First Bancorp, Inc /ME/
Form 10-Q
November 06, 2009
UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q **x Quarterly Report Pursuant to Section 13 or 15(d) of The Securities Exchange Act of 1934**

For the quarterly period ended September 30, 2009

Commission File Number 0-26589

THE FIRST BANCORP, INC.

(Exact name of Registrant as specified in its charter) **MAINE 01-0404322**

(State or other jurisdiction of incorporation or organization)(I.R.S. Employer Identification No.)

MAIN STREET, DAMARISCOTTA, MAINE 04543

(Address of principal executive offices) (Zip code)

(207) 563-3195

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 subject to such filing requirements for the past 90 days.

Yes x 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. (Check one):

Large accelerated filer [_] Accelerated filer x Non-accelerated filer [_]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes [_] No x

Indicate the number of shares outstanding of each of the registrant s classes of common stock as of November 4, 2009

Common Stock: 9,743,070 shares

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Part I. Financial Information

Selected Financial Data (Unaudited)

The First Bancorp, Inc. and Subsidiary

Dollars in thousands, except for per share amounts	**For the nine months ended September 30** **2009**	2008	**For the quarters ended September 30** **2009**	2008
Summary of Operations				
Interest Income	**$ 48,093**	$ 53,735	**$ 15,224**	$ 17,891
Interest Expense	**14,768**	26,353	**4,409**	8,268
Net Interest Income	**33,325**	27,382	**10,815**	9,623
Provision for Loan Losses	**7,660**	2,314	**3,060**	875
Non-Interest Income	**8,525**	7,550	**2,977**	2,878
Non-Interest Expense	**19,892**	17,158	**6,872**	6,306
Net Income	**10,380**	11,026	**2,890**	3,832
Per Common Share Data				
Basic Earnings per Share	**$ 0.98**	$ 1.14	**$ 0.26**	$ 0.40
Diluted Earnings per Share	**0.98**	1.13	**0.26**	0.39
Cash Dividends Declared	**0.585**	0.570	**0.195**	0.195
Book Value	**12.65**	11.96	**12.65**	11.96
Tangible Book Value [2]	**9.80**	9.10	**9.80**	9.10
Market Value	**18.60**	19.60	**18.60**	19.60
Financial Ratios				
Return on Average Equity [1]	**11.40%**	12.67%	**9.28%**	12.98%
Return on Average Tangible Equity [1,2]	**14.76%**	16.63%	**11.96%**	16.95%
Return on Average Assets [1]	**1.02%**	1.17%	**0.85%**	1.17%
Average Equity to Average Assets	**10.69%**	9.19%	**11.01%**	9.02%
Average Tangible Equity to Average Assets [2]	**8.66%**	7.01%	**8.95%**	6.91%
Net Interest Margin Tax-Equivalent [1,2]	**3.65%**	3.27%	**3.59%**	3.31%
Dividend Payout Ratio	**59.69%**	50.00%	**75.00%**	48.75%
Allowance for Loan Losses/Total Loans	**1.31%**	0.86%	**1.31%**	0.86%
Non-Performing Loans to Total Loans	**1.80%**	0.78%	**1.80%**	0.78%
Non-Performing Assets to Total Assets	**1.58%**	0.74%	**1.58%**	0.74%
Efficiency Ratio [2]	**43.01%**	46.73%	**47.54%**	48.03%
At Period End				
Total Assets	**$1,331,842**	$1,311,262	**$1,331,842**	$1,311,262
Total Loans	**973,823**	960,897	**973,823**	960,897
Total Investment Securities	**265,052**	261,057	**265,052**	261,057
Total Deposits	**960,072**	918,992	**960,072**	918,992
Total Shareholders Equity	**147,614**	115,872	**147,614**	115,872

[1]*Annualized using a 365-day basis in 2009 and a 366-day basis in 2008*

[2]*These ratios use non-GAAP financial measures. See Management s Discussion and Analysis of Financial Condition and Results of Operations for additional disclosures and information.*

Item 1 Financial Statements

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders

The First Bancorp, Inc.

We have reviewed the accompanying interim consolidated financial information of The First Bancorp, Inc. and Subsidiary as of September 30, 2009 and 2008 and for the three-month and nine-month periods then ended. These financial statements are the responsibility of the Company s management.

We conducted our reviews in accordance with standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit in accordance with standards of the Public Company Accounting Oversight Board (United States), the objective of which is to express an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

/s/ Berry, Dunn, McNeil & Parker

Portland, Maine

November 6, 2009

Consolidated Balance Sheets (Unaudited)

The First Bancorp, Inc. and Subsidiary

In thousands of dollars	**September 30, 2009**	December 31, 2008	September 30, 2008
Assets			
Cash and due from banks	**$ 16,421**	$ 16,856	$ 21,667
Overnight funds sold	**7,500**	-	-
Securities available for sale	**38,575**	13,072	20,613
Securities to be held to maturity			
(fair value $216,921 at September 30, 2009, $229,460 at December 31, 2008 and $219,483 at September 30, 2008)	**211,784**	234,767	225,751
Federal Home Loan Bank and Federal Reserve Bank stock, at cost	**14,693**	14,693	14,693
Loans held for sale (fair value approximates cost)	**2,794**	1,298	1,203
Loans	**973,823**	979,273	960,897
Less: allowance for loan losses	**12,800**	8,800	8,303
Net loans	**961,023**	970,473	952,594
Accrued interest receivable	**5,648**	5,783	6,785
Premises and equipment	**18,357**	16,028	16,301
Other real estate owned	**2,995**	2,428	2,168
Goodwill	**27,684**	27,684	27,684
Other assets	**24,368**	22,662	21,803
Total Assets	**$1,331,842**	$1,325,744	$1,311,262
Liabilities			
Demand deposits	**$ 74,049**	$ 68,399	$ 75,753
NOW deposits	**112,087**	108,188	110,365
Money market deposits	**101,352**	129,333	123,157
Savings deposits	**93,363**	82,867	85,230
Certificates of deposit under $100,000	**228,835**	246,152	413,913
Certificates $100,000 and over	**350,386**	290,797	110,574
Total deposits	**960,072**	925,736	918,992
Borrowed funds	**213,061**	272,074	264,617
Other liabilities	**11,095**	10,753	11,781
Total Liabilities	**1,184,228**	1,208,563	1,195,390
Shareholders Equity			
Preferred stock	**24,582**	-	-
Common stock	**97**	97	97
Additional paid-in capital	**45,003**	44,117	43,995
Retained earnings	**78,000**	74,057	72,939
Accumulated other comprehensive income (loss)			
Net unrealized gain (loss) on securities available for sale	**189**	(819)	(899)
Net unrealized loss on postretirement benefit costs	**(257)**	(271)	(260)
Total Shareholders Equity	**147,614**	117,181	115,872
Total Liabilities & Shareholders Equity	**$1,331,842**	$1,325,744	$1,311,262
Common Stock			
Number of shares authorized	**18,000,000**	18,000,000	18,000,000
Number of shares issued and outstanding	**9,725,405**	9,696,397	9,689,711
Book value per share	**$ 12.65**	$ 12.09	$ 11.96

See Report of Independent Registered Public Accounting Firm.

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

Consolidated Statements of Income (Unaudited)

The First Bancorp, Inc. and Subsidiary

	For the nine months ended		**For the quarters ended**	
	September 30,		**September 30,**	
In thousands of dollars	**2009**	2008	**2009**	2008
Interest income				
Interest and fees on loans	**$37,704**	$44,219	**$12,171**	$14,570
Interest on deposits with other banks	**1**	-	**1**	-
Interest and dividends on investments	**10,388**	9,516	**3,052**	3,321
Total interest income	**48,093**	53,735	**15,224**	17,891
Interest expense				
Interest on deposits	**9,403**	18,041	**2,709**	5,692
Interest on borrowed funds	**5,365**	8,312	**1,700**	2,576
Total interest expense	**14,768**	26,353	**4,409**	8,268
Net interest income	**33,325**	27,382	**10,815**	9,623
Provision for loan losses	**7,660**	2,314	**3,060**	875
Net interest income after provision for loan losses	**25,665**	25,068	**7,755**	8,748
Non-interest income				
Investment management and fiduciary income	**998**	1,138	**320**	358
Service charges on deposit accounts	**1,754**	2,191	**596**	703
Net securities gains	**-**	6	**1**	-
Mortgage origination and servicing income	**1,913**	370	**370**	154
Other operating income	**3,860**	3,845	**1,690**	1,663
Total non-interest income	**8,525**	7,550	**2,977**	2,878
Non-interest expense				
Salaries and employee benefits	**7,994**	8,625	**2,842**	2,945
Occupancy expense	**1,182**	1,150	**348**	376
Furniture and equipment expense	**1,700**	1,508	**562**	566
FDIC insurance premiums	**1,276**	266	**315**	128
Net securities losses	**147**	-	**-**	22
Other than temporary impairment charge	**916**	-	**-**	-
Amortization of identified intangibles	**213**	213	**71**	71
Other operating expense	**6,464**	5,396	**2,734**	2,198
Total non-interest expense	**19,892**	17,158	**6,872**	6,306
Income before income taxes	**14,298**	15,460	**3,860**	5,320
Applicable income taxes	**3,918**	4,434	**970**	1,488
NET INCOME	**$10,380**	$11,026	**$ 2,890**	$ 3,832
Less preferred stock dividends and premium amortization	**824**	-	**337**	-
Net income available to common shareholders	**$ 9,556**	$11,026	**$ 2,553**	$ 3,832
Earning per common share				
Basic earnings per share	**$0.98**	$1.14	**$0.26**	$0.40
Diluted earnings per share	**$0.98**	$1.13	**$0.26**	$0.39
Weighted average number of shares outstanding	**9,716,129**	9,703,901	**9,723,757**	9,689,053
Incremental shares	**26,808**	20,103	**52,629**	21,290
Cash dividends declared per share	**$0.585**	$0.570	**$0.195**	$0.195

See Report of Independent Registered Public Accounting Firm.

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

Consolidated Statements of Changes in Shareholders Equity (Unaudited)

The First Bancorp, Inc. and Subsidiary

In thousands of dollars, except number of shares	Preferred stock	Common stock and additional paid-in capital Shares	Amount	Retained earnings	Accumulated other comprehensive income (loss)	Total shareholders equity
Balance at December 31, 2007	$ -	**9,732,493**	**$ 44,859**	**$ 67,432**	**$ 162**	**$ 112,453**
Net income	-	-	-	11,026	-	11,026
Net unrealized loss on securities available for sale, net of tax benefit of $719	-	-	-	-	(1,335)	(1,335)
Unrecognized transition obligation for postretirement benefits, net of taxes of $8	-	-	-	-	14	14
Comprehensive income	-	-	-	11,026	(1,321)	9,705
Dividends declared on common stock	-	-	-	(5,527)	-	(5,527)
Equity compensation expense	-	-	28	-	-	28
Payment to repurchase common stock	-	(84,868)	(1,347)	-	-	(1,347)
Proceeds from sale of common stock	-	42,086	552	-	-	552
Tax benefit of disqualifying disposition of incentive stock option shares	-	-	-	8	-	8
Balance at September 30, 2008	**$ -**	**9,689,711**	**$ 44,092**	**$ 72,939**	**$ (1,159)**	**$ 115,872**
Balance at December 31, 2008	**$ -**	**9,696,397**	**$ 44,214**	**$ 74,057**	**$ (1,090)**	**$ 117,181**
Net income	-	-	-	10,380	-	10,380
Net unrealized gain on securities available for sale, net of taxes of $543	-	-	-	-	1,008	1,008
Unrecognized transition obligation for postretirement benefits, net of taxes of $7	-	-	-	-	14	14
Comprehensive income	-	-	-	10,380	1,022	11,402
Dividends declared on common stock	-	-	-	(5,687)	-	(5,687)
Dividends declared on preferred stock	-	-	-	(750)	-	(750)
Equity compensation expense	-	-	28	-	-	28
Proceeds from sale of preferred stock	25,000	-	-	-	-	25,000
Premium on issuance of preferred stock	(493)	-	493	-	-	-
Amortization of premium for preferred stock issuance	75	-	(75)	-	-	-
Payment to repurchase common stock	-	(7,685)	(138)	-	-	(138)
Proceeds from sale of common stock	-	36,693	578	-	-	578
Balance at September 30, 2009	**$ 24,582**	**9,725,405**	**$ 45,100**	**$ 78,000**	**$ (68)**	**$ 147,614**

See Report of Independent Registered Public Accounting Firm.

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

Consolidated Statements of Cash Flows (Unaudited)

The First Bancorp, Inc. and Subsidiary

	For nine months ended	
	September 30,	
In thousands of dollars	**2009**	2008
Cash flows from operating activities		
Net income	**$ 10,380**	$ 11,026
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation	**1,112**	923
Provision for loan losses	**7,660**	2,314
Loans originated for resale	**(98,868)**	(16,543)
Proceeds from sales and transfers of loans	**97,372**	17,157
Net loss (gain) on sale or call of investment securities	**147**	(6)
Other-then-temporary impairment charge	**916**	-
Equity compensation expense	**28**	28
Net increase in other assets and accrued interest	**(2,146)**	(4,313)
Net increase (decrease) in other liabilities	**243**	(2,734)
Net amortization of premiums on investments	**(2,359)**	(3,496)
Net acquisition amortization	**126**	180
Provision for losses on other real estate owned	**412**	-
Net loss on disposal of assets	**3**	2
Net cash provided by operating activities	**15,026**	4,538
Cash flows from investing activities		
Sale of overnight funds	**(7,500)**	-
Proceeds from maturities, payments and calls of securities available for sale	**6,128**	4,641
Proceeds from sales of securities available for sale	**2,914**	-
Proceeds from maturities, payments and calls of securities to be held to maturity	**162,389**	83,831
Proceeds from sales of other real estate owned	**568**	-
Purchases of securities available for sale	**(32,917)**	(1,463)
Purchases of securities to be held to maturity	**(138,187)**	(124,803)
Net decrease (increase) in loans	**243**	(42,885)
Capital expenditures	**(3,444)**	(745)
Net cash used by investing activities	**(9,806)**	(81,424)
Cash flows from financing activities		
Net increase (decrease) in demand, savings, and money market accounts	**(7,936)**	21,544
Net increase in certificates of deposit	**42,281**	116,184
Advances on long-term borrowings	**-**	50,000
Repayment on long-term borrowings	**(27,000)**	-
Net change in short-term borrowings	**(32,006)**	(102,085)
Proceeds from issuance of preferred stock	**25,000**	-
Payments to repurchase common stock	**(138)**	(1,347)
Proceeds from sale of common stock	**578**	552
Dividends paid	**(6,434)**	(3,549)
Net cash (used) provided by financing activities	**(5,655)**	81,299
Net (decrease) increase in cash and cash equivalents	**(435)**	4,413
Cash and cash equivalents at beginning of year	**16,856**	17,254
Cash and cash equivalents at end of period	**$ 16,421**	$ 21,667
Interest paid	**$ 12,551**	$ 26,122
Income taxes paid	**$ 4,634**	$ 5,346
Non-cash transactions		
Change in net unrealized (loss) gain on available for sale securities, net of tax	**$ (1,008)**	$ 1,335
Net transfer from loans to other real estate owned	**$ 1,547**	$ 1,341

Notes to Consolidated Financial Statements

The First Bancorp, Inc. and Subsidiary

Note 1 Basis of Presentation

The First Bancorp, Inc. (the Company) is a financial holding company that owns all of the common stock of The First, N.A. (the Bank). At the Company s Annual Meeting of Shareholders on April 30, 2008, the Company s name was changed from First National Lincoln Corporation to The First Bancorp, Inc. The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America 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 footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of Management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. All significant intercompany transactions and balances are eliminated in consolidation. The income reported for the 2009 period is not necessarily indicative of the results that may be expected for the year ending December 31, 2009. For further information, refer to the consolidated financial statements and notes included in the Company s annual report on Form 10-K for the year ended December 31, 2008.

Accounting Standards Codification

In June 2009, the Financial Accounting Standards Board (FASB) issued an accounting standard which established Accounting Standards Codification (the Codification or ASC) to become the single source of authoritative generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities, with the exception of guidance issued by the U.S. Securities and Exchange Commission (the SEC) and its staff. All guidance contained in the Codification carries an equal level of authority. The Codification is not intended to change GAAP, but rather is expected to simplify accounting research by reorganizing current GAAP into approximately 90 accounting topics. The Company adopted this accounting standard in preparing the Consolidated Financial Statements for the period ended September 30, 2009. The adoption of this accounting standard, which was subsequently codified into ASC Topic 105, Generally Accepted Accounting Principles, had no impact on retained earnings and will have no impact on the Company s consolidated financial statements.

Subsequent Events

Events occurring subsequent to September 30, 2009, have been evaluated as to their potential impact to the Financial Statements through the date of issuance, November 6, 2009.

Note 2 Investment Securities

The following table summarizes the amortized cost and estimated fair value of investment securities at September 30, 2009:

In thousands of dollars	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value (Estimated)
Securities available for sale				
U.S. Treasury and agency	$ 10,339	$ 65	$ -	$ 10,404
Mortgage-backed securities	16,484	123	(10)	16,597
State and political subdivisions	9,599	525	-	10,124
Corporate securities	1,567	-	(389)	1,178
Other equity securities	295	5	(28)	272
	$ 38,284	$ 718	$ (427)	$ 38,575
Securities to be held to maturity				
U.S. Treasury and agency	$ 44,036	$ 171	$ (17)	$ 44,190
Mortgage-backed securities	105,259	2,124	(158)	107,225
State and political subdivisions	62,339	3,184	(167)	65,356
Corporate securities	150	-	-	150
	$211,784	$5,479	$ (342)	$216,921

The following table summarizes the amortized cost and estimated fair value of investment securities at December 31, 2008:

In thousands of dollars	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value (Estimated)
Securities available for sale				
Mortgage-backed securities	$ 900	$ 22	$ -	$ 922
State and political subdivisions	8,571	339	-	8,910
Corporate securities	4,566	-	(1,589)	2,977
Other equity securities	295	2	(34)	263
	$ 14,332	$ 363	$ (1,623)	$ 13,072
Securities to be held to maturity				
U.S. Treasury and agency	$ 110,513	$ 74	$ (5,871)	$ 104,716
Mortgage-backed securities	60,774	640	(297)	61,117
State and political subdivisions	62,330	952	(684)	62,598
Corporate securities	1,150	-	(121)	1,029
	$ 234,767	$1,666	$ (6,973)	$ 229,460

The following table summarizes the contractual maturities of investment securities at September 30, 2009:

	Securities available for sale		**Securities to be held to maturity**	
In thousands of dollars	**Amortized Cost**	**Fair Value (Estimated)**	**Amortized Cost**	**Fair Value (Estimated)**
Due in 1 year or less	$ 326	$ 326	$ 339	$ 345
Due in 1 to 5 years	3,081	3,318	7,674	7,973
Due in 5 to 10 years	4,099	4,245	15,826	16,736
Due after 10 years	30,483	30,414	187,945	191,867
Equity securities	295	272	-	-
	$38,284	$38,575	$211,784	$216,921

The following table summarizes the contractual maturities of investment securities at December 31, 2008:

	Securities available for sale		**Securities to be held to maturity**	
	Amortized Cost	**Fair Value (Estimated)**	**Amortized Cost**	**Fair Value (Estimated)**
In thousands of dollars				
Due in 1 year or less	$ 1,063	$ 935	$ 935	$ 936
Due in 1 to 5 years	5,251	4,408	7,210	7,369
Due in 5 to 10 years	5,935	6,162	21,856	22,199
Due after 10 years	1,788	1,304	204,766	198,956
Equity securities	295	263	-	-
	$14,332	$13,072	$234,767	$229,460

At September 30, 2009, securities with a fair value of $176.0 million were pledged to secure public deposits, repurchase agreements, and for other purposes as required by law. This compares to securities with a fair value of $153.6 million as of December 31, 2008 pledged for the same purpose.

Gains and losses on the sale of securities available for sale are computed by subtracting the amortized cost at the time of sale from the security s selling price, net of accrued interest to be received. The following table shows securities gains and losses for the nine months ended September 30, 2009 and the year ended December 31, 2008:

In thousands of dollars	**For the nine months ended September 30, 2009**	For the year ended December 31, 2008
Proceeds from sales	$ 2,914	$14,192
Gross gains	$ 9	$ 123
Gross losses	(156)	(212)
Net loss	$ (147)	$ (89)
Related income taxes	$ (55)	$ (31)

Management reviews securities with unrealized losses for other than temporary impairment. As of September 30, 2009, there were 19 securities with unrealized losses held in the Company s portfolio. These securities were temporarily impaired as a result of changes in interest rates reducing their fair market value, of which eight had been temporarily impaired for 12 months or more. During the first quarter 2009, the Company took an after-tax charge of $596,000 for other-than-temporary impairment related to one automotive company corporate security in the investment portfolio. In Management s opinion, no additional writedown for other-than-temporary impairment is warranted.

Information regarding securities temporarily impaired as of September 30, 2009 is summarized below:

	Less than 12 months		**12 months or more**		**Total**	
In thousands of dollars	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury and agency	$ 5,574	$ (17)	$ -	$ -	$ 5,574	$ (17)
Mortgage-backed securities	20,558	(168)	12	-	20,570	(168)
State and political subdivisions	-	-	1,504	(167)	1,504	(167)
Corporate securities	326	(1)	732	(388)	1,058	(389)
Other equity securities	-	-	36	(28)	36	(28)
	$26,458	$(186)	$2,284	$(583)	$28,742	$(769)

Information regarding securities temporarily impaired as of December 31, 2008 is summarized below:

	Less than 12 months		**12 months or more**		**Total**	
	Fair	Unrealized	Fair	Unrealized	Fair	Unrealized
In thousands of dollars	Value	Losses	Value	Losses	Value	Losses
U.S. Treasury and agency	$64,951	$(4,610)	$10,043	$(1,261)	$ 74,994	$(5,871)
Mortgage-backed securities	12,498	(110)	3,534	(187)	16,032	(297)
State and political subdivisions	13,592	(573)	2,165	(111)	15,757	(684)
Corporate securities	1,821	(187)	1,709	(1,523)	3,530	(1,710)
Other equity securities	-	-	32	(34)	32	(34)
	$92,862	$(5,480)	$17,483	$(3,116)	$110,345	$(8,596)

The Bank is a member of the Federal Home Loan Bank (FHLB) of Boston. The FHLB is a cooperatively owned wholesale bank for housing and finance in the six New England States. Its mission is to support the residential mortgage and community-development lending activities of its members, which include over 450 financial institutions across New England. As a requirement of membership in the FHLB, the Bank must own a minimum required amount of FHLB stock, calculated periodically based primarily on its level of borrowings from the FHLB. The Company uses the FHLB for much of its wholesale funding needs. As of September 30, 2009 and December 31, 2008, the Company s investment in FHLB stock totaled $14.0 million.

FHLB stock is a non-marketable equity security and therefore is reported at cost, which equals par value. Shares held in excess of the minimum required amount are generally redeemable at par value. However, in the first quarter of 2009 the FHLB announced a moratorium on such redemptions in order to preserve its capital in response to current market conditions and declining retained earnings. The minimum required shares are redeemable, subject to certain limitations, five years following termination of FHLB membership. The Bank has no intention of terminating its FHLB membership.

The FHLB has announced that dividend payments for 2009 are unlikely. The Company will likely have no dividend income on its FHLB stock in 2009. On April 10, 2009, the FHLB reiterated to its members that, while it currently is meeting all its regulatory capital requirements, it is focusing on preserving capital in response to ongoing market volatility including the suspension of its quarterly dividend and the extension of a moratorium on excess stock repurchases. On October 29, 2009, the FHLB announced a net loss of $105.4 million for the third quarter of 2009 and noted that the primary challenge for the FHLB continues to be losses due to the other-than-temporary impairment of its investments in private-label mortgage-backed securities resulting in a credit loss of $174.2 million during the quarter. The associated non-credit loss on these securities is $1.6 million and results in an accumulated other comprehensive loss of $1.0 billion at September 30, 2009. Retained earnings were $136.3 million at September 30, 2009, down from $241.7 million at June 30, 2009. The FHLB remained in compliance with all regulatory capital ratios as of September 30, 2009

The Company periodically evaluates its investment in FHLB stock for impairment based on, among other things, the capital adequacy of the FHLB and its overall financial condition. No impairment losses have been recorded through September 30, 2009. The Bank will continue to monitor its investment in FHLB stock.

Note 3 Loans

The following table shows the composition of the Company s loan portfolio as of September 30, 2009, December 31, 2008 and September 30, 2008:

In thousands of dollars	**September 30, 2009**		December 31, 2008		September 30, 2008	
Commercial						
Real estate	**$236,807**	**24.3%**	$219,057	22.3%	$213,957	22.3%
Construction	**50,601**	**5.2%**	48,182	4.9%	45,035	4.7%
Other	**118,151**	**12.1%**	118,109	12.1%	120,608	12.6%
Municipal	**55,889**	**5.7%**	34,832	3.6%	25,018	2.6%
Residential						
Term	**381,718**	**39.3%**	431,520	44.0%	432,632	45.0%
Construction	**17,056**	**1.8%**	26,235	2.7%	23,499	2.4%
Heloc	**88,830**	**9.1%**	77,206	7.9%	74,850	7.8%
Consumer	**24,771**	**2.5%**	24,132	2.5%	25,298	2.6%
Total loans	**$973,823**	**100.0%**	$979,273	100.0%	$960,897	100.0%

Loan balances include net deferred loan costs of $1.9 million as of September 30, 2009 and $1.4 million as of December 31, 2008. Pursuant to collateral agreements, qualifying first mortgage loans, which were valued at $337.9 million at September 30, 2009 and $357.0 million at December 31, 2008, were used to collateralize borrowings from the Federal Home Loan Bank of Boston.

Transactions in the allowance for loan losses were as follows:

In thousands of dollars	**September 30, 2009**	December 31, 2008	September 30, 2008
Balance at beginning of year	**$ 8,800**	$ 6,800	$ 6,800
Provision charged to operating expenses	**7,660**	4,700	2,314
	16,460	11,500	9,114
Loans charged off	**(3,817)**	(2,941)	(982)
Recoveries on loans	**157**	241	171
Net loans charged off	**(3,660)**	(2,700)	(811)
Balance at end of year	**$ 12,800**	$ 8,800	$ 8,303

Loans on non-accrual status totaled $17.6 million at September 30, 2009, $12.4 million at December 31, 2008 and $7.6 million at September 30, 2008. Loans past due greater than 90 days which are accruing interest totaled $4.6 million at September 30, 2009, $5.0 million at December 31, 2008 and $2.8 million at September 30, 2008. The Company continues to accrue interest on these loans because it believes collection of principal and interest is reasonably assured. Information regarding impaired loans is as follows:

In thousands of dollars	**September 30, 2009**	December 31, 2008	September 30, 2008
Balance of impaired loans	**$17,571**	$12,449	$ 7,563
Less portion for which no allowance for loan losses is allocated	**(8,081)**	(4,805)	(1,954)
Portion of impaired loan balance for which an allowance for loan losses is allocated	**9,490**	7,644	5,609
Portion of allowance for loan losses allocated to the impaired loan balance	**$ 2,810**	$ 1,957	$ 1,596

Note 4 Stock Options

The Company established a shareholder-approved stock option plan in 1995, under which the Company may grant options to its employees for up to 600,000 shares of common stock. The Company believes that such awards align the interests of its employees with those of its shareholders. Only incentive stock options may be granted under the plan. The option price of each option grant is determined by the Options Committee of the Board of Directors, and in no instance shall be less than the fair market value on the date of the grant. An option s maximum term is ten years from the date of grant, with 50% of the options granted vesting two years from the date of grant and the remaining 50% vesting five years from date of grant. As of January 16, 2005, all options under this plan had been granted.

The Company applies the fair value recognition provisions of FASB ASC Topic 718 Compensation Stock Compensation , to stock-based employee compensation. As a result, $28,000 in compensation cost is included in the Company s financial statements for the first nine months of 2009. The unrecognized compensation cost to be amortized over a weighted average remaining vesting period of 1.25 years is $46,000, which is for 21,000 options granted in 2005. The weighted average fair market value per share was $4.41 at the time of grant. The fair market value was estimated using the Black-Scholes option pricing model and the following assumptions: quarterly dividends of $0.12, risk-free interest rate of 4.20%, volatility of 25.81%, and an expected life of ten years, the options maximum term. Volatility is based on the actual volatility of the Company s stock during the quarter in which the options were granted. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve at the time of the option grant. The following table summarizes the non-vested options as of September 30, 2009:

	Number of Shares	Weighted Average Grant Date Fair Value
Non-vested at December 31, 2008	21,000	$4.41
Granted in 2009	-	-
Vested in 2009	-	-
Forfeited in 2009	-	-
Non-vested at September 30, 2009	21,000	$4.41

During 2009, 3,000 options were exercised, with proceeds paid to the Company of $22,000. The excess of the fair value of the stock issued upon exercise over the exercise price was $32,000. A summary of the status of the Stock Option Plan as of September 30, 2009 and changes during the nine-month period then ended, is presented below.

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (In thousands)
Outstanding at December 31, 2008	76,500	$13.27		
Granted in 2009	-	-		
Vested in 2009	-	-		
Exercised in 2009	(3,000)	7.50		
Forfeited in 2009	-	-		
Outstanding at September 30, 2009	73,500	$13.51	3.5	$374
Exercisable at September 30, 2009	52,500	$11.71	2.8	$361

Note 5 Preferred Stock

On January 9, 2009, the Company received $25 million from preferred stock issuance under the U.S. Treasury Capital Purchase Program (the CPP Shares) at a purchase price of $1,000 per share. The CPP Shares call for cumulative dividends at a rate of 5.0% per year for the first five years, and at a rate of 9.0% per year in following years, payable quarterly in arrears on February 15, May 15, August 15 and November 15 of each year. Incident to such issuance, the Company issued to the U.S. Treasury warrants (the Warrants) to purchase up to 225,904 shares of the Company s common stock at a price per share of $16.60 (subject to adjustment). The CPP Shares and the related Warrants (and any shares of common stock issuable pursuant to the Warrants) are freely transferable by Treasury to third parties and the Company has filed a registration statement with the Securities and Exchange Commission to allow for possible resale of such securities. The CPP Shares qualify as Tier 1 capital on the Company s books for regulatory purposes and rank senior to the Company s common stock and senior or at an equal level in the Company s capital structure to any other shares of preferred stock the Company may issue in the future.

The Company may redeem the CPP Shares at any time using any funds available to the Company, and any redemption would be subject to the prior approval of the Federal Reserve Bank of Boston. The minimum amount that may be redeemed is 25% of the original CPP investment. The CPP Shares are perpetual preferred stock, which means that neither Treasury nor any subsequent holder would have a right to require that the Company redeem any of the shares.

During the first three years following the Company s sale of the CPP Shares, the Company is required to obtain Treasury s consent to increase the dividend per share paid on the Company s common stock unless the Company had redeemed the CPP Shares in full or Treasury had transferred all of the CPP Shares to other parties. Also during the first three years following the Company s sale of the CPP Shares, the Company is required to obtain Treasury s consent in order to repurchase any shares of its outstanding stock of any type (other than purchases of common stock or preferred stock ranking junior to the CPP Shares in the ordinary course of the Company s business and consistent with the Company s past practices in connection with a benefit plan) unless the Company had redeemed the CPP Shares in full or Treasury had transferred all of the CPP Shares to other parties.

As a condition to Treasury s purchase of the CPP Shares, during the time that Treasury holds any equity or debt instrument the Company issued, the Company is required to comply with certain restrictions and other requirements relating to the compensation of the Company s chief executive officer, chief financial officer and three other most highly compensated executive officers. These restrictions include a prohibition on severance payments to those executive officers upon termination of their employment and a $500,000 limit on the tax deductions the Company can take for compensation expense for each of those executive officers in a single year as well as a prohibition on bonus compensation to such officers other than limited amounts of long-term restricted stock.

In conjunction with the sale of the CPP Shares, the Company also issued warrants to Treasury giving it the right to purchase from the Company 225,904 shares of the Company s common stock at a price of $16.60 per share. The Warrants have a term of ten years and could be exercised by Treasury or a subsequent holder at any time or from time to time during their term. To the extent they had not previously been exercised, the Warrants would expire after ten years. Treasury will not vote any shares of common stock it receives upon exercise of the Warrants, but that restriction would not apply to third parties to whom Treasury transferred the Warrants. The Warrants (and any common stock issued upon exercise of the Warrants) could be transferred to third parties separately from the CPP Shares. The proceeds from the sale of the CPP Shares were allocated between the CPP Shares and Warrants based on their relative fair values on the issue date. The fair value of the Warrants was determined using the Black-Scholes model which includes the following assumptions: common stock price of $16.60 per share, dividend yield of 4.70%, stock price volatility of 24.43%, and a risk-free interest rate of 2.01%. The discount on the CPP Shares was based on the value that was allocated to the Warrants upon issuance, and is being accreted back to the value of the CPP Shares over a five-year period (the expected life of the shares upon issuance) on a straight-line basis.

Note 6 Common Stock

On August 16, 2007, the Company announced that its Board of Directors had authorized a program for the repurchase of up to 300,000 shares of the Company s common stock or approximately 3.1% of the outstanding shares. This program ended on August 16, 2009, and under the program the Company repurchased 182,869 shares at an average price of $15.63 and at a total cost of $2.9 million. As a consequence of the Company s issuance of securities under the U.S. Treasury s CPP program, its ability to repurchase stock while such securities remain outstanding is restricted to

purchases from employee benefit plans. In the first nine months of 2009, the Company repurchased 7,685 shares from employee benefit plans at an average price of $17.88 per share and for total proceeds of $138,000.

Note 7 Earnings Per Share

The following table sets forth the computation of basic and diluted earnings per share (EPS) for the nine months ended September 30, 2009 and 2008:

In thousands, except number of shares and per share data	Income (Numerator)	Shares (Denominator)	Per-Share Amount
For the nine months ended September 30, 2009			
Net income as reported	$10,380		
Less dividends and amortization of premium on preferred stock	824		
Basic EPS: Income available to common shareholders	9,556	9,716,129	$0.98
Effect of dilutive securities: incentive stock options and warrants		26,808	
Diluted EPS: Income available to common shareholders plus assumed conversions	$9,556	9,742,937	$0.98
For the nine months ended September 30, 2008			
Net income as reported	$11,026		
Basic EPS: Income available to common shareholders	11,026	9,703,901	$1.14
Effect of dilutive securities: incentive stock options		20,103	
Diluted EPS: Income available to common shareholders plus assumed conversions	$11,026	9,724,004	$1.13

The following table sets forth the computation of basic and diluted earnings per share (EPS) for the quarters ended September 30, 2009 and 2008:

In thousands, except number of shares and per share data	Income (Numerator)	Shares (Denominator)	Per-Share Amount
For the quarter ended September 30, 2009			
Net income as reported	$ 2,890		
Less dividends and amortization of premium on preferred stock	337		
Basic EPS: Income available to common shareholders	2,553	9,723,757	$0.26
Effect of dilutive securities: incentive stock options and warrants		52,629	
Diluted EPS: Income available to common shareholders plus assumed conversions	$ 2,553	9,776,386	$0.26
For the quarter ended September 30, 2008			
Net income as reported	$ 3,832		
Basic EPS: Income available to common shareholders	3,832	9,689,053	$0.40
Effect of dilutive securities: incentive stock options		21,290	
Diluted EPS: Income available to common shareholders plus assumed conversions	$ 3,832	9,710,343	$0.39

All earnings per share calculations have been made using the weighted average number of shares outstanding during the period. The dilutive securities are incentive stock options granted to certain key members of Management and warrants granted to the U.S. Treasury under the Capital Purchase program. The dilutive number of shares has been calculated using the treasury method, assuming that all granted options and warrants were exercisable at the end of each period.

Note 8 Employee Benefit Plans

401(k) Plan

The Bank has a defined contribution plan available to substantially all employees who have completed nine months of service. Employees may contribute up to $16,500 of their compensation if under age 50 and $22,000 if age 50 or over, and the Bank may provide a match to employee contributions not to exceed 3.0% of compensation depending on contribution level. Subject to a vote of the Board of Directors, the Bank may also make a profit-sharing contribution to the Plan. Such contribution equaled 2.0% of each eligible employee s compensation in 2008. The amount for 2009 has not been established. The expense related to the 401(k) plan was $254,000 for the nine months ended September 30, 2009 and 2008.

Supplemental Retirement Benefits

The Bank also provides unfunded, non-qualified supplemental retirement benefits for certain officers, payable in installments over 20 years upon retirement or death. The agreements consist of individual contracts with differing characteristics that, when taken together, do not constitute a postretirement plan. The costs for these benefits are recognized over the service periods of the participating officers in accordance with FASB ASC Topic 712 Compensation Nonretirement Postemployment Benefits . The expense of these supplemental retirement benefits was $147,000 and $123,000 for the nine months ended September 30, 2009 and 2008, respectively. As of September 30, 2009, the associated accrued liability was $1,370,000 compared to $1,265,000 and $1,238,000 at December 31, 2008 and September 30, 2008, respectively.

Post-Retirement Benefit Plans

The Bank sponsors two post-retirement benefit plans. One plan currently provides a subsidy for health insurance premiums to certain retired employees and a future subsidy for seven active employees who were age 50 and over in 1996. These subsidies are based on years of service and range between $40 and $1,200 per month per person. The other plan provides life insurance coverage to certain retired employees. The Bank also provides health insurance for retired directors. None of these plans are pre-funded.

The Company utilizes FASB ASC Topic 712 Compensation Nonretirement Postemployment Benefits to recognize the overfunded or underfunded status of a defined benefit postretirement plan (other than a multiemployer plan) as an asset or liability in its balance sheet and to recognize changes in the funded status in the year in which the changes occur through comprehensive income of a business entity. The Bank sponsors postretirement benefit plans which provide certain life insurance and health insurance benefits for certain retired employees and health insurance for retired directors. None of these plans are pre-funded. The following table sets forth the accumulated postretirement benefit obligation and funded status:

In thousands of dollars	**September 30, 2009**	September 30, 2008
Change in benefit obligation		
Benefit obligation at beginning of year	**$ 1,990**	$1,949
Service cost	**15**	12
Interest cost	**101**	102
Benefits paid	**(117)**	(131)
Benefit obligation at end of period	**1,989**	1,932
Funded status		
Benefit obligation at end of period	**(1,989)**	(1,932)
Accrued benefit cost	**$(1,989)**	$(1,932)

The following table sets forth the net periodic pension cost:

	For nine months ended		For three months ended	
	September 30,		September 30,	
In thousands of dollars	**2009**	2008	**2009**	2008
Components of net periodic benefit cost				
Service cost	**$ 15**	$ 12	**$ 7**	$ 4
Interest cost	**101**	102	**33**	31
Amortization of unrecognized transition obligation	**21**	21	**7**	8
Amortization of prior service credit	**(2)**	(3)	**-**	(1)
Amortization of accumulated losses	**15**	2	**5**	1
Net periodic benefit cost	**$150**	$ 134	**$52**	$ 43

Amounts not yet reflected in net periodic benefit cost and included in accumulated other comprehensive loss are as follows:

	At September 30,	
In thousands of dollars	**2009**	2008
Unamortized prior service credit	**$ -**	$ 3
Unamortized net actuarial loss	**(295)**	(274)
Unrecognized transition obligation	**(100)**	(129)
	(395)	(400)
Deferred tax benefit at 35%	**138**	140
Net unrecognized postretirement benefits included in accumulated other comprehensive loss	**$ (257)**	$ (260)

A weighted average discount rate of 7.0% was used in determining the accumulated benefit obligation and the net periodic benefit cost. The assumed health care cost trend rate is 7.0%. The measurement date for benefit obligations was as of year-end for prior years presented. The expected benefit payments for the fourth quarter of 2009 are $39,000 and the expected benefit payments for all of 2009 are $157,000. There is no expected contribution for 2009. Plan expense for 2009 is estimated to be $175,000. A 1% change in trend assumptions would create an approximate change in the same direction of approximately $100,000 in the accumulated benefit obligation, $7,000 in the interest cost and $1,400 in the service cost.

Note 9 Goodwill and Other Intangible Assets

As of December 31, 2008, in accordance FASB ASC Topic 350 Intangibles Goodwill and Other, the Company completed its annual review of goodwill and determined there has been no impairment.

Note 10 Mortgage Servicing Rights

FASB ASC Topic 940 Financial Services Mor