

BAR HARBOR BANKSHARES
Form 10-Q
August 08, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2007

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

Commission File Number: **841105-D**

BAR HARBOR BANKSHARES

(Exact name of registrant as specified in its charter)

Maine

(State or other jurisdiction of
incorporation or organization)

PO Box 400

82 Main Street, Bar Harbor, ME

(Address of principal executive offices)

01-0393663

(I.R.S. Employer
Identification Number)

04609-0400

(Zip Code)

(207) 288-3314

(Registrant's telephone number, including area code)

Inapplicable

(Former name, former address and former fiscal year, if changed since last report)

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

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

Large accelerated filer Accelerated filer

Non-accelerated filer

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-Q

Indicate by check mark whether the registrant is a shell company (as defined in exchange act rule 12b-2): YES: _____
 NO: X

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date:

<u>Class of Common Stock</u>	<u>Number of Shares Outstanding</u> <u>August 6, 2007</u>
\$2.00 Par Value	3,040,771

TABLE OF CONTENTS

	Page No.
PART I	FINANCIAL INFORMATION
Item 1.	Financial Statements (<i>unaudited</i>):
	Consolidated Balance Sheets at June 30, 2007, and December 31, 2006
	3
	Consolidated Statements of Income for the three and six months ended June 30, 2007 and 2006
	4
	Consolidated Statements of Changes in Shareholders' Equity for the six months ended June 30, 2007 and 2006
	5
	Consolidated Statements of Cash Flows for the six months ended June 30, 2007 and 2006
	6
	Consolidated Statements of Comprehensive Income for the three and six months ended June 30, 2007 and 2006
	7
	Notes to Consolidated Interim Financial Statements
	8-16
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations
	17-45
Item 3.	Quantitative and Qualitative Disclosures About Market Risk
	46-49
Item 4.	Controls and Procedures
	49
PART II	OTHER INFORMATION
Item 1.	Legal Proceedings
	49
Item 1A.	Risk Factors
	49
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds
	50
Item 3.	Defaults Upon Senior Securities
	50
Item 4.	Submission of Matters to a Vote of Security Holders
	50-51
Item 5.	Other Information
	51
Item 6.	Exhibits
	51-52
Signatures	52

PART I. FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

BAR HARBOR BANKSHARES AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
JUNE 30, 2007 AND DECEMBER 31, 2006
(Dollars in thousands, except share data)
(unaudited)

	June 30, 2007	December 31, 2006
Assets		
Cash and due from banks	\$ 9,037	\$ 11,838
Overnight interest bearing money market funds	2,884	7,709
Total cash and cash equivalents	11,921	19,547
Securities available for sale, at fair value	230,313	213,252
Investment in Federal Home Loan Bank stock	12,531	11,849
Loans	551,801	555,099
Allowance for loan losses	(4,501)	(4,525)
Loans, net of allowance for loan losses	547,300	550,574
Premises and equipment, net	11,102	11,368
Goodwill	3,158	3,158
Bank owned life insurance	6,225	6,116
Other assets	10,900	9,013
TOTAL ASSETS	\$833,450	\$824,877
Liabilities		
Deposits		
Demand deposits	\$ 53,958	\$ 53,872
NOW accounts	63,309	63,588
Savings and money market deposits	136,294	164,213
Time deposits	129,346	132,285
Brokered time deposits	134,524	82,361
Total deposits	517,431	496,319
Short-term borrowings	166,998	175,246
Long-term debt	81,997	85,466
Other liabilities	5,663	6,795
TOTAL LIABILITIES	772,089	763,826
Shareholders' equity		
Capital stock, par value \$2.00; authorized 10,000,000 shares; issued 3,643,614 shares at June 30, 2007 and December 31, 2006	7,287	7,287
Surplus	4,519	4,365
Retained earnings	60,974	59,339
Accumulated other comprehensive (loss) income:		
Prior service cost and unamortized net actuarial gains/losses on employee benefit plans, net of tax of (\$69) and \$80, at June 30, 2007 and December 31, 2006, respectively	(132)	156
Net unrealized depreciation on securities available for sale, net of tax of \$950 and \$351, at June 30, 2007 and December 31, 2006,	(1,843)	(680)

respectively

Net unrealized depreciation on derivative instruments, net of tax of \$171

and \$221 at June 30, 2007 and December 31, 2006, respectively

	(333)	(429)
Total accumulated other comprehensive loss	(2,308)	(953)

Less: cost of 599,981

and 596,169 shares of treasury stock

at June 30, 2007 and December 31, 2006, respectively

	(9,111)	(8,987)
TOTAL SHAREHOLDERS' EQUITY	61,361	61,051
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$833,450	\$824,877

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

BAR HARBOR BANKSHARES AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2007 AND 2006
(Dollars in thousands, except share data)
(unaudited)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2007	2006	2007	2006
Interest and dividend income:				
Interest and fees on loans	\$ 9,412	\$ 8,743	\$18,600	\$17,006
Interest and dividends on securities and other earning assets	3,194	2,581	6,366	5,012
Total interest and dividend income	12,606	11,324	24,966	22,018
Interest expense:				
Deposits	3,990	3,101	7,877	5,710
Short-term borrowings	1,035	1,734	2,952	3,053
Long-term borrowings	1,985	1,221	3,259	2,500
Total interest expense	7,010	6,056	14,088	11,263
Net interest income	5,596	5,268	10,878	10,755
Provision for loan losses	33	15	33	43
Net interest income after provision for loan losses	5,563	5,253	10,845	10,712
Non-interest income:				
Trust and other financial services	642	568	1,183	1,072
Service charges on deposit accounts	418	405	788	748
Other service charges, commissions and fees	53	57	105	110
Credit and debit card service charges and fees	441	393	708	623
Net securities gains (losses)	18	---	(902)	310
Other operating income	86	102	154	266
Total non-interest income	1,658	1,525	2,036	3,129
Non-interest expenses:				

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-Q

Salaries and employee benefits	2,154	2,273	4,499	4,717
Postretirement plan settlement	---	---	(832)	---
Occupancy expense	320	337	693	649
Furniture and equipment expense	439	422	888	922
Credit and debit card expenses	270	250	458	416
Other operating expense	1,370	1,168	2,644	2,631
Total non-interest expenses	4,553	4,450	8,350	9,335
Income before income taxes	2,668	2,328	4,531	4,506
Income taxes	825	682	1,313	1,297
Net income	\$ 1,843	\$ 1,646	\$ 3,218	\$ 3,209
<u>Earnings Per Share:</u>				
Basic earnings per share	\$ 0.61	\$ 0.54	\$ 1.06	\$ 1.05
Diluted earnings per share	\$ 0.59	\$ 0.53	\$ 1.03	\$ 1.03

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

BAR HARBOR BANKSHARES AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
FOR THE SIX MONTHS ENDED JUNE 30, 2007 AND 2006
(Dollars in thousands, except share data)
(unaudited)

	Capital Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total Shareholders' Equity
Balance December 31, 2005	\$7,287	\$4,002	\$55,181	\$(1,738)	\$(8,628)	\$56,104
Cumulative effect adjustment from the adoption of SAB No. 108	---	---	331	---	---	331
Adjusted balance December 31, 2005	7,287	4,002	55,512	(1,738)	(8,628)	56,435
Net income	---	---	3,209	---	---	3,209
Total other comprehensive loss	---	---	---	(2,091)	---	(2,091)
Cash dividends declared (\$0.445 per share)	---	---	(1,358)	---	---	(1,358)
Purchase of treasury stock (27,435 shares)	---	---	---	---	(764)	(764)
Stock options exercised (16,266 shares), net of tax effects	---	---	(168)	---	467	299
Recognition of stock option expense	---	71	---	---	---	71
Balance June 30, 2006	\$7,287	\$4,073	\$57,195	\$(3,829)	\$(8,925)	\$55,801
Balance December 31, 2006	\$7,287	\$4,365	\$59,339	\$(953)	\$(8,987)	\$61,051
Net income	---	---	3,218	---	---	3,218
Total other comprehensive income	---	---	---	(1,355)	---	(1,355)
Cash dividends declared (\$0.470 per share)	---	---	(1,431)	---	---	(1,431)

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-Q

Purchase of treasury stock (15,169 shares)	---	---	---	---	(488)	(488)
Stock options exercised (11,357 shares), net of tax effects	---	50	(152)	---	364	262
Recognition of stock option expense	---	104	---	---	---	104
Balance June 30, 2007	\$7,287	\$4,519	\$60,974	\$(2,308)	\$(9,111)	\$61,361

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

BAR HARBOR BANKSHARES AND SUBSIDIARIES

**CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE SIX MONTHS ENDED JUNE 30, 2007 AND 2006**

(Dollars in thousands)
(unaudited)

	2007	2006
Cash flows from operating activities:		
Net income	\$ 3,218	\$ 3,209
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of premises and equipment	626	671
Amortization of core deposit intangible	34	33
Provision for loan losses	33	43
Net securities losses (gains)	902	(310)
Net amortization of bond premiums	82	133
Recognition of stock option expense	104	71
Postretirement plan settlement	(832)	---
Net change in other assets	(1,332)	(629)
Net change in other liabilities	(591)	(395)
Net cash provided by operating activities	2,244	2,826
Cash flows from investing activities:		
Purchases of securities available for sale	(89,345)	(41,811)
Proceeds from maturities, calls and principal paydowns of securities available for sale	21,166	14,902
Proceeds from sales of securities available for sale	48,372	3,140
Net increase in Federal Home Loan Bank stock	(682)	(1,325)
Net loans repaid by (made to) customers	3,241	(29,044)
Capital expenditures	(360)	(551)
Net cash used in investing activities	(17,608)	(54,689)
Cash flows from financing activities:		

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-Q

Net increase in deposits	21,112	41,833
Net decrease in securities sold under repurchase agreements and fed funds purchased	(2,529)	(4,562)
Proceeds from Federal Home Loan Bank advances	32,000	40,500
Repayments of Federal Home Loan Bank advances	(41,188)	(23,496)
Purchases of treasury stock	(488)	(764)
Proceeds from stock option exercises, including tax benefits	262	299
Payments of dividends	(1,431)	(1,358)
Net cash provided by financing activities	7,738	52,452

Net (decrease) increase in cash and cash equivalents	(7,626)	589
Cash and cash equivalents at beginning of period	19,547	14,000
Cash and cash equivalents at end of period	\$11,921	\$14,589

Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	\$13,307	\$10,896
Income taxes	855	700

Non-cash investing and finance activities:		
Cumulative effect adjustment from the adoption of SAB No. 108	\$ ---	\$ 331
Net unrealized depreciation on securities available for sale, net of reclassification adjustment, net of tax of \$599 and \$996, respectively	(1,163)	(1,935)
Net unrealized appreciation (depreciation) on interest rate derivatives, net of tax of \$46 and (\$84), respectively	89	(163)
Ineffective portion of unrealized losses on interest rate derivatives, net of tax of \$2	4	---
Amortization of net deferred loss related to interest rate derivatives, net of tax of \$2 and \$3, respectively	3	7
Elimination of actuarial gain upon postretirement plan settlement, and related tax effect of (\$151)	(291)	---
Amortization of actuarial gain for supplemental executive retirement plan, net of related tax of \$2	3	---

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

BAR HARBOR BANKSHARES AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2007 AND 2006
(Dollars in thousands)
(unaudited)

	Three Months Ended June 30,	
	2007	2006
Net income	\$ 1,843	\$ 1,646
Net unrealized depreciation on securities available for sale, net of tax of (\$1,166) and (\$686), respectively	(2,264)	(1,331)
Less reclassification adjustment for net gains related to securities available for sale included in net income, net of tax of \$6 and \$0, respectively	(12)	---
Net unrealized appreciation (depreciation) on interest rate derivatives, net of tax of \$7 and (\$21), respectively	13	(40)
Ineffective portion of unrealized losses on interest rate derivatives, net of tax of \$5	9	---
Amortization of net deferred loss related to interest rate derivatives, net of tax of \$1 and \$3, respectively	1	6
Amortization of actuarial gain for supplemental executive retirement plan, net of related tax of \$2	1	---
Total other comprehensive loss	(2,252)	(1,365)
Total comprehensive (loss) income	\$ (409)	\$ 281
	Six Months Ended June 30,	
	2007	2006
Net income	\$ 3,218	\$ 3,209
Net unrealized depreciation on securities available for sale, net of tax of (\$906) and (\$891), respectively	(1,758)	(1,730)
Less reclassification adjustment for net losses (gains) related to securities available for sale included in net income, net of tax of \$307 and (\$105), respectively	595	(205)
Net unrealized appreciation (depreciation) on interest rate derivatives, net of tax of \$46 and (\$84), respectively	89	(163)
Ineffective portion of unrealized losses on interest rate derivatives, net of tax of \$2	4	---
Amortization of net deferred loss related to interest rate derivatives, net of tax of \$2 and \$3, respectively	3	7
Elimination of actuarial gain upon post retirement plan settlement, and related tax effect of (\$151)	(291)	---
Amortization of actuarial gain for supplemental executive retirement plan, net of related tax of \$2	3	---
Total other comprehensive loss	(1,355)	(2,091)
Total comprehensive income	\$ 1,863	\$ 1,118

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

BAR HARBOR BANKSHARES AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED INTERIM FINANCIAL STATEMENTS
JUNE 30, 2007
(Dollars in thousands, except share data)
(*unaudited*)

Note 1: Basis of Presentation

The accompanying consolidated interim financial statements are unaudited. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. All inter-company transactions have been eliminated in consolidation. Amounts in the prior period financial statements are reclassified whenever necessary to conform to current period presentation. The net income reported for the three and six months ended June 30, 2007 is not necessarily indicative of the results that may be expected for the year ending December 31, 2007, or any other interim periods.

The consolidated balance sheet at December 31, 2006 has been derived from audited consolidated financial statements at that date. The accompanying unaudited interim consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X (17 CFR Part 218). Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. For further information, refer to the consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2006, and notes thereto.

Note 2: Management's Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, income tax estimates, and the valuation of intangible assets.

Allowance For Loan Losses:

The allowance for loan losses (the "allowance") at the Company's wholly owned banking subsidiary, Bar Harbor Bank & Trust (the "Bank") is a significant accounting estimate used in the preparation of the Company's consolidated financial statements. The allowance is available to absorb losses on loans. The allowance is maintained at a level that, in management's judgment, is appropriate for the amount of risk inherent in the loan portfolio, given past and present conditions. The allowance is increased by provisions charged to operating expense and by recoveries on loans previously charged-off.

Arriving at an appropriate level of allowance for loan losses involves a high degree of judgment. The determination of the adequacy of the allowance and provisioning for estimated losses is evaluated regularly based on review of loans, with particular emphasis on non-performing and other loans that management believes warrant special consideration. The ongoing evaluation process includes a formal analysis, which considers among other factors: the character and size of the loan portfolio, business and economic conditions, real estate market conditions, collateral values, changes in product offerings or loan terms, changes in underwriting and/or collection policies, loan growth, previous charge-off experience, delinquency trends, non-performing loan trends, the performance of individual loans in relation to contract terms, and estimated fair values of collateral.

Reserves are established for specific loans including impaired loans, a pool of reserves based on historical charge-offs by loan types, and supplemental reserves that adjust historical loss experience to reflect current economic conditions, industry specific risks, and other observable data.

While management uses available information to recognize losses on loans, changing economic conditions and the economic prospects of the borrowers may necessitate future additions or reductions to the allowance. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance, which also may necessitate future additions or reductions to the allowance, based on information available to them at the time of their examination.

Income Taxes:

On January 1, 2007, the Company adopted Financial Accounting Interpretation Number 48 ("FIN 48") to account for uncertain tax positions. FIN 48 prescribes a recognition threshold of more-likely-than-not, and a measurement attribute for all tax positions taken or expected to be taken on a tax return, in order for those tax positions to be recognized in the financial statements.

The Company estimates its income taxes for each period for which a statement of income is presented. The Company uses the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. If current available information indicates that it is more likely than not that deferred tax assets will not be realized, a valuation allowance is established. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Significant management judgment is required in determining income tax expense, and deferred tax assets and liabilities. As of June 30, 2007 and December 31, 2006, there was no valuation allowance for deferred tax assets. Deferred tax assets are included in other assets on the consolidated balance sheet.

Goodwill and Identifiable Intangible Assets:

In connection with acquisitions, the Company generally records as assets on its consolidated financial statements both goodwill and identifiable intangible assets, such as core deposit intangibles.

The Company evaluates whether the carrying value of its goodwill has become impaired, in which case the value is reduced through a charge to its earnings. Goodwill is evaluated for impairment at least annually, or upon a triggering event as defined by Statement of Financial Accounting Standards ("SFAS") No. 142, using certain fair value techniques.

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-Q

Identifiable intangible assets, included in other assets on the consolidated balance sheet, consist of core deposit intangibles amortized over their estimated useful lives on a straight-line method, which approximates the amount of economic benefits to the Company. These assets are reviewed for impairment at least annually, or whenever management believes events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. Furthermore, the determination of which intangible assets have finite lives is subjective, as is the determination of the amortization period for such intangible assets.

Any changes in the estimates used by the Company to determine the carrying value of its goodwill and identifiable intangible assets, or which otherwise adversely affect their value or estimated lives, would adversely affect the Company's consolidated results of operations.

Note 3: Earnings Per Share

Earnings per share have been computed in accordance with SFAS No. 128, "Earnings Per Share."

Basic earnings per share excludes dilution and is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the Company, such as the Company's dilutive stock options.

The following is a reconciliation of basic and diluted earnings per share for the three and six months ended June 30, 2007 and 2006:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Net income	\$ 1,843	\$ 1,646	\$ 3,218	\$ 3,209
<u>Computation of Earnings Per Share:</u>				
Weighted average number of capital stock shares outstanding				
Basic	3,043,900	3,047,473	3,045,392	3,051,630
Effect of dilutive employee stock options	78,474	81,774	79,485	78,044
Diluted	3,122,374	3,129,247	3,124,877	3,129,674
EARNINGS PER SHARE:				
Basic	\$ 0.61	\$ 0.54	\$ 1.06	\$ 1.05
Diluted	\$ 0.59	\$ 0.53	\$ 1.03	\$ 1.03
Anti-dilutive options excluded from earnings per share calculation	61,436	80,476	56,482	82,874

Note 4: Retirement Benefit Plans

Prior to the first quarter of 2007, the Company sponsored a limited post-retirement benefit program, which funded medical coverage and life insurance benefits to a closed group of active and retired employees who met minimum age and service requirements. It was the Company's policy to record the cost of post-retirement health care and life insurance plans based on actuarial estimates, which were dependent on claims and premiums paid. The cost of providing these benefits was accrued during the active service period of the employee.

In the first quarter of 2007, the Company settled its limited post-retirement benefit program. The Company voluntarily paid out \$700 to plan participants, representing 64% of the accrued post retirement benefit obligation. This payment fully settled all Company obligations related to this program. In connection with the settlement of the postretirement

program, the Company recorded a reduction in non-interest expense of \$832, representing the elimination of the \$390 remaining accrued benefit obligation included in other liabilities on the consolidated balance sheet, and the \$442 actuarial gain (\$291, net of tax) related to the program. The actuarial gain was previously included in accumulated other comprehensive income, net of tax effect of \$151.

The Company has non-qualified supplemental executive retirement plans for certain retired officers. These plans provide supplemental retirement benefits payable in installments over a period of years upon retirement or death. The Company recognized the net present value of payments associated with the agreements over the service periods of the participating officers. Interest costs continue to be recognized on the benefit obligations.

The Company also has supplemental executive retirement plans for certain current executive officers. These plans provide a stream of future payments in accordance with individually defined vesting schedules upon retirement, termination, death, or in the event that the executive leaves the Company following a change of control event.

The following table summarizes the net periodic benefit costs for the three and six months ended June 30, 2007 and 2006:

	Supplemental Executive Retirement Plans	
	2007	2006
Three Months Ended June 30,		
Service cost	\$ 48	\$ 40
Interest cost	41	57
Amortization of actuarial loss	2	---
Net periodic benefit cost	\$ 91	\$ 97
Six Months Ended June 30,		
Service cost	\$ 98	\$ 87
Interest cost	81	95
Amortization of actuarial loss	5	---
Net periodic benefit cost	\$184	\$182

The Company expects to recognize \$359 of expense for the supplemental plans for the year ended December 31, 2007. The Company expects to contribute \$222 to the supplemental plans in 2007. As of June 30, 2007, the Company had contributed \$106.

Note 5: Commitments and Contingent Liabilities

The Bank is a party to financial instruments in the normal course of business to meet financing needs of its customers. These financial instruments include commitments to extend credit, unused lines of credit, and standby letters of credit.

Commitments to originate loans, including unused lines of credit, are agreements to lend to a customer provided 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 Bank uses the same credit policy to make such commitments as it uses for on-balance-sheet items, such as loans. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the borrower.

The Bank guarantees the obligations or performance of customers by issuing standby letters of credit to third parties. These standby letters of credit are primarily issued in support of third-party debt or obligations. The risk involved in issuing standby letters of credit is essentially the same as the credit risk involved in extending loan facilities to customers, and they are subject to the same credit origination, portfolio maintenance and management procedures in

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-Q

effect to monitor other credit and off-balance sheet instruments. Exposure to credit loss in the event of non-performance by the counter-party to the financial instrument for standby letters of credit is represented by the contractual amount of those instruments. Typically, these standby letters of credit have terms of five years or less and expire unused; therefore, the total amounts do not necessarily represent future cash requirements.

The following table summarizes the contractual amounts of commitments and contingent liabilities as of June 30, 2007 and December 31, 2006:

	June 30, 2007	December 31, 2006
Commitments to originate loans	\$44,206	\$13,340
Unused lines of credit	\$77,895	\$81,800
Un-advanced portions of construction loans	\$ 8,826	\$ 7,638
Standby letters of credit	\$ 512	\$ 442

As of June 30, 2007, and December 31, 2006, the fair values of the standby letters of credit were not significant to the Company's consolidated financial statements.

Note 6: Financial Derivative Instruments

As part of its overall asset and liability management strategy, the Bank periodically uses derivative instruments to minimize significant unplanned fluctuations in earnings and cash flows caused by interest rate volatility. The Bank's interest rate risk management strategy involves modifying the re-pricing characteristics of certain assets and liabilities so that changes in interest rates do not have a significant effect on net income.

The Company recognizes all of its derivative instruments on the consolidated balance sheet at fair value. On the date the derivative instrument is entered into, the Bank designates whether the derivative is part of a hedging relationship (i.e., cash flow or fair value hedge). The Bank formally documents relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking hedge transactions. The Bank also assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives used in hedging transactions are highly effective in offsetting the changes in cash flows or fair values of hedged items.

Changes in fair value of derivative instruments that are highly effective and qualify as a cash flow hedge are recorded in other comprehensive income or loss. Any ineffective portion is recorded in earnings. For fair value hedges that are highly effective, the gain or loss on the hedge and the loss or gain on the hedged item attributable to the hedged risk are both recognized in earnings, with the differences (if any) representing hedge ineffectiveness. The Bank discontinues hedge accounting when it is determined that the derivative is no longer highly effective in offsetting changes of the hedged risk on the hedged item, or management determines that the designation of the derivative as a hedging instrument is no longer appropriate.

At June 30, 2007, the Bank had four outstanding derivative instruments with notional principal amounts totaling \$50,000. These derivative instruments were interest rate swap agreements and interest rate floor agreements, with notional principal amounts totaling \$20,000 and \$30,000, respectively. The details are summarized as follows:

Interest Rate Swap Agreements:

Description	Maturity	Notional Amount	Fixed Interest Rate	Variable Interest Rate
Receive fixed rate, pay variable rate	09/01/07	\$10,000	6.04%	Prime (8.25%)
Receive fixed rate, pay variable rate	01/24/09	\$10,000	6.25%	Prime (8.25%)

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-Q

The Bank is required to pay a counter-party monthly variable rate payments indexed to Prime, while receiving monthly fixed rate payments based upon interest rates of 6.04% and 6.25%, respectively, over the term of each agreement.

The interest rate swap agreements were designated as cash flow hedges in accordance with SFAS No. 133 Implementation Issue No. G25, "Cash Flow Hedges: Using the First-Payments Received Technique in Hedging the Variable Interest Payments on a Group of Non-Benchmark-Rate-Based Loans."

At June 30, 2007, the fair market value of the interest rate swap agreements was an unrealized loss of \$324 compared with unrealized losses of \$473 and \$777 at December 31, and June 30, 2006, respectively. The fair market values of the interest rate swap agreements were included in other liabilities on the consolidated balance sheets.

During the three and six months ended June 30, 2007, the total net cash flows paid to counter-parties amounted to \$103 and \$209, compared with \$73 and \$126 during the same periods in 2006. The net cash flows paid to counter-parties were recorded as reductions in interest income on the hedged loans.

At June 30, 2007, the net unrealized loss on the interest rate swap agreements included in accumulated other comprehensive loss, net of tax, amounted to \$214, compared with \$313 and \$513 at December 31 and June 30, 2006, respectively. Also included in accumulated other comprehensive loss at June 30, 2007, was a net deferred loss, net of tax, of \$3 related to the de-designation and re-designation of these interest rate swap agreements as cash flow hedges in 2004.

Interest Rate Floor Agreements:

Notional Amount	Termination Date	Prime Strike Rate	Premium Paid
\$20,000	08/01/10	6.00%	\$186
\$10,000	11/01/10	6.50%	\$ 69

During 2005, interest rate floor agreements were purchased to limit the Bank's exposure to falling interest rates on two pools of loans indexed to the Prime interest rate. Under the terms of the agreements, the Bank paid premiums of \$186 and \$69 for the right to receive cash flow payments if the Prime interest rate falls below the floors of 6.00% and 6.50%, thus effectively ensuring interest income on the pools of prime-based loans at minimum rates of 6.00% and 6.50% for the duration of the agreements. The interest rate floor agreements were designated as cash flow hedges in accordance with SFAS 133.

At June 30, 2007, the total fair market value of the interest rate floor agreements was \$8 compared with \$40 at December 31, 2006. The fair market values of the interest rate floor agreements are included in other liabilities on the Company's consolidated balance sheets. Pursuant to SFAS 133, changes in the fair market value, representing unrealized gains or losses, are recorded in accumulated other comprehensive loss.

The premiums paid on the interest rate floor agreements are included in accumulated other comprehensive loss on the consolidated balance sheets and are being recognized as reductions of interest income over the duration of the agreements using the floorlet method, in accordance with SFAS 133. During the three and six months ended June 30, 2007, \$9 and \$18 of the premium was recognized in interest income, respectively. At June 30, 2007, the remaining unamortized premiums, net of tax, totaled \$143, compared with \$154 at December 31, 2006. During the next twelve months, \$52 of the premiums will be recognized in interest income, decreasing the interest income related to the hedged pool of Prime-based loans.

At June 30, 2007, and December 31, 2006, the unamortized premium net of the unrealized gain on the interest rate floor agreements amounted to \$138 and \$129, net of tax, respectively, and was recorded in accumulated other

comprehensive loss on the consolidated balance sheet.

A summary of the hedging related balances follows:

	June 30, 2007		December 31, 2006	
	Gross	Net of Tax	Gross	Net of Tax
Unrealized gain on interest rate floors, including ineffectiveness of \$34 at June 30, 2007 and \$28 at December 31, 2006	\$ 42	\$ 27	\$ 68	\$ 44
Unrealized loss on interest rate swaps	(324)	(214)	(473)	(313)
Unamortized premium on interest rate floors	(217)	(143)	(235)	(154)
Net deferred loss on de-designation of interest rate swaps	(5)	(3)	(10)	(6)
Total	\$(504)	\$(333)	\$(650)	\$(429)

Note 7: Recently Adopted Accounting Standards

The Company recently adopted the following accounting standards:

Accounting for Uncertainty in Income Taxes:

In June 2006, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement 109" ("FIN 48"). This statement clarifies the criteria that an individual tax position must satisfy for some or all of the benefits of that position to be recognized in a company's financial statements. FIN 48 prescribes a recognition threshold of more-likely-than-not, and a measurement attribute for all tax positions taken or expected to be taken on a tax return, in order for those tax positions to be recognized in the financial statements. FIN 48 also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, and disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006.

On January 1, 2007 the Company adopted the provisions of FIN 48 and there was no impact on the consolidated financial statements. Upon the adoption of this standard, the Company performed an analysis of its tax positions to determine whether there may be uncertainties that require further analysis under FIN 48 based upon their specific facts and circumstances. The Company did not identify any uncertain tax positions for which tax benefits should not be recognized under FIN 48 upon adoption or as of June 30, 2007. The Company accounts for interest and penalties related to uncertain tax positions as part of its provision for federal and state income taxes.

The Company is currently open to audit under the statute of limitations by the Internal Revenue Service for the years ended December 31, 2004 through 2006. The Company's state income tax returns are also open to audit under the statute of limitations for the years ended December 31, 2004 through 2006.

Accounting for Servicing of Financial Assets:

In March 2006, the FASB issued Statement of Financial Accounting Standards No. 156 ("SFAS 156"), "Accounting for Servicing of Financial Assets." This statement amends Statement of Financial Accounting Standards No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," with respect to the accounting for separately recognized servicing assets and servicing liabilities. SFAS 156 requires companies to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by

entering into a servicing contract. The statement permits a company to choose either the amortized cost method or fair value measurement method for each class of separately recognized servicing assets. This statement is effective as of the beginning of a company's first fiscal year after September 15, 2006 (January 1, 2007 for the Company). The Company's adoption of SFAS 156 did not have an impact on its financial condition or results of operations.

Prior Year Financial Statement Misstatements:

In September 2006, the SEC staff issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" ("SAB 108"). SAB 108 was issued in order to eliminate the diversity of practice surrounding how public companies quantify financial statement misstatements. There are two widely recognized methods for quantifying the effects of financial statement misstatements: the "roll-over" and "iron curtain" methods. The roll-over method, the method the Company historically used, focuses primarily on the impact of a misstatement on the income statement, including the reversing effect of prior year misstatements. Because the focus is on the income statement, the roll-over method can lead to the accumulation of misstatements in the balance sheet that may become material to the balance sheet. The iron curtain method focuses primarily on the effect of correcting the accumulated misstatement as of the balance sheet date, with less emphasis on the reversing effects of prior year errors on the income statements. In SAB 108, the SEC staff established an approach that requires quantification of financial statement misstatements based on the effects of the misstatements under both the roll-over and iron curtain methods. This framework is referred to as the "dual approach." SAB 108 permits companies to initially apply its provisions either by restating prior financial statements as if the dual approach had always been used or recording the cumulative effect of initially applying the dual approach as adjustments to the balance sheet as of the first day of the fiscal year with an offsetting adjustment recorded to retained earnings.

The Company completed an analysis under the "dual approach" and adopted SAB 108 effective as of January 1, 2006. The Company applied the SAB 108 provisions using the cumulative effect transition method. Upon adoption of SAB 108, the Company reversed \$331 of income taxes payable resulting from cumulative over accruals of income tax expense. These misstatements primarily resulted from the incorrect determination of depreciation and deferred loan origination costs for tax purposes and principally occurred prior to 2004, with certain amounts dating back to the 1990's. After considering all of the quantitative and qualitative factors, the Company determined these misstatements had not previously been material to any of those prior periods when measured using the roll-over method. Given that the effect of correcting these misstatements during 2006 would be material to the Company's 2006 financial statements, the Company concluded that the cumulative effect adjustment method of initially applying the guidance in SAB 108 was appropriate. In accordance with the transition provisions of SAB 108, the Company recorded this cumulative effect adjustment, resulting in a \$331 increase in other assets and a \$331 increase in retained earnings as of January 1, 2006.

Note 8: Recently Issued Accounting Pronouncements

The following information addresses new or proposed accounting pronouncements that could have an impact on the Company's financial condition, results of operations, earnings per share, or cash flows.

Fair Value Measurements for Financial Assets and Liabilities:

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159 ("SFAS 159"), "The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statement No. 115." This standard provides companies with an option to report selected financial assets and liabilities at fair value. The Standard's objective is to reduce both complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. Generally accepted accounting principles have required different measurement attributes for different assets and liabilities that can create volatility in earnings. SFAS 159 helps to mitigate this volatility by enabling companies to report related assets and liabilities at fair value, which would

likely reduce the need for companies to comply with detailed rules for hedge accounting. This new standard also establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. SFAS 159 requires companies to provide additional information that will help investors and other users of financial statements to more easily understand the effect of the company's choice to use fair value on its earnings. It also requires entities to display the fair value of those assets and liabilities for which the company has chosen to use fair value on the face of the balance sheet. The new Statement does not eliminate disclosure requirements included in other accounting standards, including requirements for disclosures about fair value measurements included in FASB Statements No. 157, "Fair Value Measurements," and No. 107, "Disclosures about Fair Value of Financial Instruments." SFAS 159 is effective as of the beginning of an entity's first fiscal year beginning after November 15, 2007 (January 1, 2008 for the Company). Early adoption is permitted as of the beginning of the previous fiscal year provided that the entity makes that choice in the first 120 days of that fiscal year and also adopts the provisions of SFAS 157 at the same time. The Company did not adopt SFAS 159 early and is currently evaluating the impact of adopting this statement.

Fair Value Measurements:

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements." This statement establishes a single authoritative definition of fair value, sets out a framework for measuring fair value, and requires additional disclosures about fair value measurements. The statement is effective for fair value measures already required or permitted by other standards for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within that fiscal year (January 1, 2008 for the Company). The Company is currently evaluating the impact of adopting SFAS 157, but does not anticipate that the adoption of this standard will have a material impact on its financial condition or results of operations.

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of the financial condition and results of operations of the Company and its subsidiaries should be read in conjunction with the consolidated financial statements and notes thereto, and selected financial and statistical information appearing elsewhere in this report on Form 10-Q. The purpose of this discussion is to highlight significant changes in the financial condition and results of operations of the Company and its subsidiaries, and provide supplemental information and analysis.

Amounts in the prior period financial statements are reclassified whenever necessary to conform to current period presentation.

Unless otherwise noted, all dollars are expressed in thousands, except per share data.

Use of Non-GAAP Financial Measures:

Certain information discussed below is presented on a fully taxable equivalent basis. Specifically, included in second quarter 2007 and 2006 net interest income was \$384 and \$475, respectively, of tax-exempt interest income from certain investment securities and loans. For the six months ended June 30, 2007 and 2006, the amount of tax-exempt income included in net interest income was \$790 and \$952, respectively. An amount equal to the tax benefit derived from this tax-exempt income has been added back to the interest income and net interest income totals discussed in this Management's Discussion and Analysis, resulting in tax-equivalent adjustments of \$139 and \$184 in the second quarter of 2007 and 2006, respectively, and \$288 and \$371 in tax-equivalent adjustments for the six months ended June 30, 2007 and 2006, respectively. The analysis of net interest income tables included in this Form 10-Q provide a reconciliation of tax-equivalent financial information to the Company's consolidated financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles.

Management believes the disclosure of tax-equivalent net interest income information improves the clarity of financial analysis, and is particularly useful to investors in understanding and evaluating the changes and trends in the Company's results of operations. Other financial institutions commonly present net interest income on a tax-equivalent basis. This adjustment is considered helpful in the comparison of one financial institution's net interest income to that of another institution, as each will have a different proportion of tax-exempt interest from their earning asset portfolios. Moreover, net interest income is a component of a second financial measure commonly used by financial institutions, net interest margin, which is the ratio of net interest income to average earning assets. For purposes of this measure as well, other financial institutions generally use tax-equivalent net interest income to provide a better basis of comparison from institution to institution. The Company follows these practices.

FORWARD LOOKING STATEMENTS DISCLAIMER

Certain statements, as well as certain other discussions contained in this report on Form 10-Q, or incorporated herein by reference, contain statements which may be considered to be forward-looking 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. You can identify these forward-looking statements by the use of words like "strategy," "expects," "plans," "believes," "will," "estimates," "intends," "projects," "goals," "targets," and other words of similar meaning. You can also identify them by the fact that they do not relate strictly to historical or current facts.

Investors are cautioned that forward-looking statements are inherently uncertain. Forward-looking statements include, but are not limited to, those made in connection with estimates with respect to the future results of operation, financial condition, and the business of the Company which are subject to change based on the impact of various factors that could cause actual results to differ materially from those projected or suggested due to certain risks and uncertainties. Those factors include but are not limited to:

- (i) The Company's success is dependent to a significant extent upon general economic conditions in Maine, and Maine's ability to attract new business, as well as factors that affect tourism, a major source of economic activity in the Company's immediate market areas;
- (ii) The Company's earnings depend to a great extent on the level of net interest income (the difference between interest income earned on loans and investments and the interest expense paid on deposits and borrowings) generated by the Bank, and thus the Bank's results of operations may be adversely affected by increases or decreases in interest rates;
- (iii) The banking business is highly competitive and the profitability of the Company depends on the Bank's ability to attract loans and deposits in Maine, where the Bank competes with a variety of traditional banking and non-traditional institutions, such as credit unions and finance companies;
- (iv) A significant portion of the Bank's loan portfolio is comprised of commercial loans and loans secured by real estate, exposing the Company to the risks inherent in financings based upon analysis of credit risk, the value of underlying collateral, and other intangible factors which are considered in making commercial loans and, accordingly, the Company's profitability may be negatively impacted by judgment errors in risk analysis, by loan defaults, and the ability of certain borrowers to repay such loans during a downturn in general economic conditions;
- (v) A significant delay in or inability to execute strategic initiatives designed to increase revenues and or control expenses;
- (vi) The potential need to adapt to changes in information technology systems, on which the Company is highly dependent, could present operational issues or require significant capital spending;
- (vii) Significant changes in the Company's internal controls, or internal control failures;

- (viii) Acts or threats of terrorism and actions taken by the United States or other governments as a result of such threats, including military action, could further adversely affect business and economic conditions in the United States generally and in the Company's markets, which could have an adverse effect on the Company's financial performance and that of borrowers and on the financial markets and the price of the Company's common stock;
- (ix) Significant changes in the extensive laws, regulations, and policies governing bank holding companies and their subsidiaries could alter the Company's business environment or affect its operations; and
- (x) The Company's success in managing the risks involved in all of the foregoing matters.

The forward-looking statements contained herein represent the Company's judgment as of the date of this report on Form 10-Q, and the Company cautions readers not to place undue reliance on such statements. The Company disclaims any obligation to publicly update or revise any forward-looking statement contained in the succeeding discussion, or elsewhere in this report on Form 10-Q, except to the extent required by federal securities laws.

APPLICATION OF CRITICAL ACCOUNTING POLICIES

Management's discussion and analysis of the Company's financial condition are based on the Consolidated Financial Statements, which are prepared in accordance with U.S. generally accepted accounting principles. The preparation of such financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. Management evaluates its estimates, including those related to the allowance for loan losses, on an ongoing basis. Management bases its estimates on historical experience and various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis in making judgments about the carrying values of assets that are not readily apparent from other sources. Actual results could differ from the amount derived from management's estimates and assumptions under different assumptions or conditions.

The Company's significant accounting policies are more fully enumerated in Note 1 to the Consolidated Financial Statements included in Item 8 of its December 31, 2006 report on Form 10-K. The reader of the financial statements should review these policies to gain a greater understanding of how the Company's financial performance is reported. Management believes the following critical accounting policies represent the more significant estimates and assumptions used in the preparation of the Consolidated Financial Statements:

Allowance for Loan Losses

- Management believes the allowance for loan losses ("allowance") is a significant accounting estimate used in the preparation of the Company's consolidated financial statements. The allowance, which is established through a provision for loan loss expense, is based on management's evaluation of the level of allowance required in relation to the estimated inherent risk of loss in the loan portfolio. Management regularly evaluates the allowance for loan losses for adequacy by taking into consideration factors such as previous loss experience, the size and composition of the portfolio, current economic and real estate market conditions and the performance of individual loans in relation to contract terms and estimated fair values of collateral. The use of different estimates or assumptions could produce different provisions for loan losses. A smaller provision for loan losses results in higher net income, and when a greater amount of provision for loan losses is necessary the result is lower net income. Refer to Part I, Item 2 below, *Allowance for Loan Losses and Provision* in this report on Form 10-Q, for further discussion and analysis concerning the allowance.

Income Taxes

The Company estimates its income taxes for each period for which a statement of income is presented. This involves estimating the Company's actual current tax liability, as well as assessing temporary differences resulting

from differing timing of recognition of expenses, income and tax credits, for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included in the Company's consolidated balance sheets. The Company must also assess the likelihood that any deferred tax assets will be recovered from historical taxes paid and future taxable income and, to the extent that the recovery is not likely, a valuation allowance must be established. Significant management judgment is required in determining income tax expense, and deferred tax assets and liabilities. As of June 30, 2007 and December 31, 2006, there was no valuation allowance for deferred tax assets, which are included in other assets on the consolidated balance sheet.

Goodwill and Other Intangible Assets -

The valuation techniques used by the Company to determine the carrying value of tangible and intangible assets acquired in acquisitions and the estimated lives of identifiable intangible assets involve estimates for discount rates, projected future cash flows and time period calculations, all of which are susceptible to change based upon changes in economic conditions and other factors. Any changes in the estimates used by the Company to determine the carrying value of its goodwill and identifiable intangible assets, or which otherwise adversely affect their value or estimated lives, may have an adverse affect on the Company's results of operations. Refer to Note 2 of the consolidated financial statements in Part I, Item 1 of this report on Form 10-Q for further details of the Company's accounting policies and estimates covering goodwill and other intangible assets.

EXECUTIVE OVERVIEW

Summary Results of Operations

The Company reported consolidated net income of \$1,843 or fully diluted earnings per share of \$0.59 for the three months ended June 30, 2007 compared with \$1,646 or fully diluted earnings per share of \$0.53 for the same quarter in 2006, representing increases of \$197 and \$0.06, or 12.0% and 11.3%, respectively. The annualized return on average shareholders' equity ("ROE") and average assets ("ROA") amounted to 11.79% and 0.91%, respectively, compared with 11.77% and 0.84% for the same quarter in 2006.

As more fully enumerated below, the increase in second quarter 2007 net income compared with the same quarter in 2006 was principally attributed to a \$328 or 6.2% increase in net interest income and a \$133 or 8.7% increase in non-interest income, offset in part by a \$103 or 2.3% increase in non-interest expense.

For the six months ended June 30, 2007, consolidated net income amounted to \$3,218 or fully diluted earnings per share of \$1.03, compared with \$3,209 or fully diluted earnings per share of \$1.03 for the same period in 2006. The annualized ROE and ROA amounted to 10.42% and 0.79%, respectively, compared with 11.43% and 0.84% for the same period in 2006.

As more fully discussed below, in connection with the previously reported restructuring of a portion of the Company's balance sheet, during the six months ended June 30, 2007 the Company recorded net securities losses amounting to \$902, compared with securities gains of \$310 for the same period in 2006, representing a decline of \$1,212. Partially offsetting the decline in net securities gains was an \$832 reduction in non-interest expense recorded in the first quarter of 2007, related to the Company's previously reported settlement of its limited postretirement benefit program. Excluding the impact of net securities gains and losses and the settlement of the postretirement program, non-interest income was up \$119 or 4.2% and non-interest expense was down \$153 or 1.6%, compared with the first six months of 2006.

◆ *Net Interest Income:*

For the quarter ended June 30, 2007, net interest income amounted to \$5,596, representing an increase of \$328 or 6.2%, compared with the same quarter in 2006. The increase in net interest income was largely attributed to average

earning asset growth of \$22,875, or 3.0%. Additionally, in the second quarter of 2006 the Federal Home Loan Bank of Boston, of which the Bank is a member and shareholder, did not declare a dividend, negatively impacting that quarter's net interest income by \$168.

For the six months ended June 30, 2007, net interest income amounted to \$10,878, representing an increase of \$123, or 1.1%, compared with the same period in 2006. The increase in net interest income was principally attributed to average earning asset growth of \$45,598 or 6.1%, as the net interest margin declined 13 basis points. As has widely been the situation throughout the banking industry, the decline in the net interest margin was largely attributed to the flat-to-inverted U.S. Treasury yield curve over the past 18 months, the impact of which has caused the Bank's funding costs to increase at a faster pace than the yield on its earning asset portfolios. During the latter part of the second quarter of 2007, the yield curve began to steepen, as long-term interest rates advanced to five-year highs. Company management anticipates that this steepening of the yield curve, should it continue, will have a favorable impact on future levels of net interest income.

◆ *Non-interest income:*

For the quarter ended June 30, 2007, total non-interest income amounted to \$1,658, representing an increase of \$133 or 8.7% compared with the same quarter in 2006. Trust and financial service fees, debit and credit card fees and service charges on deposit accounts led the increase in non-interest income, posting increases of 13%, 12% and 3% respectively.

For the six months ended June 30, 2007, total non-interest income amounted to \$2,036, representing a decline of \$1,093, or 34.9%, compared with the same period in 2006. The decline in non-interest income was attributed to a \$1,212 decline in net securities gains. During the first half of 2007, net securities losses of \$902 were recorded, principally resulting from the Company's previously announced restructuring of a portion of its balance sheet, compared with net securities gains of \$310 recorded during the same period in 2006. The decline in non-interest income also reflects a \$150 gain on the sale of Bank owned real estate recorded during the first quarter of 2006.

For the six months ended June 30, 2007, debit and credit card fees, trust and financial service fees and service charges on deposit accounts were up 14%, 10% and 5% compared with the same period last year, respectively.

◆ *Non-interest expense:*

For the quarter ended June 30, 2007, total non-interest expense amounted to \$4,553, representing an increase of \$103 or 2.3%, compared with the same quarter in 2006. A variety of operating expenses were up \$222 or 10.2% in the aggregate, largely offset by a \$119 or 5.2% decline in salaries and employee benefits.

For the six months ended June 30, 2007, total non-interest expense amounted to \$8,350, representing a decline of \$985, or 10.6%. The decline in non-interest expense was principally attributed to the previously reported settlement of the Company's limited postretirement program, the financial impact of which reduced first quarter 2007 non-interest expense by \$832. The decline in non-interest expense was also aided by a \$218 or 4.6% decline in salaries and employee benefits, which was principally attributed to changes in overall staffing levels and mix, and lower levels

of incentive compensation.

Summary Financial Condition

The Company's total assets ended the second quarter at \$833,450, representing increases of \$8,573 and \$31,171, or 1.0% and 3.9%, compared with December 31 and June 30, 2006, respectively.

◆ *Loans:*

Total loans ended the second quarter at \$551,801, representing a decline of \$3,298 or 0.6% and an increase of \$8,070 or 1.5% compared with December 31 and June 30, 2006, respectively. Loan growth has recently been impacted by anticipated pay offs of certain large commercial loans, combined with softening loan demand and intensifying competition in the markets served by the Bank.

◆ *Credit Quality:*

The Bank's non-performing loans remained at low levels at quarter-end, representing \$912 or 0.17% of total loans, compared with \$628 and \$652, or 0.11% and 0.12% of total loans at December 31 and June 30, 2006, respectively. The Bank's loan loss experience continued at low levels during the first six months of 2007, with net charge-offs amounting to \$57, or annualized net charge-offs to average loans outstanding of 0.02%, compared with \$179 and 0.07% during the same period in 2006, respectively. For the six months ended June 30, 2007 the Bank recorded a provision for loan losses of \$33 compared with \$43 during the same period last year.

◆ *Securities:*

Total securities ended the second quarter at \$230,313, representing increases of \$17,061 and \$25,998, or 8.0% and 12.7%, compared with December 31 and June 30, 2006, respectively.

In the second quarter of 2007, the Bank completed its previously announced restructuring of a portion of its balance sheet, selling a total of \$46,170 in securities while paying down short-term borrowings. During the later part of the second quarter, market yields soared to a five-year high, with the benchmark 10-year U.S. Treasury advancing from 4.63% in mid May to 5.30% in mid June. The increase in market yields presented opportunities for replacing the securities sold, increasing the Bank's earning assets, and generating higher levels of net interest income.

◆ *Deposits:*

Total deposits ended the second quarter at \$517,431, representing increases of \$21,112 and \$29,867, or 4.3% and 6.1% compared with December 31 and June 30, 2006, respectively. Deposit growth was largely attributed to certificates of deposit obtained in the national market, which were principally used to fund the Bank's earning asset growth and replace the seasonal deposit outflows experienced in the first half of 2007.

At June 30, 2007, retail deposits totaled \$382,907, representing declines of \$31,051 and \$15,547, or 7.5% and 3.9%, compared with December 31 and June 30, 2006, respectively. Historically, the banking business in the Bank's market area has been seasonal, with lower deposits in the winter and spring, and higher deposits in summer and autumn. The declines in retail deposits were principally attributed to declines in money market accounts offered to clients of Bar Harbor Trust Services, a Maine chartered non-depository trust company subsidiary of the Company, reflecting a reallocation of cash within certain managed asset portfolios. Comparing June 30,

2007, with December 31 and June 30, 2006, these money market deposits accounted for \$24,032 and \$23,660 of the overall retail deposit declines, respectively.

◆ **Shareholders Equity:**

The Company continued to exceed regulatory requirements for "well capitalized" institutions. At June 30, 2007, the Company's Tier I Leverage, Tier I Risk-based, and Total Risk-based capital ratios amounted to 7.44%, 11.09% and 11.92% respectively. Total shareholders' equity ended the second quarter at \$61,361, representing increases of \$310 and \$5,560, or 0.5% and 10.0%, compared with December 31 and June 30, 2006, respectively.

◆ **Tangible Book Value:**

At June 30, 2007, the Company's tangible book value per share of common stock outstanding amounted to \$19.07, compared with \$18.96 and \$17.19 at December 31 and June 30, 2006, representing increases of 0.5% and 10.9%, respectively.

◆ **Shareholder Dividends:**

On July 17, 2007, the Company declared a cash dividend of 24 cents per share of common stock for the quarter ended June 30, 2007, representing an increase of one-cent per share or 4.3% compared with the dividend paid for the same quarter in 2006.

RESULTS OF OPERATIONS

Net Interest Income

Net interest income is the principal component of the Company's income stream and represents the difference or spread between interest generated from earning assets and the interest expense paid on deposits and borrowed funds. Net interest income is entirely generated by the Bank. Fluctuations in market interest rates as well as volume and mix changes in earning assets and interest bearing liabilities can materially impact net interest income.

For the three months ended June 30, 2007, net interest income on a fully tax-equivalent basis amounted to \$5,735, compared with \$5,452 in the second quarter of 2006, representing an increase of \$283, or 5.2%.

The increase in second quarter net interest income was attributed, in part, to average earning asset growth of \$22,875, or 3.0%, compared with the same quarter in 2006. Additionally, the Federal Home Loan Bank of Boston (the "FHLB"), of which the Bank is a member and shareholder, did not declare a dividend on its stock during the second quarter of 2006. Pursuant to its "Dividend Schedule Transition Plan," in the third quarter of 2006, the FHLB declared a dividend that was "grossed up" to an equivalent accrual period matching the number of days in the second and third quarters of 2006. This action unfavorably impacted the Bank's second quarter 2006 net interest income by \$168.

For the six months ended June 30, 2007, net interest income on a fully tax-equivalent basis amounted to \$11,166, compared with \$11,126 during the same period in 2006, representing an increase of \$40, or 0.4%. The increase in net interest income was principally attributed to average earning asset growth of \$45,598 or 6.1%, as the net interest margin declined 16 basis points to 2.86% compared with the six months ended June 30, 2006.

Factors contributing to the changes in net interest income and the net interest margin are further enumerated in the following discussion and analysis.

Net Interest Income Analysis:

The following tables summarize the Company's average balance sheets and components of net interest income, including a reconciliation of tax equivalent adjustments, for the three and six months ended June 30, 2007 and 2006, respectively:

AVERAGE BALANCE SHEET AND
ANALYSIS OF NET INTEREST INCOME
THREE MONTHS ENDED
JUNE 30, 2007 AND 2006

	2007			2006		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
Interest Earning Assets:						
Loans (1,3)	\$549,980	\$ 9,432	6.88%	\$535,636	\$ 8,764	6.56%
Taxable investment securities	188,063	2,633	5.62%	172,830	2,143	4.97%
Non-taxable investment securities (3)	27,605	444	6.45%	34,696	578	6.68%
Total Investments	215,668	3,077	5.72%	207,526	2,721	5.26%
Investment in Federal Home Loan Bank stock						
	12,531	205	6.56%	12,494	---	0.00%
Fed funds sold, money market funds, and time deposits with other banks						
	2,193	31	5.67%	1,841	23	5.01%
Total Earning Assets	780,372	12,745	6.55%	757,497	11,508	6.09%
Non-Interest Earning Assets:						
Cash and due from banks	7,261			7,983		
Allowance for loan losses	(4,545)			(4,500)		
Other assets (2)	29,140			27,929		
Total Assets	\$812,228			\$788,909		
Interest Bearing Liabilities:						
Deposits	\$449,440	\$3,990	3.56%	\$425,607	\$3,101	2.92%
Securities sold under repurchase agreements and fed funds purchased	13,252	107	3.24%	13,234	84	2.55%
Borrowings from Federal Home Loan Bank	232,574	2,913	5.02%	239,230	2,871	4.81%
Total Borrowings	245,826	3,020	4.93%	252,464	2,955	4.69%
Total Interest Bearing Liabilities	695,266	7,010	4.04%	678,071	6,056	3.58%
Rate Spread			2.51%			2.51%
Non-Interest Bearing Liabilities:						
Demand deposits	49,775			48,572		
Other liabilities	4,474			6,197		
Total Liabilities	749,515			732,840		
Shareholders' equity	62,713			56,069		
Total Liabilities and Shareholders' Equity	\$812,228			\$788,909		
Net interest income and net interest margin (3)						
		5,735	2.95%		5,452	2.89%
Less: Tax Equivalent adjustment		(139)			(184)	

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-Q

Net Interest Income	\$5,596	2.88%	\$5,268	2.79%
---------------------	---------	-------	---------	-------

(1) For purposes of these computations, non-accrual loans are included in average loans.

(2) For purposes of these computations, unrealized gains (losses) on available-for-sale securities are recorded in other assets.

(3) For purposes of these computations, reported on a tax equivalent basis.

AVERAGE BALANCE SHEET AND
ANALYSIS OF NET INTEREST INCOME
SIX MONTHS ENDED
JUNE 30, 2007 AND 2006

	2007			2006		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
Interest Earning Assets:						
Loans (1,3)	\$551,992	\$18,641	6.81%	\$528,293	\$17,045	6.51%
Taxable investment securities	192,453	5,243	5.49%	164,380	3,982	4.89%
Non-taxable investment securities (3)	28,620	917	6.46%	35,404	1,177	6.70%
Total Investments	221,073	6,160	5.62%	199,784	5,159	5.21%
Investment in Federal Home Loan Bank stock	12,439	404	6.55%	12,145	149	2.47%
Fed funds sold, money market funds, and time deposits with other banks	1,847	49	5.35%	1,531	36	4.74%
Total Earning Assets	787,351	25,254	6.47%	741,753	22,389	6.09%
Non-Interest Earning Assets:						
Cash and due from banks	8,019			7,740		
Allowance for loan losses	(4,551)			(4,577)		
Other assets (2)	29,268			28,580		
Total Assets	\$820,087			\$773,496		
Interest Bearing Liabilities:						
Deposits	\$449,575	\$ 7,877	3.53%	\$415,624	\$ 5,710	2.77%
Securities sold under repurchase agreements and fed funds purchased	13,588	211	3.13%	13,963	173	2.50%
Borrowings from Federal Home Loan Bank	240,065	6,000	5.04%	231,626	5,380	4.68%

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-Q

Total Borrowings	253,653	6,211	4.94%	245,589	5,553	4.56%
Total Interest Bearing Liabilities	703,228	14,088	4.04%	661,213	11,263	3.44%
Rate Spread			2.43%			2.65%
Non-Interest Bearing Liabilities:						
Demand deposits	49,819			49,490		
Other liabilities	4,765			6,188		
Total Liabilities	757,812			716,891		
Shareholders' equity	62,275			56,605		
Total Liabilities and Shareholders' Equity	\$820,087			\$773,496		
Net interest income and net interest margin (3)		11,166	2.86%		11,126	3.02%
Less: Tax Equivalent adjustment		(288)			(371)	
Net Interest Income		\$10,878	2.79%		\$10,755	2.92%

(1) For purposes of these computations, non-accrual loans are included in average loans.

(2) For purposes of these computations, unrealized gains (losses) on available-for-sale securities are recorded in other assets.

(3) For purposes of these computations, reported on a tax equivalent basis.

Net Interest Margin:

The net interest margin, expressed on a tax-equivalent basis, represents the difference between interest and dividends earned on interest-earning assets and interest paid to depositors and other creditors, expressed as a percentage of average earning assets.

The net interest margin is determined by dividing tax-equivalent net interest income by average interest-earning assets. The interest rate spread represents the difference between the average tax-equivalent yield earned on interest earning-assets and the average rate paid on interest bearing liabilities. The net interest margin is generally higher than the interest rate spread due to the additional income earned on those assets funded by non-interest bearing liabilities, primarily demand deposits and shareholders' equity.

For the three months ended June 30, 2007, the net interest margin amounted to 2.95%, compared with 2.89% for the same quarter in 2006, representing an increase of 6 basis points. The increase in the net interest margin was principally attributed to the FHLB not paying a cash dividend on its stock in the second quarter of 2006. Excluding this factor, the second quarter 2007 net interest margin was essentially unchanged compared with the same quarter in 2006. Comparing the quarter ended June 30, 2007 with the same quarter in 2006 the weighted average yield the Bank's earning assets increased 46 basis points, the same increase experienced in its weighted average cost of funds.

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-Q

For the six months ended June 30, 2007, the net interest margin amounted to 2.86%, compared with 3.02% for the same period in 2006, representing a decline of 16 basis points. Over the past 18 months the U. S. Treasury yield curve has been flat-to-inverted, meaning short-term interest rates have been equal to or greater than long-term interest rates. The decline in the net interest margin was principally attributed to the increases in the Bank's cost of funds outpacing the increases in yields on its interest earning assets, reflecting the re-pricing of a large portion of the Bank's funding base during a period of rising short-term interest rates, combined with highly competitive pricing pressures with respect to loans and deposits, a higher utilization of wholesale funding, and the inherent net interest margin challenges widely associated with a flat or inverted U.S. Treasury yield curve. Comparing the six months ended June 30, 2007 with the same period in 2006, the increase in the cost of the Bank's interest bearing liabilities exceeded the increase in yields on its earning asset portfolios by 22 basis points.

During the latter part of the second quarter of 2007, the yield curve began to steepen, as long-term interest rates advanced to five-year highs. Company management anticipates that this steepening of the yield curve, should it continue, will have a favorable impact on future levels of net interest income. The Bank's interest rate sensitivity position is more fully described below in Part I, Item 3 of this report on Form 10-Q, *Quantitative and Qualitative Disclosures About Market Risk*.

The following table summarizes the net interest margin components, on a quarterly basis, over the past eight quarters.

NET INTEREST MARGIN ANALYSIS
FOR QUARTER ENDED

	2007		2006			2005		
	Average Rate 2nd Qtr	Average Rate 1st Qtr	4th Qtr	Average Rate 3rd Qtr	Average Rate 2nd Qtr	Average Rate 1st Qtr	Average Rate 4th Qtr	Average Rate 3rd Qtr
Interest Earning Assets:								
Loans (1,2)	6.88%	6.74%	6.67%	6.67%	6.56%	6.45%	6.34%	6.22%
Taxable investment securities	5.62%	5.38%	5.03%	4.91%	4.97%	4.79%	4.47%	4.09%
Non-taxable investment securities (2)	6.45%	6.47%	6.48%	6.43%	6.68%	6.74%	6.62%	6.84%
Total Investments	5.72%	5.52%	5.25%	5.16%	5.26%	5.16%	4.89%	4.57%
Investment in Federal Home Loan Bank stock	6.56%	6.54%	6.13%	11.04%	0.00%	5.12%	4.85%	4.41%
Fed Funds sold, money market funds, and time deposits with other banks	5.67%	4.88%	5.20%	5.27%	5.01%	3.41%	3.92%	3.46%
Total Earning Assets	6.55%	6.39%	6.28%	6.33%	6.09%	6.08%	5.94%	5.79%
Interest Bearing Liabilities:								
Deposits	3.56%	3.51%	3.37%	3.22%	2.92%	2.62%	2.27%	2.02%
Securities sold under repurchase agreements	3.24%	3.03%	2.96%	2.78%	2.55%	2.46%	2.15%	1.91%
Other borrowings	5.02%	5.06%	5.01%	5.01%	4.81%	4.54%	4.39%	4.27%
Total Borrowings	4.93%	4.95%	4.87%	4.89%	4.69%	4.42%	4.21%	4.10%
Total Interest Bearing Liabilities	4.04%	4.04%	3.89%	3.81%	3.58%	3.29%	2.96%	2.76%
Rate Spread	2.51%	2.35%	2.39%	2.52%	2.51%	2.79%	2.98%	3.03%
Net Interest Margin (2)	2.95%	2.77%	2.86%	2.95%	2.89%	3.17%	3.36%	3.39%
Net Interest Margin without Tax Equivalent Adjustments	2.88%	2.70%	2.77%	2.86%	2.79%	3.06%	3.26%	3.30%

- (1) For purposes of these computations, non-accrual loans are included in average loans.
- (2) For purposes of these computations, reported on a tax equivalent basis.

Interest Income

: For the three and six months ended June 30, 2007, total interest income, on a fully tax-equivalent basis, amounted to \$12,745 and \$25,254 compared with \$11,508 and \$22,389 during the same periods in 2006, representing increases of \$1,237 and \$2,865, or 10.7% and 12.8%, respectively.

The increases in interest income were principally attributed to average earning asset growth of \$22,875 and \$45,598 or 3.0% and 6.1% respectively, combined with 46 and 38 basis point increases in the weighted average earning asset yields, when comparing the three and six month periods ended June 30, 2007, with the same periods in 2006, respectively. Principally reflecting increases in market yields and reinvestment of earning asset cash flows in a higher interest rate environment, the weighted average yield on average earning assets amounted to 6.55% and 6.47% for the three and six months ended June 30, 2007, compared with 6.09% for the same periods in 2006, respectively.

Comparing the three and six months ended June 30, 2007, with the same periods in 2006, the weighted average yield on the Bank's loan portfolio increased 32 and 30 basis points to 6.88% and 6.81%, respectively, while the weighted average yield on the securities portfolio increased 46 and 41 basis points to 5.72% and 5.62%, respectively.

As depicted on the rate/volume analysis tables below, comparing the three and six months ended June 30, 2007 with the same periods in 2006, the increased volume of average earning assets on the balance sheet contributed \$328 and \$1,304 to the increases in interest income, while the increases attributed to the impact of higher weighted average earning asset yields contributed \$909 and \$1,561, respectively.

Interest Expense:

For the three and six months ended June 30, 2007, total interest expense amounted to \$7,010 and \$14,088, compared with \$6,056 and \$11,263 during the same periods in 2006, representing increases of \$954 and \$2,825, or 15.8% and 25.1%, respectively.

The increases in interest expense were principally attributed to 46 and 60 basis point increases in the weighted average cost of funds, combined with increases in average interest bearing liabilities amounting to \$17,195 and \$42,015, or 2.5% and 6.4%, when comparing the three and six months ended June 30, 2007 with the same periods in 2006, respectively. The increase in the average cost of interest bearing funds was principally attributed to increases in short-term market interest rates between periods and, to a lesser extent, a proportionately higher utilization of wholesale funding. In addition, given highly competitive pricing pressures and the need to strengthen customer relationships, over the past twelve months the Bank more closely followed the market with respect to the upward pricing and re-pricing of maturity and non-maturity deposits.

For the three and six months ended June 30, 2007, the weighted average cost of funds amounted to 4.04%, compared with 3.58% and 3.44% during the same periods in 2006, respectively. For the three and six months ended June 30, 2007, the weighted average cost of borrowed funds increased 24 and 38 basis points to 4.93% and 4.94%, respectively, while the weighted average cost of interest bearing deposits increased 64 and 76 basis points to 3.56% and 3.53%, respectively. The increase in the weighted average cost of interest bearing deposits outpaced the weighted average cost of borrowed funds, reflecting highly competitive market pricing pressures for deposits, combined with a higher utilization of brokered time deposits.

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-Q

As depicted on the rate/volume analysis tables below, comparing the three and six months ended June 30, 2007 with the same periods in 2006, the increased volume of average interest bearing liabilities on the balance sheet contributed \$108 and \$692 to the increases in interest expense, while the increases attributed to the impact of higher weighted average rates paid on interest bearing liabilities amounted to \$846 and \$2,133, respectively.

Rate/Volume Analysis:

The following tables set forth a summary analysis of the relative impact on net interest income of changes in the average volume of interest earning assets and interest bearing liabilities, and changes in average rates on such assets and liabilities. The income from tax-exempt assets has been adjusted to a fully tax equivalent basis, thereby allowing uniform comparisons to be made. Because of the numerous simultaneous volume and rate changes during the periods analyzed, it is not possible to precisely allocate changes to volume or rate. For presentation purposes, changes which are not solely due to volume changes or rate changes have been allocated to these categories in proportion to the relationships of the absolute dollar amounts of the change in each.

ANALYSIS OF VOLUME AND RATE CHANGES ON NET INTEREST INCOME
THREE MONTHS ENDED JUNE 30, 2007 VERSUS JUNE 30, 2006
INCREASES (DECREASES) DUE TO:

	Average Volume	Average Rate	Net Interest Income
Loans (1,2)	\$ 239	\$ 429	\$ 668
Taxable investment securities	199	291	490
Non-taxable investment securities (2)	(115)	(19)	(134)
Investment in Federal Home Loan Bank stock	---	205	205
Fed funds sold, money market funds, and time deposits with other banks	5	3	8
TOTAL EARNING ASSETS	\$ 328	\$ 909	\$1,237
Interest bearing deposits	182	707	889
Securities sold under repurchase agreements and fed funds purchased	---	23	23
Borrowings from Federal Home Loan Bank	(74)	116	42
TOTAL INTEREST BEARING LIABILITIES	\$ 108	\$ 846	\$ 954
NET CHANGE IN NET INTEREST INCOME	\$ 220	\$ 63	\$ 283

(1) For purposes of these computations, non-accrual loans are included in average loans.

(2) For the purposes of these computations, interest income is reported on a tax-equivalent basis.

ANALYSIS OF VOLUME AND RATE CHANGES ON NET INTEREST INCOME
SIX MONTHS ENDED JUNE 30, 2007 VERSUS JUNE 30, 2006
INCREASES (DECREASES) DUE TO:

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-Q

	Average Volume	Average Rate	Net Interest Income
Loans (1,2)	\$ 782	\$ 814	\$1,596
Taxable investment securities	729	532	1,261
Non-taxable investment securities (2)	(219)	(41)	(260)
Investment in Federal Home Loan Bank stock	4	251	255
Fed funds sold, money market funds, and time deposits with other banks	8	5	13
TOTAL EARNING ASSETS	\$1,304	\$1,561	\$2,865
Interest bearing deposits	496	1,671	2,167
Securities sold under repurchase agreements and fed funds purchased	(5)	43	38
Borrowings from Federal Home Loan Bank	201	419	620
TOTAL INTEREST BEARING LIABILITIES	\$ 692	\$2,133	\$2,825
NET CHANGE IN NET INTEREST INCOME	\$ 612	\$ (572)	\$ 40

(1) For purposes of these computations,
non-accrual loans are included in average loans.

(2) For purposes of these computations, reported
on a tax-equivalent basis.

Provision for Loan Losses

The provision for loan losses reflects the amount necessary to maintain the allowance for loan losses (the "allowance") at a level that, in management's judgment, is appropriate for the amount of inherent risk of loss in the Bank's current loan portfolio.

The Bank's non-performing loans remained at low levels at quarter end, representing \$912 or 0.17% of total loans, compared with \$628 and \$652, or 0.11% and 0.12% of total loans at December 31 and June 30, 2006, respectively. The allowance expressed as a percentage of non-performing loans stood at 494% at June 30, 2007, compared with 721% and 692% at December 31 and June 30, 2006, respectively.

The Bank's loan loss experience continued at low levels during the six months ended June 30, 2007, with net loan charge-offs amounting to \$57, or annualized net charge-offs to average loans outstanding of 0.02%, compared with \$179 or 0.07% during the same period in 2006.

Reflecting the continued stable performance of the loan portfolio, for the three and six months ended June 30, 2007, the Bank recorded a provision for loan losses of \$33, compared with \$15 and \$43 during the same periods in 2006, respectively.

Refer below to Item 2 of this Part I, *Allowance for Loan Losses*, in this report on Form 10-Q for further discussion and analysis regarding the allowance.

Non-interest Income

In addition to net interest income, non-interest income is a significant source of revenue for the Company and an important factor in its results of operations.

For the three and six months ended June 30, 2007, total non-interest income amounted to \$1,658 and \$2,036, compared with \$1,525 and \$3,129 during the same periods in 2006, representing an increase of \$133 or 8.7% and a decline of \$1,093 or 34.9%, respectively.

Factors contributing to the changes in non-interest income are enumerated in the following discussion and analysis:

Trust and Other Financial Services:

Income from trust and financial services is principally derived from fee income based on a percentage of the market value of client assets under management and held in custody and, to a lesser extent, revenue from brokerage services conducted through Bar Harbor Financial Services, an independent third-party broker.

For the three and six months ended June 30, 2007, income from trust and other financial services amounted to \$642 and \$1,183 compared with \$568 and \$1,072 during the same periods in 2006, representing increases of \$74 and \$111, or 13.0% and 10.4%, respectively.

The increases in fee income were driven by trust and investment management services, principally reflecting growth in assets under management.

At June 30, 2007, total managed assets at Bar Harbor Trust Services, a Maine chartered non-depository trust company and second tier subsidiary of the Company, stood at \$270,605 compared with \$252,057 and \$223,825 at December 31 and June 30, 2006, representing increases of \$18,548 and \$46,779, or 7.4% and 20.9%, respectively.

Service Charges on Deposits

: This income is principally derived from monthly deposit account maintenance and activity fees, overdraft fees, and a variety of other deposit account related fees.

For the three and six months ended June 30, 2007, income generated from service charges on deposit accounts totaled \$418 and \$788, compared with \$405 and \$748 during the same periods in 2006, representing increases of \$13 and \$40, or 3.2% and 5.3%, respectively. The increases in services charges on deposit accounts were principally attributed to the continued growth of the Bank's retail, non-maturity deposit account base.

Debit and Credit Card Service Charges and Fees:

This income is principally derived from the Bank's merchant credit card processing services, its Visa debit card product and, to a lesser extent, fees associated with its Visa credit card portfolio. Historically, the Bank's merchant credit card processing activities have been highly seasonal in nature with transaction and fee income volumes peaking in the summer and autumn, while declining in the winter and spring.

For the three and six months ended June 30, 2007, debit and credit card service charges and fees amounted to \$441 and \$708 compared with \$393 and \$623 during the same periods in 2006, representing increases of \$48 and \$85, or 12.2% and 13.6%, respectively.

The increases in debit and credit card service charges and fees were principally attributed to an increase in debit card fees, principally reflecting the ongoing growth in the Bank's demand deposits accounts base. Merchant credit card processing fees also posted a small increase, reflecting higher merchant credit card processing volumes, compared with the three and six months ended June 30, 2006. The increase in credit and debit card processing revenue was offset in part by an increase in credit and debit card processing expense, which is included in non-interest expense in the Company's consolidated statements of income.

Net Securities (Losses) Gains:

For the three months ended June 30, 2007, net realized gains on the sale of securities amounted to \$18 compared with none during the same quarter in 2006. For the six months ended June 30, 2007, net securities losses amounted to \$902,

compared with securities gains of \$310 during the same period in 2006, representing a decline of \$1,212, or 391.0%.

In April 2007, the Company's Board of Directors approved the restructuring of a portion of the Company's balance sheet through the sale of \$43,337 of its aggregate \$227,473 available for sale securities portfolio, the proceeds from which were initially used to pay down short-term borrowings. Since the Company no longer had the intent to hold these securities until a recovery of their amortized cost, which may be at maturity, the Company recorded an adjustment to write down these securities to fair value at March 31, 2007, resulting in a pre-tax impairment loss of \$1,162 included in first quarter 2007 earnings as a reduction of non-interest income. The Company's primary objectives were to improve future period earnings and provide a means to more effectively respond to the current and future yield curve environments.

The \$902 in net securities losses recorded during the six months ended June 30, 2007 were comprised of securities impairment losses of \$1,162 and realized losses of \$150 on the sale of securities, offset in part by realized gains of \$410 on the sale of securities.

Other Operating Income:

For the three and six months ended June 30, 2007, total other operating income amounted to \$86 and \$154, compared with \$102 and \$266 for the same periods in 2006, representing declines of \$16 and \$112, or 15.7% and 42.1%, respectively.

The decline in other operating income for the six months ended June 30, 2007, compared with the same period in 2006 was attributed to a \$150 gain on the sale of a parcel of Bank owned real estate adjacent to the Bank's Southwest Harbor, Maine branch office, recorded during the first quarter of 2006.

Non-interest Expense

For the three and six months ended June 30, 2007, total non-interest expenses amounted to \$4,553 and \$8,350, compared with \$4,450 and \$9,335 for the same periods in 2006, representing an increase of \$103 or 2.3% and a decline of \$985 or 10.6%, respectively.

Factors contributing to the changes in non-interest expense are enumerated in the following discussion and analysis.

Salaries and Employee Benefit Expenses:

For the three and six months ended June 30, 2007, salaries and employee benefit expenses amounted to \$2,154 and \$4,499, compared with \$2,273 and \$4,717 during the same periods in 2006, representing declines of \$119 and \$218, or 5.2% and 4.6%, respectively.

The declines in salaries and employee benefit expenses were attributed to a variety of factors including: changes to certain employee benefit programs; changes in overall staffing levels and mix; and lower levels of incentive compensation.

Postretirement Plan Settlement:

In the first quarter of 2007, the Company settled its limited postretirement benefit program, which funded medical coverage and life insurance benefits to a closed group of active and retired employees who met minimum age and service requirements. The Company voluntarily paid out \$700 to plan participants, representing 64% of the total benefit obligation. This payment fully settled all Company obligations related to this program. In connection with the settlement of the postretirement program, the Company recorded a first quarter reduction in non-interest expense of \$832, representing the remaining accrued benefit obligation and the actuarial gain related to the program.

Occupancy Expenses:

For the three and six months ended June 30, 2007, total occupancy expenses amounted to \$320 and \$693, compared with \$337 and \$649 for the same periods in 2006, representing a decline of \$17 or 5.0% and an increase of \$44 or 6.8%, respectively.

The increase in occupancy expenses for the six months ended June 30, 2007 compared with the same period last year was principally attributed to the opening of a new branch office late in the first quarter of 2006 (a leased facility), and higher fuel and utility prices combined with relatively harsh weather conditions in downeast and mid coast Maine during the first quarter of 2007 compared with the same quarter last year.

Furniture and Equipment Expenses:

For the three and six months ended June 30, 2007, furniture and equipment expenses amounted to \$439 and \$888, compared with \$422 and \$922 for the same periods in 2006, representing an increase of \$17 or 4.0% and a decline of \$34 or 3.7%, respectively.

The decline in furniture and equipment expenses for the six months ended June 30, 2007 compared with the same period in 2006 was principally attributed to certain expenses associated with the Bank's major renovation and opening of a new branch office in the community of Somesville, Maine during the first quarter of 2006.

Credit and Debit Card Expenses:

For the three and six months ended June 30, 2007, credit and debit card expenses amounted to \$270 and \$458, compared with \$250 and \$416 for the same periods in 2006, representing increases of \$20 and \$42, or 8.0% and 10.1%, respectively.

Credit and debit card expenses principally relate to the Bank's merchant credit and debit card processing activities, Visa debit card processing expenses and, to a lesser extent, its Visa credit card portfolio. Historically, the Bank's merchant credit card processing activities have been seasonal in nature with transaction volumes peaking in the summer and autumn, while declining in the winter and spring.

The increases in credit and debit card expenses were principally attributed to increases in the volume of debit card transactions, reflecting the growth of the Bank's retail checking account base. Merchant credit card processing fees were also moderately higher, principally reflecting higher merchant credit card processing volumes compared with the same periods in 2006. The increases in credit and debit card expenses were more than offset by increases in credit and debit card income, which is included in non-interest income in the Company's consolidated statements of income.

Other Operating Expenses:

For the three and six months ended June 30, 2007, other operating expenses amounted to \$1,370 and \$2,644, compared with \$1,168 and \$2,631 for the same periods in 2006, representing increases of \$202 and \$13, or 17.3% and 0.5%, respectively.

The increase in second quarter 2007 other operating expenses compared with the same quarter in 2006 was attributed to increases in a variety of expense categories including professional services, loan collection expenses, and charitable contributions.

Income Taxes

For the three and six months ended June 30, 2007, total income taxes amounted to \$825 and \$1,313, compared with \$682 and \$1,297 for the same periods in 2006, representing increases of \$143 and \$16, or 20.1% and 1.2%, respectively.

The Company's effective tax rates for the three and six months ended June 30, 2007 amounted to 30.9% and 29.0%, compared with 29.3% and 28.8% for the same periods in 2006, respectively. The income tax provisions for these periods are less than the expense that would result from applying the federal statutory rate of 34% to income before income taxes, principally because of the impact of tax exempt interest income on certain investment securities, loans and bank owned life insurance.

Fluctuations in the Company's effective tax rate can occur due to non-taxable income and non-deductible expense bearing different percentages of income before income taxes, during any given reporting period.

FINANCIAL CONDITION

Total Assets

The Company's assets principally consist of loans and investment securities, which at June 30, 2007, represented 66.2% and 27.6% of total assets, compared with 67.3% and 25.9% at December 31, 2006, respectively.

At June 30, 2007, total assets amounted to \$833,450 compared with \$824,877 and \$802,279 at December 31 and June 30, 2006, representing increases of \$8,573 and \$31,171, or 1.0% and 3.9%, respectively.

Investment Securities

The investment securities portfolio is primarily comprised of mortgage-backed securities issued by U.S. government agencies, U.S. government sponsored enterprises, and other corporate issuers. The portfolio also includes tax-exempt obligations of state and political subdivisions, and obligations of other U.S. government sponsored enterprises.

The overall objectives of the Bank's strategy for the investment securities portfolio include maintaining an appropriate liquidity reserves, diversifying earning assets, managing interest rate risk, leveraging the Bank's strong capital position, and generating acceptable levels of net interest income.

Securities available for sale represented 100% of total investment securities at June 30, 2007 and 2006. Securities available for sale are reported at their fair value with unrealized gains or losses, net of taxes, excluded from earnings but shown separately as a component of shareholders' equity.

For the six months ended June 30, 2007, the securities portfolio represented 28.1% of the Company's average earning assets and generated 24.4% of total tax-equivalent interest and dividend income, compared with 26.9% and 23.0% for the same period in 2006.

At June 30, 2007, total securities amounted to \$230,313, compared with \$213,252 and \$204,315 at December 31 and June 30, 2006, representing increases of \$17,061 and \$25,998, or 8.0% and 12.7%, respectively.

In the second quarter of 2007, the Bank completed its previously reported restructuring of a portion of its balance sheet, selling a total of \$46,170 in securities while paying down short-term borrowings. During the later part of the second quarter, market yields soared to a five-year high, with the benchmark 10-year U.S. Treasury advancing from 4.63% in mid May to 5.30% in mid June. The increase in market yields presented opportunities for replacing the securities sold, increasing the Bank's earning assets, and generating higher levels of net interest income.

Impaired Securities:

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-Q

The securities portfolio contains certain investments where amortized cost exceeds fair market value, which at June 30, 2007 amounted to an unrealized loss of \$3,220 compared with \$2,635 at December 31, 2006. The increase in unrealized losses principally reflected higher interest rates and market yields at June 30, 2007 compared with December 31, 2006.

At June 30, 2007, unrealized losses on securities in a continuous unrealized loss position more than twelve-months amounted to \$1,366 or 2.4% of their amortized cost, compared with \$2,418 or 2.4% at December 31, 2006, respectively. The decline in unrealized losses from December 31, 2006 levels was principally attributed to the previously announced restructuring of the securities portfolio, offset in part by higher interest rates and market yields at June 30, 2007 compared with December 31, 2006.

Unrealized losses that are considered other-than-temporary are recorded as a loss on the Company's consolidated statement of income. In evaluating whether impairment is other-than-temporary, management considers a variety of factors including the nature of the investment security, the cause of the impairment, the severity and duration of the impairment, and the Bank's ability and intent to hold the security to maturity. Other data considered by management includes, for example, sector credit ratings, volatility of the security's market price, and any other information considered relevant in determining whether other-than-temporary impairment has occurred.

Management believes the unrealized losses in the securities portfolio at June 30, 2007 were attributed to interest rate increases, and reflected the volatile movements in the U.S. Treasury curve over the past few years. Specifically, certain debt securities were purchased in an interest rate environment lower than where the U.S. Treasury yield curve stood on June 30, 2007. Because the decline in market value was attributable to changes in interest rates and not credit quality, and because the Bank has the ability and intent to hold these securities until a recovery of their amortized cost, which may be at maturity, the Company does not consider these securities to be other-than-temporarily impaired at June 30, 2007.

Loans

The loan portfolio is primarily secured by real estate in the counties of Hancock, Washington and Knox, Maine. The following table summarizes the components of the Bank's loan portfolio as of the dates indicated.

LOAN PORTFOLIO SUMMARY

	June 30, 2007	December 31, 2006	June 30, 2006
Commercial real estate mortgages	\$165,345	\$159,661	\$150,791
Commercial and industrial loans	56,841	61,762	63,496
Agricultural and other loans to farmers	18,011	17,743	18,217
Total commercial loans	240,197	239,166	232,504
Residential real estate mortgages	251,361	253,640	244,583
Consumer loans	9,147	10,911	13,935
Home equity loans	45,344	45,156	46,358
Total consumer loans	305,852	309,707	304,876
Tax exempt loans	5,752	6,226	6,351
Total loans	551,801	555,099	543,731

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-Q

Allowance for loan losses	(4,501)	(4,525)	(4,511)
Total loans net of allowance for loan losses	\$547,300	\$550,574	\$539,220

Total Loans

: At June 30, 2007, total loans amounted to \$551,801, compared with \$555,099 and \$543,731 at December 31, and June 30, 2006, representing a decline of \$3,298 or 0.6% and an increase of \$8,070 or 1.5%, respectively.

At June 30, 2007, total commercial loans amounted to \$240,197, compared with \$239,166 and \$232,504 at December 31 and June 30, 2006, representing increases of \$1,031 and \$7,693, or 0.4% and 3.3%, respectively.

During the six months ended June 30, 2007, commercial loan growth was impacted by anticipated payoffs of certain large commercial loans. In addition, the Bank has experienced softening loan demand and intensifying competition in the markets served by the Bank.

At June 30, 2007, total consumer loans, which principally consisted of consumer real estate (residential mortgage) loans, amounted to \$305,852, compared with \$309,707 and \$304,876 at December 31 and June 30, 2006, representing a decline of \$3,855 or 1.2% and an increase of \$976 or 0.3%, respectively. Principally reflecting a softening real estate market, consumer real estate loan originations started slowing in the later part of 2006 and this trend continued during the six months ended June 30, 2007.

At June 30, 2007, consumer and commercial loans secured by real estate comprised 86.5% of the loan portfolio, compared with 86.5% and 85.1% at December 31 and June 30, 2006, respectively. Over the past few years, the strength in the local real estate markets, both residential and commercial, has led to historically high property values in the Bank's market area. However, in the latter part of 2006 and continuing into the first six months of 2007, this trend began to soften. Recognizing the impact a softening real estate market may have on the loan portfolio and origination pipeline, the Bank periodically reviews its underwriting standards in an effort to ensure that the quality of the loan portfolio is not jeopardized by unrealistic loan to value ratios or debt service levels. There was no significant deterioration in the performance or risk characteristics of the real estate loan portfolios through the reporting period.

Credit Risk

: Credit risk is managed through loan officer authorities, loan policies, and oversight from the Bank's Senior Credit Officer, the Bank's Senior Loan Officers Committee, the Director's Loan Committee, and the Bank's Board of Directors. Management follows a policy of continually identifying, analyzing and grading credit risk inherent in the loan portfolio. An ongoing independent review, subsequent to management's review, of individual credits is performed by an independent loan review function, which reports to the Audit Committee of the Board of Directors.

As a result of management's ongoing review of the loan portfolio, loans are placed on non-accrual status, either due to the delinquent status of principal and or interest, or a judgment by management that, although payments of principal and or interest are current, such action is prudent because collection in full of all outstanding principal and interest is in doubt. Loans are generally placed on non-accrual status when principal and or interest is 90 days overdue, or sooner if judged appropriate by management. Consumer loans are generally charged-off when principal and or interest payments are 120 days overdue, or sooner if judged appropriate by management.

Non-performing Loans:

Non-performing loans include loans on non-accrual status, loans that have been treated as troubled debt restructurings and loans past due 90 days or more and still accruing interest. There were no troubled debt restructurings in the loan portfolio during 2006 and this continued to be the case during the six months ended June 30, 2007. The following

table sets forth the details of non-performing loans as of the dates indicated:

TOTAL NON-PERFORMING LOANS

	June 30, 2007	December 31, 2006	June 30, 2006
Loans accounted for on a non-accrual basis:			
Real estate loans:			
Residential mortgage	\$ 114	\$ 111	\$ 82
Loans to finance agricultural production and other loans to farmers	62	41	---
Commercial and industrial loans	653	415	533
Loans to individuals for household, family, and other personal expenditures	---	3	19
Total non-accrual loans	829	570	634
Accruing loans contractually past due 90 days or more	83	58	18
Total non-performing loans	\$ 912	\$ 628	\$ 652
Allowance for loan losses to non-performing loans	494%	721%	692%
Non-performing loans to total loans	0.17%	0.11%	0.12%
Allowance to total loans	0.82%	0.82%	0.83%

During the quarter ended June 30, 2007, non-performing loans remained at low levels. The Bank attributes this success to mature credit administration processes and underwriting standards, aided by a relatively stable local economy. The Bank maintains a centralized loan collection and managed asset department, providing timely and effective collection efforts for problem loans.

At June 30, 2007, total non-performing loans amounted to \$912, or 0.17% of total loans, compared with \$628 or 0.11% at December 31, 2006, and \$652 or 0.12% at June 30, 2006.

While the level of non-performing loan ratios continued to reflect the favorable quality of the loan portfolio at June 30, 2007, Bank management is cognizant of relatively softening economic conditions overall, and believes it is managing credit risk accordingly. Future levels of non-performing loans may be influenced by changing economic conditions, including the impact of those conditions on the Bank's customers, including higher interest rates and debt service levels, oil and gas prices, tourism activity, and other factors existing at the time. Management believes the economic activity and conditions in the local real estate markets will continue to be significant determinants of the quality of the loan portfolio in future periods and, thus, the Company's results of operations and financial condition.

Other Real Estate Owned:

When the Bank takes ownership of collateral property upon foreclosure of a real estate secured loan, the property is transferred from the loan portfolio to Other Real Estate Owned ("OREO") at its fair value. If the loan balance is higher than the fair value of the property, the difference is charged to the allowance for loan losses at the time of the transfer. OREO is classified on the consolidated balance sheet with other assets. At June 30, 2007, there was no OREO, unchanged from December 31 and June 30, 2006.

Allowance for Loan Losses

: The allowance for loan losses ("allowance") is available to absorb losses on loans. The determination of the adequacy of the allowance and provisioning for estimated losses is evaluated quarterly based on review of loans, with particular emphasis on non-performing and other loans that management believes warrant special consideration.

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-Q

The allowance is maintained at a level that, in management's judgment, is appropriate for the amount of risk inherent in the current loan portfolio, and adequate to provide for estimated losses.

Specific reserves for impaired loans are determined in accordance with SFAS No. 114, "Accounting by Creditors For Impairment of a Loan," as amended by SFAS No. 118, "Accounting by Creditors For Impairment of a Loan-Income Recognition and Disclosures." The amount of loans considered to be impaired totaled \$715 as of June 30, 2007, compared with \$456 and \$533 as of December 31 and June 30, 2006, respectively. The related allowance for loan losses on these impaired loans amounted to \$257 as of June 30, 2007, compared with \$130 and \$142 at December 31 and June 30, 2006, respectively.

Management recognizes that early and accurate recognition of risk is the best means to reduce credit losses and maximize earnings. The Bank employs a comprehensive risk management structure to identify and manage the risk of loss. For consumer loans, the Bank identifies loan delinquency beginning at 10-day delinquency and provides appropriate follow-up by written correspondence or personal contact. Non-residential mortgage consumer loan losses are recognized no later than the point at which a loan is 120 days past due. Residential mortgage losses are recognized during the foreclosure process, or sooner, when that loss is quantifiable and reasonably assured. For commercial loans, the Bank applies a risk grading system, which stratifies the portfolio and allows management to focus appropriate efforts on the highest risk components of the portfolio. The risk grades include ratings that correlate with regulatory definitions of "Pass," "Other Assets Especially Mentioned," "Substandard," "Doubtful," and "Loss."

Loan loss provisions are recorded based upon overall aggregate data, and the allowance is increased when, on an aggregate basis, additional estimated losses are identified and deemed by management as being likely. No portion of the allowance is restricted to any loan or group of loans, and the entire allowance is available to absorb realized losses. The amount and timing of realized losses and future allowance allocations could vary from current estimates.

While management uses available information to recognize losses on loans, changing economic conditions and the economic prospects of the borrowers may necessitate future additions or reductions to the allowance. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance, which also may necessitate future additions or reductions to the allowance, based on information available to them at the time of their examination.

The Bank's loan loss experience remained at low levels during six months ended June 30, 2007, with net loan charge-offs amounting to \$57, or annualized net charge-offs to average loans outstanding of 0.02%, compared with \$179 or annualized net charge-offs to average loans outstanding of 0.07% during the same period in 2006.

There were no material changes in loan concentrations during the six months ended June 30, 2007.

The following table details changes in the allowance and summarizes loan loss experience by loan type for the six-month periods ended June 30, 2007 and 2006.

	ALLOWANCE FOR LOAN LOSSES SIX MONTHS ENDED JUNE 30, 2007 AND 2006	
	2007	2006
Balance at beginning of period	\$ 4,525	\$ 4,647
Charge-offs:		

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-Q

Commercial, financial, agricultural, other loans to farmers	43	2
Real estate mortgages	---	193
Installments and other loans to individuals	49	38
Total charge-offs	92	233
Recoveries:		
Commercial, finance agricultural, other loans to farmers	18	1
Real estate mortgages	---	39
Installments and other loans to individuals	17	14
Total recoveries	35	54
Net charge-offs	57	179
Provision charged to operations	33	43
Balance at end of period	\$ 4,501	\$ 4,511
Average loans outstanding during period	\$551,992	\$528,293
Annualized net charge-offs to average loans outstanding	0.02%	0.07%

Based upon the process employed and giving recognition to all attendant factors associated with the loan portfolio, management believes the allowance for loan losses at June 30, 2007, to be appropriate for the risks inherent in the loan portfolio and resident in the local and regional economy as of that date.

Deposits

During the three and six months ended June 30, 2007, the most significant funding source for the Bank's earning assets continued to be retail deposits, gathered through its network of twelve banking offices throughout downeast and midcoast Maine.

Historically, the banking business in the Bank's market area has been seasonal, with lower deposits in the winter and spring and higher deposits in summer and autumn. These seasonal swings have been fairly predictable and have not had a materially adverse impact on the Bank. Seasonal swings in deposits have been typically absorbed by the Bank's strong liquidity position, including borrowing capacity from the Federal Home Loan Bank of Boston, brokered certificates of deposit obtained from the national market and cash flows from the securities portfolio.

At June 30, 2007, total deposits amounted to \$517,431, compared with \$496,319 and \$487,564 at December 31 and June 30, 2006, representing increases of \$21,112 and \$29,867, or 4.3% and 6.1%, respectively.

Deposit growth was principally attributed to certificates of deposit obtained from the national market ("brokered deposits"), which at June 30, 2007 totaled \$134,524, compared with \$82,361 and \$89,110 at December 31 and June 30, 2006, representing increases of \$52,163 and \$45,414, or 63.3% and 51.0%, respectively. The increases in brokered deposits were utilized to help fund the Bank's earning asset growth, as retail deposits posted moderate declines. Also, during the six months ended June 30, 2007, brokered deposits were utilized to replace anticipated seasonal deposit outflows. Additionally, during the six months ended June 30, 2007, the Bank modified its funding and liquidity strategies, providing more balance between brokered deposits and borrowed funds. In this regard, borrowed funds at June 30, 2007 declined by \$11,717 and \$3,143 compared with December 31 and June 30, 2006, respectively.

At June 30, 2007, retail deposits totaled \$382,907 compared with \$413,958 and \$398,454 at December 31 and June 30, 2006, representing declines of \$31,051 and \$15,547, or 7.5% and 3.9%, respectively. The declines in retail deposits were principally attributed to declines in money market deposit accounts offered to clients of Trust Services amounting to \$24,032 and \$23,660, principally reflecting a reallocation of cash within certain managed asset portfolios. The decline in retail deposits from December 31, 2006 also reflects anticipated outflows of seasonal deposits.

Excluding deposit accounts offered to clients of Trust Services, comparing June 30, 2007 with the same date in 2006, total retail deposits increased by \$8,113, or 2.2%.

In general, without considering the declines in money market accounts offered to clients of Trust Services, the Bank's retail deposit growth has moderately lagged historical norms. Management believes that competition from banks and non-banks has intensified, as savers and investors seek higher returns, and that financial institutions in particular have been aggressively pricing their deposits in order to fund earning asset growth. Management also believes that investors have been reallocating a portion of their cash positions, believing the equity markets have recently become more attractive from a total return perspective.

Since short-term interest rates began rising, Bank management has exercised restraint with respect to overly aggressive deposit pricing strategies, and has sought to achieve an appropriate balance between retail deposit growth and wholesale funding levels, while considering the associated impacts on the Bank's net interest margin and liquidity position.

Borrowed Funds

Borrowed funds principally consist of advances from the Federal Home Loan Bank of Boston (the "FHLB") and, to a lesser extent, securities sold under agreements to repurchase. Advances from the FHLB are principally secured by stock in the FHLB, securities, and blanket liens on qualifying mortgage loans and home equity loans.

The Bank utilizes borrowed funds in leveraging its strong capital position and supporting its earning asset portfolios. Borrowed funds are principally utilized to support the Bank's securities portfolio and, to a lesser extent, fund loan growth. Borrowed funds also provide a means to help manage balance sheet interest rate risk, given the Bank's ability to select desired amounts, terms and maturities on a daily basis.

At June 30, 2007, total borrowings amounted to \$248,995, compared with \$260,712 and \$252,138 at December 31 and June 30, 2006, representing declines of \$11,717 and \$3,143, or 4.5% and 1.2%, respectively.

As discussed above, during the six months ended June 30, 2007, Bank modified its funding and liquidity strategies, providing more balance between brokered deposits and borrowed funds.

At June 30, 2007, total borrowings expressed as a percent of total assets amounted to 29.9%, compared with 31.6% and 31.4% at December 31 and June 30, 2006, respectively.

Capital Resources

Consistent with its long-term goal of operating a sound and profitable organization, during the second quarter of 2007 the Company maintained its strong capital position and continued to be a "well capitalized" financial institution according to applicable regulatory standards. Management believes this to be vital in promoting depositor and investor confidence and providing a solid foundation for future growth.

The Company and the Bank are subject to the risk based capital guidelines administered by the Company's and the Bank's principal regulators. The risk based capital guidelines are designed to make regulatory capital requirements more sensitive to differences in risk profiles among banks and bank holding companies, to account for off-balance sheet exposure and to minimize disincentives for holding liquid assets. Under these guidelines, assets and off-balance sheet items are assigned to broad risk categories, each with appropriate weights. The resulting capital ratios represent capital as a percentage of risk weighted assets and off-balance sheet items. The guidelines require all banks and bank holding companies to maintain a minimum ratio of total risk based capital to risk weighted assets of 8%, including a minimum ratio of Tier I capital to total risk weighted assets of 4% and a Tier I capital to average assets of 4% ("Leverage Ratio"). Failure to meet minimum capital requirements can initiate certain mandatory, and possibly

additional discretionary actions by regulators that, if undertaken, could have a material effect on the Company's financial statements.

As of June 30, 2007, the Company and the Bank were considered well capitalized under the regulatory framework for prompt corrective action. Under the capital adequacy guidelines, a well capitalized institution must maintain a minimum total risk based capital to total risk weighted assets ratio of at least 10%, a minimum Tier I capital to total risk weighted assets ratio of at least 6%, and a minimum Tier I leverage ratio of at least 5%.

The following table sets forth the Company's regulatory capital at June 30, 2007 and December 31, 2006, under the rules applicable at that date.

	June 30, 2007		December 31, 2006	
	Amount	Ratio	Amount	Ratio
Total Capital to Risk Weighted Assets	\$64,712	11.92%	\$63,325	11.65%
Regulatory Requirement	43,419	8.00%	43,491	8.00%
Excess over "adequately capitalized"	\$21,293	3.92%	\$19,834	3.65%
Tier 1 Capital to Risk Weighted Assets	\$60,211	11.09%	\$58,800	10.82%
Regulatory Requirement	21,710	4.00%	21,745	4.00%
Excess over "adequately capitalized"	\$38,501	7.09%	\$37,055	6.82%
Tier 1 Capital to Average Assets	\$60,211	7.44%	\$58,800	7.34%
Regulatory Requirement	32,356	4.00%	32,040	4.00%
Excess over "adequately capitalized"	\$27,855	3.44%	\$26,760	3.34%

The Company's principal source of funds to pay cash dividends and support its commitments is derived from Bank operations. The Company declared dividends in the aggregate amount of \$1,431 and \$1,358 during the six months ended June 30, 2007 and 2006, at a rate of \$0.470 and \$0.445 per share, respectively.

In March 2004, the Company announced a second stock repurchase plan. The Board of Directors of the Company authorized open market and privately negotiated purchases of up to 10% of the Company's outstanding shares of common stock, or 310,000 shares. Purchases began on March 4, 2004 and continued through December 31, 2006. The Company's Board of Directors subsequently authorized the continuance of this stock repurchase plan through December 31, 2007. Depending on market conditions and other factors, these purchases may be commenced or suspended at any time, or from time-to-time, without prior notice. As of June 30, 2007, the Company had repurchased 159,171 shares of stock under this plan, or 51.3% of the total authorized, at a total cost of \$4,491 and an average price of \$28.21 per share. The Company records the repurchased shares as treasury stock.

The Company believes that a stock repurchase plan is a prudent use of capital at this time. Management anticipates the stock repurchase plan will be accretive to the return on average shareholders' equity and earnings per share. Management also believes the stock repurchase plan helps facilitate an orderly market for the disposition of large blocks of stock, and lessens the price volatility associated with the Company's thinly traded stock.

Contractual Obligations

The Company is a party to certain contractual obligations under which it is obligated to make future payments. These principally include borrowings from the FHLB, consisting of short and long-term fixed rate borrowings, and collateralized by all stock in the FHLB, a blanket lien on qualified collateral consisting primarily of loans with first and second mortgages secured by one-to-four family properties, and certain pledged investment securities. The Company has an obligation to repay all borrowings from the FHLB.

The Company is also obligated to make payments on operating leases for its branch office in Somesville and its office in Bangor, Maine.

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-Q

The following table summarizes the Company's contractual obligations at June 30, 2007. Borrowings are stated at their contractual maturity due dates and do not reflect call features, or principal amortization features, on certain borrowings.

CONTRACTUAL OBLIGATIONS
(Dollars in thousands)

Description	Total Amount of Obligations	Payments Due By Period			
		< 1 Year	> 1-3 Years	> 3-5 Years	> 5 Years
Operating leases	\$ 285	\$ 71	\$ 139	\$ 75	\$ ---
Borrowings from Federal Home Loan Bank	236,597	154,600	37,349	40,648	4,000
Securities sold under agreements to repurchase	12,398	12,398	---	---	---
Total	\$249,280	\$167,069	\$37,488	\$40,723	\$4,000

All FHLB advances are fixed-rate instruments. Advances are payable at their call dates or final maturity dates. Advances are stated at their contractual final maturity dates in the above table. At June 30, 2007, the Bank had \$56,500 in callable advances.

In the normal course of its banking and financial services business, and in connection with providing products and services to its customers, the Company has entered into a variety of traditional third party contracts for support services. Examples of such contractual agreements would include services providing ATM, Visa debit and credit card processing, trust services accounting support, student loan servicing, check printing, statement rendering and the leasing of T-1 telecommunication lines supporting the Company's wide area technology network.

The majority of the Company's core operating systems and software applications are maintained "in-house" with traditional third party maintenance agreements of one year or less.

Off-Balance Sheet Arrangements

The Company is, from time to time, a party to certain off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on the Company's financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources, that may be considered material to investors.

The Bank guarantees the obligations or performance of certain customers by issuing standby letters of credit to third parties. These letters of credit are sometimes issued in support of third party debt. The risk involved in issuing standby letters of credit is essentially the same as the credit risk involved in extending loan facilities to customers, and they are subject to the same origination, portfolio maintenance and management procedures in effect to monitor other credit products. The amount of collateral obtained, if deemed necessary by the Bank upon issuance of a standby letter of credit, is based upon management's credit evaluation of the customer.

At June 30, 2007, commitments under existing standby letters of credit totaled \$512, compared with \$442 and \$115 at December 31 and June 30, 2006. The fair values of the standby letters of credit were not significant as of the foregoing dates.

Off-Balance Sheet Risk

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-Q

The Bank is party to financial instruments with off-balance sheet risk in the normal course of business to meet the financial needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit and certain financial derivative instruments; namely, interest rate swap agreements and interest rate floor agreements.

Commitments to Extend Credit:

Commitments to extend credit represent agreements by the Bank to lend to a customer provided there is no violation of any condition established in the contract. These commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee.

Since many of these commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis using the same credit policies as it does for its balance sheet instruments. The amount of collateral obtained, if deemed necessary by the Bank upon the issuance of commitment, is based on management's credit evaluation of the customer.

The following table summarizes the Bank's commitments to extend credit as of the dates shown:

(Dollars in thousands)	June 30, 2007	December 31, 2006	June 30, 2006
Commitments to originate loans	\$ 44,206	\$ 13,340	\$ 27,058
Unused lines of credit	77,895	81,800	74,820
Un-advanced portions of construction loans	8,826	7,638	9,166
Total	\$130,927	\$102,778	\$111,044

Financial Derivative Instruments:

As part of its overall asset and liability management strategy, the Bank periodically uses derivative instruments to minimize significant unplanned fluctuations in earnings and cash flows caused by interest rate volatility. The Bank's interest rate risk management strategy involves modifying the re-pricing characteristics of certain assets and liabilities so that changes in interest rates do not have a significant adverse effect on net interest income. Derivative instruments that management periodically uses as part of its interest rate risk management strategy include interest rate swap agreements and interest rate floor agreements. A policy statement, approved by the Board of Directors of the Bank, governs use of derivative instruments.

At June 30, 2007, the Bank had four outstanding derivative instruments with notional amounts totaling \$50,000. The notional amounts of the financial derivative instruments do not represent exposure to credit loss. The Bank is exposed to credit loss only to the extent the counter-party defaults in its responsibility to pay interest under the terms of the agreements. Management does not anticipate non-performance by the counter-parties to the agreements, and regularly reviews the credit quality of the counter-parties from which the instruments have been purchased.

The details of the Bank's financial derivative instruments as of June 30, 2007 are summarized below. Also refer to Note 6 of the consolidated financial statements in Part I, Item 1 of this report on Form 10-Q.

INTEREST RATE SWAP AGREEMENTS

Description	Maturity	Notional Amount (in	Fixed Interest Rate	Variable Interest Rate
-------------	----------	------------------------	------------------------	---------------------------

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-Q

		thousands)		
Receive fixed rate, pay variable rate	09/01/07	\$10,000	6.04%	Prime (8.25%)
Receive fixed rate, pay variable rate	01/24/09	\$10,000	6.25%	Prime (8.25%)

The interest rate swap agreements were designated as cash flow hedges in accordance with SFAS No. 133 Implementation Issue No. G25, "Cash Flow Hedges: Using the First-Payments Received Technique in Hedging the Variable Interest Payments on a Group of Non-Benchmark-Rate-Based Loans."

The Company is required to pay a counter-party monthly variable rate payments indexed to Prime, while receiving monthly fixed rate payments based upon interest rates of 6.04% and 6.25%, respectively, over the term of each respective agreement.

The following table summarizes the contractual cash flows of the interest rate swap agreements outstanding at June 30, 2007, based upon the then current Prime interest rate of 8.25%.

	Total	Less Than 1 Year	1-3 Years
Fixed payments due from counter-party	\$1,087	\$731	\$356
Variable payments due to counter-party based on prime rate	1,440	970	470
Net cash flow	(\$ 353)	(\$239)	(\$114)

INTEREST RATE FLOOR AGREEMENTS

Notional Amount	Termination Date	Prime Strike Rate	Premium Paid
\$20,000	08/01/10	6.00%	\$186
\$10,000	11/01/10	6.50%	\$ 69

In 2005, interest rate floor agreements were purchased to limit the Bank's exposure to falling interest rates on two pools of loans indexed to the Prime interest rate. Under the terms of the agreements, the Bank paid premiums of \$186 and \$69 for the right to receive cash flow payments if the Prime interest rate falls below the floors of 6.00% and 6.50%, thus effectively ensuring interest income on the pools of prime-based loans at minimum rates of 6.00% and 6.50% on the \$20,000 and \$10,000 notional amounts for the duration of the agreements, respectively. The interest rate floor agreements were designated as cash flow hedges in accordance with SFAS 133.

Liquidity

Liquidity is measured by the Company's ability to meet short-term cash needs at a reasonable cost or minimal loss. The Company seeks to obtain favorable sources of liabilities and to maintain prudent levels of liquid assets in order to satisfy varied liquidity demands. Besides serving as a funding source for maturing obligations, liquidity provides flexibility in responding to customer-initiated needs. Many factors affect the Company's ability to meet liquidity needs, including variations in the markets served by its network of offices, its mix of assets and liabilities, reputation and credit standing in the marketplace, and general economic conditions.

The Bank actively manages its liquidity position through target ratios established under its Asset Liability Management Policy. Continual monitoring of these ratios, both historical and through forecasts under multiple rate scenarios, allows the Bank to employ strategies necessary to maintain adequate liquidity.

The Bank uses a basic surplus model to measure its liquidity over 30 and 90-day time horizons. The relationship between liquid assets and short-term liabilities that are vulnerable to non-replacement are routinely monitored. The Bank's policy is to maintain its liquidity position at approximately 5% of total assets. At June 30, 2007, liquidity, as measured by the basic surplus/deficit model, was 9.1% over the 30-day horizon and 9.3% over the 90-day horizon.

At June 30, 2007, the Bank had unused lines of credit and net unencumbered qualifying collateral availability to support its credit line with the FHLB approximating \$65,000. The Bank also had capacity to borrow funds on a secured basis utilizing certain un-pledged securities in its securities portfolio. The Bank's loan portfolio provides an additional source of contingent liquidity that could be accessed in a reasonable time period through pledging or sales. The Bank also has access to the national brokered deposit market, and has been using this funding source to bolster its liquidity position.

The Bank maintains a liquidity contingency plan approved by the Bank's Board of Directors. This plan addresses the steps that would be taken in the event of a liquidity crisis, and identifies other sources of liquidity available to the Company. Company management believes that the level of liquidity is sufficient to meet current and future funding requirements. However, changes in economic conditions, including consumer savings habits and availability or access to the brokered deposit market could potentially have a significant impact on the Company's liquidity position.

Impact of Inflation and Changing Prices

The Consolidated Financial Statements and the accompanying Notes to the Consolidated Financial Statements presented elsewhere in this report have been prepared in accordance with U.S. generally accepted accounting principles, which require the measurement of financial position and operating results in terms of historical dollars without considering changes in the relative purchasing power of money over time due to inflation.

Unlike many industrial companies, substantially all of the assets and virtually all of the liabilities of the Company are monetary in nature. As a result, interest rates have a more significant impact on the Company's performance than the general level of inflation. Over short periods of time, interest rates and the U.S. Treasury yield curve may not necessarily move in the same direction or in the same magnitude as inflation.

While the financial nature of the Company's consolidated balance sheets and statements of income is more clearly affected by changes in interest rates than by inflation, inflation does affect the Company because as prices increase the money supply tends to increase, the size of loans requested tends to increase, total Company assets increase, and interest rates are affected by inflationary expectations. In addition, operating expenses tend to increase without a corresponding increase in productivity. There is no precise method, however, to measure the effects of inflation on the Company's financial statements. Accordingly, any examination or analysis of the financial statements should take into consideration the possible effects of inflation.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk is the risk of loss in a financial instrument arising from adverse changes in market rates/prices, such as interest rates, foreign currency exchange rates, commodity prices and equity prices. Interest rate risk is the most significant market risk affecting the Company. Other types of market risk do not arise in the normal course of the Company's business activities.

Interest Rate Risk:

Interest rate risk can be defined as an exposure to movement in interest rates that could have an adverse impact on the Bank's net interest income. Interest rate risk arises from the imbalance in the re-pricing, maturity and/or cash flow characteristics of assets and liabilities. Management's objectives are to measure, monitor and develop strategies in response to the interest rate risk profile inherent in the Bank's balance sheet. The objectives in managing the Bank's

balance sheet are to preserve the sensitivity of net interest income to actual or potential changes in interest rates, and to enhance profitability through strategies that promote sufficient reward for understood and controlled risk.

The Bank's interest rate risk measurement and management techniques incorporate the re-pricing and cash flow attributes of balance sheet and off balance sheet instruments as they relate to current and potential changes in interest rates. The level of interest rate risk, measured in terms of the potential future effect on net interest income, is determined through the use of modeling and other techniques under multiple interest rate scenarios. Interest rate risk is evaluated in depth on a quarterly basis and reviewed by the Asset/Liability Committee ("ALCO") and the Bank's Board of Directors.

The Bank's Asset Liability Management Policy, approved annually by the Bank's Board of Directors, establishes interest rate risk limits in terms of variability of net interest income under rising, flat, and decreasing rate scenarios. It is the role of ALCO to evaluate the overall risk profile and to determine actions to maintain and achieve a posture consistent with policy guidelines.

The Bank utilizes an interest rate risk model widely recognized in the financial industry to monitor and measure interest rate risk. The model simulates the behavior of interest income and expense of all balance sheet and off-balance sheet instruments, under different interest rate scenarios together with a dynamic future balance sheet. Interest rate risk is measured in terms of potential changes in net interest income based upon shifts in the yield curve.

The interest rate risk sensitivity model requires that assets and liabilities be broken down into components as to fixed, variable, and adjustable interest rates, as well as other homogeneous groupings, which are segregated as to maturity and type of instrument. The model includes assumptions about how the balance sheet is likely to evolve through time and in different interest rate environments. The model uses contractual re-pricing dates for variable products, contractual maturities for fixed rate products, and product specific assumptions for deposits accounts, such as money market accounts, that are subject to re-pricing based on current market conditions. Re-pricing margins are also determined for adjustable rate assets and incorporated in the model. Investment securities and borrowings with call provisions, are examined on an individual basis in each rate environment to estimate the likelihood of a call. Prepayment assumptions for mortgage loans and mortgage backed securities are developed from industry median estimates of prepayment speeds, based upon similar coupon ranges and seasoning. Cash flows and maturities are then determined, and for certain assets, prepayment assumptions are estimated under different interest rate scenarios. Interest income and interest expense are then simulated under several hypothetical interest rate conditions including:

- A flat interest rate scenario in which current prevailing rates are locked in and the only balance sheet fluctuations that occur are due to cash flows, maturities, new volumes, and re-pricing volumes consistent with this flat rate assumption.
- A 200 basis point rise or decline in interest rates applied against a parallel shift in the yield curve over a twelve-month horizon together with a dynamic balance sheet anticipated to be consistent with such interest rate changes.
- Various non-parallel shifts in the yield curve, including changes in either short-term or long-term rates over a twelve-month horizon, together with a dynamic balance sheet anticipated to be consistent with such interest rate changes.
- An extension of the foregoing simulations to each of two, three, four and five year horizons to determine the interest rate risk with the level of interest rates stabilizing in years two through five. Even though rates remain stable during this two to five year time period, re-pricing opportunities driven by maturities, cash flow, and adjustable rate products will continue to change the balance sheet profile for each of the rate conditions.

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-Q

Changes in net interest income based upon the foregoing simulations are measured against the flat interest rate scenario and actions are taken to maintain the balance sheet interest rate risk within established policy guidelines.

The following table summarizes the Bank's net interest income sensitivity analysis as of June 30, 2007, over one and two-year horizons and under different interest rate scenarios.

INTEREST RATE RISK
CHANGE IN NET INTEREST INCOME FROM THE FLAT RATE SCENARIO
JUNE 30, 2007

(Dollars in thousands)	-200 Basis Points Parallel Yield Curve Shift	+200 Basis Points Parallel Yield Curve Shift	-200 Basis Points Short Term Rates
Year 1			
Net interest income change (\$)	\$1,224	(\$1,812)	\$1,629
Net interest income change (%)	5.11%	(7.56%)	6.80%
Year 2			
Net interest income change vs. year one base (\$)	\$1,970	(\$3,758)	\$4,286
Net interest income change vs. year one base (%)	8.22%	(15.68%)	17.88%

The foregoing interest rate sensitivity modeling results indicate that the Bank's balance sheet is liability sensitive and is favorably positioned for declining interest rates over the one and two-year horizons. The interest rate sensitivity model also suggests that the Bank is exposed to a parallel increase in short-term and long-term rates over the one and two-year horizons but, as discussed below, management believes that this is a scenario that is less likely to occur.

At June 30, 2007, the U.S. Treasury yield curve (the "yield curve") was relatively flat, with the two and ten-year U.S. Treasury notes closing at 4.86% and 5.02%, respectively, and the overnight Fed Funds rate holding at 5.25%. Given this atypical shape of the yield curve, interest rate risk sensitivity modeling is more challenging than would traditionally be the case. Traditional modeling of parallel movements in the June 30, 2007 yield curve would suggest that it would remain relatively flat in either an increasing or declining interest rate environment, a scenario management believes is not likely and one that has historically not occurred. These challenges are discussed in the following discussion and analysis covering the Bank's interest rate risk sensitivity.

Assuming interest rates remain at their current levels and the Bank's balance sheet structure and size remain at current levels, the interest rate sensitivity simulation model suggests that net interest income will trend upward over the one and two-year horizons. The upward trend principally results from the re-investment of securities and loan cash flows into higher current interest rate levels, while loans will continue to "index up" in response to past interest rate movements more quickly than funding costs. However, margins could narrow if the Bank is prompted to increase deposit interest rates in response to competitive market pricing pressures. Management anticipates that continued earning asset growth would be needed to meaningfully increase the Bank's current level of net interest income, should interest rates remain at current levels.

Assuming short-term and long-term interest rates decline from current levels (i.e., a parallel yield curve shift) and the Bank's balance sheet structure and size remain at current levels, management believes net interest income will increase over the one and two-year horizons. The interest rate sensitivity simulation model suggests that funding cost reductions will outpace falling asset yields, favorably impacting net interest income. Management anticipates that only moderate earning asset growth will be needed to meaningfully increase the Bank's current level of net interest income,

should interest rates decline in parallel.

The interest rate sensitivity model is used to evaluate the impact on net interest income given certain non-parallel shifts in the yield curve, including changes in either short-term or long-term interest rates. In view of the relatively flat yield curve at June 30, 2007, management modeled alternative future interest rate scenarios and the anticipated impact on net interest income. Assuming the Bank's balance sheet structure and size remain at current levels, with the short-term Federal Funds interest rate declining 200 basis points, and with the balance of the yield curve returning to its historical ten-year average, the interest rate sensitivity model suggests that net interest income will meaningfully improve over the twelve-month horizon and continue to strengthen over the twenty-four month horizon. The model indicated that funding costs will show meaningful declines while loan and securities cash flows will be reinvested into higher yielding earning assets. Management believes this scenario is more likely than a parallel 200 basis point decline in short and long-term interest rates, given the current shape of the yield curve. Management also believes this scenario will meaningfully increase net interest income without earning asset growth.

Assuming the Bank's balance sheet structure and size remain at current levels and the Federal Reserve increases short-term interest rates by 200 basis points, and the balance of the yield curve shifts in parallel with these increases, management believes net interest income will post significant declines over the twelve-month horizon, and then begin a steady recovery over the twenty-four month horizon and beyond. The interest rate sensitivity simulation model suggests that as interest rates rise, the Bank's funding costs will re-price more quickly than its earning asset portfolios over a twelve-month horizon, causing a sharp decline in net interest income. As funding costs begin to stabilize in the second year of the simulation, the earning asset portfolios continue to re-price at prevailing interest rate levels and cash flows from earning asset portfolios will be reinvested into higher yielding earning assets, resulting in a widening of spreads and improving levels of net interest income. Management believes that strong earning asset growth will be necessary to maintain the current level of net interest income should short and long-term interest rates rise in parallel. Management believes this is a scenario that is less likely to occur, given that the yield curve would have to remain relatively flat over the one and two-year horizons, a phenomenon that has historically not occurred. Management also believes that, based on a variety of current economic indicators, it is not likely the Federal Reserve will increase short-term interests any time in the near future.

The preceding sensitivity analysis does not represent a Company forecast and should not be relied upon as being indicative of expected operating results. These hypothetical estimates are based upon numerous assumptions including: the nature and timing of interest rate levels and yield curve shape, prepayment speeds on loans and securities, deposit rates, pricing decisions on loans and deposits, reinvestment or replacement of asset and liability cash flows, and others. While assumptions are developed based upon current economic and local market conditions, the Company cannot make any assurances as to the predictive nature of these assumptions including how customer preferences or competitor influences might change.

As market conditions vary from those assumed in the sensitivity analysis, actual results may also differ due to: prepayment and refinancing levels deviating from those assumed; the impact of interest rate change caps or floors on adjustable rate assets; the potential effect of changing debt service levels on customers with adjustable rate loans; depositor early withdrawals and product preference changes; and other such variables. The sensitivity analysis also does not reflect additional actions that the Bank's ALCO and board of directors might take in responding to or anticipating changes in interest rates, and the anticipated impact on the Bank's net interest income.

ITEM 4. CONTROLS AND PROCEDURES

Company management evaluated, with the participation of the Chief Executive Officer and Chief Financial Officer, the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this quarterly report. Based on such evaluation, the Chief Executive Officer and the Chief Financial Officer have concluded that the Company's disclosure controls and procedures are designed to ensure that information required to be disclosed by the Company in the

reports it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and regulations and are operating in an effective manner.

No change in the Company's internal control over financial reporting (as defined in Rules 13a-15(f) and 15(d)-15(f) under the Securities Exchange Act of 1934) occurred during the most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1: Legal Proceedings

The Company and its subsidiaries are parties to certain ordinary routine litigation incidental to the normal conduct of their respective businesses, which in the opinion of management based upon currently available information will have no material effect on the Company's consolidated financial statements.

Item 1A: Risk Factors

There have been no material changes in the Company's risk factors from those disclosed in Part I, Item 1A of the Company's Annual Report on Form 10-K for the year ended December 31, 2006.

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

(a) None

(b) None

(c) The following table sets forth information with respect to any purchase made by or on behalf of the Company or any "affiliated purchaser," as defined in Section 240.10b-18(a)(3) under the Exchange Act, of shares of Company's common stock during the periods indicated.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares	
			Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
April 1 - 30, 2007	1,735	\$32.24	1,735	159,652
May 1 - 31, 2007	5,377	\$32.22	5,377	154,275
June 1 - 30, 2007	3,446	\$31.70	3,446	150,829

In March 2004, the Company's Board of Directors approved a program to repurchase up to 10% of the Company's outstanding shares of common stock, or approximately 310,000 shares. Purchases began March 4, 2004 and were continued through December 31, 2006. The Company's Board of Directors subsequently authorized the continuance of this stock repurchase plan through December 31, 2007. Depending on market conditions and other factors, these purchases may be commenced or suspended at any time, or from time-to-time, without prior notice.

Item 3: Defaults Upon Senior Securities

None

Item 4: Submission of Matters to a Vote of Security Holders

(a) The Annual Meeting of the Company's shareholders was held on May 15, 2007.

(b) Proxies for the meeting were solicited pursuant to Section 14(a) of the Securities and Exchange Act of 1934. There were no solicitations in opposition to the nominees for election to the Company's Board of Directors as listed in the proxy statement.

The votes for Directors were as follows:

Nominee Elected as Director	For	Withheld	Term Expires
Joseph M. Murphy	2,510,282.79	124,076.00	2010
Robert M. Phillips	2,567,457.79	66,901.00	2010
Constance C. Shea	2,561,690.99	72,667.80	2010
Kenneth E. Smith	2,543,296.77	91,062.01	2010

Continuing members of the Board of Directors were as follows:

Name	Position	Current Term Expires
Thomas A. Colwell	Director	2008
Robert C. Carter	Director	2009
Jacquelyn S. Dearborn	Director	2008
Peter Dodge	Director	2009
Martha T. Dudman	Director	2008
Lauri E. Fernald	Director	2009
Gregg S. Hannah	Director	2008
Clyde H. Lewis	Director	2009
Scott G. Toothaker	Director	2009
David B. Woodside	Director	2008

The vote to set the number of Directors for the ensuing year at fourteen was as follows:

For	Against	Abstain	Un-voted
2,636,347.00	43,992.96	48,4811.70	0

Item 5: Other Information

(a) None

(b) None

Item 6: Exhibits

(a) Exhibits.

EXHIBIT
NUMBER

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-Q

3	3.1 Articles of Incorporation	Articles as amended July 11, 1995 are incorporated by reference to Form S-14 filed with the Commission March 26, 1984 (Commission Number 2-90171).
	3.2 Bylaws	Bylaws as amended to date are incorporated by reference to Form 10-K, Item 14 (a)(3) filed with the Commission March 28, 2002. (Commission Number 001-13349)
31.1	Certification of the Chief Executive Officer under Rule 13a-14(a)/15d-14(a)	Filed herewith.
31.2	Certification of the Chief Financial Officer under Rule 13a-14(a)/15d-14(a)	Filed herewith.
32.1	Certification of Chief Executive Officer under 18 U.S.C. Section 1350	Filed herewith.
32.2	Certification of Chief Financial Officer under 18 U.S.C. Section 1350	Filed herewith.

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

Date: August 8, 2007

Date: August 8, 2007

BAR HARBOR BANKSHARES
(Registrant)
/s/Joseph M. Murphy
Joseph M. Murphy
Chief Executive Officer
/s/Gerald Shencavitz
Gerald Shencavitz
Chief Financial Officer