NORTHEAST BANCORP /ME/
Form 10-Q
May 15, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2013

Commission File Number: 1-14588

Northeast Bancorp

(Exact name of registrant as specified in its charter)

Maine	**01-0425066**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
500 Canal Street, Lewiston, Maine	**04240**
(Address of Principal executive offices)	(Zip Code)

(207) 786-3245

Registrant s telephone number, including area code

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

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

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

Large accelerated filer o	Accelerated filer o
Non-accelerated filer o	Smaller Reporting Company x

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date. As of April 30, 2013, the registrant had outstanding 9,565,680 shares of voting common stock, $1.00 par value per share and 880,963 shares of non-voting common stock, $1.00 par value per share.

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PART 1- FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

NORTHEAST BANCORP AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

(Unaudited)

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

	March 31, 2013	June 30, 2012
Assets		
Cash and due from banks	$ 2,936	$ 2,538
Short-term investments	139,633	125,736
Total cash and cash equivalents	142,569	128,274
Available-for-sale securities, at fair value	128,549	133,264
Loans held for sale	7,768	9,882
Loans	380,311	356,254
Less: Allowance for loan losses	1,033	824
Loans, net	379,278	355,430
Premises and equipment, net	10,013	9,205
Real estate owned and other repossessed collateral, net	2,038	834
Federal Home Loan Bank and Federal Reserve Bank stock, at cost	5,121	5,473
Intangible assets, net	3,751	4,487
Bank owned life insurance	14,266	14,295
Other assets	6,224	8,052
Total assets	$ 699,577	$ 669,196
Liabilities and Stockholders Equity		
Liabilities		
Deposits		
Demand	$ 46,783	$ 45,323
Savings and interest checking	89,394	90,204
Money market	83,129	45,024
Time deposits	286,280	241,637
Total deposits	505,586	422,188
Federal Home Loan Bank advances	33,117	43,450
Structured repurchase agreements	25,518	66,183
Short-term borrowings	2,360	1,209
Junior subordinated debentures issued to affiliated trusts	8,227	8,106
Capital lease obligation	1,783	1,911
Other liabilities	7,249	7,010

Total liabilities		583,840		550,057
Commitments and contingencies				
Stockholders equity				
Preferred stock, $1.00 par value, 1,000,000 shares authorized; no shares issued and outstanding at March 31, 2013; 4,227 shares issued and outstanding at June 30, 2012; liquidation preference of $1,000 per share		0		4
Voting common stock, $1.00 par value, 25,000,000 and 13,500,000 shares authorized at March 31, 2013 and June 30, 2012, respectively; 9,565,680 and 9,307,127 issued and outstanding at March 31, 2013 and June 30, 2012, respectively		9,566		9,307
Non-voting common stock, $1.00 par value, 3,000,000 and 1,500,000 shares authorized at March 31, 2013 and June 30, 2012, respectively; 880,963 and 1,076,314 issued and outstanding at March 31, 2013 and June 30, 2012, respectively		881		1,076
Additional paid-in capital		92,556		96,359
Retained earnings		13,260		12,235
Accumulated other comprehensive (loss) income		(526)		158
Total stockholders equity		115,737		119,139
Total liabilities and stockholders equity	$	699,577	$	669,196

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

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NORTHEAST BANCORP AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

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

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2013	**2012**	**2013**	**2012**
Interest and dividend income:				
Interest on loans	$ 9,601	$ 5,870	$ 25,209	$ 16,881
Interest on available-for-sale securities	234	422	929	1,602
Other interest and dividend income	85	60	283	176
Total interest and dividend income	9,920	6,352	26,421	18,659
Interest expense:				
Deposits	1,084	875	3,090	2,548
Federal Home Loan Bank advances	232	256	750	772
Structured repurchase agreements	135	247	515	744
Short-term borrowings	4	7	15	15
Junior subordinated debentures issued to affiliated trusts	190	188	574	556
Obligation under capital lease agreements	22	25	69	76
Total interest expense	1,667	1,598	5,013	4,711
Net interest and dividend income before provision for loan losses	8,253	4,754	21,408	13,948
Provision for loan losses	346	100	821	634
Net interest and dividend income after provision for loan losses	7,907	4,654	20,587	13,314
Noninterest income:				
Fees for other services to customers	430	326	1,202	1,036
Net securities gains	0	731	792	1,111
Gain on sales of loans held for sale	625	634	2,295	2,060
Gain on sales of portfolio loans	1,228	219	2,226	422
Gain recognized on real estate owned and other repossessed collateral, net	230	(24)	681	11
Investment commissions	758	720	2,232	2,111
Bank-owned life insurance income	118	124	599	377
Other noninterest income	12	18	68	75
Total noninterest income	3,401	2,748	10,095	7,203
Noninterest expense:				
Salaries and employee benefits	5,262	4,093	13,732	11,539
Occupancy and equipment expense	1,258	970	3,483	2,735
Professional fees	388	539	1,210	1,231
Data processing fees	306	260	858	823
Marketing expense	249	142	688	487
Loan acquisition and collection expense	352	244	1,285	798
FDIC insurance premiums	125	125	364	364
Intangible asset amortization	205	262	735	935
Other noninterest expense	686	598	2,112	1,836

Total noninterest expense		8,831		7,233		24,467		20,748
Income (loss) from continuing operations before income tax expense (benefit)		2,477		169		6,215		(231)
Income tax expense (benefit)		811		15		2,000		(209)
Net income (loss) from continuing operations	$	1,666	$	154	$	4,215	$	(22)
Discontinued operations:								
Income from discontinued operations	$	0	$	0	$	0	$	186
Gain on sale of discontinued operations		0		22		0		1,551
Income tax expense		0		8		0		600
Net income from discontinued operations	$	0	$	14	$	0	$	1,137
Net income	$	1,666	$	168	$	4,215	$	1,115
Net income available to common stockholders	$	1,666	$	70	$	3,860	$	821
Weighted-average shares outstanding:								
Basic		10,425,576		3,494,498		10,397,280		3,494,498
Diluted		10,425,576		3,512,273		10,397,280		3,494,498
Earnings per common share:								
Basic:								
Income (loss) from continuing operations	$	0.16	$	0.02	$	0.37	$	(0.09)
Income from discontinued operations		0.00		0.00		0.00		0.32
Net income	$	0.16	$	0.02	$	0.37	$	0.23
Diluted:								
Income (loss) from continuing operations	$	0.16	$	0.02	$	0.37	$	(0.09)
Income from discontinued operations		0.00		0.00		0.00		0.32
Net income	$	0.16	$	0.02	$	0.37	$	0.23
Cash dividends declared per common share	$	0.09	$	0.09	$	0.27	$	0.27

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

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NORTHEAST BANCORP AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(Dollars in thousands)

	Three Months Ended March 31, 2013	Three Months Ended March 31, 2012	Nine Months Ended March 31, 2013	Nine Months Ended March 31, 2012
Net income	$ 1,666	$ 168	$ 4,215	$ 1,115
Other comprehensive (loss) income, before tax:				
Available-for-sale securities:				
Change in net unrealized gain or loss on available-for-sale securities	(164)	(687)	(318)	676
Reclassification adjustment for net gains included in net income	0	(731)	(792)	(1,111)
Total available-for-sale securities	(164)	(1,418)	(1,110)	(435)
Derivatives and hedging activities:				
Change in accumulated loss on effective cash flow hedges	62	12	127	(132)
Reclassification adjustments for net gains included in net income	(17)	(19)	(54)	(62)
Total derivatives and hedging activities	45	(7)	73	(194)
Total other comprehensive loss, before tax	(119)	(1,425)	(1,037)	(629)
Income tax benefit related to other comprehensive loss	(40)	(484)	(353)	(214)
Other comprehensive loss, net of tax	(79)	(941)	(684)	(415)
Comprehensive income (loss)	$ 1,587	$ (773)	$ 3,531	$ 700

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

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NORTHEAST BANCORP AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY

(Unaudited)

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

	Preferred Stock Shares	Preferred Stock Amount	Voting Common Stock Shares	Voting Common Stock Amount	Non-voting Common Stock Shares	Non-voting Common Stock Amount	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders Equity
Balance at June 30, 2011	4,227	$ 4	3,312,173	$ 3,312	195,351	$ 195	$ 49,943	$ 11,726	$ (226)	$ 64,954
Net income	0	0	0	0	0	0	0	1,115	0	1,115
Other comprehensive loss, net of tax	0	0	0	0	0	0	0	0	(415)	(415)
Dividends on preferred stock	0	0	0	0	0	0	0	(159)	0	(159)
Dividends on common stock at $0.27 per share	0	0	0	0	0	0	0	(946)	0	(946)
Stock-based compensation	0	0	0	0	0	0	321	0	0	321
Accretion of preferred stock	0	0	0	0	0	0	135	(135)	0	0
Balance at March 31, 2012	4,227	$ 4	3,312,173	$ 3,312	195,351	$ 195	$ 50,399	$ 11,601	$ (641)	$ 64,870
Balance at June 30, 2012	4,227	$ 4	9,307,127	$ 9,307	1,076,314	$ 1,076	$ 96,359	$ 12,235	$ 158	$ 119,139
Net income	0	0	0	0	0	0	0	4,215	0	4,215
Other comprehensive loss, net of tax	0	0	0	0	0	0	0	0	(684)	(684)
Conversion of non-voting common stock to voting common stock	0	0	195,351	195	(195,351)	(195)	0	0	0	0
Dividends on preferred stock	0	0	0	0	0	0	0	(113)	0	(113)
Dividends on common stock at $0.27 per share	0	0	0	0	0	0	0	(2,809)	0	(2,809)
Offering costs	0	0	0	0	0	0	(59)	0	0	(59)
Stock-based compensation	0	0	0	0	0	0	374	0	0	374
Issuance of restricted common stock	0	0	63,202	64	0	0	(64)	0	0	0
Redemption of preferred stock and warrants	(4,227)	(4)	0	0	0	0	(4,322)	0	0	(4,326)
Accretion of preferred stock	0	0	0	0	0	0	268	(268)	0	0
Balance at March 31, 2013	0	$ 0	9,565,680	$ 9,566	880,963	$ 881	$ 92,556	$ 13,260	$ (526)	$ 115,737

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

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NORTHEAST BANCORP AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(Dollars in thousands)

	Nine Months Ended March 31, 2013	Nine Months Ended March 31, 2012
Operating activities:		
Net income	$ 4,215	$ 1,115
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Provision for loan losses	821	634
Gain on sale or impairment of real estate owned and other repossessed collateral, net	(681)	(11)
Accretion of fair value adjustments on loans, net	(6,805)	(1,559)
Accretion of fair value adjustments on deposits, net	(758)	(1,001)
Accretion of fair value adjustments on borrowings, net	(877)	(1,621)
Originations of loans held for sale	(106,770)	(93,879)
Net proceeds from sales of loans held for sale	111,179	94,761
Gain on sales of loans held for sale	(2,295)	(2,060)
Gain on sales of portfolio loans	(2,226)	(422)
Amortization of intangible assets	735	1,004
Bank-owned life insurance income, net	(599)	(377)
Depreciation of premises and equipment	1,283	907
Gain on sale of premises and equipment	0	(2)
Net gain on sale of available-for-sale securities	(792)	(1,111)
Stock-based compensation	374	321
Gain on sale of assets of insurance division	0	(1,580)
Amortization of securities, net	1,253	1,239
Changes in other assets and liabilities:		
Other assets	1,828	(513)
Other liabilities	737	(161)
Net cash provided by (used in) operating activities	622	(4,316)
Investing activities:		
Proceeds from sales of available-for-sale securities	159,579	179,045
Purchases of available-for-sale securities	(167,294)	(185,991)
Proceeds from maturities and principal payments on available-for-sale securities	10,858	18,615
Loan purchases	(75,227)	(59,849)
Loan originations and principal collections, net	49,759	22,363
Purchases of premises and equipment	(2,361)	(1,841)
Proceeds from sales of premises and equipment	0	124
Proceeds from sales of portfolio loans	6,749	2,405
Proceeds from sales of repossessed collateral	2,758	661
Proceeds from life insurance benefits	628	0
Proceeds from redemption of regulatory stock	352	287
Proceeds from sale of assets of insurance division	0	9,863
Net cash used in investing activities	(14,199)	(14,318)
Financing activities:		
Net increase in deposits	84,156	3,618
Net increase (decrease) in short-term borrowings	1,151	(679)

Dividends paid on preferred stock		(113)		(159)
Dividends paid on common stock		(2,809)		(946)
Stock offering costs		(59)		0
Repayment of structured repurchase agreements		(40,000)		0
Repayment of Federal Home Loan Bank advances		(10,000)		0
Repayment of other borrowings		0		(2,129)
Redemption of preferred stock and warrants		4,326		0
Repayment of capital lease obligation		(128)		(122)
Net cash provided by (used in) financing activities		27,872		(417)
Net increase (decrease) in cash and cash equivalents		14,295		(19,051)
Cash and cash equivalents, beginning of period		128,274		83,931
Cash and cash equivalents, end of period	$	142,569	$	64,880
Supplemental schedule of noncash investing and financing activities:				
Transfers from loans to real estate owned and other repossessed collateral	$	4,066	$	919
Transfers from real estate owned and other repossessed collateral to loans		1,055		44
Transfers from premises and equipment to real estate owned and other repossessed collateral		270		0

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

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NORTHEAST BANCORP AND SUBSIDIARY

Notes to Unaudited Consolidated Financial Statements

March 31, 2013

1. Basis of Presentation

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

These financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, the accompanying consolidated financial statements contain all adjustments (consisting principally of normal recurring accruals) considered necessary for a fair presentation of the Company s financial position at March 31, 2013, the results of operations for the three and nine months ended March 31, 2013 and 2012, comprehensive income for the three and nine months ended March 31, 2013 and 2012, the changes in stockholders equity for the nine months ended March 31, 2013 and 2012, and the cash flows for the nine months ended March 31, 2013 and 2012. Operating results for the nine months ended March 31, 2013 are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2013 (Fiscal 2013). For further information, refer to the audited consolidated financial statements and notes thereto for the fiscal year ended June 30, 2012 (Fiscal 2012) included in the Company s Annual Report on Form 10-K filed with the Securities and Exchange Commission.

2. Recent Accounting Pronouncements

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

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

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

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

In February 2013, the FASB issued ASU No. 2013-02, *Comprehensive Income (Topic 220): Reporting of Amounts Reclassified out of Accumulated Other Comprehensive Income* (ASU 2013-02). This ASU requires entities to (1) present (either on the face of the statement where net income is presented or in the notes) the effects on the line items of net income of significant amounts reclassified out of accumulated other comprehensive income but only if the item reclassified is required under GAAP to be reclassified to net income in its entirety in the same reporting period and (2) cross-reference to other disclosures currently required under GAAP for other reclassification items (that are not required under GAAP) to be reclassified directly to net income in their entirety in the same reporting period. This would be the case when a portion of the amount reclassified out of accumulated other comprehensive income is initially transferred to a balance sheet account instead of directly to income or expense. The new standards are effective for reporting periods

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beginning after December 15, 2012. The adoption of ASU No. 2013-02 did not have a material impact on the Company s financial statements.

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3. Securities Available-for-Sale

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

	March 31, 2013		June 30, 2012	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(Dollars in thousands)			
U.S. Government agency securities	$ 45,422	$ 45,482	$ 45,824	$ 45,808
Agency mortgage-backed securities	83,613	83,067	86,816	87,456
	$ 129,035	$ 128,549	$ 132,640	$ 133,264

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

	March 31, 2013		June 30, 2012	
	Gross Unrealized Gains	Gross Unrealized Losses	Gross Unrealized Gains	Gross Unrealized Losses
	(Dollars in thousands)			
U.S. Government agency securities	$ 60	$ 0	$ 5	$ 21
Agency mortgage-backed securities	42	588	640	0
	$ 102	$ 588	$ 645	$ 21

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

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2013	2012	2013	2012
	(Dollars in thousands)			
Gross realized gains	$ 0	$ 731	$ 831	$ 1,180
Gross realized losses	0	0	(39)	(69)
Net security gains	$ 0	$ 731	$ 792	$ 1,111

At March 31, 2013, investment securities with a fair value of approximately $50.2 million were pledged as collateral to secure outstanding borrowings.

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

	March 31, 2013					
	Less than 12 Months		More than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(Dollars in thousands)					
U.S. Government agency securities	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
Agency mortgage-backed securities	64,958	588	0	0	64,958	588
	$ 64,958	$ 588	$ 0	$ 0	$ 64,958	$ 588

	June 30, 2012					
	Less than 12 Months		More than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(Dollars in thousands)					
U.S. Government agency securities	$ 36,585	$ 21	$ 0	$ 0	$ 36,585	$ 21
Agency mortgage-backed securities	0	0	0	0	0	0
	$ 36,585	$ 21	$ 0	$ 0	$ 36,585	$ 21

There were no other-than-temporary impairment losses on securities during the three and nine months ended March 31, 2013 or 2012.

At March 31, 2013, the Company did not have any securities in a continuous loss position for greater than twelve months. At March 31, 2013, all of the Company s available-for-sale securities were issued or guaranteed by either government agencies or government-

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sponsored enterprises. The decline in fair value of the Company s available-for-sale securities at March 31, 2013 is attributable to changes in interest rates.

Management of the Company, in addition to considering current trends and economic conditions that may affect the quality of individual securities within the Company s investment portfolio, also considers the Company s ability and intent to hold such securities to maturity or recovery of cost. Management does not believe any of the Company s available-for-sale securities are other-than-temporarily impaired at March 31, 2013.

The amortized cost and fair values of available-for-sale debt securities by contractual maturity are shown below as of March 31, 2013. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
	(Dollars in thousands)	
Due within one year	$ 42,354	$ 42,410
Due after one year through five years	3,068	3,072
Due after five years through ten years	44,641	44,579
Due after ten years	38,972	38,488
	$ 129,035	$ 128,549

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4. Loans, Allowance for Loan Losses and Credit Quality

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

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

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

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

The composition of the Company s loan portfolio follows.

	March 31, 2013			June 30, 2012		
	Originated	Purchased	Total	Originated	Purchased	Total
			(Dollars in thousands)			
Residential real estate	$ 82,208	$ 4,238	$ 86,446	$ 90,944	$ 3,931	$ 94,875

Home equity	37,848	0	37,848	42,696	0	42,696
Commercial real estate	97,176	126,264	223,440	100,196	80,539	180,735
Construction	42	0	42	1,187	0	1,187
Commercial business	18,460	0	18,460	19,612	0	19,612
Consumer	14,075	0	14,075	17,149	0	17,149
Total loans	$ 249,809	$ 130,502	$ 380,311	$ 271,784	$ 84,470	$ 356,254

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Purchased credit impaired (PCI) loans include those loans acquired with specific evidence of deterioration of credit quality since origination and for which it is probable, at acquisition, that the Company will be unable to collect all contractually required payments receivable. The Company does not characterize purchased loans with no or insignificant credit impairment as PCI loans. The following table presents a summary of PCI loans purchased by the LASG during the nine months ended March 31, 2013 and 2012.

	PCI Loans Acquired Nine Months Ended March 31,			
	2013		2012	
	(Dollars in thousands)			
Contractually required payments receivable	$	48,954	$	13,943
Nonaccretable difference		(11,186)		(4,011)
Cash flows expected to be collected		37,768		9,932
Accretable yield		(15,595)		(3,427)
Fair value of loans acquired	$	22,173	$	6,505

	PCI Loans: Activity in Accretable Yield Nine Months Ended March 31,			
	2013		2012	
	(Dollars in thousands)			
Beginning balance	$	7,169	$	0
Accretion		(4,629)		(778)
Acquisitions		15,595		3,427
Reclassifications from nonaccretable difference		1,111		310
Disposals and transfers		(3,557)		(614)
Other changes		23		0
End balance	$	15,712	$	2,345

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

	March 31, 2013		June 30, 2012	
	(Dollars in thousands)			
Unpaid principal balance	$	41,777	$	21,359
Carrying amount	$	25,174	$	13,866

Allowance for Loan Losses

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

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

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

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

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

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

Purchased: Loans in this segment are secured by commercial real estate, multi-family residential real estate, or business assets and have been acquired by the LASG. Loans acquired by the LASG are, with limited exceptions, performing loans at the date of purchase. Loans in this segment acquired with specific material credit deterioration since origination are identified as purchased credit-impaired. Repayment of loans in this segment is largely dependent on cash flow from the successful operation of the property, in the case of non-owner occupied property, or operating business, in the case of owner-occupied property. Loan performance may be adversely affected by factors affecting the general economy or conditions specific to the real estate market, such as geographic location or property type. Loans in this segment are evaluated for impairment under ASC 310-30. The Company reviews expected cash flows from purchased loans on a quarterly basis. The effect of a decline in expected cash flows subsequent to the acquisition of the loan is recognized through a specific allocation in the allowance for loan losses.

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

- Levels and trends in delinquencies
- Trends in the volume and nature of loans
- Trends in credit terms and policies, including underwriting standards, procedures and practices, and the experience and ability of lending management and staff
- Trends in portfolio concentration
- National and local economic trends and conditions.
- Effects of changes or trends in internal risk ratings
- Other effects resulting from trends in the valuation of underlying collateral

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

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

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

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

	Three Months Ended March 31, 2013					
	Residential Real Estate	Commercial Real Estate	Commercial Business	Consumer	Purchased (1)	Total
	(Dollars in thousands)					
Beginning balance	$ 492	$ 102	$ 47	$ 234	$ 0	$ 875
Provision (benefit)	186	117	0	(4)	47	346
Recoveries	2	5	0	5	0	12
Charge-offs	(102)	(43)	0	(8)	(47)	(200)
Ending balance	$ 578	$ 181	$ 47	$ 227	$ 0	$ 1,033

	Three Months Ended March 31, 2012					
	Residential Real Estate	Commercial Real Estate	Commercial Business	Consumer	Purchased (1)	Total
	(Dollars in thousands)					
Beginning balance	$ 125	$ 147	$ 231	$ 234	$ 0	$ 737
Provision (benefit)	20	(11)	17	74	0	100
Recoveries	1	0	2	4	0	7
Charge-offs	(20)	0	0	(76)	0	(96)
Ending balance	$ 126	$ 136	$ 250	$ 236	$ 0	$ 748

(1) Purchased loans include commercial real estate, commercial business, and commercial loans secured by residential real estate loans. The Company separately analyzes all loans purchased by the LASG from other segments in determining the allowance for loan losses under ASC 310-30.

	Nine Months Ended March 31, 2013					
	Residential Real Estate	Commercial Real Estate	Commercial Business	Consumer	Purchased (1)	Total
	(Dollars in thousands)					
Beginning balance	$ 214	$ 93	$ 292	$ 225	$ 0	$ 824
Provision (benefit)	598	126	(42)	92	47	821
Recoveries	3	5	0	12	0	20
Charge-offs	(237)	(43)	(203)	(102)	(47)	(632)
Ending balance	$ 578	$ 181	$ 47	$ 227	$ 0	$ 1,033

	Nine Months Ended March 31, 2012					
	Residential Real Estate	Commercial Real Estate	Commercial Business	Consumer	Purchased (1)	Total
	(Dollars in thousands)					
Beginning balance	$ 34	$ 147	$ 238	$ 18	$ 0	$ 437
Provision (benefit)	171	13	(17)	467	0	634
Recoveries	2	0	37	30	0	69
Charge-offs	(81)	(24)	(8)	(279)	0	(392)
Ending balance	$ 126	$ 136	$ 250	$ 236	$ 0	$ 748

(1) Purchased loans include commercial real estate, commercial business, and commercial loans secured by residential real estate loans. The Company separately analyzes all loans purchased by the LASG from other segments in determining the allowance for loan losses under

ASC 310-30.

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

	Residential Real Estate	Commercial Real Estate	March 31, 2013 Commercial Business (Dollars in thousands)	Consumer	Total
Allowance for loan losses:					
Individually evaluated	$ 301	$ 119	$ 43	$ 28	$ 491
Collectively evaluated	277	61	4	200	542
Purchased (1)	0	0	0	0	0
Total	$ 578	$ 180	$ 47	$ 228	$ 1,033
Loans:					
Individually evaluated	$ 2,495	$ 2,192	$ 103	$ 150	$ 4,940
Collectively evaluated	117,561	95,026	18,357	13,925	244,869
Purchased (1)	4,238	126,264	0	0	130,502
Total	$ 124,294	$ 223,482	$ 18,460	$ 14,075	$ 380,311

	Residential Real Estate	Commercial Real Estate	June 30, 2012 Commercial Business (Dollars in thousands)	Consumer	Total
Allowance for loan losses:					
Individually evaluated	$ 3	$ 41	$ 284	$ 0	$ 328
Collectively evaluated	211	52	8	225	496
Purchased(1)	0	0	0	0	0
Total	$ 214	$ 93	$ 292	$ 225	$ 824
Loans:					
Individually evaluated	$ 399	$ 3,112	$ 1,127	$ 0	$ 4,638
Collectively evaluated	133,241				