NORTHEAST BANCORP /ME/
Form 10-K
September 25, 2009

FORM 10-K

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

(Mark One)

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For fiscal year ended June 30, 2009

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

For the transition period from to

Commission file number (1-14588)

NORTHEAST BANCORP
(Exact name of registrant as specified in its charter)

Maine	01-0425066
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
500 Canal Street, Lewiston, Maine	04240
(Address of principal executive offices)	(Zip Code)
Registrant's telephone number, including area code:	(207) 786-3245

Securities registered pursuant to Section 12(b) of the Act:

Title of each class:	Name of each exchange on which registered:
Common Stock, $1.00 par value	NASDAQ

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer as defined in Rule 405 of the Securities Act. Yes_ No X

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes_ No X

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of “large accelerated filer," "accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one): Large Accelerated Filer _ Accelerated filer _ Non-accelerated filer _ Smaller Reporting Company X

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

The aggregate market value of the Registrant's common shares held by non-affiliates, as of December 31, 2008, was approximately $16,736,804 based on the last reported sales price of the Company's common shares on the NASDAQ exchange as of the close of business on such date. Although directors and executive officers of the registrant and its subsidiaries were assumed to be "affiliates" of the registrant for the purposes of this calculation, this classification is not to be interpreted as an admission of such status. There were 2,321,332 common shares of the registrant outstanding as of September 18, 2009.

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DOCUMENTS INCORPORATED BY REFERENCE

The following documents, in whole or in part, are specifically incorporated by reference in the indicated Part of this Annual Report on Form 10-K:

Document	Form 10-K Reference Location
Proxy Statement for the 2009 Annual Meeting of Shareholders	III

This Annual Report on Form 10-K contains certain forward-looking statements within the meaning of Section 27A of the Securities Exchange Act of 1933 and Section 21E of the Securities Act of 1934 and is subject to risks, uncertainties, and other factors which could cause actual results to differ materially from those expressed or implied by such forward-looking statements. See "Item 1. Business -Forward Looking Statements and Risk Factors."

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PART I

Item 1. Business

Overview and History

Northeast Bancorp ("us", "our", "we", or the "Company"), a Maine corporation chartered in April 1987, is a bank holding company registered under the Bank Holding Company Act of 1956 (the "BHCA"). Prior to 1996, the Company operated under the name Bethel Bancorp. The Company's primary subsidiary and principal asset is its wholly-owned banking subsidiary, Northeast Bank (the "Bank" or "Northeast Bank"), which has eleven banking branches. The Bank offers property and casualty insurance products through the Bank's wholly owned subsidiary, Northeast Bank Insurance Group, Inc. ("NBIG"). NBIG has fourteen insurance agency offices, four of which are located in our banking branches. In addition, we also offer investment services, including financial planning products and services, through our office in Falmouth, Maine.

Northeast Bank, which was originally organized in 1872 as a Maine-chartered mutual savings bank and was formerly known as Bethel Savings Bank F.S.B. ("Bethel"), is a Maine state-chartered bank and a member of the Federal Reserve System. From 1987 to August 2004, Northeast Bank was a federal savings bank, and the Company was a unitary savings and loan holding company registered with the Office of Thrift Supervision ("OTS"). In August 2004, Northeast Bank's charter was converted into a Maine state-chartered universal bank, and the Company became a bank holding company under the BHCA. In connection with the conversion of its charter, Northeast Bank applied for and was granted membership in the Federal Reserve System. Accordingly, the Company and Northeast Bank are currently subject to the regulatory oversight of the Federal Reserve Bank of Boston ("FRB") and the State of Maine Bureau of Financial Institutions.

As of June 30, 2009, the Company, on a consolidated basis, had total assets of approximately $598 million, total deposits of approximately $385 million, and stockholders' equity of approximately $47 million. Unless the context otherwise requires, references herein to the Company include the Company and the Bank on a consolidated basis.

Strategy

Northeast Bancorp through its subsidiary, Northeast Bank, the Bank's subsidiary, NBIG, and third party affiliations, provides a broad range of financial services to individuals and companies in western and south-central Maine and southeastern New Hampshire. Although historically the Bank had been primarily a residential mortgage lender, over the last decade the Bank has expanded its commercial loan business, increased its line of financial products and services, and expanded its market area. Management’s strategy is to continue modest, but profitable, growth by increasing our loan and deposit market share in our existing markets in western and south-central Maine and southeastern New Hampshire, closely managing the yields on earning assets and rates on interest-bearing liabilities, introducing new financial products and services, increasing the number of bank services per household, increasing non-interest income from expanded investment and insurance brokerage and trust services, and controlling the growth of non-interest expenses. Management believes that this strategy will increase core earnings in the long term by providing stronger interest margins, additional non-interest income and increased loan volume. We believe that the local character of the Bank's business and its "community bank" management philosophy allows it to compete effectively in its market area.

Our community banking strategy emphasizes the development of long-term comprehensive banking relationships with customers at each branch location by increasing the number of products and services with each customer and providing consistent, high quality service from:

- employees with local decision-making authority;

- employees who are familiar with the customers' needs, their business environment and competitive demands; and
- employees who are able to develop and customize personalized financial solutions that are tailored to the customer's needs.

With the goal of providing a full range of banking, financial planning, investment brokerage, and property and casualty insurance services to our customers, and in an effort to develop strong, long-term primary banking relationships with businesses and individuals, we have expanded our commercial banking operations by selectively making commercial loans to small and medium sized companies. In this regard, our business development efforts have been directed towards full service credit packages and financial services, as well as competitively priced mortgage packages. In our effort to attract and maintain strong customer relationships, we also have continually expanded the financial products and services that we make available to our customers. In particular, we expanded our insurance division through acquisitions in order to provide a broader array of insurance products to our customers, and we have continued to maintain an investment services division to provide financial planning products and service to them as well.

The Bank is subject to examination and comprehensive regulation by the Maine Bureau of Financial Institutions (the "Maine Bureau") and the FRB, and its deposits are insured by the Federal Deposit Insurance Corporation (the "FDIC") to the extent permitted by law. The Bank also is a member of the Federal Home Loan Bank ("FHLB") of Boston.

The principal executive offices of Northeast Bancorp and the Bank are located at 500 Canal Street, Lewiston, Maine, 04240, and the telephone number is (207) 786-3245.

Market Area

The Bank is headquartered in Lewiston, Maine with full service branches in Auburn, Augusta, Bethel, Brunswick, Buckfield, Harrison, Lewiston (2), Mechanic Falls, Portland and South Paris, Maine. The Bank's investment brokerage division has an office in Falmouth, Maine from which investment, insurance and financial planning products and services are offered. The Bank’s mortgage loan orginators are in most of our branches and an office in Portsmouth, New Hampshire. NBIG has offices in Auburn, Anson, Augusta, Berwick, Bethel, Jackman, Livermore Falls, Mexico, Rangeley, Scarborough, South Paris, Thomaston and Turner, Maine and an office in Rochester, New Hampshire from where the Bank's insurance division offers personal and commercial casualty and property insurance products. The Company's primary market area, which covers western and south central regions of the State of Maine, is characterized by a diverse economy, but a slow growth area even apart from the current economy.

Market for Services

Management believes that the Bank's principal markets are: (i) the residential real estate market within its primary market area; (ii) small-to-medium sized businesses within its primary market area; (iii) the growing consumer loan market, including indirect automobile dealer and recreational vehicle loans; and (iv) the growing consumer demand for a wide range of other consumer-oriented financial services and products such as financial planning services, investments, life insurance, property and casualty insurance, trust services, college loans and other similar products.

Businesses are solicited through the personal efforts of the officers and directors of both Northeast Bancorp and the Bank. We believe that a locally-based, independent bank is often perceived by the local business community as possessing a clearer understanding of local commerce and its needs. We also believe that we are able to make prudent lending decisions more quickly than our competitors without compromising asset quality or profitability.

Competition

We encounter intense competition in our market area in making loans, attracting deposits, and selling other customer products and services. The deregulation of the banking industry, the ability to create financial services holding companies to engage in a wide range of financial services other than banking, and the widespread enactment of state laws which permit multi-bank holding companies, as well as the availability of nationwide interstate banking, has created a highly competitive environment for financial services providers. In one or more aspects of our business, we compete with other savings banks, commercial banks, credit unions, mutual funds, insurance companies, brokerage and investment banking companies, finance companies, and other financial intermediaries operating in Maine and elsewhere. Many of our primary competitors, some of which are affiliated with large bank holding companies or other larger financial-based institutions, have substantially greater resources, larger established customer bases, higher lending limits, extensive branch networks, numerous ATMs and greater advertising and marketing budgets. They may also offer services that we do not currently provide.

The principal factors in competing for deposits are convenient office locations, flexible hours, interest rates and services, and Internet banking, while those relating to loans are interest rates, the range of lending services offered and lending fees. Additionally, we believe that an emphasis on personalized financial planning and advice tailored to individual customer needs, together with the local character of the Bank's business and its "community bank" management philosophy will enhance our ability to compete successfully in our market areas. Further, we also offer a wide range of financial services to our customers, including not only basic loan and deposit services, but also investment services, trust services, and insurance products. We believe that our ability to provide such services and advice, and to provide the financial services and products required by our customers, will be an attractive alternative to consumers in our market area.

Lending Activities

General

The primary source of income generated by the Bank is from the interest earned from our loan portfolio. The principal lending activities of the Bank are the origination and purchase of conventional mortgages for the purpose of constructing, financing, or re-financing one-to-four family residential properties and commercial properties. The majority of the properties securing the mortgage loan portfolio are located in the State of Maine. Interest rates and origination fees charged on loans originated by the Bank are generally competitive with other financial institutions and other mortgage originators in our general market area.

Although residential and commercial real estate lending remains a strong component of the Bank's lending operations, consistent with our business strategy, we also actively seek an increased volume of commercial and consumer loans. Commercial loans are originated for commercial construction, acquisition, remodeling and general business purposes. In this regard, the Bank, among other things,

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also originates loans to small businesses in association with the Small Business Administration, Rural Development Administration and Finance Authority of Maine. Consumer loans include those for the purchase of automobiles, boats, home improvements and personal investments.

Residential Lending

The major component of the Bank's lending activities consists of the origination of 1-4 family residential mortgage loans collateralized by owner-occupied property, second mortgage and investment properties, most of which are located in its primary service areas. The Bank offers a variety of mortgage loan products. Its originations generally consist of adjustable rate mortgages ("ARMs") or fixed rate mortgage loans having terms of 10, 15, 20 or 30 years amortized on a monthly basis, with principal and interest due each month. The Bank holds in portfolio most adjustable rate mortgage loans. Fixed rate loans are generally sold into the secondary market. Additionally, the Bank offers home equity loans and home equity lines of credit.

Fixed rate and adjustable rate mortgage loans collateralized by 1-4 family residential real estate generally have been originated in amounts of no more than 80% of appraised value. The Bank may, however, lend up to 102% of the value of the property collateralizing the loan, but if made in excess of 80% of the value of the property, they must be insured by private or federally guaranteed mortgage insurance which includes but is not limited to Federal Housing Administration (“FHA”), Veterans Administration (“VA”) and Rural Development (“RD”). In the case of mortgage loans, the Bank requires mortgagee's title insurance to protect against defects in its lien on the property that collateralizes the loan. The Bank in most cases requires title, fire, and extended casualty insurance to be obtained by the borrower, and, where required by applicable regulations, flood insurance. The Bank maintains its own errors and omissions insurance policy to protect against loss in the event of failure of a mortgagor to pay premiums on fire and other hazard insurance policies.

The Bank offers adjustable rate mortgages with rate adjustments tied to the weekly average rate of one, three and five year U.S. Treasury securities with specified minimum and maximum interest rate adjustments. The interest rates on a majority of these mortgages are adjusted yearly with limitations on upward adjustments of 2% per adjustment period and 6% over the life of the loan. The Bank generally charges a higher interest rate if the property is not owner-occupied. It has been the Bank's experience that the proportions of fixed-rate and adjustable-rate loan originations depend in large part on the interest rate environment. As interest rates fall, there is generally a reduced demand for variable rate mortgages and, as interest rates rise, there is generally an increased demand for variable rate mortgages.

Although the contractual loan payment period for 1-4 family residential real estate loans is generally for a 10, 15, 20 or 30 year period, such loans often remain outstanding for significantly shorter periods than their contractual terms. The Bank generally does not charge a penalty for prepayment of mortgage loans. Mortgage loans originated by the Bank customarily include a "due on sale" clause giving the Bank the right to declare a loan immediately due and payable in the event, among other events, that the borrower sells or otherwise disposes of the real property subject to a mortgage. In general, the Bank enforces due on sale clauses. The Bank generally applies the same underwriting criteria to residential mortgage loans whether purchased or originated. In its loan purchases, the Bank generally reserves the right to reject particular loans from a loan package being purchased and does reject loans in a package that do not meet its underwriting criteria. In connection with loan purchases, the Bank receives various representations and warranties from the sellers of the loans regarding the quality and characteristics of the loans. In determining whether to purchase or originate a loan, the Bank assesses both the borrower's ability to repay the loan and the adequacy of the proposed collateral. On originations, the Bank obtains appraisals of the property securing the loan. Appraisals must comply with the Home valuation Code of Conduct and are subject to review by the Bank’s appraisal unit. On purchases, the Bank reviews the appraisal obtained by the loan seller or originator. On purchases and originations, the Bank reviews information concerning the income, financial condition, employment and credit history of the applicant.

We have adopted written, non-discriminatory underwriting standards for use in the underwriting and review of every loan considered for origination or purchase. These underwriting standards are reviewed and approved annually by our board of directors. Our underwriting standards for fixed rate residential mortgage loans generally conform to standards established by Fannie Mae ("FNMA") and the Federal Home Loan Mortgage Corporation (the "FHLMC"). A loan application is obtained or reviewed by the Bank's underwriters to determine the borrower's ability to repay, and confirmation of the more significant information is obtained through the use of credit reports, financial statements, and employment and other verifications.

Commercial Real Estate Lending

The Bank originates both multi-family and commercial real estate loans. Multi-family and commercial property loans generally are made in amounts up to 80% of the lesser of the appraised value or purchase price of the property. Although the largest multi-family or commercial loan in our portfolio at June 30, 2009 was $3,925,612, most of these loans have balances under $500,000.

The Bank's permanent commercial real estate loans are secured by improved property such as office buildings, medical facilities, retail centers, warehouses, apartment buildings, condominiums and other types of buildings, which are located in its primary market area. Multi-family and commercial real estate loans generally have fixed or variable interest rates indexed to FHLB and prime interest rates with notes having terms of 3 - 5 years. Mortgage loan maturities have terms up to 20 years.

Loans secured by multi-family and commercial real estate generally are larger and involve greater risks than one-to-four family residential mortgage loans. Because payments on loans secured by multi-family and commercial properties often are dependent on successful operation or management of the properties, repayment of such loans may be subject to a greater extent to adverse conditions in the real estate market or the economy. We seek to minimize these risks in a variety of ways, including limiting the size of our multi-family and commercial real estate loans and generally restricting such loans to our primary market area. In determining whether to originate multi-family or commercial real estate loans, we also consider such factors as the financial condition of the borrower and the debt service coverage of the property. The Company intends to continue to make multi-family and commercial real estate loans as the market demands and economic conditions permit.

Commercial Lending

The Bank offers a variety of commercial loan services, including term loans, lines of credit and equipment and receivables financing. A broad range of short-to-medium term commercial loans, both collateralized and uncollateralized, are made available to businesses for working capital (including the support of inventory and receivables), business expansion (including acquisitions of real estate and improvements), and the purchase of equipment and machinery. Equipment loans are typically originated on both a one year line of credit basis and on a fixed-term basis ranging from one to five years. The purpose of a particular loan generally determines its structure.

The Bank's commercial loans primarily are underwritten in the Company's market areas on the basis of the borrower's ability to make repayment from the cash flow of their business and generally are collateralized by business assets, such as accounts receivable, equipment, and inventory. As a general practice, the Bank takes as collateral a security interest in any available real estate, equipment, or other business assets, although such loans may be made on an uncollateralized basis. Collateralized working capital loans are primarily secured by short-term assets whereas term loans are primarily secured by long-term assets.

The availability of funds for the repayment of commercial loans may be substantially dependent on the success of the business itself. Further, the collateral underlying the loans, which may depreciate over time, usually cannot be appraised with as much precision as residential real estate, and may fluctuate in value based on the success of the business.

Consumer Loans

Consumer loans made by the Bank have included automobiles, recreational vehicles, boats, second mortgages, home improvements, mobile home loans, home equity lines of credit, personal (collateralized and uncollateralized) and deposit account collateralized loans. The Bank's consumer loan portfolio consists primarily of loans to individuals for various consumer purposes, but includes some business purpose loans, primarily small trucks and automobiles, which are payable on an installment basis. Most of these loans are for terms of up to 60 months and, although generally collateralized by liens on various personal assets of the borrower, they may be originated without collateral. Consumer loans are made at fixed and variable interest rates and may be made based on up to a 7 year amortization schedule.

Consumer loans are attractive to us because they typically have a shorter term and carry higher interest rates than that charged on other types of loans. Consumer loans, however, do pose additional risks of collectability when compared to traditional types of loans granted by banks, such as residential mortgage loans. In many instances, the Bank is required to rely on the borrower's ability to repay since the collateral may be of reduced value at the time of collection. Accordingly, the initial determination of the borrower's ability to repay is of primary importance in the underwriting of consumer loans.

The Bank discontinued its indirect lending in October, 2008 due to increasing delinquencies and increasing charge-offs resulting in an unprofitable line of business.

Construction Loans

The Bank originates residential construction loans to finance the construction of single-family dwellings. Most of the residential construction loans are made to individuals who intend to erect owner-occupied housing on a purchased parcel of real estate. The Bank's construction loans to individuals typically range in size from $100,000 to $400,000. Construction loans also are made to contractors to erect single-family dwellings for resale. Construction loans are generally offered on the same basis as other residential real estate loans, except that a larger percentage down payment is typically required.

The Bank also may make residential construction loans to real estate developers for the acquisition, development and construction of residential subdivisions. The Bank has limited reliance on this type of loan. Such loans may involve additional risk attributable to the fact that funds will be advanced to fund the project under construction, which is of uncertain value prior to completion, and because it is relatively difficult to evaluate accurately the total amount of funds required to complete a project.

The Bank finances the construction of individual, owner-occupied houses on the basis of written underwriting and construction loan management guidelines. Construction loans are structured either to be converted to permanent loans with the Bank at the end of the construction phase or to be paid off upon receiving financing from another financial institution. Construction loans on residential properties are generally made in amounts up to 80% of appraised value. Construction loans to developers generally have terms of up to 9 months. Loan proceeds on builders' projects are disbursed in increments as construction progresses and as inspections warrant. The maximum loan amount for construction loans is based on the lesser of the current appraisal value or the purchase price for the property.

Loans collateralized by multi-family residential real estate and subdivisions generally are larger than loans collateralized by single-family, owner-occupied housing and also generally involve a greater degree of risk. Payments on these loans depend to a large degree on the results of operations and management of the properties, and repayment of such loans may be more subject to adverse conditions in the real estate market or the economy.

Loan Origination and Processing

Loan originations are derived from a number of sources. Residential loan originations can be attributed to real estate broker referrals, mortgage loan brokers, direct solicitation by the Bank's loan officers, present depositors and borrowers, builders, attorneys, walk-in customers and, in some instances, other lenders. Loan applications, whether originated through the Bank or through mortgage brokers, are underwritten and closed based on the same standards, which generally meet FHLMC, FNMA, FHA, VA, RD or Maine State Housing underwriting guidelines. Consumer and commercial real estate loan originations emanate from many of the same sources. The legal lending limit of the Bank, as of June 30, 2009, was approximately $9.0 million.

The loan underwriting procedures followed by the Bank conform to regulatory specifications and are designed to assess the borrower's ability to make principal and interest payments and the value of any assets or property serving as collateral for the loan. Generally, as part of the process, a bank loan officer meets with each applicant to obtain the appropriate employment and financial information as well as any other required loan information. Upon receipt of the borrower's completed loan application, the Bank then obtains reports with respect to the borrower's credit record, and orders and reviews an appraisal of any collateral for the loan (prepared for the Bank through an independent appraiser and in compliance with the Home Valuation Code of Conduct). The loan information supplied by the borrower is independently verified. Loan officers or other loan production personnel in a position to directly benefit monetarily through loan solicitation fees from individual loan transactions do not have approval authority. Once a loan application has been completed and all information has been obtained and verified, the loan request is submitted to a final review process. As part of the loan approval process, all uncollateralized loans of more than $25,000 and all new collateralized loans of more than $750,000 require pre-approval by the Bank's loan committee. Loans to one borrower are subject to limits depending on our internal risk ratings.

Loan applicants are notified promptly of the decision of the Bank by telephone and a letter. If the loan is approved, the commitment letter specifies the terms and conditions of the proposed loan including the amount of the loan, interest rate, amortization term, a brief description of the required collateral and required insurance coverage. Prior to closing any long-term loan, the borrower must provide proof of fire and casualty insurance on the property serving as collateral which insurance must be maintained during the full term of the loan. Title insurance is required on loans collateralized by real property. Interest rates on committed loans are normally locked in at the time of application for a 30 to 60 day period.

Other Subsidiaries

The Company acquired a wholly-owned subsidiary, ASI Data Services, Inc. (ASI), through two stock purchases during 1993-1994. ASI initially provided data processing services to the Company and its subsidiaries. The Company's board transferred the assets and operations of ASI to the Bank in 1996, and ASI now is an inactive corporate subsidiary.

NBIG, a Maine corporation and a wholly-owned subsidiary of the Bank, was originally formed in 1982 and was formerly known as Northeast Financial Services, Inc. ("NFS"). It transitioned from an entity for real estate development projects, which terminated in fiscal 2005, to acquiring insurance agencies. Subsequent to the 2004 acquisition of Solon-Anson Insurance Agency, Inc. ("Solon Anson") by NFS, Solon-Anson was merged into NFS in April, 2005. NFS's name was then changed to Northeast Bank Insurance Group, Inc. in May 2005. NBIG now supports the Bank's insurance agencies, which allows the Bank to deliver insurance products to its customers. At June 30, 2009, investment in and loans to this subsidiary constituted 2.24% of the Company's total assets.

Employees

As of June 30, 2009, the Company, the Bank and its subsidiary together employed 228 full-time and 33 part-time employees. The Company's employees are not represented by any collective bargaining unit. The Company believes that its relations with its employees are good.

Supervision and Regulation

The banking industry is extensively regulated under both federal and state law. This regulatory framework is intended primarily to protect depositors and the federal deposit insurance funds, and not for the protection of shareholders. The following discussion summarizes certain aspects of the regulatory framework applicable to the Company and Northeast Bank. To the extent that the following information describes statutory and regulatory provisions, it is qualified in its entirety by reference to the particular statutory and regulatory provisions.

Bank Holding Company Regulation

General. As a bank holding company registered under the Bank Holding Company Act of 1956 (the "BHCA"), the Company is subject to the regulation and supervision of, and inspection by, the Federal Reserve Board ("FRB"), its primary regulator. The Company also is registered as a Maine financial institution holding company under Maine law and is subject to regulation and examination by the Superintendent of Financial Institutions of the State of Maine ("Superintendent"). The Company is required to file reports with, and provide other information regarding its business operations and those of its subsidiaries to, the FRB and the Superintendent.

The BHCA prohibits a bank holding company, with certain limited exceptions, from (i) acquiring or retaining direct or indirect ownership or control of more than 5% of the outstanding voting stock of any company which is not a bank or bank holding company, or (ii) engaging directly or indirectly in activities other than those of banking, managing or controlling banks, or performing services for its subsidiaries unless such non-banking business is determined by the FRB to be so closely related to banking or managing or controlling banks as to be properly incident thereto. Generally, permissible activities for bank holding companies include, among other things, factoring accounts receivable, acquiring and servicing loans, leasing personal property, performing certain data processing services, acting as an agent or broker in selling credit life insurance and certain other types of insurance in connection with credit transactions, and conducting certain insurance underwriting activities. The BHCA does not place territorial limits on permissible non-bank activities of bank holding companies. In making determinations of what non-banking activities are permissible, the FRB is required to weigh the expected benefit to the public, such as greater convenience, increased competition or gains in efficiency, against the possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest or unsound banking practices. Generally, bank holding companies, such as the Company, are required to obtain prior approval of the FRB to engage in any new activity not previously approved by the FRB. Further, despite prior approval, the FRB reserves the power to order any bank holding company or its subsidiaries to terminate any activity when the FRB has reasonable grounds to believe that continuation of such activity constitutes a serious risk to the financial soundness, safety, or stability of the bank holding company or any of its bank subsidiaries.

Financial Modernization. The Gramm-Leach-Bliley Financial Modernization Act of 1999 (the "GLB Act"), which amended the BHCA, significantly relaxed previously existing restrictions on the activities of bank holding companies and their subsidiaries to:

- allow bank holding companies that qualify as "a financial holding company" to engage in a substantially broader range of activities that are financial in nature;
- allow insurers and other financial service companies to acquire banks;
- remove various restrictions that apply to bank holding company ownership of securities firms and mutual fund advisory companies; and
- establish the overall regulatory structure applicable to bank holding companies that also engage in insurance and securities operations.

Under the GLB Act, an eligible bank holding company may elect to be a "financial holding company" and thereafter engage in a range of activities that are financial in nature and that are not permissible for bank holding companies. These activities, which can be conducted either directly or through a subsidiary, include those that are "financial in nature", such as insurance underwriting, securities underwriting and dealing and making merchant banking investments in commercial and financial companies. A financial holding company also may engage in any activity that the FRB determines by rule or order to be financial in nature, incidental to such financial activity, or complementary to a financial activity and does not pose a substantial risk to the safety and soundness of an institution or the financial system generally. In addition to these activities, a financial holding company may engage in those activities permissible for a bank holding company.

In order for a bank holding company to be eligible for financial holding company status, all of the subsidiary insured depository institutions must be "well-capitalized" and "well-managed" and have at least a satisfactory rating on its most recent Community Reinvestment Act of 1977 ("CRA") review. A bank holding company seeking to become a financial holding company must file a declaration with the FRB that it elects to become a financial holding company. If, after becoming a financial holding company, any of the insured depository institution subsidiaries should fail to continue to meet these requirements, the financial holding company would be prohibited from engaging in activities not permissible for bank holding companies unless it was able to return to compliance within a specified period of time.

Although Northeast Bank, our sole banking subsidiary, meets the applicable capital, management and CRA requirements, the Company has not made an election to become a financial holding company and at this time has no plans to do so.

Banking Acquisitions. The BHCA requires, among other things, the prior approval of the FRB in any case where a bank holding company proposes to (i) acquire direct or indirect ownership or control of more than 5% of the outstanding voting stock of any bank or bank holding company (unless it already owns a majority of such voting shares), (ii) acquire all or substantially all of the assets of another bank or bank holding company, or (iii) merge or consolidate with any other bank holding company. The FRB will not approve any acquisition, merger, or consolidation that would result in a monopoly, or which would have a substantially anti-competitive effect, unless the anti-competitive impact of the proposed transaction is clearly outweighed by a greater public interest in meeting the convenience and needs of the community to be served. The FRB also is required to consider the financial and managerial resources and future prospects of the holding companies and banks, the projected capital adequacy on a post-acquisition basis, and the acquiring institution's performance under the CRA.

In addition, Maine law requires the prior approval of the Superintendent for (i) the acquisition of more than 5% of the voting shares of a Maine financial institution or any financial institution holding company that controls a Maine financial institution, or (ii) the acquisition by a Maine financial institution holding company of more than 5% of a financial institution or a financial institution holding company domiciled outside the State of Maine.

Interstate Banking and Branching. The Reigle-Neal Interstate Banking and Branching Efficiency Act of 1994 (the "Interstate Banking and Branching Act") provides that bank holding companies which meet specified capital and management adequacy standards, and any state-imposed age requirements, are eligible to acquire banks in states other than their home states unless, as a result of such acquisition, the bank would control more than 10% of the total deposits of insured depository institutions in the United States or more than 30% of such deposits in that state (or other applicable state law limits).

Further, the Interstate Banking and Branching Act authorizes adequately capitalized and managed banks to cross state lines to merge with other banks, subject to certain restrictions, thereby creating interstate branches. A bank also may open new branches in a state in which it does not directly have banking operations if that state has enacted a law permitting de novo branching.

Maine law expressly authorizes interstate banking combinations that are approved by the Superintendent and do not result in deposit concentrations exceeding 30% of the total deposits of the State of Maine (unless such limitation is waived by the Superintendent). Further, interstate branch acquisitions and the establishment of de novo branches also are authorized under Maine law. However, if an out-of-state financial institution seeks to establish or acquire branches in Maine, the laws of the jurisdiction of such financial institution must expressly authorize, under conditions no more restrictive than the State of Maine, the Maine financial institution to engage in interstate branch acquisitions or establishment of de novo branches in that state.

Source of Strength; Safety and Soundness. Under FRB policy, the Company is expected to act as a source of financial strength to, and commit resources to support, Northeast Bank. In addition, any capital loans by a bank holding company to its subsidiary banks are subordinate in right of payment to deposits and to certain other indebtedness of such subsidiary banks. In the event of a bank holding company's bankruptcy, any commitment by the bank holding company to a Federal bank regulatory agency to maintain the capital of a subsidiary bank will be assumed by the bankruptcy trustee and entitled to a priority of payment.

There are a number of obligations and restrictions imposed on bank holding companies and their depository institution subsidiaries by law and regulatory policy that are designed to minimize potential loss to the depositors of such depository institutions and the FDIC insurance funds in the event of a depository institution default. For example, under the Federal Deposit Insurance Company Improvement Act of 1991 ("FDICIA"), to avoid receivership of an insured depository institution subsidiary, a bank holding company is required to guarantee the compliance of any insured depository institution subsidiary that may become "undercapitalized" with the terms of any capital restoration plan filed by such subsidiary with its appropriate Federal bank regulatory agency up to the lesser of (i) an amount equal to 5% of the institution's total assets at the time the institution became undercapitalized or (ii) the amount that is necessary (or would have been necessary) to bring the institution into compliance with all applicable capital standards as of the time the institution fails to comply with such capital restoration plan. See "-- Capital Adequacy Guidelines - Classification of Banking Institutions" and "- Enforcement, Policies and Actions".

In addition, the "cross-guarantee" provisions of FDICIA require insured depository institutions which are under common control to reimburse the FDIC for any loss incurred, or reasonably expected to be incurred, by the FDIC as a result of the default of a commonly controlled insured depository institution or for any assistance provided by the FDIC to a commonly controlled insured depository institution in danger of default. Accordingly, the cross-guarantee provisions enable the FDIC to access a bank holding company's healthy members of the FDIC. The FDIC may decline to enforce the cross-guarantee provisions if it determines that a waiver is in the best interest of the insurance fund. The FDIC's claims are superior to claims of stockholders of the insured depository institution or its holding company but are subordinate to claims of depositors, secured creditors and holders of subordinated debt (other than affiliates) of the commonly controlled insured depository institutions.

Under FDICIA, as amended, Federal banking regulatory agencies have adopted guidelines prescribing safety and soundness standards. These guidelines establish general standards relating to internal controls and information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth and compensation, fees and benefits. In general, the guidelines require, among other things, appropriate systems and practices to identify and manage the risk and exposures specified in the guidelines.

U. S. Treasury's Capital Purchase Program. The Company sold $4.2 million of Series A Preferred Shares to the U. S. Treasury under this program. Under the terms and conditions of the Capital Purchase Program, the Company's ability to declare and pay dividends on any of our common shares and repurchase our common shares, has been restricted. The Company also has to comply with executive compensation and corporate governance standards. The preferred dividends of 5% will increase in five years to 9% unless the preferred stock is redeemed. Company contributed the net proceeds to the Bank as additional paid-in-capital.

Bank Regulation

General. Northeast Bank is a Maine state-chartered banking corporation and a member of the Federal Reserve System and, as such, is subject to the supervision, examination, and regulation by the Maine Bureau of Financial Institutions and the FRB.

As a state-chartered commercial bank, Northeast Bank is subject to the applicable provisions of Maine law and the regulations adopted by the Maine Bureau of Financial Institutions. The FRB and the Maine Bureau of Financial Institutions regularly examine the operations of Northeast Bank and are given authority to approve or disapprove mergers, consolidations, the establishment of branches and similar corporate actions. Maine law and the Superintendant regulate (in conjunction with applicable federal laws and regulations), among other things, Northeast Bank's capital, permissible activities, reserves, investments, lending authority, the issuance of securities, payment of dividends, transactions with affiliated parties and borrowing. The federal and state banking regulators also have the power to prevent the continuance or development of unsafe or unsound banking practices or other violations of law.

Transactions with Affiliates. There are various legal restrictions on the extent to which the Company and any non-bank subsidiaries affiliated with Northeast Bank can borrow or otherwise obtain credit from Northeast Bank. Northeast Bank also is subject to certain restrictions on the purchase of, or investments in, the securities of, and purchase of assets from, the Company and of its non-bank subsidiaries, on loans or extensions of credit by a bank to third parties collateralized by the securities or obligations of the Company and any of its non-bank subsidiaries, on the issuance of guaranties, acceptances and letters of credit on behalf of the Company or any of its non-bank subsidiaries. Northeast Bank is subjected to further restrictions on most types of transactions with the Company and its non-bank subsidiaries which require the terms of such transactions to be substantially equivalent to the terms of similar transactions with non-affiliated entities.

Further, the Company and Northeast Bank are prohibited from engaging in certain tie-in arrangements in connection with any extension of credit, lease or sale of property, or furnishing of services. For example, Northeast Bank may not generally require a customer to obtain other services from Northeast Bank or the Company, and may not require the customer to promise not to obtain other services from a competitor, as a condition to an extension of credit.

Loans to Insiders. Northeast Bank also is subject to certain restrictions imposed by federal and state banking regulatory agencies on extensions of credit to executive officers, directors, principal shareholders or any related interest of such persons. Sections 22(g) and 22(h) of the Federal Reserve Act, as amended, and Regulation O, promulgated by the FRB, provide that extensions of credit to such insiders (a) must be made on substantially the same terms, including interest rates and collateral as, and follow credit underwriting procedures that are not less stringent than those prevailing at the time for, comparable transactions with persons not covered above and who are not employees, (b) must not involve more than the normal risk of repayment or present other unfavorable features, and (c) may not exceed certain limitations on the amount of credit extended to such persons, individually and in the aggregate, which limits are based, in part, on the amount of Northeast Bank's capital. The regulators do allow small discounts on fees on residential mortgages for directors, officers, and employees. Northeast Bank also is subject to certain lending limits and restrictions on overdrafts to such persons and extensions of credit in excess of certain limits must be approved by the board of directors of Northeast Bank. A violation of these restrictions may result in the assessment of substantial civil monetary penalties on Northeast Bank or any officer, director, employee, agent or other person participating in the conduct of the affairs of Northeast Bank or the imposition of a cease and desist order.

Bank Subsidiaries' Activities. The powers of Maine-chartered banks include provisions designed to provide these banks with competitive equity to the powers of national banks. In addition, the GLB Act permits state banks to engage in activities that are permissible for subsidiaries of financial holding companies to the extent such activities are permitted under applicable state law. The GLB Act also expressly preserves the ability of state banks, such as Northeast Bank, to retain all existing subsidiaries. In order to form a financial subsidiary, a state bank must be "well capitalized." State banks with financial subsidiaries will be subject to certain capital deduction, risk management, and affiliate transaction rules. In this regard, FRB rules provide that state bank subsidiaries that engage only in activities that the bank could engage in directly will not be deemed to be a financial subsidiary.

Dividend Restrictions

The Company is a legal entity separate and distinct from Northeast Bank. The primary source of revenues and funds of the Company, including funds to pay dividends to our shareholders, have been and will likely continue to be from dividends, if any, paid to us by

Northeast Bank. There are statutory and regulatory limitations on the payment of dividends by Northeast Bank to the Company as well as by the Company to its shareholders. As to the payment of dividends, Northeast Bank is subject to the laws and regulations of the State of Maine and to the regulations of the FRB.

If, in the opinion of the applicable federal bank regulatory authority, a depository institution or holding company under its jurisdiction is engaged in or is about to engage in an unsafe or unsound practice (which, depending on the financial condition of the depository institution or holding company, could include the payment of dividends), such authority may require, after notice and hearing (except in the case of an emergency proceeding where there is no notice or hearing), that such institution or holding company cease and desist from such practice. The Federal bank regulatory agencies have indicated that paying dividends that deplete a depository institution's or holding company's capital base to an inadequate level would be such an unsafe and unsound banking practice. Moreover, under FDICIA, an insured institution may not pay a dividend if payment would cause it to become undercapitalized or if it already is undercapitalized. See "- Capital Adequacy Guidelines - Prompt Corrective Regulatory Action". Moreover, the FRB and the FDIC have issued policy statements which provide that bank holding companies and insured depository institutions generally should only pay dividends out of current operating earnings.

At June 30, 2009, under dividend restrictions imposed under federal and state laws, Northeast Bank could declare, without obtaining governmental approvals, aggregate dividends to the Company of approximately $1,599,000.

Capital Adequacy Guidelines

Minimum Capital Requirements. The Company and Northeast Bank are required to comply with capital adequacy standards established by the FRB. There are two basic measures of capital adequacy for bank holding companies that have been promulgated by the FRB: a risk-based measure and a leverage measure.

The risk-based capital standards are designed to make regulatory capital requirements more sensitive to differences in credit and market risk profile among banks and bank holding companies, to account for off-balance sheet exposure and to lessen disincentives for holding liquid assets. Under these standards, assets and off-balance sheet items are assigned to broad risk categories, each with appropriate weights. The resulting capital ratios represent capital as a percentage of total risk-weighted assets and off-balance sheet items. In addition, the Federal bank regulatory agencies may from time to time require that a banking organization maintain capital above the minimum limits, whether because of its financial condition or actual or anticipated growth. FRB policy also provides that banking organizations generally, and in particular those that are experiencing substantial internal growth or actively making acquisitions, are expected to maintain capital positions that are substantially in excess of the minimum supervisory levels, without significant reliance on intangible assets.

These risk-based capital standards define a two-tier capital framework. Under these regulations, the minimum ratio of total capital ("Total Capital") to risk-weighted assets (including certain off-balance sheet activities, such as stand-by letters of credit) is 8%. At least one-half of the Total Capital must be "Tier 1 Capital," consisting of common equity, retained earnings or undivided profits, qualifying non-cumulative perpetual preferred stock, and a limited amount of cumulative perpetual preferred stock and minority interests in the equity account of consolidated subsidiaries, less certain goodwill items and other intangible assets (i.e., at least 4% of the risk weighted assets). The remainder ("Tier 2 Capital") may consist of (a) the allowance for credit losses of up to 1.25% of risk-weighted risk assets, (b) preferred stock that does not qualify as Tier 1 Capital, (c) qualifying hybrid capital instruments, (d) perpetual debt, (e) mandatory convertible securities, and (f) subordinated debt and intermediate term-preferred stock up to 50% of Tier 1 Capital. Assets and off-balance sheet items are assigned to one of four categories of risk weights, based primarily on relative credit risk. The minimum guideline for Tier 1 Capital is 4.0%. At June 30, 2009, the Company's consolidated Tier 1 Capital ratio was 8.12% and its Total Capital ratio was 13.23%.

In addition, the FRB has established minimum leverage ratio guidelines for bank holding companies. The guidelines provide for a minimum Tier 1 Capital to average assets (less goodwill and certain other intangible assets) ("Leverage Ratio") of at least 3% plus an additional cushion of 100 to 200 basis points. The Company's Leverage Ratio at June 30, 2008, was 11.81%.

Federal bank regulatory agencies also have adopted regulations which require regulators to take into consideration concentrations of credit risk and risks from non-traditional activities, as well as an institution's ability to manage those risks, when determining the adequacy of an institution's capital. Other factors taken into consideration include: interest rate exposure; liquidity, funding and market risk; the quality and level of earnings; the quality of loans and investments; the effectiveness of loan and investment policies; and management's overall ability to monitor and control financial and operational risks, including concentrations of credit and non-traditional activities. This evaluation is made as part of the institution's regular safety and soundness examination. Further, each Federal banking agency prescribes standards for depository institution holding companies relating to internal controls, information systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation, maximum rates of classified assets to capital, minimum earnings sufficient to absorb losses and other standards as they deem appropriate. In addition, pursuant to the requirements of FDICIA, Federal bank regulatory agencies all have adopted regulations requiring regulators to consider interest rate risk (when interest rate sensitivity of an institution's assets does not match its liabilities or its off-balance sheet position) in the evaluation of a bank's capital adequacy.

Northeast Bank is subject to substantially similar risk-based and leverage capital requirements as those applicable to the Company. As of June 30, 2009, Northeast Bank was in compliance with applicable minimum capital requirements.

Classification of Banking Institutions. Among other things, FDICIA provides Federal bank regulatory agencies with broad powers to take "prompt corrective action" with respect to depository institutions that do not meet minimum capital requirements. The extent of those powers depends upon whether the institutions in question are "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized," or "critically undercapitalized." A depository institution's capital tier will depend upon where its capital levels are in relation to various relevant capital measures, which include a risk-based capital measure and a leverage ratio capital measure, and certain other factors.

The Federal bank regulatory agencies have adapted regulations establishing relevant capital measures and relevant capital levels. Under these regulations, a bank will be considered:

	Total Risk Based Capital Ratio	Tier 1 Risk-Based Capital Ratio	Leverage Ratio	Other
Well Capitalized:	10% or greater	6% or greater	5% or greater	Not subject to any order or written directive to meet and maintain a specific capital level for any capital measure
Adequately Capitalized	8% or greater	4% or greater	4% or greater (3% in the case of a bank with a composite CAMEL rating of 1)*	
Undercapitalized	less than 8%	less than 4%	less than 4% ((3% in the case of a bank with a composite CAMEL rating of 1)*	
Significantly Undercapitalized	less than 6%	less than 3%	less than 3%	
Critically Undercapitalized				Ratio of tangible equity to total assets is less than or equal to 2%

*Banking regulators issue CAMEL ratings based upon the results of their periodic safety and soundness examinations of financial institutions. The ratings cover capital, asset quality, management, earnings, and liquidity. The CAMEL rating for each financial institution is by law confidential.

Under certain circumstances, a depository institution's primary Federal bank regulatory agency may use its authority to reclassify a "well classified" bank as "adequately capitalized" or subject an "adequately capitalized" or "undercapitalized" institution to supervisory actions applicable to the next lower capital category if it determines that the bank is in an unsafe or unsound condition or deems the bank to be engaged in an unsafe or unsound practice and not have corrected the deficiency. The banking agencies are permitted to establish individual minimum capital requirements exceeding the general requirements described above. Generally, failing to maintain the status of a "well capitalized" or "adequately capitalized" depository institution subjects the institution to restrictions and limitations on its business that become progressively more severe as capital levels decrease. At June 30, 2008, Northeast Bank met the definition of a "well capitalized" institution.

Prompt Corrective Regulatory Action. Federal banking regulators are required to take "prompt corrective action" if an insured depository institution fails to satisfy certain minimum capital requirements and other measures deemed appropriate by the federal banking regulators. See "- Capital Adequacy Guidelines" and "- Enforcement Policies and Actions." Failure to meet the capital adequacy guidelines could subject a banking institution to capital raising requirements. A bank is prohibited from making any capital distribution (including the payment of a dividend) or paying a management fee to its holding company if the bank would thereafter be "undercapitalized". Limitations exist for "undercapitalized" depository institutions regarding, among other things, asset growth, acquisitions, branching, new lines of business, acceptance of brokered deposits and borrowings from the Federal Reserve System. These institutions also are required to submit a capital instruction plan that includes a guarantee from the institution's holding company. See "Bank Holding Company Regulation - Source of Strength; Safety and Soundness". A "significantly undercapitalized" depository institution may be subject to a number of requirements and restrictions, including orders to sell a sufficient quantity of voting stock to become "adequately capitalized," requirements to reduce total assets and cessation of receipt of deposits from correspondent banks. The appointment of a receiver or conservator may be required for "critically undercapitalized" institutions.

Enforcement Policies and Actions

The enforcement powers available to Federal banking regulators and the Supervisor over commercial banks and bank holding companies are extensive. This enforcement authority includes, among other things, the ability to assess civil money penalties, to issue cease-and-desist or removal orders, to initiate injunctive actions against banking organizations and affiliated parties, and, in extreme cases, to terminate deposit insurance. In general, these enforcement actions may be initiated for violations of laws and regulations and unsafe or unsound practices. Other actions or inactions may provide the basis for enforcement action, including misleading or untimely reports filed with the Federal bank regulatory agencies. Current law generally requires public disclosure of final enforcement actions.

Community Reinvestment Act

Bank holding companies and their subsidiary banks are subject to the provisions of the CRA and the regulations promulgated there under by the appropriate Federal bank regulatory agency. Under the terms of the CRA, Northeast Bank has a continuing and affirmative obligation consistent with its safe and sound operation to help meet the credit needs of its entire community, including low and moderate income neighborhoods. The CRA does not establish specific lending requirements or programs for financial institutions nor does it limit an institution's discretion to develop the types of products and services that it believes are best suited to its particular community, consistent with the CRA. The CRA requires each appropriate Federal bank regulatory agency, in connection with its examination of a subsidiary depository institution, to assess such institution's record of meeting the credit needs of its community and to take such record into account in its evaluation of certain applications by that institution. The CRA also requires all institutions to make public disclosure of their CRA ratings. Further, such assessment also is part of the FRB's consideration of applications to acquire, merge or consolidate with, or assume the liabilities of, another banking institution or its holding company, or to open or relocate a branch office. In the case of a bank holding company applying for approval to acquire a bank or a bank holding company, the FRB will assess the record of each subsidiary bank of the applicant bank holding company in considering the application. Pursuant to current CRA regulations, an institution's CRA rating is based on its actual performance in meeting community needs. In particular, the rating system focuses on three tests: (a) a lending test, which evaluates the institution's record of making loans in its service areas; (b) an investment test, which evaluates the institution's record of investing community development projects, affordable housing, and programs benefiting low or moderate income individuals and businesses; and (c) a service test, which evaluates the institution's delivery of services through its branches, ATMs, and other offices. The current CRA regulations also clarify how an institution's CRA performance will be considered in the application process. Northeast Bank received a "satisfactory" CRA rating in its most recent examination.

FDIC Insurance Premiums

Northeast Bank is required to pay quarterly FDIC deposit insurance assessments. Under the FDIC's risk-based insurance system, insured institutions are currently assessed premiums based on the institution's capital position and other supervisory factors. Each financial institution is assigned to one of three capital groups - well capitalized, adequately capitalized or undercapitalized - and further assigned to one of three subgroups - within a capital group, on the basis of supervisory evaluations by the institution's primary federal and, if applicable, state supervisors and other information relevant to the institution's financial condition and the risk posed to the applicable FDIC deposit insurance fund. The actual assessment rate applicable to a particular institution (and any applicable refund) will, therefore, depend in part upon the risk assessment classification so assigned to the institution by the FDIC.

Due to the recent bank and saving association failures in 2009, the FDIC made a special assessment on all insured institutions of 5 basis points of total assets minus Tier 1 capital as of June 30, 2009. The special assessment for Northeast Bank was $275,000 and will be collected on September 30, 2009 by the FDIC.

Gramm-Leach-Bliley Act

The GLB Act, enacted in 1999, amended and repealed portions of the Glass-Steagall Act and other federal laws restricting the ability of bank holding companies, securities firms, and insurance companies to affiliate with each other and enter into new lines of business. The GLB Act established a comprehensive framework to permit financial companies to expand their activities, including through affiliations, and to modify the federal regulatory structure governing some financial services activities. The increased authority of financial firms to broaden the type of financial services that they may offer to customers and to affiliates with other types of financial service companies may lead to further consolidation in the financial services industry. However, it also may lead to additional competition in these markets in which we operate by allowing new entrants into various segments of those markets that were not the traditional competitors in the segments. Furthermore, the authority granted by the GLB Act may encourage the growth of larger competitors.

With respect to bank securities activities, the GLB Act repeals the exemption from the definition of "broker" previously afforded to banks and replaces it with a set of limited exemptions that permits certain activities which have been performed historically by banks to continue. Further, the GLB Act amends the securities laws to include banks with the general definition of dealer.

In addition, the GLB Act imposes regulations on financial institutions with respect to customer privacy. The GLB generally prohibits disclosure of customer information to non-affiliated third parties unless the customer had been given the opportunity to object and has not objected to such disclosure. Financial institutions are further required to provide written disclosure of their privacy policies to customers at the time the banking relationship is formed and annually thereafter. Financial institutions, however, are required to comply with state law if it is more protective of customer privacy than the GLB Act. The privacy provisions became effective in July 2001.

The GLB Act contains a variety of other provisions including a prohibition against ATM surcharges unless the customer has first been provided notice of the imposition and amount of the fee. The GLB Act reduces the frequency of CRA examinations for smaller institutions and imposes certain reporting requirements on depository institutions that make payment to non-governmental entities in connection with the CRA.

Anti-Money Laundering and Anti-Terrorism Legislation

Congress enacted the Bank Secrecy Act of 1970 (the "BSA") to require financial institutions, including the Company and Northeast Bank, to maintain certain records and to report certain transactions to prevent such institutions from being used to hide money derived from criminal activity and tax evasion. The BSA establishes, among other things: (a) record keeping requirements to assist government enforcement agencies in tracing financial transactions and flow of funds; (b) reporting requirements for Suspicious Activity Reports and Currency Transaction Reports to assist government enforcement agencies in detecting patterns of criminal activity; (c) enforcement provisions authorizing criminal and civil penalties for illegal activities and violations of the BSA and its implementing regulations; and (d) safe harbor provisions that protect financial institutions from civil liability for the cooperative efforts.

The USA Patriot Act of 2001 (the "USA Patriot Act") is intended to strengthen the ability of U.S. law enforcement agencies and the intelligence communities to work cohesively to combat terrorism on a variety of fronts. The USA Patriot Act amended the BSA and incorporates anti-terrorist financing provisions into the requirements of the BSA and its implementing regulations. Under the USA Patriot Act, FDIC insured banks and commercial banks are required to increase their due diligence efforts for correspondent accounts and private banking customers. The USA Patriot Act requires banks to engage in additional record keeping or reporting, requiring identification of owners of accounts, or of the customers of foreign banks with accounts, and restricting or prohibiting certain correspondent accounts. Among other things, the USA Patriot Act requires all financial institutions, including the Company and Northeast Bank, to institute and maintain a risk-based anti-money laundering compliance program that includes a customer identification program, provides for information sharing with law enforcement and between certain financial institutions by means of an exemption from the privacy provision of the GLB Act, prohibits U.S. banks and broker-dealers from maintaining accounts with foreign "shell" banks, establishes due diligence and enhanced due diligence requirements for certain foreign correspondent banking and foreign private banking accounts and imposes additional record keeping requirements for certain correspondent banking arrangements. The USA Patriot Act also grants broad authority to the Secretary of the Treasury to take actions to combat money laundering, and federal bank regulators are required to evaluate the effectiveness of an applicant in combating money laundering in determining whether to approve any application submitted by a financial institution. The Company and Northeast Bank have adopted policies, procedures, and controls to comply with the BSA and the USA Patriot Act, and they engage in very few transactions of any kind with foreign financial institutions or foreign persons.

The Department of the Treasury's Office of Foreign Asset Control ("OFAC") administers and enforces economic and trade sanctions against targeted foreign countries, entities and individuals based on U.S. foreign policy and national security goals. As a result, financial institutions, including the Company and Northeast Bank, must scrutinize transactions to ensure that they do not represent obligations of, or ownership interests in, entities owned or controlled by sanctioned targets. In addition, the Company and Northeast Bank restrict transactions with certain targeted countries except as permitted by OFAC.

Sarbanes-Oxley Act

The Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley Act") implemented a broad range of corporate governance and accounting measures, executive compensation disclosure requirements, and enhanced and timely disclosure obligations for corporate information, all of which are designed to ensure that the stockholders of corporate America are treated fairly and have full and accurate information about the public companies in which they invest. All companies that file periodic reports with the SEC are affected by the Sarbanes-Oxley Act.

Specifically, the Sarbanes-Oxley Act and various regulations promulgated there under, established among other things:

- the creation of an independent accounting oversight board to oversee the audit of public companies and auditors who perform such audits;
- auditor independence provisions which restrict non-audit services that independent accountants may provide to their audit clients;
- additional responsibilities regarding financial statements for the chief executive officer and chief financial officer of the reporting entity;
    - a prohibition on personal loans to directors and officers, except certain loans made by financial institutions on non-preferential terms and in compliance with other bank regulatory requirements;

- additional corporate governance and responsibility measures which (a) require the chief executive officer and chief financial officer to certify financial statements and to forfeit salary and bonuses in certain situations, and (b) protect whistleblowers and informants;
- enhanced independence and expertise requirements of members of audit committees;
- expansion of the audit committee's authority and responsibility by requiring that the audit committee (a) have direct control of the outside auditor, (b) be able to hire and fire the auditor, and (c) approve all non-audit services;
- mandatory disclosure by analysts of potential conflicts of interest; and
- enhanced penalties for fraud and other violations.

On September 11, 2007, the Company changed its listing from the American Stock Exchange to the NASDAQ Stock Exchange. Both exchanges have adopted corporate governance rules that have been approved by the SEC.

The Company has taken steps to comply with the provisions of the Sarbanes-Oxley Act and the regulations adopted there under. Based on our total assets, we are first required to provide management's assessment of the company's internal control over financial reporting in our annual report on Form 10-K filed for our first fiscal year ending on or after December 15, 2007 (i.e., fiscal year 2008). In addition, we are required to obtain an attestation report by our auditors for the annual report on Form 10-K filed for our first fiscal year ending on or after December 15, 2009 (i.e., fiscal year 2010). Compliance with the foregoing provisions is expected to increase our administrative costs.

Monetary Policy and Economic Control

The commercial banking business is affected not only by legislation, regulatory policies, and general economic conditions, but also by the monetary policy of the FRB. Changes in the discount rate on member bank borrowing, availability of borrowing at the "discount window," open market operations, the imposition of changes in reserve requirements against member banks' deposit and assets of foreign branches and the imposition of and changes in reserve requirements against certain borrowings by banks and their affiliates are some of the instruments of monetary policy available to the FRB. These monetary policies are used in varying combinations to influence overall growth and distributions of bank loans, investments and deposits, and these policies may affect interest rates charged on loans or paid on deposits. The monetary policies of the FRB have had a significant effect on the operating results of commercial banks and are expected to do so in the future. The monetary policies of these agencies are influenced by various factors, including inflation, unemployment, short-term and long-term changes in the international trade balance and in the fiscal policies of the United States Government. Future monetary policies and the effect of such policies on the future business and earnings of Northeast Bank cannot be predicted.

Industry Restructuring

For well over a decade, the banking industry has been undergoing a restructuring process which is anticipated to continue. The restructuring has been caused by product and technological innovations in the financial services industry, deregulation of interest rates and increased competition from foreign and nontraditional banking competitors, and has been characterized principally by the gradual erosion of geographic barrier to intrastate and interstate banking and the gradual expansion of investment and lending authorities for bank institutions.

Members of Congress and the administration may consider additional legislation designed to institute reforms to promote the viability of the industry. Such legislation could revise the federal regulatory structure for insured depository institutions; others could affect the nature of products, services, and activities that bank holding companies and their subsidiaries may offer or engage in, and the types of entities that may control depository institutions. There can be no assurance as to whether or in what form any such future legislation might be enacted, or what impact such legislation might have upon the Company or Northeast Bank.

See Risk Factors for additional discussion of industry restructuring.

STATISTICAL DISCLOSURE

The additional statistical information contained in Item 8(b) of this Form 10-K, "Financial Statements and Supplementary Data" as it relates to the disclosures required by Industry Guide 3 under the Securities Act of 1933, as amended, is incorporated herein by reference.

FORWARD-LOOKING STATEMENTS AND RISK FACTORS

This Annual Report on Form 10-K (including the Exhibits hereto) contains certain "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, such as statements relating to our financial condition, prospective results of operations, future performance or expectations, plans, objectives, prospects, loan loss reserve adequacy, simulation of changes in interest rates, capital spending and interest and non-interest revenue sources. These statements relate to expectations concerning matters that are not historical facts. Accordingly, statements that are based on management's projections, estimates, assumptions, and judgments constitute forward-looking statements. These forward-looking statements, which are based on various assumptions (some of which are beyond the Company's control), may be identified by reference to a future period or periods, or by the use of forward-looking terminology such as "believe", "expect", "estimate", "anticipate", "continue", "plan", "intend", "objective", "goal", "project", or other similar terms or variations on those terms, or the future or conditional verbs such as "will", "may", "should", "could", and "would". In addition, the Company may from time to time make such oral or written "forward-looking statements" in future filings with the Securities and Exchange Commission (including exhibits thereto), in its reports to shareholders, and in other communication made by or with the approval of the Company.

Such forward-looking statements reflect our current views and expectations based largely on information currently available to our management, and on our current expectations, assumptions, plans, estimates, judgments and projections about our business and our industry, and they involve inherent risks and uncertainties. Although we believe that these forward-looking statements are based on reasonable estimates and assumptions, they are not guarantees of future performance and are subject to known and unknown risks, uncertainties, contingencies and other factors. Accordingly, we cannot give you any assurance that our expectations will in fact occur or that our estimates or assumptions will be correct. We caution you that actual results could differ materially from those expressed or implied by such forward-looking statements due to a variety of factors, including, but not limited to, those related to the economic environment, particularly in the market areas in which the Company operates, competitive products and pricing, fiscal and monetary policies of the U.S. Government, changes in government regulations affecting financial institutions, including regulatory fees and capital requirements, changes in prevailing interest rates, acquisitions and the integration of acquired businesses, credit risk management, asset/liability management, changes in technology, changes in the securities markets and the availability of and the costs associated with sources of liquidity. Accordingly, investors and others are cautioned not to place undue reliance on such forward-looking statements.

Potential risks, uncertainties, and other factors which could cause the Company's financial performance or results of operations to differ materially from current expectations or such forward-looking statements include, but are not limited to:

a) general economic conditions, either nationally or in the markets where the Company or its subsidiaries offer their financial products or services, may be less favorable than expected, resulting in, among other things, a deterioration of credit quality or in a decreased demand for our products or services;
b) A significant increase in competitive pressures in the banking and financial services industry and, more particularly, a significant increase in competition in the Company's market areas as described under "Business -- Market for Services and Competition";
c) changes in the interest rate environment which could reduce our margins and increase defaults in our loan portfolio, including those described under "Management's Discussion and Analysis of Results of Operations and Financial Condition --Risk Management";
d)

the adequacy of the allowance for loan losses and the Bank's asset quality, including those matters described in "Management's Discussion and Analysis of Results of Operations and Financial Condition -- Results of Operations";

e) changes in political conditions or changes occurring in the legislative or regulatory environment that adversely affects the businesses in which we are engaged, including the impact of any changes in laws and regulations relating to banking, securities, taxes, and insurance;
f) changes in technology;
g) the ability to increase market share and to control expenses, and changes in consumer spending, borrowing, and saving habits;
h) changes in trade, tax, monetary, or fiscal policies, including the interest rate policies of the FRB;
i) money market and monetary fluctuations, and changes in inflation or in the securities markets;
j) future acquisitions and the integration of acquired businesses and assets;
k) changes in the Company's organizational structure and in its compensation and benefit plans, including those necessitated by pressures in the labor market for attracting and retaining qualified personnel;
l) the effect of changes in accounting policies and practices, as may be adopted by regulatory agencies as well as the Financial Accounting Standards Board;
m) unanticipated litigation, regulatory, or other judicial proceedings;
n) the success of the Company at managing the risks involved in the foregoing;
o) other one-time events, risks and uncertainties detailed from time to time in the filings of the Company with the Securities and Exchange Commission;
p) Continue diversification of income streams;
q) U. S. Treasury’s ability to changes the terms, rules, or requirements of the Capital Purchase Program could adversely affect the Company; and
r) additional special assessments for deposit insurance from the FDIC.

All written or oral forward-looking statements that are made or attributable to us are expressly qualified in their entirety by this cautionary notice. Such forward-looking statements speak only to the date that such statements are made, and the Company undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events.

The Company's results are strongly influenced by general economic conditions in its market areas in the western, central, and mid-coastal regions of the State of Maine. Deterioration in these conditions could have a material adverse effect on the quality of the Bank's loan portfolio and the demand for its products and services. In particular, changes in the real estate or service industries, or a slow-down in population growth, may adversely impact the Company's performance. See "Item 7. Management's Discussion and Analysis of Results of Operations and Financial Condition."

All forward-looking statements presume a continuation of the existing regulatory environment and monetary policy. The banking industry is subject to extensive state and federal regulation, and significant new laws or regulations, or changes in or repeals of existing laws or regulations may cause results of the Company to differ materially. Further, federal monetary policy, particularly as implemented by the FRB, significantly affect credit conditions for the Bank and its customers. Such changes could adversely impact the Company's financial results. In addition, the Sarbanes-Oxley Act of 2002 and the numerous rulemaking initiatives adopted or proposed in connection therewith or in reaction thereto have significantly increased the regulatory burdens of publicly held companies. Accordingly, the cost of compliance with, and the personnel necessary to satisfy the obligations imposed by, these regulatory initiatives may divert resources from our core business operations and may adversely affect our profitability. See "Item 1. Business Supervision and Regulation."

A significant source of risks arise from the possibility that losses will be sustained because borrowers, guarantors, and related parties fail to perform in accordance with the terms of their loans. The Bank has adopted underwriting and credit monitoring procedures and credit policies, including the establishment and review of the allowance for loan losses, that management believe are appropriate to minimize the risks in assessing the likelihood of nonperformance, tracking loan performance, and diversifying the Bank's loan portfolio. However, such policies may not prevent unexpected losses that could adversely affect the Company's results and the allowance for loan losses may not be adequate in all instances. See "Item 7. Management's Discussion and Analysis of Results of Operations and Financial Condition - Results of Operations,"" - Financial Condition," and" - Risk Management." Further, certain types of lending relationships carry greater risks of nonperformance and collectability, such as commercial and consumer loans. For a discussion of the risks associated with such lending relationships, see "Item 1. Business -- Lending Activities."

ITEM 1.a. Risk Factors

The following discussion presents risks that management believes are specific to our business and could have a negative impact on the Company’s financial performance. When analyzing an investment in the Company, the risks and uncertainties described below, together with all of the other information included or incorporated by reference in this report, should be carefully considered. This list should not be viewed as comprehensive and may not include all risks that may affect the financial performance of the Company:

Difficult conditions in the capital markets and the economy generally may materially adversely affect our business and results of operations and we do not expect these conditions to improve in the near future.

Our results of operations are materially affected by conditions in the capital markets and the economy generally. The capital and credit markets have been experiencing extreme volatility and disruption for more than twenty-four months. The volatility and disruption have reached unprecedented levels. In many cases, these markets have produced downward pressure on stock prices of, and credit availability to, certain companies without regard to those companies’ underlying financial strength.

Recently, concerns over inflation, energy costs, geopolitical issues, the availability and cost of credit, the U.S. mortgage market and a declining U.S. real estate market have contributed to increased volatility and diminished expectations for the economy and the capital and credit markets going forward. These factors, combined with volatile oil prices, declining business and consumer confidence and increased unemployment, have precipitated an economic slowdown. In addition, the fixed-income markets have been experiencing a period of extreme volatility which has negatively impacted market liquidity conditions. Initially, the concerns on the part of market participants were focused on the subprime segment of the mortgage-backed securities market. However, these concerns have since expanded to include a broad range of mortgage-and asset-backed and other fixed income securities, including those rated investment grade, the U.S. and international credit and interbank money markets generally, and a wide range of financial institutions and markets, asset classes and sectors. As a result, the market for fixed income instruments has experienced decreased liquidity, increased price volatility, credit downgrade events, and increased probability of default. Securities that are less liquid are more difficult to value and may be hard to dispose of. Domestic and international equity markets have also been experiencing heightened volatility and turmoil, with issuers (such as our company) that have exposure to the real estate, mortgage and credit markets particularly affected. These events and the continuing market upheavals, may have an adverse effect on us, in part because we have a large investment portfolio and also because we are dependent upon customer behavior. Our revenues are likely to decline in such circumstances, and our profit margins could erode. In addition, in the event of extreme and prolonged market events, such as the global credit crisis, we could incur significant losses. Even in the absence of a market downturn, we are exposed to substantial risk of loss due to market volatility.

Factors such as consumer spending, business investment, government spending, the volatility and strength of the capital markets, and inflation all affect the business and economic environment and, ultimately, the amount and profitability of our business. In an economic downturn characterized by higher unemployment, lower family income, lower corporate earnings, lower business investment and lower consumer spending, the demand for our financial products could be adversely affected. Adverse changes in the economy could affect earnings negatively and could have a material adverse effect on our business, results of operations and financial condition. The current mortgage crisis has also raised the possibility of future legislative and regulatory actions in addition to the recent enactment of the Emergency Economic Stabilization Act of 2008 (the "EESA") that could further impact our business. We cannot predict whether or when such actions may occur, or what impact, if any, such actions could have on our business, results of operations and financial condition.

Changes in interest rate risk may have adverse impact on the Company's profitability.

The Company's profitability is largely a function of the spread between the interest rates earned on interest- earning assets and the interest rates paid on deposits and other interest-bearing liabilities. Like most financial institutions, the Company's net interest income and margin will be affected by general economic conditions and other factors, including fiscal and monetary policies of the Federal government and competition, that influence market interest rates and the Company's ability to respond to changes in such rates. At any given time, the Company's assets and liabilities may be such that they are affected differently by a change in interest rates. As a result, an increase or decrease in rates, the length of loan terms or the mix of adjustable- and fixed- rate loans or investment securities could have a positive or negative effect on its net income, capital and liquidity. Although management believes it has implemented strategies and guidelines to reduce the potential effects of changes in interest rates on results of operations, any substantial and prolonged change in market interest rates, including the slope of the interest rate curve, could adversely affect operating results.

Changes in economic conditions and the composition of the Company's loan portfolio could lead to higher charge-offs or an increase in the Company's provision for loan losses and may reduce the Company's net income.

As a lender, the Company is exposed to the risk that its borrowers may be unable to repay their loans and that any collateral securing the payment of their loans may not be sufficient to assure repayment in full. Credit losses are inherent in the lending business and could have a material adverse effect on the operating results of the Company. Adverse changes in the economy or business conditions, either nationally or in the Company's market areas, could increase credit-related losses and expenses and/or limit growth. Substantially all of the Company's loans are to businesses and individuals in its limited geographic area and any economic decline in this market could impact the Company adversely. We make various assumptions and judgments about the collectibility of our loan portfolio and provide for an allowance for loan losses based on a number of factors. If these assumptions are incorrect, the allowance for loan losses may not be sufficient to cover losses, thereby having an adverse effect on operating results, and may cause the Company to increase the allowance in the future by increasing the provision for loan losses. The Company has adopted underwriting and credit monitoring procedures and credit policies that management believes are appropriate to control these risks; however, such policies and procedures may not prevent unexpected losses that could have a material adverse affect on the Company's financial condition or results of operations.

Our loan portfolio is concentrated in loans with a higher risk of loss.

Most of our loans are secured by real estate. Our real estate secured lending is generally sensitive to regional and local economic conditions as they significantly impact the ability of borrowers to meet their loan payment obligations, making loss levels difficult to predict. Collateral evaluation and analysis of the borrower's financial position and ability to meet current payment obligations when these types of loans are originated requires detailed evaluation and review at the time of loan underwriting and on an ongoing basis. The decline in real estate values due to the downturn in the housing and commercial real estate markets have reduced the value of the real estate collateral securing the majority of our loans and increased the risk that we would incur losses if borrowers defaulted on their loans. Continued declines in real estate sales and prices coupled with the current recession and the associated increases in unemployment may result in higher than expected loan delinquencies or problem assets, a decline in demand for our products and services, or lack of growth or a decrease in deposits. These potential negative events may cause us to incur losses, adversely affect our capital, and damage our financial condition and business operations. These declines may have a greater effect on our earnings and capital than on the earnings and capital of financial institutions whose loan portfolios are more diversified. At June 30, 2009, we had $267 million, or 68%, of total loans held for investments in residential and commercial real estate loans.

Impairment risk may impact our profitability.

The Company regularly purchases U.S. Government-sponsored enterprise debt securities, U.S. Government-sponsored enterprise issued mortgage-backed securities, corporate debt securities, municipal bonds, trust preferred securities and equity securities. The Company is exposed to the risk that the issuers of these securities may experience significant deterioration in credit quality which could impact the market value of the issue. The Company periodically evaluates its investments to determine if market value declines are other-than-temporary. Once a decline is determined to be other-than-temporary, the value of the security is reduced and a corresponding charge to earnings is recognized. The Company recognized $428,000 of securities related impairment expense in the year ending June 30, 2009.

The Company also periodically evaluates its goodwill and other intangibles to determine impairment. There is risk that the discounted cash flow from the insurance agency acquisitions that created the goodwill and other intangibles could result in a present value lower than the book amount. Once the goodwill or other intangibles are determined to be impaired, the carrying amount of these assets is reduced and a charge to earnings is recognized.

Strong competition within our markets may impact our profitability.

The financial services industry is highly competitive, with competition for attracting and retaining deposits and making loans coming from other banks and savings institutions, credit unions, mutual fund companies, insurance companies and other non-bank businesses. Many of the Company’s competitors are much larger in terms of total assets and market capitalization, have a higher lending limit, greater access to capital and funding and offer a broader array of financial products and services. In light of these factors, the Company’s ability to continue to compete effectively is dependent upon its ability to maintain and build relationships through top quality service.

The banking business is heavily regulated.

The banking industry is heavily regulated under both federal and state law. Banking regulations, designed primarily for the safety of depositors, may limit a financial institution’s growth and the return to its investors, by restricting such activities as the payment of dividends, mergers with or acquisitions by other institutions, expansion of branch offices and the offering of securities. The Company is also subject to capitalization guidelines established by federal law and could be subject to enforcement actions to the extent that its subsidiary bank is found, by regulatory examiners, to be undercapitalized. It is difficult to predict what changes, if any, will be made to existing federal and state legislation and regulations or the effect that such changes may have on the Company’s future business and earnings prospects. Any substantial changes to applicable laws or regulations could also subject the Company to additional costs, limit the types of financial services and products it may offer, and inhibit its ability to compete with other financial service providers.

The Company’s participation in the Treasury’s Capital Purchase Program which includes restrictions on the ability to pay dividends or repurchase outstanding common stock, as well as restrictions on executive compensation, may act to depress the market value of the Company’s common stock and hinder its ability to attract and retain well qualified executives.

Pursuant to the terms of the Securities Purchase Agreement between the Company and the Treasury, the ability to declare or pay dividends on any of the Company’s common shares is limited to $0.09 per share per quarter. Specifically, the Company is unable to declare or pay dividends on common shares if in arrears on the payment of dividends on the Series A Preferred Shares. In addition, the ability to repurchase outstanding common shares is restricted. The approval of the Treasury generally is required for the Company to make any stock repurchase (other than purchases of Series A Preferred Shares or common shares in connection with the administration of any employee benefit plan in the ordinary course of business and consistent with past practice) unless all of the Series A Preferred Shares have been redeemed or transferred by the Treasury to unaffiliated third parties. Further, outstanding common shares may not be repurchased if the Company is in arrears on the payment of Series A Preferred Share dividends. The restriction on the Company’s ability to pay dividends may depress its common share market price.

As a recipient of government funding under the Capital Purchase Program, the Company must comply with the executive compensation and corporate governance standards imposed by the American Recovery and Reinvestment Act for as long as the Treasury holds any securities acquired from the Company pursuant to the Securities Purchase Agreement or upon exercise of the Warrant, excluding any period during which the Treasury holds only the Warrant. In addition, the restrictions on the Company’s ability to compensate senior executives in relationship to executive compensation at companies that are not recipients of TARP funds may limit the Company’s ability to recruit and retain senior executives.

The Treasury's ability to change the terms, rules or requirements of the Capital Purchase Program could adversely affect the Company's financial condition and results of operations.

If the Company is unable to redeem the Series A Preferred Shares after five years, the cost of this capital will increase substantially.

If the Company is unable to redeem the Series A Preferred Shares prior to December 12, 2013, the cost of this capital will increase substantially on that date, from 5.0% per annum to 9.0% per annum. Depending on the Company's financial condition at the time, this increase in the annual dividend rate on the Series A Preferred Shares could have a material negative effect on liquidity and results of operations.

The Series A Preferred Shares impact net income available to holders of the Company's Common Shares and earnings per Common Share, and the Warrant issued to the Treasury may be dilutive to holders of Company Common Shares.

While the additional capital raised through participation in the Treasury's CPP Program provides further funding for the Company's business, it has increased the number of diluted outstanding common shares and carries a preferred dividend. The dividends declared and the accretion of discount on the Series A Preferred Shares will reduce the net income available to holders of Company common shares and earnings per common share. The Series A Preferred Shares will also receive preferential treatment in the event of the Company's liquidation, dissolution or winding up. Additionally, the ownership interest of the existing holders of Company common shares will be diluted to the extent the Warrant issued to the Treasury in conjunction with the sale to the Treasury of the Series A Preferred Shares is exercised. The common shares underlying the Warrant represented approximately 2.9% of total common shares outstanding as of June 30, 2009. Although the Treasury has agreed not to vote any of the common shares it receives upon exercise of the Warrant, a transferee of any portion of the Warrant or of any common shares acquired upon exercise of the Warrant is not bound by this restriction.

If we do not maintain strong internal controls and procedures, it may impact our profitability.

Management diligently reviews and updates its internal controls, disclosure controls and procedures, and corporate governance policies and procedures. This system is designed to provide reasonable, not absolute, assurances that the internal controls comply with appropriate regulatory guidance. Any undetected circumvention of these controls could have a material adverse impact on the Company's financial condition and results of operations.

We are subject to litigation in the normal course of our business, which may impact profitability.

Although there is currently no litigation to which the Company is a party, future litigation that arises during the normal course of business could be material and have a negative impact on the Company's earnings. Future litigation could also adversely impact the reputation of the Company in the communities that it serves. We maintain insurance, but the scope of this coverage may not provide us with full or partial coverage in any particular case.

Attracting and retaining skilled personnel may impact the quality of services to customers.

Attracting and retaining key personnel is critical to the Company's success, and difficulty finding qualified personnel could have a significant impact on the Company's business due to the lack of required skill sets and years of industry experience. Management is cognizant of these risks, and succession planning is built into the Company's long-range strategic planning process.

Recent negative developments in the financial industry and the credit markets may subject us to additional regulation.

As a result of the recent global financial crisis, the potential exists for new federal or state laws and regulations regarding lending and funding practices and liquidity standards to be promulgated, and bank regulatory agencies are expected to be active in responding to concerns and trends identified in examinations, including the expected issuance of many formal enforcement orders. Negative developments in the financial industry and the domestic and international credit markets, and the impact of new legislation in response to those developments, may negatively impact our operations by restricting our business operations, including our ability to originate or sell loans, and adversely impact our financial performance.

Our future growth may require us to raise additional capital in the future, but that capital may not be available when it is needed.

We are required by regulatory authorities to maintain adequate levels of capital to support our operations. We anticipate that our current capital levels will satisfy our regulatory requirements for the foreseeable future. We may at some point, however, need to raise additional capital to support our continued growth. Our ability to raise additional capital will depend, in part, on conditions in the capital markets at that time, which are outside our control, and our financial performance. Accordingly, we may be unable to raise additional capital, if and when needed, on terms acceptable to us, or at all. If we cannot raise additional capital when needed, our ability to further expand our operations through internal growth and acquisitions could be materially impaired. In addition, if we decide to raise additional equity capital, your interest could be diluted.

The terms of the Capital Purchase Program which the Company issued securities to the United States Department of Treasury may limit the Company’s ability to return capital to shareholders.

The FDIC deposit insurance special assessments that we are required to pay may materially increase in the future, which would have an adverse effect on our earnings.

Beginning in late 2008, the economic environment caused higher levels of bank failures, which dramatically increased FDIC resolution costs and led to a significant reduction in the Deposit Insurance Fund. As a result, the FDIC has significantly increased the initial base assessment rates paid by financial institutions for deposit insurance. The base assessment rate was increased by seven basis points (7 cents for every $100 of deposits) for the first quarter of 2009. Effective April 1, 2009, initial base assessment rates were changed to range from 12 basis points to 45 basis points across all risk categories with possible adjustments to these rates based on certain specified factors. These increases in the base assessment rate have increased our deposit insurance costs and will negatively impact our earnings. In addition, in May 2009, the FDIC imposed a special assessment on all insured institutions due to recent bank and savings association failures. The emergency assessment amounts to 5 basis points on each institution's assets minus Tier 1 capital as of June 30, 2009, subject to a maximum equal to 10 basis points times the institution's assessment base. The assessment will be collected on September 30, 2009. Our special assessment was $275,000. The special assessment will negatively impact our earnings. In addition, the FDIC may impose additional emergency special assessments after June 30, 2009, of up to 5 basis points per quarter on each institution's assets minus Tier 1 capital if necessary to maintain public confidence in federal deposit insurance or as a result of deterioration in the deposit insurance fund reserve ratio due to institution failures. The earliest possible date for imposing any such additional special assessment is September 30, 2009, with collection on December 30, 2009. The latest date possible for imposing any such additional special assessment is December 31, 2009, with collection on March 30, 2010. Any additional emergency special assessment imposed by the FDIC will further hurt our earnings.

Item 2. Properties

The principal executive and administrative offices of the Company and the Bank are located at 500 Canal Street, Lewiston, Maine ("Headquarters Building"). In 2005, the Bank entered into a 15 year lease with respect to the Headquarters Building, and we moved our principal executive and administrative offices to this four story building located in downtown Lewiston. We lease the entire building, a total of 27,000 square feet. For the first ten years of the lease, the annual rent expense is approximately $264,000. In addition to executive and administrative offices, this building also houses our operations, loan processing and underwriting, loan servicing, accounting, human resources and commercial lending departments. We also opened a 500 square foot branch office in this building.

In addition to the branch office located in our Headquarters Building, we have 10 additional banking branches and fourteen insurance agency offices located in the State of Maine and one insurance agency office that is located in New Hampshire as set forth below.

Branch Locations	Ownership
232 Center Street, Auburn	Lease (1)
235 Western Avenue, Augusta	Fee Simple
11 Main Street, Bethel	Fee Simple
168 Maine Street, Brunswick	Fee Simple
2 Depot Street, Buckfield	Fee Simple
46 Main Street, Harrison	Fee Simple
882 Lisbon Street, Lewiston	Lease (2)
500 Canal Street, Lewiston	Lease (3)
26 Pleasant Street, Mechanic Falls	Fee Simple
77 Middle Street, Portland	Lease (4)
235 Main Street, South Paris	Fee Simple

Insurance Agency Locations

59 Main Street, Anson, Maine	Fee Simple
232 Center Street, Auburn, Maine*	Lease (1)
235 Western Avenue, Augusta, Maine*	Fee Simple
4 Sullivan Square, Berwick, Maine	Fee Simple
11 Main Street, Bethel, Maine*	Fee Simple
346 Main Street, Jackman, Maine	Lease (6)
28 Main Street, Livermore Falls, Maine	Lease (7)
89 Main Street, Mexico, Maine	Fee Simple
2568 Main Street, Rangeley, Maine	Fee Simple
59 South Main Street, Rochester, New Hampshire	Lease (8)
423 U. S. Route 1, Scarborough, Maine	Lease (9)
235 Main Street, South Paris, Maine*	Fee Simple
472 Main Street, Thomaston, Maine	Lease (10)
10 Snell Hill Road, Turner, Maine	Fee Simple

*Each of these insurance agency locations are situated in an existing bank branch location at the address indicated.

(1) Lease term is ten years and expires May 1, 2016.
(2) Lease term is 15 years and expires January 14, 2014.
(3) Lease term is 15 years and expires July 15, 2020.
(4) Lease term is five years and expires September 30, 2012.
(5) Lease term is 21 years and expires December 31 2028.
(6) Lease term is one year and automatically renews in September each year.
(7) Lease is a tenant at will.
(8) Lease is a tenant at will.
(9) Lease term is three years and expires July 31, 2010.
(10) Lease is a tenant at will.

The Bank's investment division leases space at 202 US Route One, Falmouth, Maine, which has a term of five years and expires August 31, 2012. In addition, the Bank has purchased land in Windham, Maine and Northeast Bank Insurance Group, Inc. has purchased land in Jay, Maine.

Northeast Bank Insurance Group, Inc. (“NBIG”) exercised its option to purchase the building occupied by the Spence & Matthews Insurance Agency located at 4 Sullivan Square, Berwick, Maine from a senior officer of Northeast Bank Insurance Group, Inc. The transaction closed on June 24, 2009. The option price of $375,000 was determined at the time NBIG acquired the Spence & Mathews Agency in November 2007. The purchase transaction was subject to approval by the Board of Directors of Northeast Bank, the sole owner of Northeast Bank Insurance Group.

On December 13, 2007 and January 8, 2008, Northeast Bank Insurance Group, Inc. (“NBIG”) purchased from a company owned by the president of NBIG the land and building of the leased insurance agency offices in Anson, Mexico and Rangeley, Maine and a land lot in Jay, Maine. The purchase price totaled $516,000. The purchase price for each transaction was based upon an independent third party appraisal, except for the price of the land lot. The purchase transaction was subject to approval by the Board of Directors of Northeast Bank, the sole owner of NBIG.

On September 1, 2006, the Bank purchased its South Paris, Maine branch, previously leased from a member of our Board of Directors. The $400,000 purchase price was based upon an independent appraisal. The consideration paid was 5,000 shares of Company common stock and $297,000 in cash. The common stock issued was based on the market price on the day prior to the closing. This acquisition was not material to the balance sheet or the results of operations for the Company.

Item 3. Legal Proceedings

There are no pending legal proceedings to which the Company is a party or to which any of its property is subject. There are no material pending legal proceedings, other than ordinary routine litigation incidental to the business of banking, to which the Bank is a party or of which any of the Bank's property is the subject. There are no material pending legal proceedings to which any director, officer or affiliate of the Company, any owner of record beneficially of more than five percent of the common stock of the Company, or any associate of any such director, officer, affiliate of the Company or any security holder is a party adverse to the Company or has a material interest adverse to the Company or the Bank.

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

There were no matters submitted to a vote of the Company's shareholders during the fourth quarter of the fiscal year ended June 30, 2009.

Executive Officers of the Registrant

The name, age, and position of each executive officer of the Company and the Bank are set forth below along with such officer's business experience during the past five years. Officers are elected annually by the respective Boards of Directors of the Company and the Bank to hold office until the earlier of their death, resignation, or removal.

Name	Age	Position with Company and/or Bank
James D. Delamater	58	President and Chief Executive Officer (1)
Pender J. Lazenby	59	Chief Risk Officer
Marcel Blais	50	Chief Operating Officer
Robert S. Johnson	57	Chief Financial Officer (1)
Suzanne Carney	42	Clerk

(1) Each of these individuals serves both the Company and the Bank in the same capacities as indicated above.

James D. Delamater has been President, Chief Executive Officer, and a director of the Company and the Bank, since 1987.

Marcel Blais has been the Senior Vice President of the Bank – Chief Operating Officer since 1998. Mr. Blais joined the Company in 1997 as the Vice President of the Bank - Branch Administration. Prior to joining the Company he served as Vice President of Atlantic Bank from 1995 to 1997, and as Vice President - Branch Manager of Casco Bank from 1977 until 1995.

Robert S. Johnson has been the Chief Financial Officer of the Bank since December 2001. Prior to joining the company he served as Mortgage Controller of Banknorth Group from 1998 to 1999 and as President and Chief Financial Officer of Pepperell Bank & Trust from 1999 to 2001.

Pender J. Lazenby has been a director of the Company and the Bank since 2003. Mr. Lazenby has also served as the Senior Vice President Chief Risk Officer since February 2005 and prior to joining the Company served in a variety of positions with Fleet Boston and Bank Boston prior to its acquisition in 1999.

Suzanne Carney has been Clerk of the Bank since March 1999 and has been with the Company since 1994 in the Accounting Division.

There is no family relationship between any of the directors or executive officers of the Company.

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchase of Equity Securities

On September 11, 2007, the Company changed its listing from AMEX to NASDAQ. The common stock of Northeast Bancorp currently trades on the NASDAQ under the symbol "NBN". As of the close of business on September 1, 2009, there were approximately 2,321,332 shares of common stock outstanding held by approximately 414 stockholders of record.

The following table sets forth the high and low closing sale prices of the Company's Common Stock as reported on AMEX, and dividends paid during each quarter for periods indicated.

2008 – 2009	High	Low	Div Pd
Jul 1- Sep 30	11.97	9.44	.090
Oct 1 - Dec 31	11.03	6.54	.090
Jan 1 - Mar 31	8.80	6.61	.090
Apr 1 - Jun 30	10.86	7.35	.090

2007 – 2008	High	Low	Div Pd
Jul 1- Sep 30	18.63	15.82	.090
Oct 1 - Dec 31	17.30	13.72	.090
Jan 1 - Mar 31	15.53	13.31	.090
Apr 1 - Jun 30	14.79	11.17	.090

On September 18, 2009, the last reported sale price of the Company's Common stock as quoted on NASDAQ was $8.40. Holders of the Company's Common stock are entitled to receive dividends when and if declared by the Board of Directors out of funds legally available therefore. The amount and timing of future dividends payable on the Company's Common Stock will depend on, among other things, the financial condition of the Company, regulatory considerations, and other factors. Under the terms and condition of the Capital Purchase Program, dividends paid by the Company to common shareholders are restricted to $0.09 share per quarter. The Company is a legal entity separate from the Bank, but its revenues are derived primarily from the Bank. Accordingly, the ability of the Company to pay cash dividends on its stock in the future generally will be dependent upon the earnings of the Bank and the Bank's ability to pay dividends to the Company. The payment of dividends by the Bank will depend on a number of factors, including capital requirements, regulatory limitations, the Bank's results of operations and financial condition, tax considerations, and general economic conditions. Banking laws regulate and restrict the ability of the Bank to pay dividends to the Company. See "Item 1. Business - Supervision and Regulation".

There were no stock repurchases under the 2006 Stock Repurchase Plan for the year ended June 30, 2009.

Unregistered Sales of Equity Securities and Use of Proceeds

The following table provides the information on any purchase made by or on behalf of the Company of shares of Northeast Bancorp common stock during the indicated periods.

Period (1)	Total Number Of Shares Purchased (2)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program	Maximum Number of Shares that May Yet be Purchased Under The Program (3)
Apr. 1 – Apr. 30	-	-	-	58,400
May 1 – May 31	-	-	-	58,400
Jun. 1 – Jun. 30	-	-	-	58,400

(1) Based on trade date, not settlement date.

(2) Represents shares purchased in open-market transactions pursuant to the Company's 2006 Stock Repurchase Plan.

(3) On December 15, 2006, the Company announced that its Board of Directors of the Company approved the 2006 Stock Repurchase Plan pursuant to which the Company is authorized to repurchase in open-market transactions up to 200,000 shares from time to time until the plan expires on December 31, 2009, unless extended.

Item 6. Selected Financial Data

	2009	2008	2007	2006	2005
	At or for the Year Ended June 30,				
	(Dollars in thousands except for Per Share Data)				
Selected operations data:					
Interest income	$33,766	$35,398	$35,682	$35,456	$32,674
Interest expense	16,980	21,051	20,097	16,761	13,967
Net interest income	16,786	14,347	15,585	18,695	18,707
Provision for loan losses	2,168	836	989	1,226	1,302
Other operating income (1)	11,265	10,510	7,903	6,578	5,083
Net securities gains	268	293	42	17	68
Other operating expenses (2)	25,153	21,855	20,075	18,209	16,684
Income before income taxes	998	2,459	2,466	5,855	5,872
Income tax expense	39	528	579	1,851	1,853
Net income	$959	$1,931	$1,887	$4,004	$4,019
Net income available to common stockholders	$825	$1,931	$1,887	$4,004	$4,019
Consolidated per share data:					
Net income:					
Basic	$0.36	$0.82	$0.77	$1.61	$1.60
Diluted	$0.36	$0.82	$0.76	$1.59	$1.57
Cash dividends	$0.36	$0.36	$0.36	$0.36	$0.36
Selected balance sheet data:					
Total assets	$598,148	$598,274	$556,801	$562,918	$575,900
Loans receivable	393,651	409,194	425,571	435,663	461,052
Deposits	385,386	363,374	364,554	395,293	396,219
Borrowings	162,389	186,830	147,564	124,860	136,293
Total stockholders' equity	47,317	40,273	40,850	39,096	39,870
Other ratios:					
Return on average assets	0.16 %	0.33 %	0.34 %	0.70 %	0.71 %
Return on average equity	2.14 %	4.63 %	4.59 %	9.95 %	10.39 %
Average equity to average total assets	7.35 %	7.23 %	7.37 %	7.07 %	6.86 %
Common dividend payout ratio	101.14 %	44.10 %	46.77 %	22.40 %	22.65 %

(1) Includes primarily fees for deposit, investment brokerage and trust services to customers, insurance commission revenue
and gains on the sale of loans.
(2) Includes salaries, employee benefits, occupancy, equipment and other expenses.

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Item 7. Management's Discussion and Analysis of Results of Operations and Financial Condition

The Management's Discussion and Analysis of Results of Operations and Financial Condition, which follows, presents a review of the consolidated operating results of Northeast Bancorp, Inc. (the "Company") for the fiscal years ended June 30, 2009, 2008 and 2007. This discussion and analysis is intended to assist you in understanding the results of our operations and financial condition. You should read this discussion together with your review of the Company's Consolidated Financial Statements and related notes and other statistical information included in this report. Certain amounts in the years prior to 2009 have been reclassified to conform to the 2009 presentation.

A NOTE ABOUT FORWARD LOOKING STATEMENTS

This report contains certain "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, such as statements relating to our financial condition, prospective results of operations, future performance or expectations, plans, objectives, prospects, loan loss reserve adequacy, simulation of the impact of changes in interest rates, capital spending, and revenue sources. These statements relate to expectations concerning matters that are not historical facts. Accordingly, statements that are based on management's projections, estimates, assumptions, and judgments constitute forward-looking statements. These forward looking statements, which are based on various assumptions (some of which are beyond the Company's control), may be identified by reference to a future period or periods, or by the use of forward-looking terminology such as "believe", "expect", "estimate", "anticipate", "continue", "plan", "intend", “objective”, “goal”, “project”, or other similar terms or variations on those terms, or the future or conditional verbs such as "will", "may", "should", "could", and "would". In addition, the Company may from time to time make such oral or written "forward-looking statements" in future filings with the Securities and Exchange Commission (including exhibits thereto), in its reports to shareholders, and in other communications made by or with the approval of the Company.

Such forward-looking statements reflect our current views and expectations based largely on information currently available to our management, and on our current expectations, assumptions, plans, estimates, judgments, and projections about our business and our industry, and they involve inherent risks and uncertainties. Although we believe that these forward-looking statements are based on reasonable estimates and assumptions, they are not guarantees of future performance and are subject to known and unknown risks, uncertainties, contingencies, and other factors. Accordingly, we can not give you any assurance that our expectations will in fact occur or that our estimates or assumptions will be correct. We caution you that actual results could differ materially from those expressed or implied by such forward-looking statements due to a variety of factors, including, but not limited to, those related to the economic environment, particularly in the market areas in which the Company operates, competitive products and pricing, fiscal and monetary policies of the U.S. Government, changes in government regulations affecting financial institutions, including regulatory fees and capital requirements, changes in prevailing interest rates, acquisitions and the integration of acquired businesses, credit risk management, asset/liability management, changes in technology, changes in the securities markets, the availability of and the costs associated with sources of liquidity and changes in the current economic climate. Accordingly, investors and others are cautioned not to place undue reliance on such forward-looking statements. For a more complete discussion of certain risks and uncertainties affecting the Company, please see "Item 1. Business - Forward-Looking Statements and Risk Factors" set forth in our Form 10-K. These forward-looking statements speak only as of the date of this report and we do not undertake any obligation to update or revise any of these forward-looking statements to reflect events or circumstances occurring after the date of this report or to reflect the occurrence of unanticipated events.

CRITICAL ACCOUNTING POLICIES

Note 1 to the Consolidated Financial Statements contains a summary of Northeast Bancorp's significant accounting policies.

Allowance for Loan Losses

The allowance for loan losses represents management's estimate of probable losses inherent in the loan portfolio. The level of the allowance for loan losses is important to the presentation of the Company's results of operations and financial condition. The determination of what the loan loss allowance should be requires management to make subjective and difficult judgments, some of which may relate to matters that are inherently uncertain. Actual results may differ materially from these estimates and assumptions. This evaluation process is subject to numerous estimates and judgments. The frequency of default, risk ratings, and the loss recovery rates, among other things, are considered in making this evaluation, as are the size and diversity of individual large credits. Changes in these estimates could have a direct impact on the provision and could result in a change in the allowance. The larger the provision for loan loss, the greater the negative impact on our net income. Larger balance, non-homogeneous loans representing significant individual credit exposures are evaluated based upon the borrower's overall financial condition, resources, and payment record, the prospects for support from any financially responsible guarantors and, if appropriate, the realizable value of any collateral. The allowance for loan losses attributed to these loans is established through a process that includes estimates of historical and projected default rates and loss severities, internal risk ratings and geographic, industry, the regional economy and other factors. Management also considers overall portfolio indicators, including trends in internally risk-rated loans, classified loans, nonaccrual loans, and historical and forecasted write-offs, and a review of industry, geographic, and portfolio concentrations, including current developments. In addition, management considers the current business strategy and credit process, including credit limit setting and compliance, credit approvals, loan underwriting criteria and loan workout procedures. Each portfolio of smaller balance, homogeneous loans, including residential real estate and consumer loans, is collectively evaluated for impairment. The allowance for loan losses is established via a process that includes historical delinquency and credit loss experience, together with analyses that reflect current trends and conditions. Management also considers overall portfolio indicators, including historical credit losses, delinquent, non-performing and classified loans, trends in volumes, terms of loans, an evaluation of overall credit quality and the credit process, including lending policies and procedures and economic factors.

For a further description of our estimation process in determining the allowance for loan losses, see "Asset Quality" below.

GENERAL

Northeast Bancorp (the "Company") is a Maine corporation and a bank holding company registered with the Federal Reserve Bank of Boston ("FRB") under the Bank Holding Company Act of 1956. The Company also is a registered Maine financial institution holding company. The FRB is the primary regulator of the Company and the Company is also subject to regulation and examination by the Superintendent of the Maine Bureau of Financial Institutions. We conduct business from our headquarters in Lewiston, Maine and, as of June 30, 2009, from 11 banking offices, one financial center and 13 insurance agency offices located in western and south-central Maine, one insurance agency office located in Rochester, New Hampshire, and a mortgage loan production office in Portsmouth, New Hampshire. At June 30, 2009, we had consolidated assets of $598.1 million and consolidated stockholders' equity of $47.3 million.

Northeast Bancorp's principal asset is all the capital stock of Northeast Bank (the "Bank"), a Maine state-chartered universal bank. Accordingly, the Company's results of operations are primarily dependent on the results of the operations of the Bank. In addition to the Bank's eleven branch offices, its investment brokerage division has an office in Falmouth, Maine from which investment, insurance and financial planning products and services are offered. The Bank's wholly-owned subsidiary, Northeast Bank Insurance Group, Inc. ("NBIG"), offers personal and commercial property and casualty insurance products. Four of NBIG's fourteen insurance agency offices operate in our Auburn, Augusta, Bethel, and South Paris, Maine branches.

Business Strategy

The principal business of the Bank consists of attracting deposits from the general public and applying those funds to originate or acquire residential mortgage loans, commercial loans, commercial real estate loans, indirect consumer loans and consumer loans. The Bank sells residential mortgage and commercial real estate loans into the secondary market. The Bank also invests in mortgage-backed securities, securities issued by United States Government-sponsored enterprises and municipal securities. The Bank emphasizes the growth of noninterest sources of income from sale of residential mortgage loans, trust management, financial planning, investment brokerage and insurance commissions. The Bank's profitability depends primarily on net interest income, which is the difference between interest income earned from interest-earning assets (i.e. loans and investments) and interest expense incurred on interest-bearing liabilities (i.e. customer deposits and borrowed funds). Our net interest margin (net interest income as a percentage of average interest earning assets) is lower than our peers primarily due to our cost of funds. The Bank has focused on increasing the mix of demand deposit and non-maturing, interest-bearing deposit accounts which have a lower cost compared to certificates of deposit.

Our goal is to continue modest, but profitable, growth by increasing our loan and deposit market share in our existing markets in western and south-central Maine, closely managing the yields on interest earning assets and rates on interest-bearing liabilities, introducing new financial products and services, increasing the number of bank services per household, increasing noninterest income from expanded trust, investment and insurance brokerage services and controlling the growth of noninterest expenses. It also is part of our business strategy to make targeted acquisitions in our current market areas from time to time when opportunities present themselves. For the twelve months ended June 30, 2009, we acquired one insurance agency.

The Company's profitability is affected by the Bank's net interest income, which is affected by the measure known as interest rate spread, which is the difference between the average yield earned on its interest-earning assets and the average rate paid on its interest-bearing liabilities, or alternatively by interest margin, which is net interest income as a percentage of average interest-earning assets. Net income is also affected by the level of the provision for loan losses, noninterest income and noninterest expense of Northeast Bancorp and the Bank, and the effective tax rate. Noninterest income consists primarily of loan and deposit service fees, trust, investment brokerage and insurance commission revenue and gains on the sales of loans and investments. Noninterest expenses consist of compensation and benefits, occupancy related expenses, deposit insurance premiums paid to the FDIC, and other operating expenses, which include advertising, computer services, supplies, telecommunication and postage expenses.

Economic Conditions

We believe that our market area has generally witnessed an economic decline and a decrease in residential and commercial real estate values from 2008 through 2009. The economy and real estate markets in our market areas will continue to be significant determinants of the quality of our assets in future periods and our results of operations, liquidity and financial condition. We believe future

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economic activity will significantly depend on consumer confidence, consumer spending and business expenditures for new capital equipment, all of which are tied to strong employment.

EXECUTIVE SUMMARY

The following were significant factors comparing our results for fiscal 2009 to fiscal 2008:

- Strategic accomplishments during fiscal 2009 included:
  - o Increased noninterest income by 8%
  - o Increased customer deposits
  - o Exited the indirect lending business due to increasing delinquencies and credit losses
  - o Acquired the Goodrich Associates insurance agency in Berwick, Maine on May 15, 2009.

- Capital ratios for the Company and the Bank increased in fiscal 2009 compared to fiscal 2008, exceeding the regulatory definition for “well capitalized”.

o The Company participated in the Capital Purchase Program by selling $4.2 million of preferred stock and warrants to the U. S. Treasury in December, 2008. The Company contributed these proceeds as additional capital to the Bank.

- The allowance for loan losses was $5,764,000 at June 30, 2009, an increase of $108,000 compared to June 30, 2008. It increased as a percentage of total loans to 1.46% at June 30, 2009 compared to 1.38% at June 30, 2008. Total loans decreased $15.5 million during fiscal 2009.

- Net interest margin increased to 299 basis points in fiscal 2009 compared to 270 basis points in fiscal 2008, resulting in an increase in net interest income year over year. This increase in net interest margin was primarily due to a significant portion of our maturing certificates of deposit resetting to lower interest rates, lowering our overall cost of funds. Total average earning assets increased $28.7 million as a result of purchasing mortgage-backed securities, a leveraging strategy implemented in fiscal 2008. We reduced our wholesale funding, which includes FHLB advances, structured repurchase agreements, short-term borrowings, junior subordinated debentures, and other borrowings, by $23.9 million by increasing customer deposits.

- Net income decreased to $958,989 for fiscal 2009 compared to $1,931,289 for fiscal 2008, a decrease of $972,300. Increased net interest income and noninterest income were more than offset by increases in the provision for loan losses from higher net credit losses and noninterest expense from higher FDIC insurance costs, collection expenses and investment security impairment expense.

RESULTS OF OPERATIONS

Comparison of Fiscal Years Ended June 30, 2009 and 2008

Overview

For the fiscal year ended June 30, 2009 ("fiscal 2009"), we reported net income of $958,989, or $0.36 per diluted share, as compared to $1,931,289, or $0.82 per diluted share, for the fiscal year ended June 30, 2008 ("fiscal 2008"), an decrease of $972,300, or 50%. This decrease was attributable to an increase in the provision for loan losses and an increase in noninterest expense partially offset by an increases in net interest income and noninterest income. The return on average assets was 0.16% in fiscal 2009 compared to 0.33% in fiscal 2008. The return on average equity was 2.1% in fiscal 2009 compared to 4.63% in fiscal 2008. The decrease in our return on average assets and return on average equity was primarily due to the decrease in net income. Average assets increased $31.7 million in fiscal 2009 compared to fiscal 2008, also contributing to the decrease in the return on average assets. Similarly, average equity increased $3.0 million primarily from the sale of preferred stock and contributed to the decrease in the return on average equity.

Net interest income increased by 17% in fiscal 2009 as compared to fiscal 2008. This increase was primarily due to an increase in our net interest margin of 29 basis points compared to fiscal 2008. Average interest earning assets increased approximately $28.7 million as compared to the average interest earning assets in fiscal 2008. Noninterest income increased 7% during fiscal 2009, primarily from increased insurance commission revenue, gain on sale of residential real estate loans, and higher fees and services charges on loans and deposits. These increases were partially offset by lower investment brokerage commission revenue and lower net securities gains. The provision for loan losses increased 159% primarily due to an increase in net credit losses of $1.1 million in fiscal 2009 compared to fiscal 2008. Noninterest expense increased 15% during fiscal 2009, which was primarily due to the full year impact of three insurance agency acquisitions completed in fiscal 2008, including the amortization of intangibles, increases in benefits expense, FDIC insurance expense, loan collection expense and investment security impairment expenses.

Net Interest Income

Net interest income increased by $2,438,807, or 17%, during fiscal 2009, primarily as a result of an increase in net interest margin. Average interest earning assets also increased $28.7 million, or 5%, during fiscal 2009 resulting from an increase in average available-for-sale securities of $35.5 million and an increase in average interest-bearing deposits and regulatory stock of $2.4 million, partially offset by a decrease in average loans of $9.7 million. The increase in average investment securities was due to increases in mortgage-backed securities which were used as collateral for structured repurchase agreements, FHLB advances and letters of credit, and securities sold under agreements to repurchase. The overall decrease in average loans was due to the decrease in average residential real estate, commercial and consumer loans of $19.3 million which was partially offset by a $9.6 million increase in commercial real estate and construction loans. Average interest-bearing deposits increased by $6.0 million, or 2%, during fiscal 2009 primarily due to an increase in average money market, which increased by $15.2 million, or 111%, partially offset by the decrease in brokered deposits of $4.1 million and NOW accounts of $5.3 million, or 10%. Average short-term borrowings increased during fiscal 2009 by $2.0 million, or 6%. Average borrowings increased $19.2 million, or 14%, primarily from structured repurchase agreements and advances from Fed Discount Window borrower-in-custody program. The yield on average interest earning assets decreased 62 basis points, to 5.98%, in fiscal 2009. The cost of funds decreased 99 basis points, to 3.23%, due to a decrease in the cost of interest-bearing deposits. Table 1 provided in Item 8 of this Form 10-K shows the average balances, yields and rates of assets, liabilities, and stockholders' equity of the Company for the past three years. The table below shows the changes from 2008 to 2009 in net interest income by category due to changes in rate and volume.

Rate/Volume Analysis for the Year Ended
June 30, 2009 versus June 30, 2008

	Difference Due to		
	Volume	Rate	Total
Investments	$1,844,748	$170,156	$2,014,904
Loans, net	(639,281)	(2,744,528)	(3,383,809)
FHLB deposits & other	63,597	(323,424)	(259,827)
Total interest-earning assets	1,269,064	(2,897,796)	(1,628,732)
Deposits	233,359	(3,955,032)	(3,721,673)
Short-term borrowings	67,327	(593,674)	(526,347)
Borrowings	882,612	(705,158)	177,454
Total interest-bearing liabilities	1,183,298	(5,253,864)	(4,070,566)
Net interest income	$85,766	$2,356,068	$2,441,834

Rate/volume amounts which are partly attributable to rate and volume are spread proportionately between Volume and Rate based on the direct change attributable to rate and volume. Borrowings in the table above include FHLB advances, obligation under capital leases, structured repurchase agreements and junior subordinated debentures. The adjustments to interest income and yield required to make the presentation on a fully tax equivalent basis were $203,504 and $200,477 for the twelve months ended June 30, 2009 and 2008, respectively.

Provision for Loan Losses

The provision for loan losses in fiscal 2009 was $2,167,515, an increase of $1,331,031, or 159%, compared to fiscal 2008. Net charge-offs were $2,059,515 in fiscal 2009 compared to $936,484 in fiscal 2008, an increase of $1,123,031. The increase in charge-offs was the primary reason for the increase in the provision for loan losses for fiscal 2009. The impact of the decrease in loans on the provision for loan losses was offset by increases in loan delinquency, classified and criticized loans, net losses and nonperforming loans for fiscal 2009. Of the total net charge offs in fiscal 2009, indirect consumer loans accounted for $1,077,431, a 190% increase in fiscal 2009 compared to fiscal 2008. Net charge-offs to average loans outstanding was 0.51% in fiscal 2009 compared to 0.23% in fiscal 2008.

The allowance for loan losses at June 30, 2009 was $5,764,000 as compared to $5,656,000 at June 30, 2008, an increase of $108,000, or 2%. The ratio of the allowance to total loans was 1.46% at June 30, 2009 compared to 1.38% at June 30, 2008. The ratio of the allowance for loan losses to nonperforming loans was 58% at June 30, 2009 and 73% at June 30, 2008. The decrease in this ratio reflects an increase of $2,191,000 in nonperforming loans, to $9,894,000, primarily from nonperforming residential real estate and commercial real estate loans. Since our quarterly testing of the allowance for loans losses includes nonperforming loans, management believes the allowance for loan losses is sufficient to absorb the estimated credit losses associated with nonperforming loans. Of total non-performing loans at June 30, 2009, $3,352,000 was current with principal and interest payments. Nonperforming loans were 2.51% of total loans at June 30, 2009 as compared to 1.88% at June 30, 2008. The increase in the ratio of nonperforming loans to total loans was due to the increase in nonperforming loans and a decrease in total loans comparing fiscal 2009 to fiscal 2008. For additional information on the allowance for loan losses, see “Critical Accounting Policies” above, and see “Asset Quality” below for additional discussion on loans.

Noninterest Income

Noninterest income for the fiscal years ended June 30, 2009 and 2008 was $11,533,251 and $10,803,224, respectively, an increase of $730,027, or 7%, in fiscal 2009. Most of this increase was due to the increase in insurance commission income and gain from sale of loans.

Fees for other services to customers of $1,103,681 increased $9,638, or 1%, during fiscal 2009. This increase was due to higher overdraft, ATM and debit card fee revenue as compared to fiscal 2008.

Net securities gains, of $268,373, decreased $24,728, or 8%, during fiscal 2009. The gains in fiscal 2009 primarily resulted from restructuring the bond portfolio by selling mortgage-backed securities with significant extension risk in a rising rate environment. Extension risk is the increase in average lives of mortgage-backed securities based on the estimated reduction in loan principal prepayments as interest rates increase. Gains from the sale of equity and bond securities are subject to market and economic conditions, and there can be no assurance that gains reported in prior periods will be achieved in the future.

Gains on the sales of loans of $1,519,226 increased $904,632, or 147%, during fiscal 2009. This increase was due to increased volume of residential real estate loans sold as the Bank increased the number of mortgage loan originators during fiscal 2009. Sold loan volume is subject to changing interest rates. Fixed rate residential real estate loans are sold to reduce our exposure to interest rate risk.

Investment commission revenue of $1,588,656 decreased $634,279, or 29%, during fiscal 2009. This decrease was primarily due to the equity market conditions in 2009.

Insurance commissions of $5,864,743 increased $500,463, or 9%, during the fiscal year 2009. The increase resulted from the full year impact of the acquisition of the Hartford, Spence & Mathews and Hyler insurance agencies acquired in fiscal 2008, accounting for $950,198, and the Goodrich Associates acquisition, accounting for $12,062, with these increases partially offset by a decrease in net bonus payments of $377,807 and a decrease in commission revenue of $83,990 from agency offices acquired prior to fiscal 2008.

Bank owned life insurance (BOLI) income of $491,309 increased $34,111, or 7%, during fiscal 2009. This increase was due to a full year impact of additional policies purchased in fiscal 2008. The average interest yield, net of mortality cost, was 3.98% in fiscal 2009 compared to 4.07% in fiscal 2008. The additions to cash surrender value are based on this average interest yield. These interest rates are determined by the life insurance companies and are reset quarterly or annually. Each policy is subject to minimum interest rates.

Other noninterest income of $651,926 decreased $69,663, or 10%, during fiscal 2009. This decrease was primarily due to decreases in trust income of $59,263 and gains from the trading of covered call options of $34,558, partially offset by the increase in loan servicing fees of $37,580.

Noninterest Expense

Noninterest expense for fiscal years ended June 30, 2009 and 2008 was $25,153,569 and $21,854,454, respectively, an increase of $3,299,115, or 15%. Our efficiency ratio, which is noninterest expense as a percentage of the total of net interest income and noninterest income, increased to 88.8% during fiscal 2009 from 86.9% in fiscal 2008. The increase in operating expenses, resulting from the full year impact of the insurance agencies acquired in fiscal 2008 and increases in group medical benefits claims expense, FDIC insurance expense and collection expense in 2009 compared to the prior year, offset the increases in net interest income and noninterest income resulting in the increase in the efficiency ratio.

Salaries and employee benefits expense of $14,442,398 increased $1,423,000, or 11%, during the fiscal year 2009. This increase includes the salary and employee benefits full year impact from insurance agency acquisitions in fiscal 2008 of $631,365, an increase in group medical benefits expense for our insurance agency and bank of $695,326 due to increased claims in our self-insured group medical plan and an increase in temporary help, deferred compensation and other benefits of $96,309. Total full-time equivalent employees were 248 compared to 244 at June 30, 2009 and 2008, respectively.

Occupancy expense of $1,810,019 increased $17,192, or 1%, during the fiscal 2009. This increase was primarily due to increased ground maintenance, utilities, janitorial, and depreciation expense related to the insurance agencies offices acquired in fiscal 2008 and the new building added to the South Paris branch totaling $85,331. These increases were partially offset by a decrease in rent expense and building repair and maintenance expense of $68,139.

Equipment expense of $1,603,519 increased $16,222, or 1%, during the fiscal 2009. The increase was due to depreciation and computer repairs and maintenance expense. These expenses were partially offset by decreases in software and vehicle depreciation expense and personal property tax expense compared to fiscal 2008.

Intangible asset amortization of $747,947 increased $137,290, or 22%, in fiscal 2009 from the full year impact of amortization of customer list and non-compete intangibles from insurance agency acquisitions in fiscal 2008.

Other expense of $6,549,686 increased $1,705,411, or 35%, during fiscal year 2009. This increase compared to fiscal 2008 was due to an increase in FDIC insurance expense, of $519,716 associated with the increased cost of deposit insurance coverage to $250,000 combined with the special assessment at June 30, 2009 of $275,000 (based on total assets of the Bank less its Tier I capital), an increase in computer services expense of $190,220 resulting from higher item processing, Internet banking processing and conversions to our core software systems of recently acquired insurance agencies, collection and loan expense increasing $538,960 from the increase in the volume of loan workouts and collateral recovery, an increase in other losses of $100,000 resulting from the settlement of a lawsuit and an increase in other-than-temporary impairment expense on equity and non-marketable securities of $428,209 and $10,005, respectively, for fiscal 2009 compared to $147,247 and $47,020, respectively, in fiscal 2008, resulting in aggregate increase of $243,947. These other-than-temporary impairment expenses resulted from the periodic analysis by management of impaired securities under which management determined that recovery of cost was unlikely within a reasonable period of time for certain equity, bank–issued trust preferred securities, and non-marketable securities. The impairment expense includes $98,730 of credit component impairment on debt securities in accordance with FSP FAS 115-2 and FAS 124-2. The $112,568 balance was attributable to professional fees, advertising, and postage expense increases, partially offset by decreases of in other insurance, supplies expense, deposit expense, and dues and subscriptions expense.

The Company's effective tax rate was 3.9% and 21.5% for the fiscal years ended June 30, 2009 and 2008, respectively. See Note 12 in the Consolidated Financial Statements for additional information.

Comprehensive Income

The Company's comprehensive income was $3,714,205 and $2,541,763 during 2009 and 2008, respectively. Comprehensive income differed from our net income in 2009 and 2008 due to the change in the fair value of available-for-sale securities, net of income tax. In fiscal 2009, there was a net increase in fair value of $2,755,216 attributable to an increase in net unrealized gains on available-for-sale securities, net of income tax. There was a net increase in fair value in fiscal 2008 of $610,474. See the Consolidated Statements of Changes in Shareholders' Equity and Note 16 in the Consolidated Financial Statements for additional information.

Comparison of Fiscal Years Ended June 30, 2008 and 2007

Overview

For the fiscal year ended June 30, 2008 ("fiscal 2008"), we reported net income of $1,931,289, or $0.82 per diluted share, as compared to $1,886,677, or $0.76 per diluted share, for the fiscal year ended June 30, 2007 ("fiscal 2007"), an increase of $44,612, or 2%. This increase was attributable to a decrease in the provision for loan losses and an increase in noninterest income which was partially offset by a decrease in net interest income due to a decrease in net interest margin and increased noninterest expense. The return on average assets was 0.33% in fiscal 2008 compared to 0.34% in fiscal 2007. The return on average equity was 4.63% in fiscal 2008 and 4.59% in fiscal 2007. The small decrease in our return on average assets was due to the $19.3 million increase in average earning assets in fiscal 2008 compared to fiscal 2007. The increase in the return on average equity was due to increased net income for fiscal 2008 and a relatively constant level of shareholders' equity.

Net interest income decreased by 8% in fiscal 2008. This decrease was primarily due to a decrease in our net interest margin of 29 basis points compared to fiscal 2007. Average interest earning assets increased approximately $11.3 million as compared to the average interest earning assets in fiscal 2007 due to the increase in average available for sale securities of $31.8 million, partially offset by a decrease in average loans of $18.7 million and a decrease in average interest-bearing deposits and regulatory stock of $1.8 million. Noninterest income increased 36% during fiscal 2008, primarily from increased insurance commission revenue, higher fees and services charges on loans and deposits and net securities gains. These increases were partially offset by lower brokerage commission revenue and lower gains on the sale of residential real estate and commercial real estate loans. The provision for loan losses decreased 15% primarily due to a decrease in total loans. Noninterest expense increased 9% during fiscal 2008, which was primarily due to increases in salaries and employee benefits expense, equipment expense, amortization of intangibles associated with the three insurance agency acquisitions in fiscal 2008, the full year impact of four insurance agency acquisitions completed in fiscal 2007 and other expenses.

Net Interest Income

Net interest income decreased by $1,238,688, or 8%, during fiscal 2008, primarily as a result of the increased volume of average borrowings contributing to an increase in the cost of funds. Average interest earning assets increased $11.3 million during fiscal 2008 due to a $31.8 million increase in average investment securities that was partially offset by an $18.7 million decrease in average loans. Regulatory stock and interest-bearing deposits decreased $1.8 million. The decrease in average residential real estate, construction, commercial real estate and commercial loans of $22.6 million was partially offset by a $3.9 million increase in consumer loans. The increase in average investment securities was due to increases in mortgage-backed securities used as collateral for structured repurchase agreements, FHLB advances and securities sold under agreements to repurchase. Average interest-bearing deposits decreased by $13.8 million, or 4%, during fiscal 2008 primarily due to a decrease in average brokered deposits, which decreased by $19.3 million. Excluding the decrease in brokered deposits, average other deposits increased $5.5 million. Average short-term borrowings decreased during fiscal 2008 by $1.7 million, or 5%. Average borrowings increased, primarily due to structured repurchase agreements and debt incurred in the acquisition of insurance agencies. The yield on average interest earning assets decreased 19 basis points, to 6.60%, in fiscal 2008. The cost of funds increased 2 basis points, to 4.22%, due to an increase in the cost of interest-bearing deposits. Table 1 provided in Item 8 of this Form 10-K shows the average balances, yields and rates of assets, liabilities, and stockholders' equity of the Company for the past three years. The table below shows the changes from 2007 to 2008 in net interest income by category due to changes in rate and volume.

Rate/Volume Analysis for the Year Ended
June 30, 2008 versus June 30, 2007

	Difference Due to		
	Volume	Rate	Total
Investments	$1,574,259	$335,033	$1,909,292
Loans, net	(1,334,395)	(760,382)	(2,094,777)
FHLB deposits & other	(68,000)	(28,650)	(96,650)
Total interest-earning assets	171,864	(453,999)	(282,135)
Deposits	(549,860)	149,563	(400,297)
Repurchase agreements	(68,165)	(192,329)	(260,494)
Borrowings	1,818,309	(203,511)	1,614,798
Total interest-bearing liabilities	1,200,284	(246,277)	954,007
Net interest income	$(1,028,420)	$(207,722)	$(1,236,142)

Rate/volume amounts which are partly attributable to rate and volume are spread proportionately between Volume and Rate based on the direct change attributable to rate and volume. Borrowings in the table above include FHLB advances, obligation under capital leases, structured repurchase agreements and junior subordinated debentures. The adjustments to interest income and yield required to make the presentation on a fully tax equivalent basis were $200,477 and $197,931 for the twelve months ended June 30, 2008 and 2007, respectively.

Provision for Loan Losses

The provision for loan losses in fiscal 2008 was $836,484, a decrease of $152,674, or 15%, compared to fiscal 2007. This decrease in the provision for loan losses reflects the overall decrease in loans of approximately $16.4 million. The impact of this decrease in loans on the provision for loan losses was partially offset by increases in loan delinquency, classified and criticized loans, net losses and nonperforming loans for fiscal 2008. Net charge-offs were $936,500 in fiscal 2008 compared to $729,200 in fiscal 2007. This $207,300 increase was primarily in charge-offs of commercial real estate and indirect consumer loans. Net charge-offs to average loans outstanding was 0.23% in fiscal 2008 compared to 0.17% in fiscal 2007.

The allowance for loan losses at June 30, 2008 was $5,656,000 as compared to $5,756,000 at June 30, 2007, a decrease of $100,000, or 2%. The ratio of the allowance to total loans was 1.38% at June 30, 2008 compared to 1.35% at June 30, 2007. The ratio of the allowance for loan losses to nonperforming loans was 73% at June 30, 2008 and 113% at June 30, 2007, reflecting a decrease of $100,000 in the allowance for loan losses and a $2,613,000 increase in nonperforming loans, to $7,703,000, primarily due to nonperforming residential real estate and commercial loans. Since our quarterly testing of the allowance for loans losses includes nonperforming loans, management believes the allowance for loan losses is sufficient to absorb the estimated credit loss associated with nonperforming loans. Of total non-performing loans at June 30, 2008, $2,510,000 was current with principal and interest payments. Nonperforming loans were 1.88% of total loans at June 30, 2008 as compared to 1.20% at June 30, 2007, also due to the increase in nonperforming loans and a decrease in total loans. For additional information on the allowance for loan losses, see "Critical Accounting Policies" above, and see "Asset Quality" below for additional discussion on loans.

Noninterest Income

Noninterest income for the fiscal years ended June 30, 2008 and 2007 was $10,803,224 and $7,944,827, respectively, an increase of $2,858,397, or 36%, in fiscal 2008. Most of this increase was due to the increase in insurance commission income and gain from sale of securities.

Fees for other services to customers of $1,094,043 increased $51,395, or 5%, during fiscal 2008. This increase was due to higher ATM and debit card fee revenue as compared to fiscal 2007.

Net securities gains of $293,101 increased $250,752, or 592%, during fiscal 2008. The volume of securities sold in fiscal 2008 increased from fiscal 2007 due to restructuring the bond portfolio by selling U.S. government enterprise bonds and replacing them with higher yielding mortgage-backed securities. Gains from the sale of equity and bond securities are subject to market and economic conditions, and there can be no assurance that gains reported in prior periods will be achieved in the future.

Gains on the sales of loans of $614,594 decreased $294,213, or 32%, during fiscal 2008. This decrease was primarily due to gains on the sales of commercial loans of $31,197 in fiscal 2008 compared to $455,680 in fiscal 2007. Gains on the sales of residential real estate loans were $583,397, an increase of $130,270 over fiscal 2007. Sold loan volume is subject to changing interest rates. Fixed rate residential real estate loans are sold to reduce our exposure to interest rate risk.

Investment commission revenue of $2,222,935 decreased $162,183, or 7%, during fiscal 2008. This decrease was primarily due to the equity market conditions in 2008.

Insurance commissions of $5,364,280 increased $3,033,845, or 130%, during the fiscal year 2008. The full year impact of the acquisition of the Palmer, Sturtevant & Ham, Southern Maine, and Russell insurance agencies acquired in fiscal 2007 accounted for $712,583 of the increase, and the partial year impact of the Hartford, Spence & Mathews and Hyler insurance agencies acquired in fiscal 2008 accounted for $1,663,949. The balance of the increase was due to contingent and growth bonus payments.

Bank owned life insurance (BOLI) income of $457,198 increased $68,585, or 18%, during fiscal 2008. This increase was due to purchasing one new general account policy of $2,000,000 in bank owned life insurance and an increase in the average interest yield, net of mortality cost, to 4.07% in fiscal 2008 from 3.85% in fiscal 2007. The additions to cash surrender value are based on this average interest yield. These interest rates are determined by the life insurance companies and are reset quarterly or annually. Each policy is subject to minimum interest rates.

Other noninterest income of $721,589 decreased $84,935, or 11%, during fiscal 2008. This decrease was primarily due to the fiscal 2007 gain on sale of fixed assets of $73,963 from the sale of the former Lisbon Falls branch building and land, with no such corresponding transaction occurring in fiscal 2008, and a decrease in gains from the trading of covered call options of $10,639.

Noninterest Expense

Noninterest expense for fiscal years ended June 30, 2008 and 2007 was $21,854,454 and $20,075,186, respectively, an increase of $1,779,268, or 9%. The increase in fiscal 2008 was primarily due to an increase in salaries and employee benefits, intangible assets amortization and other expenses from the insurance agency acquisitions. Our efficiency ratio, which is noninterest expense as a percentage of the total of net interest income and noninterest income, increased to 86.9% during fiscal 2008 from 85.3% in fiscal 2007. The increase in operating expenses from the insurance agency acquisitions and the decrease in net interest income in fiscal 2008 compared to the prior year contributed to the increase in the efficiency ratio.

Salaries and employee benefits expense of $13,019,398 increased $997,361, or 8%, during the fiscal year 2008. This increase included the salary and benefits of staff addition from insurance agency acquisitions of $1,275,909, partially offset by a decrease in deferred compensation expense of $233,478 and salary expense savings from unfilled positions. Total full-time equivalent employees were 244 compared to 214 at June 30, 2008 and 2007, respectively.

Occupancy expense of $1,792,827 increased $70,446, or 4%, during the fiscal year 2008. This increase was primarily due to increased ground maintenance, utilities and rent expense related to the insurance agencies acquired. These increases were partially offset by a decrease in amortization expense.

Equipment expense of $1,587,297 increased $56,021, or 4%, during the fiscal year 2008. The increase was due to higher depreciation and computer repairs and maintenance expense. These expenses were partially offset by lower furniture and equipment depreciation expense.

Other expense of $4,844,275 increased $359,367, or 8%, during fiscal year 2008. This increase was due to increases in professional fees, advertising expense, FDIC insurance, collections, deposit fraud losses, telephone, travel and dues and subscriptions expense. Other noninterest expense includes other-than-temporary write-downs on equity and non-marketable securities of $147,247 and $47,020, respectively, for fiscal 2008 compared to $50,442 and $248,482, respectively, in fiscal 2007, an aggregate decrease of $104,657. These other-than-temporary write-downs resulted from the periodic analysis by management of impaired securities whereby management determined that recovery of cost was unlikely within a reasonable period of time for certain equity and non-marketable securities. Also partially offsetting these increases were decreases in postage and supplies expense.

The Company's effective tax rate was 21.5% and 23.5% for the fiscal years ended June 30, 2008 and 2007, respectively. See Note 12 in the Consolidated Financial Statements for additional information.

Comprehensive Income

The Company's comprehensive income was $2,541,763 and $2,594,600 during 2008 and 2007, respectively. Comprehensive income differed from our net income in 2008 and 2007 due to the change in the fair value of available-for-sale securities, net of income tax. In fiscal 2008, there was a net increase in fair value of $610,474 attributable to a decrease in net unrealized loss on available-for-sale securities, net of income tax. There was a net increase in fair value in fiscal 2007 of $707,923. See the Consolidated Statements of

Changes in Shareholders' Equity and Note 16 in the Consolidated Financial Statements for additional information.

FINANCIAL CONDITION

The Company's total assets decreased $125,520, or less than 1%, to $598,148,130 at June 30, 2009 compared to $598,273,650 at June 30, 2008. This decrease was primarily due to a $15,651,207 decrease in net loans partially offset by an increase of $13,927,163 in available for sale securities and an increase of $1,951,015 in loans held-for-sale. Stockholders' equity totaled $47,316,880 and $40,273,312 at June 30, 2009 and 2008, respectively, an increase of $7,043,568. Stockholders' equity was increased by proceeds from the sale of preferred stock to the US Treasury under the Capital Purchase Program of $4,200,994, net income of $958,989, an increase in unrealized gains on available-for-sale securities of $2,755,216, stock options exercised and stock grants totaling $52,228, partially offset by the payment of cash dividends on common and preferred stock of $923,859.

Cash and Cash Equivalents

Average cash and cash equivalents (cash and due from bank and short-term investments) increased $2,105,214, or 23%, to $11,393,608, in fiscal 2009 as compared to $9,288,394 in fiscal 2008. This increase was due to an increase in interest-bearing deposits, primarily margin accounts, with the issuers of our structured repurchase agreements.

Investments Securities and Other Interest-earning Assets

The average balance of the available-for-sale securities portfolio was $152,050,639 and $116,558,331 for fiscal 2009 and fiscal 2008, respectively. This increase of $35,492,308, or 30%, was primarily due to a leverage strategy executed through increasing mortgage-backed securities funded with structured and wholesale repurchase agreements. The structured repurchase agreements were imbedded primarily with purchased interest rate caps to reduce the interest rate risk our liability sensitive balance sheet (interest-bearing liabilities repricing more quickly than interest-bearing assets) has to rising interest rates. The portfolio is comprised of U.S. Government-sponsored enterprise bonds and mortgage-backed securities, municipal securities, and equity and bank-issued trust preferred securities, with 89% of our investment portfolio consisting of U.S. Government-sponsored enterprise mortgage-backed securities and short-term U.S. Government-sponsored enterprise bonds. See Item 8, Tables 2 and 3, for a detail of available-for-sale securities and investment maturities, respectively, and note 8 of the consolidated financial statements for details on the structured repurchase agreements

All of the Company's securities are classified as available-for-sale and were carried at fair value of $148,410,140 and $134,482,977 as of June 30, 2009 and 2008, respectively. These securities had net unrealized gains after taxes of $1,451,144 at June 30, 2009 and net unrealized losses after tax of $1,304,072 at June 30, 2008. See Note 2 to the Consolidated Financial Statements. These unrealized gains and losses do not impact net income or regulatory capital, but are recorded as an adjustment to stockholders' equity, net of related deferred income taxes, and are a component of comprehensive income contained in the Consolidated Statements of Changes in Stockholders' Equity.

Loans

The average balance for loans, including loans held for sale, was $405,610,821 in fiscal 2009, compared to $414,837,099 in fiscal 2008. This decrease of $9,226,278, or 2%, in our average balance for loans at June 30, 2009, was attributable to decreases in average residential real estate, commercial, and consumer loans, partially offset by an increase in average commercial real estate and construction loans. See Item 8, Tables 4 and 5, for additional information on the composition of the loan portfolio and loan maturities, respectively.

Residential real estate loans averaged $141,059,082 in fiscal 2009, as compared to $144,084,050 in fiscal 2008. This decrease of $3,024,968, or 2%, was attributable to a decrease in residential real estate loans partially offset by an increase in loans held-for-sale. We continued to sell most of the 15 year and 30 year fixed rate residential real estate loans originated by us into the secondary market. Residential real estate loans were 35% of the total loan portfolio at June 30, 2009, compared to 34% at 2008. Of residential real estate loans at June 30, 2009, approximately 37% were variable rate products, compared to 34% at June 30, 2008. This increase in the percentage of variable rate products resulted from an increase in home equity lines of credit and customers refinancing from variable rate products to fixed rate products, which were subsequently sold into the secondary market.

Commercial real estate loans increased and commercial loans decreased during fiscal 2009. The increase in commercial loans reflects the increased market opportunity as competitors focused on problem loans. The decrease in commercial loans reflects the Bank's efforts to tighten its credit underwriting standards as delinquencies and classified and criticized loans increased, and priced these loans to reflect risk. Generally, competition for new and renewing commercial real estate and commercial loans has been intense.

Commercial real estate loans averaged $114,686,143 in fiscal 2009 and $106,810,660 in fiscal 2008. This increase of $7,875,483, or 7%, reflects the factors noted above. Our focus was to lend primarily to small businesses within our market areas. This portfolio consists of loans secured primarily by income-producing commercial real estate and multifamily residential real estate. Commercial real estate loans were 31% and 27% of the total loan portfolio at June 30, 2009 and 2008, respectively. Approximately 95% of the commercial real estate loans were variable rate product, with this portfolio reflecting our desire to minimize the interest rate risk, at both June 30, 2009 and 2008, respectively.

Construction loans averaged $7,329,835 in fiscal 2009 and $5,629,860 in fiscal 2008. This increase of $1,699,975, or 30%, was primarily in commercial construction loans. Construction loans were 2% and 1% of the total loan portfolio at June 30, 2009 and 2008, respectively. Most construction loans are subject to interest rates based on the prime rate, have contractual maturities less than 12 months, and disbursements are made on construction-as-completed basis and verified by inspection. Approximately 51% of the construction loans were variable rate product at June 30, 2009, compared to approximately 37% at June 30, 2008.

Commercial loans averaged $29,880,572 in fiscal 2009 and $36,385,671 in fiscal 2008. This decrease of $6,505,099, or 18%, reflects the above factors. Commercial loans were 8% of total loans at June 30, 2009 and 2008, respectively. Variable rate products comprised 70% and 67% of this loan portfolio at June 30, 2009 and 2008, respectively. The commercial loan credit risk exposure is highly dependent on the cash flow of the customer's business. The Company mitigates credit risk by strictly adhering to our underwriting and credit policies.

Consumer and other loans averaged $110,286,010 in fiscal 2009 and $119,194,281 in fiscal 2008. This decrease of $8,908,271, or 7%, was attributable to the Bank exiting the indirect vehicle loan business in October 2008. Consumer and other loans comprised 25% and 29% of the total loan portfolio at June 30, 2009 and 2008, respectively. Consumer and other loans, including indirect auto and recreational vehicle, are mostly fixed rate products. At June 30, 2009 and 2008, we held $25,862,715 and $34,980,847 of indirect auto loans, respectively. Indirect auto, indirect RV and indirect mobile home loans together comprised approximately 94% and 95% of total consumer and other loans, at June 30, 2009 and 2008, respectively. The detail of consumer loans at June 30, 2009 and 2008 appears in the following table. Management attempts to mitigate credit and interest rate risk by keeping the products offered short-term, earning a rate of return commensurate with the risk, and lending to individuals in the Company's known market areas. We experienced a decrease in consumer loan delinquency from 2.73% to 2.28% and a decrease in non-performing from $640,000 to $574,000 for the fiscal years ended June 30, 2008 and 2009, respectively. Net charge-off of consumer loans increased from $585,000 to $1,376,000 for the fiscal years ended June 30, 2008 and 2009, respectively.

Consumer Loans

	June 30, 2009	% of Total		June 30, 2008	% of Total	
Indirect Auto	$ 25,862,715	27	%	$ 34,980,847	30	%
Indirect RV	46,002,568	48	%	54,915,583	47	%
Indirect Mobile Home	18,874,678	19	%	21,759,537	18	%
Subtotal Indirect	90,739,961	94	%	111,655,967	95	%
Other	5,725,006	6	%	5,390,792	5	%
Total	$ 96,464,967	100	%	$ 117,046,759	100	%

BOLI averaged $12,531,526 in fiscal 2009 and $11,240,716 in fiscal 2008. This increase was $1,290,810, or 11%, and reflects the full year impact of one new general account policy that was purchased in fiscal 2008 for $2,000,000. BOLI assets were invested in the general account of three insurance companies and separate accounts in a fourth insurance company. A general account policy’s cash surrender value is supported by the general assets of the insurance company. A separate account policy’s cash surrender value is supported by assets segregated from the general assets of the insurance company. Standard and Poor's rated these companies A+ or better at June 30, 2009. Interest earnings, net of mortality costs, increase the cash surrender value. These interest earnings are based on interest rates reset each year, subject to minimum interest rates. The increases in cash surrender value offset all or a portion of the increase in employee benefit costs. The increase in cash surrender value was recognized in other income and was not subject to income taxes. Borrowing on or surrendering the policy may subject the Bank to income tax expense on the increase in cash surrender value. For these reasons, management considers BOLI an illiquid asset. BOLI represented 24.08% of capital plus the allowance for loan losses at June 30, 2009.

Goodwill and intangible average assets were $4,406,778 and $8,139,464, respectively, for fiscal 2009, and $4,306,182 and $6,819,158, respectively, for fiscal 2008. These increases resulted from the full year impact of three insurance agencies acquired during fiscal 2008 and one insurance agency during fiscal 2009. The allocation of the purchase price paid for the insurance agency acquisition in fiscal 2009 in excess of tangible assets acquired added $100,160 to goodwill and $615,000 to intangibles in the form of customer lists and non-compete agreements. These intangibles are being amortized over lives from 11 to 24 years, with an average life of 13.59 years and a remaining average life of 12.40 years. Goodwill and intangibles are subject to impairment testing annually. No impairment expense was recognized in fiscal 2009 or fiscal 2008.

Deposits

Average demand deposit accounts were $33,615,942 for the year ended June 30, 2009 as compared to $33,317,154 in fiscal 2008. The increase was $298,788, or 1%.

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Average interest-bearing deposits increased by $5,962,833, or 2%, during fiscal 2009 to $334,720,811. This increase was primarily due to increased money market and certificates of deposit balances, a total of $16,266,828. This increase was partially offset by decreases in average NOW balances of $5,324,620, or 10%, to $45,813,904, decreases in average regular savings balances of $882,760, or 4%, to $19,515,190, and decreases in average brokered certificates of deposit balances of $4,096,615, or 23%, to $14,001,271. Both increases were due to marketing promotions. These increases allowed the Bank to decrease brokered time deposits as they matured. NOW and savings balances declined as customers moved balances to higher yielding money market and time deposits. The average interest rate paid on NOW accounts decreased from 1.99% in fiscal 2008 to 0.99% in fiscal 2009. The average interest rate paid on money market accounts decreased from 3.05% in fiscal 2008 to 1.87% in fiscal 2009. The average interest rate paid on savings accounts decreased from 0.79% in fiscal 2008 to 0.36% in fiscal 2009. The average interest rate paid on certificates of deposit decreased from 4.72% in fiscal 2008 to 3.45% in fiscal 2009. See Item 8, Table 10, for the scheduled maturities of certificates of deposit of $100,000 or more.

At June 30, 2009 and 2008, total deposits increased $22,012,215, or 6%, to $385,385,986 from $363,373,771.

We use brokered time deposits as part of our overall funding strategy and as an alternative to retail certificates of deposits, FHLB and FRB Borrower-in-custody advances, and junior subordinated debentures, to fund the growth of our earning assets. These deposits are limited by policy to 25% of total assets and individual brokered time deposit maturities do not exceed $5 million in any one month. We use five national brokerage firms to source time deposits, which are obtained through agents of the brokerage company soliciting customers from throughout the United States. The terms of these brokered time deposits allow for termination prior to maturity only in the case of the depositor's death, have maturities generally beyond one year and have interest rates equal to or slightly above comparable FHLB advances. At June 30, 2009, outstanding brokered time deposits of $10,906,378 as a percentage of total assets was 1.82%, compared to 2.11% at June 30, 2008. The average interest rate paid on brokered time deposits decreased from 5.14% in fiscal 2008 to 4.30% in fiscal 2009. Generally, interest rates paid on brokered time deposits exceed rates paid on FHLB advances with similar maturities, but the incremental interest expenses did not have a material impact on the results of operations for fiscal 2009 or fiscal 2008.

Other Funding Sources

Short-term borrowings, which consist of securities sold under repurchase agreements and other sweep accounts, Federal Home Loan Bank of Boston (FHLB) advances, Fed Discount Window Borrower-in-custody advances, structured repurchase agreements and junior subordinated debentures are the Company's sources of funding other than deposits.

Average FHLB advances for fiscal 2009 were $61,851,068, compared to $82,062,405 in fiscal 2008. This decrease was $20,211,337, or 25%. These advances had an average cost of 3.94% during fiscal 2009 compared to 4.49% during fiscal 2008. At June 30, 2009 and 2008, FHLB advances were $40,815,000 and $90,575,000, respectively, a decrease of $49,760,000, or 55%. The Company had unused advance capacity with the FHLB of $39,246,000 at June 30, 2009. Management intends to increase available FHLB advance capacity by continuing to add qualifying securities. See Note 8 to the Consolidated Financial Statements.

Average structured repurchase agreements for fiscal 2009 were $58,794,521 compared to $30,710,383 in fiscal 2008, an increase of $28,084,138, or 91%. At June 30, 2009, structured repurchase agreements increased $25,000,000 compared to June 30, 2008. The structured repurchase agreements were collateralized by acquiring and pledging U.S. Government-sponsored enterprise mortgage-backed securities as a leverage strategy to improve net interest income. They had imbedded purchased interest rate caps with a notional amount of $70 million in fiscal 2009 compared to $50 million in fiscal 2008. One structured repurchase agreement had an imbedded sold interest rate floor with a notional amount of $20 million. All purchased interest rate caps and sold interest rate floors had strike rates based on three month LIBOR. The purchased interest rate caps were utilized to reduce the interest rate risk exposure to rising interest rates. On August 28, 2009, $40 million of purchased interest rate caps and $20 million of sold interest rate floors will expire. See Note 8 to the Consolidated Financial Statements for additional information.

Average short-term borrowings during fiscal 2009 were $36,412,192 compared to $34,449,012 during fiscal 2008, an increase of $1,963,180, or 6%. This liability was collateralized by U.S. government-sponsored enterprise bonds and mortgage-backed securities. Other sweep accounts were subject to Federal Home Loan Bank Letter of Credit coverage. See Note 8 to the Consolidated Financial Statements.

Average Fed Discount Window Borrower-in-custody advances during fiscal 2009 were $11,584,088 compared to $139,344 during fiscal 2008. Under the terms of this credit line, the Bank has pledged its indirect auto loans and eligible municipal bonds, and the line bears an interest rate equal to the then current federal funds rate plus 0.25%. At June 30, 2009, the credit availability under the Borrower in Custody program was $27,004,000. There were no borrowings outstanding under this credit line at June 30, 2009.

The following is a summary of the unused borrowing capacity of the Bank at June 30, 2009 available to meet our short-term funding needs:

Brokered time deposits	$138,631,000	Subject to policy limitation of 25% of total assets
Federal Home Loan Bank of Boston	39,246,000	Unused advance capacity subject to eligible and qualified collateral
Fed Discount Window Borrower-in-Custody	27,004,000	Unused credit line subject to the pledge of indirect auto loans and eligible municipal bonds
Total Unused Borrowing Capacity	$204,881,000	

We had outstanding $16,496,000 at June 30, 2009 and 2008, respectively, of junior subordinated debentures issued by us to affiliated trusts. See "Capital" for more information on junior subordinated debentures and affiliated trusts.

ASSET QUALITY

Our lending and credit policies require the regular independent review of our loan portfolio to monitor our asset quality. We also maintain an internal rating system which provides a process to regularly assess the adequacy of our allowance for loan losses.

At June 30, 2009 and 2008, the allowance for loan losses was $5,764,000 and $5,656,000, respectively. The increase in the allowance for loan losses was attributable to the increase in loss factors used to determine the adequacy of the allowance for loan losses, such as increases in loan delinquencies, non-performing loans and classified and criticized loans in fiscal 2009 compared to fiscal 2008.

The allowance for loan losses as a percentage of total loans was 1.46% and 1.38% at June 30, 2009 and 2008, respectively. This increase of 8 basis points was attributable primarily to a decline in loans in fiscal 2009 compared to fiscal 2008.

Classified loans, exclusive of non-performing loans, that could potentially become non-performing due to delinquencies or marginal cash flows were $1,037,000 and $2,680,000 at June 30, 2009 and 2008, respectively. Significant credit losses are not expected on these loans.

The following table reflects the annual trend of total delinquencies 30 days or more past due, including loans on non-accrual status, which are not delinquent, as a percentage of total loans:

06/30/09	06/30/08	06/30/07	06/30/06
4.27%	3.64%	2.90%	2.09%

Non-performing Assets

Total non-performing loans were $9,894,000 and $7,703,000 at June 30, 2009 and 2008, respectively. This increase of $2,191,000, or 28%, was attributable primarily to residential real estate and commercial real estate loans. Of non-performing commercial real estate and commercial loans, $1,989,000 and $1,345,000, respectively, were current and paying as agreed. Many of these substandard loans were subject to a specific review in order to estimate the risk of loss based on the liquidation of the collateral. This risk of loss is incorporated in determining the adequacy of the allowance for loan losses and represented approximately 15% of the allowance at June 30, 2009. The following table represents non-performing loans by category as of June 30, 2009 and 2008.

Description	June 30, 2009	June 30, 2008

Residential real estate	$	1,620,000	$	1,390,000
Commercial real estate		4,373,000		2,358,000
Construction loans		-		101,000
Commercial loans		3,327,000		3,214,000
Consumer and other		574,000		640,000
Total non-performing	$	9,894,000	$	7,703,000

Non-performing loans as a percentage of total loans were 2.51% and 1.88% at June 30, 2009 and 2008, respectively. The allowance for loan losses was equal to 58% and 73% of total non-performing loans at June 30, 2009 and 2008, respectively. At June 30, 2009, non-performing loans included $3,352,000 of loans that are current and paying as agreed, but which the Bank classifies as non-performing until the respective borrowers have demonstrated a sustainable period of performance. Excluding these loans, the total delinquencies 30 days and more past due as a percentage of total assets would be 3.42% and 3.03% for June 30, 2009 and 2008, respectively.

See Item 8 Table 8 for a summary of non-performing assets for the last five years.

We continue to focus on asset quality issues and allocate significant resources to credit policy and loan review. The collection, workout and asset management functions focus on the reduction of non-performing assets. Despite this ongoing effort on asset quality, there can be no assurance that adverse changes in the real estate markets and economic conditions will not result in higher non-performing assets levels in the future and negatively impact our results of operations through higher provision for loan losses, net loan charge-offs, decreased accrual of income and increased noninterest expenses.

Residential real estate, commercial real estate, commercial, and consumer and other loans are generally placed on nonaccrual when they reach 90 days past due. Secured consumer loans are written down to realizable value and unsecured consumer loans are charged-off when they become 90 days past due. Based on our judgment, we may place on nonaccrual status and classify as non-performed loans which are currently less than 90 days past due or performing in accordance with their terms but are likely to present future principal and/or interest repayment problems.

Net charge-offs were $2,060,000 during 2009, compared to $936,000 in 2008. Net charge-offs as a percentage of average loans outstanding were 0.51% and 0.23% in 2009 and 2008, respectively. The increase of $1,124,000 was primarily due to higher gross charge-offs in indirect consumer loans, residential real estate loans and commercial real estate loans. See Item 8 Table 6 for more information concerning charge-offs and recoveries for the last five years.

Potential Problem Loans

Commercial real estate and commercial loans are periodically evaluated under an eight-point risk rating system. These ratings are guidelines in assessing the risk of a particular loan. We had classified commercial real estate and commercial loans totaling $17,307,000 and $15,801,000 at June 30, 2009 and 2008, respectively, as substandard or lower under our risk rating system. This increase was primarily due to commercial customer relationships experiencing weaknesses in the underlying businesses. These loans were subject to our internal specific review for the risk of loss based on the liquidation of collateral. This risk of loss was included in determining the adequacy of the allowance for loan loss. At June 30, 2009, $7,700,000 of this amount was non-performing commercial real estate and commercial loans. The remaining $9,607,000 of commercial real estate and commercial loans classified as substandard at June 30, 2009 evidence one or more weaknesses or potential weaknesses and may become non-performing loans in future periods.

Management actively monitors the Bank's asset quality to evaluate the adequacy of the allowance for loan losses, charges off loans against the allowance for loan losses when appropriate, establishes specific loss allowances and changes the level of the loan loss allowance. The process of evaluating the allowance involves a high degree of management judgment. The methods employed to evaluate the allowance for loan losses are quantitative in nature and consider such factors as the loan mix, the level of non-performing loans, delinquency trends, past charge-off history, loan reviews and classifications, collateral and the current economic climate. The liquidation value of collateral for each classified commercial real estate or commercial loan is also considered in the evaluation of the allowance for loan loss.

Management believes that the allowance for loan losses is adequate considering the level of risk in the loan portfolio. While management believes that it uses the best information available to make its determinations with respect to the allowance, there can be no assurance that the Company will not have to increase its allowance for loan losses in the future as a result of changing economic conditions, adverse markets for real estate or other factors. Regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance for loan losses. These agencies may require the Bank to recognize additions to the allowance for loan losses based on their judgments about information available to them at the time of their examination. No such adjustments were proposed by the Federal Reserve Bank of Boston or the Maine Bureau of Financial Institutions based on their 2009 examination.

At June 30, 2009, the Company had acquired assets of $672,669, compared to $678,350 at June 30, 2008, a decrease of $5,681. The collateral for indirect loans is written down to its estimated realizable value once the loan reaches 90 days or more delinquent. We continue to carry it as a loan, on non-accrual status, until sold. Gains and losses on disposition are recognized as recoveries and additional charge-offs, respectively. At each quarter end, indirect loans 90 days or more delinquent and adjusted to its estimated realizable value are reclassified as acquired assets. Total indirect loans 90 days or more past due at June 30, 2009 reclassified to acquired assets were $502,000. See Note 5 of the Consolidated Financial Statements for additional information. Management periodically receives independent appraisals on acquired assets. As a result of this review and the review of the acquired assets portfolio, the Company believes the allowance for losses on acquired assets is adequate to state acquired assets at lower of cost or fair value less estimated selling costs.

A reserve for off-balance sheet credit risk is part of other liabilities. At June 30, 2008, this account balance was $16,070, compared to $19,334 at June 30, 2009. The adequacy of this balance is subject to an analysis similar to the analysis applied to the allowance for loan losses by taking into consideration outstanding letters of credit and unadvanced construction loans.

RISK MANAGEMENT

Asset-Liability Management

The Company's operating results are largely dependent upon its ability to manage interest rate risk. Interest rate risk can be defined as the exposure of the Company's net interest income to adverse movements in interest rates. Although the Company regularly manages other risks, such as credit and liquidity risk, in the normal course of its business, management considers interest rate risk to be its most significant market risk and it could potentially have the most material effect on the Company's financial condition and results of operations.

Asset-liability management is governed by policies reviewed and approved annually by the Board. The Board delegates responsibility for asset-liability management to the Asset Liability Management Committee (ALCO) which is comprised of members of senior management who set the strategic directives that guide the day-to-day asset-liability management activities. ALCO reviews and approves all major risk, liquidity and capital management programs, except for pricing, which is approved by a subcommittee comprised of ALCO members.

The Company continues to attempt to minimize the volatility of its net interest margin by managing the relationship of interest-rate sensitive assets to interest-rate sensitive liabilities. To accomplish this, management undertakes steps to increase the percentage of variable rate assets as a percentage of its total earning assets. The focus has been to originate variable rate commercial and commercial real estate loans, which reprice or mature more quickly than similar fixed-rate loans. Variable rate residential real estate loans are originated for the loan portfolio. Fixed rate residential real estate loans are originated for sale to the secondary market. Consumer loans, including indirect auto and recreational vehicle loans, are primarily originated with fixed rates. The Company's adjustable-rate loans are primarily tied to published indices, such as the Wall Street Journal prime rate and one-year U.S. Treasury Bills. Management considers the Bank's assets and liabilities well matched. The balance sheet is slightly liability sensitive.

The overall objective of interest rate risk management is to deliver consistent net interest income growth over a range of possible interest rate environments. We focus on interest rates, careful review of the cash flows of loans and deposits and other modeling assumptions and asset liability strategies to help attain our goals and objectives.

Another objective of interest rate risk management is to control our estimated exposure to interest rate risk within limits established by the asset/liability committee and approved by our Board. These limits reflect our tolerance for interest rate risk over a wide range of both short-term and long-term measurements. We also evaluate risk through liquidation or run-off measures of assets and liabilities on our balance sheet and stress test measures. Stress testing demonstrates the impact of very extreme but lower probability events. The combination of these measures gives management a comprehensive view of the possible risk to future earnings. We attempt to control interest rate risk by identifying and quantifying these risks.

Net interest income is our largest source of revenue. Net interest income sensitivity is our primary short-term measurement used to assess the interest rate risk of our on-going business. We believe that net interest income sensitivity gives us the best perspective on how day-to-day decisions affect our interest rate risk profile. We subject estimated net interest income over a 12 month period to various rate movements using a simulation model for various specified interest rate scenarios. Simulations are run quarterly and include scenarios where market rates are shocked up and down. Our base simulation assumes that rates do not change for the next 12 months. The sensitivity measurement is calculated as a percentage variance of the net interest income simulations to the base simulation results. The results are compared to policy guidelines and are disclosed in the following table.

Assuming a 200 basis point increase and 100 basis point decrease in interest rates starting on June 30, 2009, we estimate that our net interest income in the following 12 months would decrease by 0.34% if rates went up 200 basis points and increase by 1.52% if rates went down 100 basis points. These results demonstrate the liability sensitivity nature of our balance sheet under which a simulated increase in interest expense would be greater than the increase in interest income in a rising rate environment because our interest-bearing liabilities reprice more quickly than our interest-bearing assets. In a falling rate environment, the interest-bearing liabilities reprice downward more quickly than our interest-bearing assets. Also shown in the table are the results assuming a 200 basis point increase and a 100 basis point decrease starting June 30, 2009 and 200 basis point increase and decrease in interest rates starting June 30, 2008. The decrease in federal funds interest rates during fiscal 2008 to 2.00% caused the interest rate simulation for decreasing rates to change to 100 basis points from 200 basis points.

	Up 200 Basis Points	Down 100 Basis Points
June 30, 2009	-0.34%	1.52%

	Up 200 Basis Points	Down 100 Basis Points
June 30, 2008	-1.38%	2.00%

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LIQUIDITY

On a parent Company only basis, our commitments and debt service requirements at June 30, 2009 consisted of junior subordinated notes issued to NBN Capital Trust II and NBN Capital Trust III totaling $6,186,000 due March 30, 2034 and junior subordinated debentures issued to NBN Capital Trust IV totaling $10,310,000 due February 23, 2035. NBN Capital Trust II and NBN Capital Trust III each issued $3,093,000 of junior subordinated notes with a variable interest rate based on three month LIBOR plus 2.80%, which reprice quarterly. The interest rate was 3.40% at June 30, 2009. NBN Capital Trust IV issued $10,310,000 of junior subordinated debentures with a fixed interest rate of 5.88% until February 23, 2010, when the interest rate will become variable based on three month LIBOR plus 1.89%. NBN Capital Trust II and III had a call option on March 30, 2009, which was not exercised, and NBN Capital Trust IV has a call option on February 23, 2010. See Note 18 to the Consolidated Financial Statements. Based on the interest rates at June 30, 2009, the annual aggregate payments to meet the debt service of the junior subordinated debentures is approximately $817,000.

Affiliated Trusts	Trust Preferred Securities	Common Securities	Junior Subordinated Debentures	Interest Rate	Maturity Date
NBN Capital Trust II	$ 3,000,000	$ 93,000	$ 3,093,000	3.40 %	March 30, 2034
NBN Capital Trust III	3,000,000	93,000	3,093,000	3.40 %	March 30, 2034
NBN Capital Trust IV	10,000,000	310,000	10,310,000	5.88 %	February 23, 2035
Total	$ 16,000,000	$ 496,000	$ 16,496,000	4.95 %	

The principal sources of funds for us to meet parent-only obligations are dividends from our banking subsidiary, which are subject to regulatory limitations, and borrowings from public and private sources. For information on the restrictions on the payment of dividends by our banking subsidiary, see Note 9 to the Consolidated Financial Statements. Under the terms and conditions of receiving funds from the US Treasury's Capital Purchase Program, the Company's payment dividends paid to common shareholders are limited the per share dividends paid in the quarter ended September 30, 2008, or $0.09 per share.

For our banking subsidiary, liquidity represents the ability to fund asset growth, accommodate deposit withdrawals and meet other contractual obligations and commitments. Liquidity risk is the risk that a bank cannot meet anticipated or unexpected funding requirements or can meet them only at excessive cost. Liquidity is measured by the ability to raise cash when needed at a reasonable cost. Many factors affect a bank's ability to meet liquidity needs, including variation in the markets served, its asset-liability mix, its reputation and credit standing in the market and general economic conditions.

In addition to traditional deposits, the Bank has other liquidity sources, including the proceeds from maturing securities and loans, the sale of securities, asset securitizations and borrowed funds such as FHLB and FRB Borrower-in-custody advances and brokered time deposits. We monitor and forecast our liquidity position. There are several interdependent methods used by us for this purpose, including daily review of federal funds positions, monthly review of balance sheet changes, monthly review of liquidity ratios, quarterly review of liquidity forecasts and periodic review of contingent funding plans.

At June 30, 2008, our banking subsidiary had $205 million of immediately accessible liquidity, defined as cash that could be raised within 7 days through collateralized borrowings, brokered deposits or security sales. This position represented 34% of total assets, compared to a policy minimum of 10%.

OFF-BALANCE SHEET ARRANGEMENTS & AGGREGATE CONTRACTUAL OBLIGATIONS

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

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit, unused lines of credit and standby letters of credit is represented by the contractual amount of those instruments. To control the credit risk associated with entering into commitments and issuing letters of credit, the Company uses the same credit quality, collateral policies, and monitoring controls in making commitments and letters of credit as it does with its lending activities. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation.

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

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers.

Unused lines of credit and commitments to extend credit typically result in loans with a market interest rate.

A summary of the amounts of the Company's (a) contractual obligations, and (b) other commitments with off-balance sheet risk, both at June 30, 2009, follows:

		Payments Due by Period			
Contractual Obligations	Total	Less Than 1 Year	1-3 Years	4-5 Years	After 5 Years
FHLB advances	$40,815,000	$2,815,000	$8,000,000	$15,000,000	$15,000,000
Structured Repurchase Agreements	65,000,000	30,000,000	20,000,000	15,000,000	-
Junior subordinated debentures	16,496,000	16,496,000	-	-	-
Capital lease obligation	2,378,827	148,198	319,349	353,279	1,558,001
Other borrowings	3,263,817	634,157	1,024,299	1,161,785	443,576
Total long-term debt	127,953,644	50,093,355	29,343,648	31,515,064	17,001,577
Operating lease obligations	1,757,395	468,816	790,289	316,355	181,935
Total contractual obligations	$129,711,039	$50,562,171	$ 30,133,937	$31,831,419	$17,183,512

		Amount of Commitment Expiration - Per Period			
Commitments with off-balance sheet risk	Total	Less Than 1 Year	1-3 Years	4-5 Years	After 5 Years
Commitments to extend credit (1)(3)	$24,442,000	$24,442,000	$-	$-	$-
Commitments related to loans held for sale(2)	8,268,000	8,268,000	-	-	-
Unused lines of credit (3)(4)	39,023,000	18,207,000	1,824,000	4,410,000	14,582,000
Standby letters of credit (5)	1,024,000	1,024,000	-	-	-
	$72,757,000	$51,941,000	$1,824,000	$4,410,000	$14,582,000

(1) Represents commitments outstanding for residential real estate, commercial real estate, and commercial loans.
(2) Commitments of residential real estate loans that will be held for sale.
(3) Loan commitments and unused lines of credit for commercial and construction loans that expire or are subject to renewal in twelve months or less.
(4) Represents unused lines of credit from commercial, construction, and home equity loans.
(5) Standby letters of credit generally expiring in twelve months.

The Bank has written options limited to those residential real estate loans designated for sale in the secondary market and subject to a rate lock. These rate-locked loan commitments are used for trading activities, not as a hedge. The fair value of the outstanding written options at June 30, 2009 was a loss of $90,998.

CAPITAL

At June 30, 2009 and 2008, stockholders' equity totaled $47,316,880 and $40,273,312, respectively, or 7.91% and 6.73% of total assets, respectively. In addition, we had on both June 30, 2009 and 2008, $16,496,000 of junior subordinated debentures which mature in 2034 and 2035 and qualify as Tier 1 Capital. See Note 18 to the Consolidated Financial Statements. The changes in stockholders' equity include net income for the year ended June 30, 2009 of $958,989, net proceeds from the Capital Purchase Program of $4,200,994, stock issued for $50,500 from the exercise of stock options, $1,728 from a stock grant and a decrease of $2,755,216 in the net unrealized losses on available-for-sale securities offset by common dividend payments of $834,036, and preferred stock payments of $89,823. See Note 9 to the Consolidated Financial Statements for additional information on capital ratios.

Under the terms of the U. S. Treasury's Capital Purchase Program, the Company must have the consent of the US Treasury to redeem, purchase, or acquire any shares of our common stock or other equity or capital securities, other than in connection with benefit plans consistent with past practice and certain other circumstances specified in the Purchase Agreement. The Board of Directors extended the 2006 Stock Repurchase Plan to permit stock repurchases in connection with benefit plans. Although the Board of Directors may discontinue the repurchase program at any time, it is scheduled to terminate on December 31, 2009. The Company may purchase up to 200,000 shares of its common stock from time to time in the open market at prevailing prices. Common stock repurchased pursuant to the plan is classified as authorized but unissued shares of common stock available for future issuance as determined by the Board of Directors. There was no stock repurchases under the 2006 Plan in fiscal 2009. Total stock repurchases under the 2006 Plan in fiscal 2008 were 137,800 shares, for $2,314,330, at an average price of $16.79 per share. The remaining repurchase capacity of the 2006 Plan is 58,400 shares. Since inception, total stock repurchases under the 2006 plan were 141,600 shares, for $2,382,274, through June 30, 2009. Management believes that these and future purchases have not and will not have a significant impact on the Company's liquidity.

Regulatory capital guidelines require the Bank to maintain certain capital ratios. The Bank's Tier 1 Capital was $45,931,000, or 7.72% of total average assets, at June 30, 2009 compared to $40,302,000, or 7.06% of total average assets, at June 30, 2008. The increase in the Bank's Tier 1 Capital ratio was primarily due to the injection of capital from the Company of net funds from Capital Purchase Program. We are also required to maintain risk-based capital ratios based on the level of certain assets, as adjusted to reflect their perceived level of risk. Our regulatory capital ratios currently exceed all applicable requirements. See Note 9 to the Consolidated Financial Statements.

IMPACT OF INFLATION

The consolidated financial statements and related notes have been presented in terms of historic dollars without considering changes in the relative purchasing power of money over time due to inflation. Unlike industrial companies, substantially all of the assets and virtually all of the liabilities of the Company are monetary in nature. As a result, interest rates have a more significant impact on the Company's performance than the general level of inflation. Over short periods of time, interest rates may not necessarily move in the same direction or in the same magnitude as inflation.

IMPACT OF NEW ACCOUNTING STANDARDS

Note 1 of the Consolidated Financial Statement includes the Financial Accounting Standards Board (FASB) and the SEC issued statements and interpretations affecting the Company.

EVENTS SUBSEQUENT TO JUNE 30, 2009

The employment contract for the president of Northeast Bank Insurance Group, Inc., which expires on September 29, 2009, will not be renewed. The terms of a separation agreement require a cash payment to the president and the recognition of expense in the quarter ended September 30, 2009 which management believes is not material to the operating results for fiscal 2010.

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Item 7 a. Quantitative and Qualitative Disclosure about Market Risk

See Item 7 of our Form 10-K, "Management's Discussion and Analysis of Financial Condition and Results of Operations - Risk Management" and accompanying table set forth therein for quantitative and qualitative disclosures about market risk.

Item 8. Financial Statements and Supplementary Data

a. Financial Statements Required by Regulation S-X

To the Board of Directors
Northeast Bancorp
Lewiston, Maine

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We have audited the accompanying consolidated balance sheets of Northeast Bancorp and Subsi