204 thousand in other noninterest expense, principally due to non-capital expenditures associated with the Company's upcoming core banking software system conversion.

Nine Months Ended March 31, 2014 and 2013

Noninterest expense increased by \$494 thousand for the nine months ended March 31, 2014 compared to the nine months ended March 31, 2013. Changes of significance when comparing the nine months ended March 31, 2014 to the nine months ended March 31, 2013 are:

- An increase of \$454 thousand in salaries and employee benefits, principally due to increased costs associated with severance, employee benefits, and stock-based compensation.
- An increase of \$734 thousand in occupancy and equipment expense, primarily due to the relocation of the Company's Boston office in the second quarter of fiscal 2013 as well as increased utilities, depreciation, and software expenses.
- A decrease of \$453 thousand in marketing expense, primarily due to a reduction in deposit marketing in fiscal 2014.
- A decrease of \$153 thousand in intangible asset amortization. The Company's core deposit intangible amortizes on an accelerated basis.
- A legal settlement recovery of \$250 thousand recognized in the nine months ended March 31, 2014.

- An increase of \$250 thousand in other noninterest expense, principally due to non-capital expenditures associated with the Company's core banking software system conversion.

Income Taxes

Three Months Ended March 31, 2014 and 2013

The Company's income tax expense was \$287 thousand, or an effective rate of 39.6%, for the quarter ended March 31, 2014. The Company's income tax expense was \$792 thousand, or an effective rate of 32.7%, for the quarter ended March 31, 2013. The Company's effective income tax rate may vary in any one quarter due to fluctuations in its projected pre-tax income and permanent book to tax differences for the fiscal year.

Nine Months Ended March 31, 2014 and 2013

The Company's income tax expense was \$1.1 million, or an effective rate of 34.1%, for the nine months ended March 31, 2014, as compared to \$1.9 million, or an effective rate of 32.1%, for the nine months ended March 31, 2013. The increased effective income tax rate in the nine months ended March 31, 2014 principally resulted from higher statutory rates resulting from expected state tax apportionment.

Results of Operations **Discontinued Operations**

The Company concluded all investment brokerage activities in the second quarter of fiscal 2014. Accordingly, operations associated with these activities have been classified as discontinued operations.

The Company earned net income from discontinued operations of \$36 thousand in the quarter ended March 31, 2013, compared to none in the quarter ended March 31, 2014. The Company reported a net loss from discontinued operations of \$8 thousand for the nine months ended March 31, 2014, compared to net income of \$166 thousand in the nine months ended March 31, 2013.

Table of Contents

Item 3. Quantitative and Qualitative Disclosure about Market Risk

Not required for smaller reporting companies.

Item 4. Controls and Procedures

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

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

Based on this evaluation of the Company s disclosure controls and procedures, the Chief Executive Officer and Chief Financial Officer have concluded that these disclosure controls and procedures were effective as of March 31, 2014.

There were no changes in the Company s internal controls over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) that occurred during the quarter ended March 31, 2014 that have materially affected, or is reasonably likely to materially affect, the Company s internal controls over financial reporting.

PART II OTHER INFORMATION

Item 1. Legal Proceedings

None.

Item 1A. Risk Factors

Not required for smaller reporting companies.

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

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

Table of Contents

Exhibits

No.	Description
31.1	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Rule 13a-14(a)). *
31.2	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Rule 13a-14(a)). *
32.1	Certificate of the Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Rule 13a-14(b)). **
32.2	Certificate of the Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Rule 13a-14(b)). **
101	The following materials from Northeast Bancorp's Quarterly Report on Form 10-Q for the quarter ended March 31, 2014 formatted in XBRL: (i) Consolidated Balance Sheets at March 31, 2014 and June 30, 2013; (ii) Consolidated Statements of Income for the three and nine months ended March 31, 2014 and 2013; (iii) Consolidated Statements of Comprehensive Income for the three and nine months ended March 31, 2014 and 2013; (iv) Consolidated Statements of Changes in Shareholders' Equity for the nine months ended March 31, 2014 and 2013; (v) Consolidated Statements of Cash Flows for the nine months ended March 31, 2014 and 2013; and (v) Notes to Unaudited Consolidated Financial Statements. ***

* Filed herewith

** Furnished herewith

*** Pursuant to Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this Quarterly Report on Form 10-Q is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933, as amended, and Section 18 of the Securities Exchange Act of 1934, as amended.

Table of Contents

SIGNATURES

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

Date: May 8, 2014

By: **NORTHEAST BANCORP**
/s/ Richard Wayne
Richard Wayne
President and CEO

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

Table of Contents

NORTHEAST BANCORP

Index to Exhibits

Exhibits No.	Description
31.1	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Rule 13a-14(a)). *
31.2	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Rule 13a-14(a)). *
32.1	Certificate of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Rule 13a-14(b)). **
32.2	Certificate of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Rule 13a-14(b)). **
101	The following materials from Northeast Bancorp's Quarterly Report on Form 10-Q for the quarter ended March 31, 2014 formatted in XBRL: (i) Consolidated Balance Sheets at March 31, 2014 and June 30, 2013; (ii) Consolidated Statements of Income for the three and nine months ended March 31, 2014 and 2013; (iii) Consolidated Statements of Comprehensive Income for the three and nine months ended March 31, 2014 and 2013; (iv) Consolidated Statements of Changes in Shareholders' Equity for the nine months ended March 31, 2014 and 2013; (v) Consolidated Statements of Cash Flows for the nine months ended March 31, 2014 and 2013; and (v) Notes to Unaudited Consolidated Financial Statements. ***

* Filed herewith

** Furnished herewith

*** Pursuant to Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this Quarterly Report on Form 10-Q is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933, as amended, and Section 18 of the Securities Exchange Act of 1934, as amended.