First Bancorp, Inc /ME/
Form 10-Q
August 07, 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 June 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 August 5, 2009

Common Stock: 9,723,306 shares

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Part I. Financial Information

Selected Financial Data (Unaudited)

The First Bancorp, Inc. and Subsidiary

	For the six months ended		For the quarters ended	
Dollars in thousands,	**June 30**		**June 30**	
except for per share amounts	**2009**	2008	**2009**	2008
Summary of Operations				
Interest Income	**$ 32,869**	$ 35,844	**$ 16,251**	$ 17,514
Interest Expense	**10,359**	18,085	**4,814**	8,572
Net Interest Income	**22,510**	17,759	**11,437**	8,942
Provision for Loan Losses	**4,600**	1,439	**2,950**	939
Non-Interest Income	**5,549**	4,694	**2,963**	2,518
Non-Interest Expense	**13,021**	10,874	**6,234**	5,425
Net Income	**7,490**	7,194	**3,762**	3,603
Per Common Share Data				
Basic Earnings per Share	**$ 0.72**	$ 0.74	**$ 0.35**	$ 0.37
Diluted Earnings per Share	**0.72**	0.74	**0.35**	0.37
Cash Dividends Declared	**0.390**	0.375	**0.195**	0.190
Book Value	**12.51**	11.84	**12.51**	11.84
Tangible Book Value [2]	**9.66**	8.99	**9.66**	8.99
Market Value	**19.47**	13.65	**19.47**	13.65
Financial Ratios				
Return on Average Equity [1]	**12.48%**	12.68%	**12.60%**	12.63%
Return on Average Tangible Equity [1,2]	**16.18%**	16.76%	**16.40%**	16.66%

Return on Average Assets [1]	**1.10%**	1.16%	**1.11%**	1.15%
Average Equity to Average Assets	**10.54%**	9.17%	**10.46%**	9.13%
Average Tangible Equity to Average Assets [2]	**8.52%**	6.94%	**8.43%**	6.92%
Net Interest Margin Tax-Equivalent [1,2]	**3.68%**	3.23%	**3.76%**	3.21%
Dividend Payout Ratio	**54.17%**	50.68%	**55.71%**	51.35%
Allowance for Loan Losses/Total Loans	**1.20%**	0.82%	**1.20%**	0.82%
Non-Performing Loans to Total Loans	**1.57%**	0.40%	**1.57%**	0.40%
Non-Performing Assets to Total Assets	**1.36%**	0.29%	**1.36%**	0.29%
Efficiency Ratio [2]	**40.78%**	45.97%	**41.40%**	45.02%
At Period End				
Total Assets	**$1,369,986**	$1,285,373	**$1,369,986**	$1,285,373
Total Loans	**982,336**	951,814	**982,336**	951,814
Total Investment Securities	**298,292**	246,378	**298,292**	246,378
Total Deposits	**913,949**	842,120	**913,949**	842,120
Total Shareholders Equity	**146,198**	114,758	**146,198**	114,758

[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 June 30, 2009 and 2008 and for the three-month and six-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

August 7, 2009

Consolidated Balance Sheets (Unaudited)

The First Bancorp, Inc. and Subsidiary

In thousands of dollars	**June 30, 2009**	December 31, 2008	June 30, 2008
Assets			
Cash and due from banks	**$ 18,575**	$ 16,856	$ 19,997
Securities available for sale	**35,972**	13,072	22,157
Securities to be held to maturity			
(fair value $247,100 at June 30, 2009, $229,460 at December 31, 2008 and $206,475 at June 30, 2008)	**247,627**	234,767	209,528
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)	**3,162**	1,298	2,253
Loans	**982,336**	979,273	951,814
Less: allowance for loan losses	**11,752**	8,800	7,800
Net loans	**970,584**	970,473	944,014
Accrued interest receivable	**7,140**	5,783	7,886
Premises and equipment	**18,610**	16,028	16,046
Other real estate owned	**2,797**	2,428	1,558
Goodwill	**27,684**	27,684	27,684
Other assets	**23,142**	22,662	19,557
Total Assets	**$1,369,986**	$1,325,744	$1,285,373
Liabilities			
Demand deposits	**$ 63,266**	$ 68,399	$ 62,755
NOW deposits	**100,283**	108,188	108,543
Money market deposits	**104,803**	129,333	114,096
Savings deposits	**86,305**	82,867	87,023
Certificates of deposit under $100,000	**202,039**	246,152	339,620
Certificates $100,000 and over	**357,253**	290,797	130,083
Total deposits	**913,949**	925,736	842,120
Borrowed funds	**297,361**	272,074	317,055
Other liabilities	**12,478**	10,753	11,440
Total Liabilities	**1,223,788**	1,208,563	1,170,615
Shareholders Equity			
Preferred stock	**24,557**	-	-
Common stock	**97**	97	97
Additional paid-in capital	**44,958**	44,117	44,030

Retained earnings	**77,320**	74,057	70,996
Accumulated other comprehensive loss			
Net unrealized loss on securities available for sale	**(472)**	(819)	(100)
Net unrealized loss on postretirement benefit costs	**(262)**	(271)	(265)
Total Shareholders Equity	**146,198**	117,181	114,758
Total Liabilities & Shareholders Equity	**$1,369,986**	$1,325,744	$1,285,373
Common Stock			
Number of shares authorized	**18,000,000**	18,000,000	18,000,000
Number of shares issued and outstanding	**9,722,204**	9,696,397	9,690,182
Book value per share	**$ 12.51**	$ 12.09	$ 11.84

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 six months ended		**For the quarters ended**	
	June 30,		**June 30,**	
In thousands of dollars	**2009**	2008	**2009**	2008
Interest income				
Interest and fees on loans	**$25,533**	$29,649	**$12,606**	$14,357
Interest on deposits with other banks	**-**	-	**-**	-
Interest and dividends on investments	**7,336**	6,195	**3,645**	3,157
Total interest income	**32,869**	35,844	**16,251**	17,514
Interest expense				
Interest on deposits	**6,694**	12,349	**3,049**	5,910
Interest on borrowed funds	**3,665**	5,736	**1,765**	2,662
Total interest expense	**10,359**	18,085	**4,814**	8,572
Net interest income	**22,510**	17,759	**11,437**	8,942
Provision for loan losses	**4,600**	1,439	**2,950**	939
Net interest income after provision for loan losses	**17,910**	16,320	**8,487**	8,003
Non-interest income				
Investment management and fiduciary income	**678**	780	**353**	390
Service charges on deposit accounts	**1,158**	1,488	**600**	805
Net securities gains	**-**	28	**-**	-
Mortgage origination and servicing income	**1,543**	216	**862**	123
Other operating income	**2,170**	2,182	**1,148**	1,200
Total non-interest income	**5,549**	4,694	**2,963**	2,518
Non-interest expense				
Salaries and employee benefits	**5,152**	5,680	**2,563**	2,755
Occupancy expense	**834**	774	**393**	363
Furniture and equipment expense	**1,138**	942	**569**	452
FDIC insurance premium	**961**	138	**599**	115
Net securities losses	**148**	-	**6**	-
Other than temporary impairment charge	**916**	-	**-**	-
Amortization of identified intangibles	**142**	142	**71**	71
Other operating expense	**3,730**	3,198	**2,033**	1,669
Total non-interest expense	**13,021**	10,874	**6,234**	5,425
Income before income taxes	**10,438**	10,140	**5,216**	5,096
Applicable income taxes	**2,948**	2,946	**1,454**	1,493
NET INCOME	**$ 7,490**	$ 7,194	**$ 3,762**	$ 3,603
Less preferred stock dividends and premium amortization	**488**	-	**337**	-
Net income available to common shareholders	**$ 7,002**	$ 7,194	**$ 3,425**	$ 3,603

Earning per common share

Basic earnings per share	**$0.72**	$0.74	**$0.35**	$0.37
Diluted earnings per share	**$0.72**	$0.74	**$0.35**	$0.37
Weighted average number of shares outstanding	**9,712,252**	9,711,869	**9,718,650**	9,707,568
Incremental shares	**16,951**	19,377	**21,626**	20,298
Cash dividends declared per share	**$0.390**	$0.375	**$0.195**	$0.190

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	-	-	-	7,194	-	7,194
Net unrealized loss on securities available for sale, net of tax benefit of $288	-	-	-	-	(536)	(536)
Unrecognized transition obligation for postretirement benefits, net of taxes of $5	-	-	-	-	9	9
Comprehensive income	-	-	-	7,194	(527)	6,667
Dividends declared on common stock	-	-	-	(3,638)	-	(3,638)
Equity compensation expense	-	-	19	-	-	19
Payment to repurchase common stock	-	(73,095)	(1,134)	-	-	(1,134)
Proceeds from sale of common stock	-	30,784	383	-	-	383
Tax benefit of disqualifying disposition of incentive stock option shares	-	-	-	8	-	8
Balance at June 30, 2008	**$ -**	**9,690,182**	**$44,127**	**$70,996**	**$(365)**	**$114,758**
Balance at December 31, 2008	**$ -**	**9,696,397**	**$ 44,214**	**$ 74,057**	**$ (1,090)**	**$ 117,181**
Net income	-	-	-	7,490	-	7,490
Net unrealized gain on securities available for sale, net of tax benefit of $186	-	-	-	-	347	347
Unrecognized transition obligation for postretirement benefits, net of taxes of $6	-	-	-	-	9	9
Comprehensive income	-	-	-	7,490	356	7,846
Dividends declared on common stock	-	-	-	(3,789)	-	(3,789)
Dividends declared on preferred stock	-	-	-	(438)	-	(438)
Equity compensation expense	-	-	19	-	-	19
Proceeds from sale of preferred stock	25,000	-	-	-	-	25,000
Premium on issuance of preferred stock	(493)	-	493	-	-	-
Amortization of premium for preferred stock issuance	50	-	(50)	-	-	-
Payment to repurchase common stock	-	(2,637)	(39)	-	-	(39)
Proceeds from sale of common stock	-	28,444	418	-	-	418
Balance at June 30, 2009	**$ 24,557**	**9,722,204**	**$ 44,055**	**$ 77,320**	**$ (734)**	**$ 146,198**

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

In thousands of dollars	**For six months ended June 30, 2009**	2008
Cash flows from operating activities		
Net income	**$ 7,490**	$ 7,194
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation	**746**	623
Provision for loan losses	**4,600**	1,439
Loans originated for resale	**(80,646)**	(12,328)
Proceeds from sales and transfers of loans	**78,782**	11,892
Net loss (gain) on sale or call of investment securities	**148**	(28)
Other-then-temporary impairment charge	**916**	-
Equity compensation expense	**19**	19
Net increase in other assets and accrued interest	**(2,165)**	(3,528)
Net increase (decrease) in other liabilities	**1,731**	(1,191)
Net amortization of premiums on investments	**(1,862)**	(2,126)
Net acquisition amortization	**126**	120
Provision for losses on other real estate owned	**126**	-
Net loss on disposal of assets	**4**	-
Net cash provided by operating activities	**10,015**	2,086
Cash flows from investing activities		
Proceeds from maturities, payments and calls of securities available for sale	**3,154**	4,330
Proceeds from sales of securities available for sale	**2,914**	-
Proceeds from maturities, payments and calls of securities to be held to maturity	**126,174**	68,512
Proceeds from sales of other real estate owned	**20**	-
Purchases of securities available for sale	**(28,485)**	(1,463)
Purchases of securities to be held to maturity	**(138,187)**	(94,612)
Net increase in loans	**(5,226)**	(32,820)
Capital expenditures	**(3,331)**	(188)
Net cash used by investing activities	**(42,967)**	(56,241)
Cash flows from financing activities		
Net decrease in demand, savings, and money market accounts	**(34,130)**	(544)
Net increase in certificates of deposit	**22,352**	61,395
Advances on long-term borrowings	**-**	40,000
Repayment on long-term borrowings	**(12,000)**	-
Net change in short-term borrowings	**37,294**	(39,653)
Proceeds from issuance of preferred stock	**25,000**	-
Payments to repurchase common stock	**(39)**	(1,134)
Proceeds from sale of common stock	**418**	383
Dividends paid	**(4,224)**	(3,549)
Net cash provided by financing activities	**34,671**	56,898
Net increase in cash and cash equivalents	**1,719**	2,743
Cash and cash equivalents at beginning of year	**16,856**	17,254
Cash and cash equivalents at end of period	**$ 18,575**	$ 19,997
Interest paid	**$ 7,887**	$ 17,830
Income taxes paid	**$ 2,569**	$ 3,531
Non-cash transactions		
Change in net unrealized gain (loss) on available for sale securities, net of tax	**$ 347**	$ (536)
Net transfer from loans to other real estate owned	**$ 515**	$ -

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. Events occurring subsequent to June 30, 2009, have been evaluated as to their potential impact to the Financial Statements through the date of issuance, August 7, 2009.

Note 2. Investment Securities

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

In thousands of dollars	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value (Estimated)
Securities available for sale				
U.S. Treasury and agency	$ 10,150	$ -	$ (550)	$ 9,600
Mortgage-backed securities	14,893	105	(53)	14,945
State and political subdivisions	9,793	331	(41)	10,083
Corporate securities	1,568	-	(493)	1,075
Other equity securities	295	-	(26)	269
	$ 36,699	$ 436	$(1,163)	$ 35,972
Securities to be held to maturity				
U.S. Treasury and agency	$ 65,234	$ 317	$(2,437)	$ 63,114
Mortgage-backed securities	119,217	1,340	(342)	120,215
State and political subdivisions	63,026	1,058	(463)	63,621
Corporate securities	150	-	-	150
	$247,627	$2,715	$(3,242)	$247,100

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 June 30, 2009:

	Securities available for sale		**Securities to be held to maturity**	
	Amortized Cost	**Fair Value**	**Amortized Cost**	**Fair Value**
In thousands of dollars		**(Estimated)**		**(Estimated)**
Due in 1 year or less	$ 326	$ 318	$ 385	$ 393
Due in 1 to 5 years	3,289	3,477	7,735	7,981
Due in 5 to 10 years	3,803	3,939	15,426	15,820
Due after 10 years	28,986	27,969	224,081	222,906
Equity securities	295	269	-	-
	$36,699	$35,972	$247,627	$247,100

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**	**Amortized Cost**	**Fair Value**
In thousands of dollars		**(Estimated)**		**(Estimated)**
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	14,988	14,956	-	-
	$29,025	$27,765	$234,767	$229,460

At June 30, 2009, securities with a fair value of $151.5 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 six months ended June 30, 2009 and twelve months ended December 31, 2008:

	For the six months ended	For the year ended
In thousands of dollars	**June 30, 2009**	December 31, 2008
Proceeds from sales	**$ 2,044**	$14,192
Gross gains	**$ 18**	$ 123
Gross losses	**(167)**	(212)
Net gain (loss)	**$ (149)**	$ (89)
Related income taxes	**$ (52)**	$ (31)

Management reviews securities with unrealized losses for other than temporary impairment. As of June 30, 2009, there were 67 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 13 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 June 30, 2009 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	$ 54,036	$ (2,628)	$ 5,142	$ (359)	$ 59,178	$ (2,987)
Mortgage-backed securities	41,717	(395)	12	-	41,729	(395)
State and political subdivisions	10,350	(156)	2,014	(348)	12,364	(504)
Corporate securities	318	(8)	637	(485)	955	(493)
Other equity securities	-	-	130	(26)	130	(26)
	$ 106,421	$ (3,187)	$ 7,935	$ (1,218)	$ 114,356	$ (4,405)

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 most of its wholesale funding needs. As of June 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, and announced that its 2008 net loss included a charge to earnings of $381.7 million representing an other-than-temporary impairment charge on its private-label mortgage-backed securities portfolio. The estimated fair value of private-label mortgage-backed securities owned by the FHLB at December 31, 2008 was approximately $1.6 billion less than the $4.0 billion amortized cost of the securities. In the future, if additional unrealized losses on the FHLB s private-label mortgage-back securities are deemed to be other-than-temporary, the associated impairment charges could put into question whether the fair value of the FHLB stock owned by the Company is less than par value. The FHLB has stated that it expects and intends to hold its private-label mortgage-backed securities to maturity. 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 June 30, 2009. The Bank will continue to monitor its investment in FHLB stock.

Note 3 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 Statement of Financial Accounting Standards (SFAS) No. 123 (Revised 2004), Share-Based Payment , to stock-based employee compensation. As a result, $19,000 in compensation cost is included in the Company s financial statements for the first six months of 2009. The unrecognized compensation cost to be amortized over a weighted average remaining vesting period of 1.5 years is $56,000, 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 status of the Company s non-vested options as of June 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 June 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 Company s Stock Option Plan as of June 30, 2009 and changes during the six-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	$13.37		
Granted in 2009	-	-		
Vested in 2009	-	-		
Exercised in 2009	(3,000)	7.50		
Forfeited in 2009	-	-		
Outstanding at June 30, 2009	73,500	$13.51	3.8	$438
Exercisable at June 30, 2009	52,500	$11.71	3.1	$407

Note 4 Preferred Stock

On January 9, 2009, the Company received $25 million from preferred stock issuance of 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 during the first three years only with the proceeds the Company receives from the sale for cash of other Tier 1 qualifying perpetual preferred or common stock that results in aggregate gross proceeds to the Company of not less than 25% of the issue price of the CPP Shares. After three years, the Company could redeem the CPP Shares at its option, in whole or in part, at any time using any funds available to the Company. Any redemption would be subject to the prior approval of the Federal Reserve Bank of Boston. The CPP Shares would be 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 will be 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 would be 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 will be 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 5 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. The Company expects such repurchases to be effected from time to time, in the open market, in private transactions or otherwise, during a period of up to 24 months. The amount and timing of shares to be purchased will be subject to market conditions and will be based on several factors, including the price of the Company s stock and the level of stock issuances under the Company s employee stock plans. No assurance can be given as to the specific timing of the share repurchases or as to whether and to what extent the share repurchase will be consummated. 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 six months of 2009, the Company repurchased 2,636 from employee benefit plans at an average price of $15.21 per share and for total proceeds of $40,000. As of June 30, 2009, the Company had repurchased 178,110 shares under the repurchase plan at an average price of $15.53 and at a total cost of $2.8 million.

Note 6 Earnings Per Share

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

In thousands, except number of shares and per share data	Income (Numerator)	Shares (Denominator)	Per-Share Amount
For the six months ended June 30, 2009			
Net income as reported	$7,490		
Less dividends and amortization of premium on preferred stock	488		
Basic EPS: Income available to common shareholders	7,002	9,712,252	$0.72
Effect of dilutive securities: incentive stock options		16,951	
Diluted EPS: Income available to common shareholders plus assumed conversions	$7,002	9,729,203	$0.72
For the six months ended June 30, 2008			
Net income as reported	$7,194		
Basic EPS: Income available to common shareholders	7,194	9,711,869	$0.74
Effect of dilutive securities: incentive stock options		19,377	
Diluted EPS: Income available to common shareholders plus assumed conversions	$7,194	9,731,246	$0.74

The following table sets forth the computation of basic and diluted earnings per share (EPS) for the quarters ended June 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 June 30, 2009			
Net income as reported	$3,762		
Less dividends and amortization of premium on preferred stock	337		
Basic EPS: Income available to common shareholders	3,425	9,718,650	$0.35
Effect of dilutive securities: incentive stock options		21,626	
Diluted EPS: Income available to common shareholders plus assumed conversions	$3,425	9,740,276	$0.35
For the quarter ended June 30, 2008			
Net income as reported	$3,603		
Basic EPS: Income available to common shareholders	3,603	9,707,568	$0.37
Effect of dilutive securities: incentive stock options		20,298	
Diluted EPS: Income available to common shareholders plus assumed conversions	$3,603	9,727,866	$0.37

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 7 Employee Benefit Plans

401(k) Plan

The Bank has a defined contribution plan available to substantially all employees who have completed six months of service. Employees may contribute up to $15,500 of their compensation if under age 50 and $20,500 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 and 2007. The amount for 2009 has not been established. The expense related to the 401(k) plan was $169,000 and $170,000 for the six months ended June 30, 2009 and 2008, respectively.

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 Accounting Principles Board Opinion No. 12. The expense of these supplemental retirement benefits was $88,000 and $82,000 for the six months ended June 30, 2009 and 2008, respectively. As of June 30, 2009 and 2008, the associated accrued liability was $1,325,000 compared to $1,265,000 and $1,211,000 at December 31, 2008 and June 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.

In December 2003, the federal Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act) was signed into law. The Act included two features to Medicare (Medicare Part D) that could affect the measurement of the accumulated post-retirement benefit obligation and net periodic postretirement benefit costs: a subsidy to plan sponsors that is based on 28% of an individual beneficiary s annual prescription drug costs between $250 and $5,000, and the opportunity for a retiree to obtain a prescription drug benefit under Medicare. During 2004, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) FAS 106-2, Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003. The FSP addresses employers accounting for the effects of the Act and was effective for the Company in 2004. The accounting for the Act will depend on the Company s assessment as to whether the prescription drug benefits available under its plan are actuarially equivalent to Medicare Part D, among other factors. The Company s Plan has not been actuarially determined to be equivalent to Medicare Part D. Accordingly, the impact of applying the FSP has not been reflected in the consolidated financial statements.

In December 2006, the Company implemented SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106, and 132(R) . This Statement requires an employer 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	**June 30, 2009**	June 30, 2008
Change in benefit obligation		
Benefit obligation at beginning of year	**$ 1,990**	$ 1,949
Service cost	**10**	8
Interest cost	**68**	68
Benefits paid	**(78)**	(87)
Benefit obligation at end of period	**1,990**	1,938
Funded status		
Benefit obligation at end of period	**(1,990)**	(1,938)
Accrued benefit cost	**$(1,990)**	$(1,938)

The following table sets forth the net periodic pension cost:

	For six months ended	**For three months ended**

In thousands of dollars	**June 30, 2009**	2008	**June 30, 2009**	2008
Components of net periodic benefit cost				
Service cost	**$ 8**	$ 8	**$ 4**	$ 4
Interest cost	**68**	68	**34**	34
Amortization of unrecognized transition obligation	**14**	14	**7**	7
Amortization of prior service credit	**(2)**	(2)	**(1)**	(1)
Amortization of accumulated losses	**10**	2	**5**	1
Net periodic benefit cost	**$ 98**	$ 90	**$ 49**	$ 45

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

In thousands of dollars	**At June 30, 2009**	2008
Unamortized prior service credit	**$ -**	$ 4
Unamortized net actuarial loss	**(296)**	(274)
Unrecognized transition obligation	**(107)**	(137)
	(403)	(407)
Deferred tax benefit at 35%	**141**	142
Net unrecognized postretirement benefits included in accumulated other comprehensive loss	**$ (262)**	$ (265)

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 third 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 8 Goodwill and Other Intangible Assets

As of December 31, 2008, in accordance with SFAS No. 142, Goodwill and Other Intangible Assets, the Company completed its annual review of goodwill and determined there has been no impairment.

Note 9 Mortgage Servicing Rights

SFAS No. 156, Accounting for Servicing of Financial Assets , requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable. Servicing assets and servicing liabilities are reported using the amortization method or the fair value measurement method. In evaluating the carrying values of mortgage servicing rights, the Company obtains third party valuations based on loan level data including note rate, type and term of the underlying loans. The model utilizes several assumptions, the most significant of which is loan prepayments, calculated using a three-month moving average of weekly prepayment data published by the Public Securities Association (PSA) and modeled against the serviced loan portfolio, and the discount rate to discount future cash flows. As of June 30, 2009, the prepayment assumption using the PSA model was 254, which translates into an anticipated prepayment rate of 15.27%. The discount rate is the quarterly average ten-year U.S. Treasuries plus 5.0%. Other assumptions include delinquency rates, foreclosure rates, servicing cost inflation, and annual unit loan cost. All assumptions are adjusted periodically to reflect current circumstances. Amortization of mortgage servicing rights, as well as write-offs due to prepayments of the related mortgage loans, are recorded as a charge against mortgage servicing fee income.

For the six months ended June 30, 2009 and 2008, servicing rights capitalized totaled $866,000 and $162,000, respectively. Servicing rights capitalized for the three month periods ended June 30, 2009 and 2008, were $580,000 and $87,000 respectively. Servicing rights amortized for the six month periods ended June 30, 2009 and 2008, were $567,000 and $236,000, respectively. Servicing rights amortized for the three month periods ended June 30, 2009 and 2008, were $430,000 and $119,000, respectively. At June 30, 2009 and 2008, the Bank serviced loans for others totaling $206.2 million and $171.0 million, respectively. Mortgage servicing rights are included in other assets and detailed in the following table:

In thousands of dollars	**June 30, 2009**	December 31, 2008	June 30, 2008
Mortgage servicing rights	**$ 4,694**	$ 4,239	$ 3,917
Accumulated amortization	**(3,594)**	(3,412)	(3,146)
Impairment reserve	**(74)**	(224)	(64)
	$ 1,026	$ 603	$ 707

Note 10 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. Effective January 1, 2007, the Company has adopted the provisions of FIN 48 and there was no material effect on the financial statements, and no cumulative effect. The Company is currently open to audit under the statute of limitations by the IRS for the years ended December 31, 2006 through 2008.

Note 11 Reclassifications

Certain items from the prior year were reclassified in the financial statements to conform with the current year presentation. These do not have a material impact on the balance sheet or statement of income presentations.

Note 12 Fair Value Disclosures

Certain assets and liabilities are recorded at fair value to provide additional insight into the Company s quality of earnings. Some of these assets and liabilities are measured on a recurring basis while others are measured on a nonrecurring basis, with the determination based upon applicable existing accounting pronouncements. For example, securities available for sale are recorded at fair value on a recurring basis. Other assets, such as, mortgage servicing rights, loans held for sale, and impaired loans, are recorded at fair value on a nonrecurring basis using the lower of cost or market methodology to determine impairment of individual assets.

Under Statement of Financial Accounting No. 157, Fair Value Measurements, the Company groups assets and liabilities which are recorded at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. A financial instrument s level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement (with level 1 considered highest and level 3 considered lowest). A brief description of each level follows.

Level 1 Valuation is based upon quoted prices for identical instruments in active markets.

Level 2 Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3 Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates that market participants would use in pricing the asset or liability. Valuation techniques include use of discounted cash flow models and similar techniques.

The most significant instruments that the Company fair values include securities which fall into Level 2 in the fair value hierarchy. The securities in the available for sale portfolio are priced by independent providers. In obtaining such valuation information from third parties, the Company has evaluated their valuation methodologies used to develop the fair values in order to determine whether the valuations are representative of an exit price in the Company s principal markets. The Company s principal markets for its securities portfolios are the secondary institutional markets, with an exit price that is predominantly reflective of bid level pricing in those markets.

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

Securities Available for Sale. Investment securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices for similar assets, if available. If quoted prices are not available, fair values are measured using matrix pricing models, or other model-based valuation techniques requiring observable inputs other than quoted prices such as yield curves, prepayment speeds, and default rates. Recurring Level 1 securities would include U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets. Recurring Level 2 securities include federal agency securities, mortgage-backed securities, collateralized mortgage obligations, municipal bonds and corporate debt securities.

The following table presents the balances of assets and liabilities that were measured at fair value on a recurring basis as of June 30, 2009 and December 31, 2008.

	At June 30, 2009			
In thousands of dollars	**Level 1**	**Level 2**	**Level 3**	**Total**
Securities available for sale	$ -	$ 35,972	$ -	$ 35,972
Total assets	$ -	$ 35,972	$ -	$ 35,972

	At December 31, 2008			
In thousands of dollars	**Level 1**	**Level 2**	**Level 3**	**Total**
Securities available for sale	$ -	$ 13,072	$ -	$ 13,072
Total assets	$ -	$ 13,072	$ -	$ 13,072

Assets and Liabilities Recorded at Fair Value on a Non-Recurring Basis

Mortgage Servicing Rights. Mortgage servicing rights represent the value associated with servicing residential mortgage loans. Servicing assets and servicing liabilities are reported using the amortization method or the fair value measurement method. In evaluating the carrying values of mortgage servicing rights, the Company obtains third party valuations based on loan level data including note rate, type and term of the underlying loans. As such, the Company classifies mortgage servicing rights as nonrecurring Level 2.

Loans Held for Sale. Mortgage loans held for sale are recorded at the lower of carrying value or market value. The fair value of mortgage loans held for sale is based on what secondary markets are currently offering for portfolios with similar characteristics. As such, the Company classifies mortgage loans held for sale as nonrecurring Level 2.

Other Real Estate Owned. Real estate acquired through foreclosure is recorded at market value. The fair value of other real estate owned is based on property appraisals and an analysis of similar properties currently available. As such, the Company records other real estate owned as nonrecurring Level 2.

Impaired Loans. A loan is considered to be impaired when it is probable that all of the principal and interest due under the original underwriting terms of the loan may not be collected. Impairment is measured based on the fair value of the underlying collateral. The Company measures impairment on all nonaccrual loans for which it has established specific reserves as part of the specific allocated allowance component of the allowance for loan losses. As such, the Company records impaired loans as nonrecurring Level 2.

The following table includes assets measured at fair value on a nonrecurring basis that have had a fair value adjustment since their initial recognition at March 31, 2008. Other real estate owned is presented net of an allowance of $451,000. Impaired loans are presented net of a related specific allowance for loan losses of $2.7 million.

	At June 30, 2009			
In thousands of dollars	**Level 1**	**Level 2**	**Level 3**	**Total**
Mortgage servicing rights	$ -	$ 1,026	$ -	$ 1,026
Loans held for sale	-	3,162	-	3,162
Other real estate owned	-	2,797	-	2,797
Impaired loans	-	12,720	-	12,720
Total assets	$ -	$ 19,705	$ -	$ 19,705

	At December 31, 2008			
In thousands of dollars	**Level 1**	**Level 2**	**Level 3**	**Total**
Mortgage servicing rights	$ -	$ 311	$ -	$ 311
Loans held for sale	-	1,298	-	1,298
Other real estate owned	-	2,428	-	2,428
Impaired loans	-	10,492	-	10,492
Total assets	$ -	$ 14,529	$ -	$ 14,529