NORTHEAST BANCORP /ME/
Form 10-Q
February 13, 2015
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended December 31, 2014

Commission File Number: 1-14588

Northeast Bancorp

(Exact name of registrant as specified in its charter)

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

(207) 786-3245

Registrant s telephone number, including area code

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

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

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

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

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date. As of January 31, 2015 the registrant had outstanding 8,957,474 shares of voting common stock, $1.00 par value per share and 880,963 shares of non-voting common stock, $1.00 par value per share.

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PART 1- FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

NORTHEAST BANCORP AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

(Unaudited)

(Dollars in thousands, except share data)

	December 31, 2014	June 30, 2014
Assets		
Cash and due from banks	$ 2,626	$ 3,372
Short-term investments	80,643	78,887
Total cash and cash equivalents	83,269	82,259
Available-for-sale securities, at fair value	107,841	113,881
Loans held for sale	5,154	11,945
Loans	575,335	516,416
Less: Allowance for loan losses	1,664	1,367
Loans, net	573,671	515,049
Premises and equipment, net	8,494	9,135
Real estate owned and other repossessed collateral, net	2,058	1,991
Federal Home Loan Bank stock, at cost	4,102	4,102
Intangible assets, net	2,467	2,798
Bank owned life insurance	15,055	14,836
Other assets	7,924	5,935
Total assets	$ 810,035	$ 761,931
Liabilities and Stockholders Equity		
Liabilities		
Deposits:		
Demand	$ 51,920	$ 50,140
Savings and interest checking	95,373	98,340
Money market	144,523	83,901
Time	339,904	341,948
Total deposits	631,720	574,329
Federal Home Loan Bank advances	35,244	42,824
Wholesale repurchase agreements	10,117	10,199
Short-term borrowings	2,775	2,984
Junior subordinated debentures issued to affiliated trusts	8,530	8,440
Capital lease obligation	1,464	1,558
Other liabilities	9,262	9,531
Total liabilities	699,112	649,865
Commitments and contingencies		
Stockholders equity		
Preferred stock, $1.00 par value, 1,000,000 shares authorized; no shares issued and outstanding at December 31, 2014 and June 30, 2014		

Voting common stock, $1.00 par value, 25,000,000 shares authorized; 8,965,424 and 9,260,331 shares issued and outstanding at December 31, 2014 and June 30, 2014, respectively		8,965		9,260
Non-voting common stock, $1.00 par value, 3,000,000 shares authorized; 880,963 shares issued and outstanding at December 31, 2014 and June 30, 2014		881		881
Additional paid-in capital		87,404		90,914
Retained earnings		15,314		12,294
Accumulated other comprehensive loss		(1,641)		(1,283)
Total stockholders equity		110,923		112,066
Total liabilities and stockholders equity	$	810,035	$	761,931

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

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NORTHEAST BANCORP AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

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

	Three Months Ended December 31,		Six Months Ended December 31,	
	2014	**2013**	**2014**	**2013**
Interest and dividend income:				
Interest on loans	$ 10,948	$ 10,282	$ 21,870	$ 18,739
Interest on available-for-sale securities	232	262	475	544
Other interest and dividend income	79	96	146	147
Total interest and dividend income	11,259	10,640	22,491	19,430
Interest expense:				
Deposits	1,281	979	2,410	2,026
Federal Home Loan Bank advances	265	327	588	651
Wholesale repurchase agreements	73	98	145	192
Short-term borrowings	7	6	16	11
Junior subordinated debentures issued to affiliated trusts	188	192	394	385
Obligation under capital lease agreements	19	21	38	43
Total interest expense	1,833	1,623	3,591	3,308
Net interest and dividend income before provision for loan losses	9,426	9,017	18,900	16,122
Provision for loan losses	113	151	433	227
Net interest and dividend income after provision for loan losses	9,313	8,866	18,467	15,895
Noninterest income:				
Fees for other services to customers	392	421	786	861
Gain on sales of loans held for sale	447	341	1,029	880
Gain on sales of portfolio loans	445	13	525	230
(Loss) gain recognized on real estate owned and other repossessed collateral, net	(31)	(77)	(54)	(115)
Bank-owned life insurance income	110	116	219	234
Other noninterest income	7	21	19	34
Total noninterest income	1,370	835	2,524	2,124
Noninterest expense:				
Salaries and employee benefits	4,737	4,253	9,270	8,865
Occupancy and equipment expense	1,181	1,311	2,384	2,601
Professional fees	458	281	766	657
Data processing fees	347	277	692	554
Marketing expense	80	103	148	139
Loan acquisition and collection expense	413	290	687	763
FDIC insurance premiums	110	117	234	227
Intangible asset amortization	166	210	331	420
Legal settlement recovery				(250)
Other noninterest expense	718	772	1,437	1,490
Total noninterest expense	8,210	7,614	15,949	15,466
Income from continuing operations before income tax expense	2,473	2,087	5,042	2,553
Income tax expense	893	676	1,818	832

Net income from continuing operations	1,580	1,411	3,224	1,721
(Loss) income from discontinued operations before tax (benefit) expense		(27)		(12)
Income tax (benefit) expense		(9)		(4)
Net (loss) income from discontinued operations		(18)		(8)
Net income	$ 1,580	$ 1,393	$ 3,224	$ 1,713
Weighted-average shares outstanding:				
Basic	10,132,349	10,432,833	10,155,598	10,436,673
Diluted	10,132,349	10,432,833	10,155,598	10,436,673
Earnings per common share:				
Basic:				
Income from continuing operations	$ 0.16	$ 0.13	$ 0.32	$ 0.16
Income from discontinued operations				
Net Income	$ 0.16	$ 0.13	$ 0.32	$ 0.16
Diluted:				
Income from continuing operations	$ 0.16	$ 0.13	$ 0.32	$ 0.16
Income from discontinued operations				
Net income	$ 0.16	$ 0.13	$ 0.32	$ 0.16
Cash dividends declared per common share	$ 0.01	$ 0.09	$ 0.02	$ 0.18

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

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NORTHEAST BANCORP AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(Dollars in thousands)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2014	2013	2014	2013
Net income	$ 1,580	$ 1,393	$ 3,224	$ 1,713
Other comprehensive income (loss), before tax:				
Available-for-sale securities:				
Change in net unrealized gain or loss on available-for-sale securities	538	(647)	263	(130)
Reclassification adjustment for net gains included in net income				
Total available-for-sale securities	538	(647)	263	(130)
Derivatives and hedging activities:				
Change in accumulated loss on effective cash flow hedges	(500)	565	(770)	584
Reclassification adjustments for net gains included in net income	(24)	(17)	(34)	(36)
Total derivatives and hedging activities	(524)	548	(804)	548
Total other comprehensive income (loss), before tax	14	(99)	(541)	418
Income tax expense (benefit) related to other comprehensive (loss) income	4	(34)	(183)	142
Other comprehensive income (loss), net of tax	10	(65)	(358)	276
Comprehensive income	$ 1,590	$ 1,328	$ 2,866	$ 1,989

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

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NORTHEAST BANCORP AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY

(Unaudited)

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

	Preferred Stock		Voting Common Stock		Non-voting Common Stock		Additional	Retained	Accumulated Other Comprehensive	Total Stockholders
	Shares	Amount	Shares	Amount	Shares	Amount	Paid-in Capital	Earnings	Loss	Equity
Balance at June 30, 2013		$	9,565,680	$ 9,566	880,963	$ 881	$ 92,745	$ 12,524	$ (1,914)	$ 113,802
Net income								1,713		1,713
Other comprehensive income, net of tax									276	276
Dividends on common stock at $0.18 per share								(1,879)		(1,879)
Stock-based compensation							471			471
Forfeiture of restricted common stock			(14,149)	(14)			14			
Balance at December 31, 2013		$	9,551,531	$ 9,552	880,963	$ 881	$ 93,230	$ 12,358	$ (1,638)	$ 114,383
Balance at June 30, 2014		$	9,260,331	$ 9,260	880,963	$ 881	$ 90,914	$ 12,294	$ (1,283)	$ 112,066
Net income								3,224		3,224
Other comprehensive income, net of tax									(358)	(358)
Common stock repurchased			(448,686)	(449)			(3,653)			(4,102)
Dividends on common stock at $0.02 per share								(204)		(204)
Stock-based compensation							297			297
Issuance of restricted common stock			168,000	168			(168)			
Forfeiture of restricted common stock			(14,221)	(14)			14			
Balance at December 31, 2014		$	8,965,424	$ 8,965	880,963	$ 881	$ 87,404	$ 15,314	$ (1,641)	$ 110,923

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

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NORTHEAST BANCORP AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(Dollars in thousands)

	Six Months Ended December 31, 2014	Six Months Ended December 31, 2013
Operating activities:		
Net income	$ 3,224	$ 1,713
Adjustments to reconcile net income to net cash provided by (used in) by operating activities:		
Provision for loan losses	433	227
Loss on sale and impairment of real estate owned and other repossessed collateral, net	54	115
Accretion of fair value adjustments on loans, net	(6,117)	(4,099)
Accretion of fair value adjustments on deposits, net	(120)	(415)
Accretion of fair value adjustments on borrowings, net	(72)	(132)
Originations of loans held for sale	(49,444)	(44,651)
Net proceeds from sales of loans held for sale	57,264	47,299
Gain on sales of loans held for sale	(1,029)	(880)
Gain on sales of portfolio loans	(525)	(230)
Amortization of intangible assets	331	420
Bank-owned life insurance income, net	(219)	(234)
Depreciation of premises and equipment	847	1,035
Loss (gain) on sale of premises and equipment	28	(1)
Net gain on sale of available-for-sale securities		
Stock-based compensation	297	471
Amortization of securities, net	519	668
Changes in other assets and liabilities:		
Other assets	(1,693)	(6,568)
Other liabilities	(1,071)	3,290
Net cash provided (used in) by operating activities	2,707	(1,972)
Investing activities:		
Proceeds from sales of available-for-sale securities		
Purchases of available-for-sale securities		(12,083)
Proceeds from maturities and principal payments on available-for-sale securities	5,786	18,165
Loan purchases	(39,667)	(29,967)
Proceeds from sales of portfolio loans	3,665	216
Loan originations and principal collections, net	(16,778)	(34,000)
Purchases of premises and equipment	(234)	(594)
Proceeds from sales of premises and equipment		11
Proceeds from sales of real estate owned and other repossessed collateral	129	528
Net cash used in investing activities	(47,099)	(57,724)
Financing activities:		
Net increase in deposits	57,511	52,314
Net (decrease) increase in short-term borrowings	(209)	1,843
Repurchase of common stock	(4,102)	
Dividends paid on common stock	(204)	(1,879)
Proceeds from FHLB advances		15,000
Repayments of FHLB advances	(7,500)	
Repayment of wholesale repurchase agreements		(10,000)

Repayment of capital lease obligation		(94)		(89)
Net cash provided by financing activities		45,402		57,189
Net decrease in cash and cash equivalents		1,010		(2,507)
Cash and cash equivalents, beginning of period		82,259		65,934
Cash and cash equivalents, end of period	$	83,269	$	63,427
Supplemental schedule of noncash investing and financing activities:				
Transfers from loans to real estate owned and other repossessed collateral	$	241	$	1,727
Transfers from real estate owned and other repossessed collateral to loans		2		

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

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NORTHEAST BANCORP AND SUBSIDIARY

Notes to Unaudited Consolidated Financial Statements

December 31, 2014

1. Basis of Presentation

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

These financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, the accompanying consolidated financial statements contain all adjustments (consisting principally of normal recurring accruals) considered necessary for a fair presentation of the Company s financial position, results of operations, and cash flows for the interim periods presented. These financial statements and notes should be read in conjunction with the audited consolidated financial statements and notes thereto for the fiscal year ended June 30, 2014 (Fiscal 2014) included in the Company s Annual Report on Form 10-K filed with the Securities and Exchange Commission.

2. Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued ASU 2014-09*, Revenue from Contracts with Customers (Topic 606)* (ASU 2014-09). ASU 2014-09 implements a common revenue standard that clarifies the principles for recognizing revenue. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve that core principle, an entity should apply the following steps: (i) identify the contract(s) with a customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract and (v) recognize revenue when (or as) the entity satisfies a performance obligation. ASU 2014-09 is effective January 1, 2017 and is not expected to have a significant impact on the Company s financial statements.

In June 2014, the FASB issued ASU 2014-11, *Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures* (ASU 2014-11). ASU 2014-11 requires that repurchase-to-maturity transactions be accounted for as secured borrowings consistent with the accounting for other repurchase agreements. In addition, ASU 2014-11 requires separate accounting for repurchase financings, which entails the transfer of a financial asset executed contemporaneously with a repurchase agreement with the same counterparty. ASU 2014-11 requires entities to disclose certain information about transfers accounted for as sales in transactions that are economically similar to repurchase agreements. In addition, ASU 2014-11 requires disclosures related to collateral, remaining contractual tenor and of the potential risks associated with repurchase agreements, securities lending transactions and repurchase-to-maturity transactions. ASU 2014-11 is effective January 1, 2015 and is not expected to have a significant impact on the Company s financial statements.

In August 2014, the FASB issued ASU 2014-14, *Receivables - Troubled Debt Restructurings by Creditors (Subtopic 310-40): Classification of Certain Government-Guaranteed Mortgage Loans upon Foreclosure (* ASU 2014-14 *)* . ASU 2014-14 affects creditors that hold government-guaranteed mortgage loans, including those guaranteed by the Federal Housing Administration (FHA) of the U.S. Department of Housing and Urban Development (HUD), and the U.S. Department of Veterans Affairs (VA). The update requires that, upon foreclosure, a guaranteed mortgage loan be derecognized and a separate other receivable be recognized when specific criteria are met. ASU 2014-14 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2014. The adoption of this guidance is not expected to have a significant impact on the Company s financial statements.

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3. Securities Available-for-Sale

The following presents a summary of the amortized cost, gross unrealized holding gains and losses, and fair value of securities available for sale.

	December 31, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
U.S. Government agency securities	$ 48,302	$ 43	$ (28)	$ 48,317
Agency mortgage-backed securities	60,553	4	(1,033)	59,524
	$ 108,855	$ 47	$ (1,061)	$ 107,841

	June 30, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
U.S. Government agency securities	$ 48,415	$ 31	$ (28)	$ 48,418
Agency mortgage-backed securities	66,744	3	(1,284)	65,463
	$ 115,159	$ 34	$ (1,312)	$ 113,881

When securities are sold, the adjusted cost of the specific security sold is used to compute the gain or loss on sale. There were no securities sold during the three and six months ended December 31, 2014 or 2013. At December 31, 2014, investment securities with a fair value of approximately $34.7 million were pledged as collateral to secure outstanding borrowings.

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

	December 31,2014					
	Less than 12 Months		More than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(Dollars in thousands)					
U.S. Government agency securities	$ 27,086	$ (28)	$	$	$ 27,086	$ (28)
Agency mortgage-backed securities	2,188	(8)	54,970	(1,025)	57,158	(1,033)
	$ 29,274	$ (36)	$ 54,970	$ (1,025)	$ 84,244	$ (1,061)

	June 30, 2014					
	Less than 12 Months		More than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(Dollars in thousands)					
U.S. Government agency securities	$ 24,141	$ (28)	$	$	$ 24,141	$ (28)

Agency mortgage-backed securities						62,734		(1,284)		62,734		(1,284)
	$	24,141	$	(28)	$	62,734	$	(1,284)	$	86,875	$	(1,312)

There were no other-than-temporary impairment losses on securities during the three and six months ended December 31, 2014 or 2013.

At December 31, 2014, the Company had twenty securities in a continuous loss position for greater than twelve months. At December 31, 2014, all of the Company s available-for-sale securities were issued or guaranteed by either government agencies or government-sponsored enterprises. The decline in fair value of the Company s available-for-sale securities at December 31, 2014 is attributable to changes in interest rates.

Management of the Company, in addition to considering current trends and economic conditions that may affect the quality of individual securities within the Company s investment portfolio, also considers the Company s ability and intent to hold such securities to maturity or recovery of cost. Management does not believe any of the Company s available-for-sale securities are other-than-temporarily impaired at December 31, 2014.

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The amortized cost and fair values of available-for-sale debt securities by contractual maturity are shown below as of December 31, 2014. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
	(Dollars in thousands)	
Due within one year	$ 9,035	$ 9,039
Due after one year through five years	39,267	39,278
Due after five years through ten years	30,053	29,718
Due after ten years	30,500	29,806
	$ 108,855	$ 107,841

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4. Loans, Allowance for Loan Losses and Credit Quality

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

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

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

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

The composition of the Company s loan portfolio is as follows on the dates indicated.

	December 31, 2014			June 30, 2014		
	Originated	**Purchased**	**Total**	**Originated**	**Purchased**	**Total**
			(Dollars in thousands)			

Residential real estate	$	112,272	$	2,211	$	114,483	$	116,972	$	3,687	$	120,659
Home equity		25,534				25,534		27,975				27,975
Commercial real estate		125,567		217,914		343,481		116,617		199,481		316,098
Commercial business		82,672		267		82,939		41,518		282		41,800
Consumer		8,898				8,898		9,884				9,884
Total loans	$	354,943	$	220,392	$	575,335	$	312,966	$	203,450	$	516,416

Related Party Loans

The Bank s authority to extend credit to their respective directors and executive officers, as well as to entities controlled by such persons, is currently governed by the requirements of the Sarbanes-Oxley Act of 2002 and Regulation O of the Board of Governors of the Federal Reserve System. Among other things, these provisions require that extensions of credit to insiders (1) be made on terms that are substantially the same as, and follow credit underwriting procedures that are not less stringent than, those prevailing for comparable transactions with unaffiliated persons and that do not involve more than the normal risk of repayment or present other unfavorable features; and (2) 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 the Bank s capital. In addition, the extensions of credit to insiders must be approved by each Bank s Board of Directors.

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Total loans and advances, to directors, executive officers and their affiliates were $416 thousand at December 31, 2014. All loans were performing at December 31, 2014.

Allowance for Loan Losses and Impaired Loans

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. For residential and consumer loans, a charge-off is recorded no later than the point at which a loan is 180 days past due if the loan balance exceeds the fair value of the collateral, less costs to sell. For commercial loans, a charge-off is recorded on a case-by-case basis when all or a portion of the loan is deemed to be uncollectible. Subsequent recoveries, if any, are credited to the allowance.

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

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

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

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

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

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

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

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

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There were no significant changes in the Company s policies or methodology pertaining to the general component of the allowance for loan losses during the three and six months ended December 31, 2014 or 2013.

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

For all portfolio segments, except loans accounted for under ASC 310-30, a loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower s prior payment record, and the amount of the shortfall in relation to the principal and interest owed. For the purchased loan segment, a loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to realize cash flows as estimated at acquisition. For loans accounted for under ASC 310-30 for which cash flows can reasonably be estimated, loan impairment is measured based on the decrease in expected cash flows from those estimated at acquisition, excluding changes due to changes in interest rate indices and other non-credit related factors, discounted at the loan s effective rate assumed at acquisition. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting the scheduled principal and interest payments when due.

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

	Three Months Ended December 31, 2014						
	Residential Real Estate	**Commercial Real Estate**	**Commercial Business**	**Consumer**	**Purchased**	**Unallocated**	**Total**
	(Dollars in thousands)						
Beginning balance	$ 783	$ 340	$ 49	$ 51	$ 271	$ 45	$ 1,539
Provision	2	(53)	5	8	142	9	113
Recoveries	11	1		3			15
Charge-offs				(3)			(3)
Ending balance	$ 796	$ 288	$ 54	$ 59	$ 413	$ 54	$ 1,664

	Three Months Ended December 31, 2013						
	Residential Real Estate	**Commercial Real Estate**	**Commercial Business**	**Consumer**	**Purchased**	**Unallocated**	**Total**
	(Dollars in thousands)						
Beginning balance	$ 695	$ 163	$ 50	$ 148	$ 101	$ 67	$ 1,224
Provision	(33)	158	2	(24)	106	(58)	151
Recoveries				12			12
Charge-offs	(13)			(24)			(37)

Ending balance	$ 649	$ 321	$ 52	$ 112	$ 207	$ 9	$ 1,350

Beginning balance	$ 580	$ 358	$ 48	$ 79	$ 267	$ 35	$ 1,367
Provision	360	(71)	6	(27)	146	19	433
Recoveries	16	1		13			30
Charge-offs	(160)			(6)			(166)
Ending balance	$ 796	$ 288	$ 54	$ 59	$ 413	$ 54	$ 1,664

	Six Months Ended December 31, 2013						
	Residential Real Estate	Commercial Real Estate	Commercial Business	Consumer	Purchased	Unallocated	Total
				(Dollars in thousands)			
Beginning balance	$ 594	$ 173	$ 70	$ 189	$ 76	$ 41	$ 1,143
Provision	82	148	(24)	(78)	131	(32)	227
Recoveries	6		6	31			43
Charge-offs	(33)			(30)			(63)
Ending balance	$ 649	$ 321	$ 52	$ 112	$ 207	$ 9	$ 1,350

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

	December 31, 2014						
	Residential Real Estate	Commercial Real Estate	Commercial Business	Consumer	Purchased	Unallocated	Total
				(Dollars in thousands)			
Allowance for loan losses:							
Individually evaluated	$ 367	$ 21	$	$ 17	$ 374	$	$ 779
Collectively evaluated	429	267	54	42		54	846
ASC 310-30					39		39
Total	$ 796	$ 288	$ 54	$ 59	$ 413	$ 54	$ 1,664
Loans:							
Individually evaluated	$ 3,426	$ 2,567	$	$ 605	$ 10,117	$	$ 16,715
Collectively evaluated	134,380	123,000	82,672	8,293			348,345
ASC 310-30					210,275		210,275
Total	$ 137,806	$ 125,567	$ 82,672	$ 8,898	$ 220,392	$	$ 575,335

Allowance for loan losses:							
Individually evaluated	$ 190	$ 84	$	$ 6	$ 166	$	$ 446
Collectively evaluated	390	274	48	73		35	820
ASC 310-30					101		101
Total	$ 580	$ 358	$ 48	$ 79	$ 267	$ 35	$ 1,367
Loans:							
Individually evaluated	$ 2,314	$ 2,549	$	$ 240	$ 4,747	$	$ 9,850
Collectively evaluated	142,633	114,068	41,518	9,644			307,863
ASC 310-30					198,703		198,703
Total	$ 144,947	$ 116,617	$ 41,518	$ 9,884	$ 203,450	$	$ 516,416

The following table sets forth information regarding impaired loans. Loans accounted for under ASC 310-30 that have performed based on cash flow and accretable yield expectations determined at date of acquisition are not considered impaired assets and have been excluded from the tables below.

	December 31, 2014	June 30, 2014
	Unpaid	Unpaid

	Recorded Investment	Principal Balance	Related Allowance	Recorded Investment	Principal Balance	Related Allowance
			(Dollars in thousands)			
Impaired loans without a valuation allowance:						
Originated:						
Residential real estate	$ 1,372	$ 1,448	$	$ 1,005	$ 1,081	$
Consumer	393	395		200	205	
Commercial real estate	1,557	1,575		1,368	1,371	
Commercial business						
Purchased:						
Commercial real estate	8,783	12,301		2,857	4,148	
Total	12,105	15,719		5,430	6,805	
Impaired loans with a valuation allowance:						
Originated:						
Residential real estate	2,055	1,983	367	1,309	1,278	190
Consumer	212	204	17	40	47	6
Commercial real estate	1,010	1,003	21	1,181	1,187	84
Commercial business						
Purchased:						
Commercial real estate	1,333	2,095	374	1,890	2,215	166
Total	4,610	5,285	779	4,420	4,727	446
Total impaired loans	$ 16,715	$ 21,004	$ 779	$ 9,850	$ 11,532	$ 446

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The following tables set forth information regarding interest income recognized on impaired loans.

	Three Months Ended December 31,			
	2014		2013	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(Dollars in thousands)			
Impaired loans without a valuation allowance:				
Originated:				
Residential real estate	$ 1,384	$ 28	$ 901	$ 8
Consumer	292	68	96	1
Commercial real estate	1,182	30	413	7
Commercial business			72	3
Purchased:				
Commercial real estate	6,901	85	2,833	41
Total	9,759	211	4,315	60
Impaired loans with a valuation allowance:				
Originated:				
Residential real estate	2,080	7	1,344	19
Consumer	121	15	117	2
Commercial real estate	1,248	11	1,186	19
Commercial business			44	1
Purchased:				
Commercial real estate	1,295	21	1,067	46
Total	4,744	54	3,758	87
Total impaired loans	$ 14,503	$ 265	$ 8,073	$ 147

	Six Months Ended December 31,			
	2014		2013	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(Dollars in thousands)			
Impaired loans without a valuation allowance:				
Originated:				
Residential real estate	$ 1,188	$ 45	$ 986	$ 14
Consumer	297	71	93	2
Commercial real estate	1,462	37	420	14
Commercial business			63	6
Purchased:				
Commercial real estate	5,820	160	2,198	48
Total	8,767	313	3,760	84
Impaired loans with a valuation allowance:				
Originated:				
Residential real estate	1,682	35	1,385	37
Consumer	126	16	98	3
Commercial real estate	1,095	31	1,165	45
Commercial business			50	1
Purchased:				
Commercial real estate	1,612	24	778	48
Total	4,515	106	3,476	134

Total impaired loans	$	13,282	$	419	$	7,236	$	218

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Credit Quality

The Company utilizes a ten-point internal loan rating system for commercial real estate, construction, commercial business, and certain residential loans as follows:

Loans rated 1 6: Loans in these categories are considered pass rated loans. Loans in categories 1-5 are considered to have low to average risk. Loans rated 6 are considered marginally acceptable business credits and have more than average risk.

Loans rated 7: Loans in this category are considered special mention. These loans show signs of potential weakness and are being closely monitored by management.

Loans rated 8: Loans in this category are considered substandard. Loans classified as substandard are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified have a well-defined weakness or weaknesses that jeopardize the orderly repayment of the debt.

Loans rated 9: Loans in this category are considered doubtful. Loans classified as doubtful have all the weaknesses inherent in one graded 8 with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable.

Loans rated 10: Loans in this category are considered loss and of such little value that their continuance as loans is not warranted.

On an annual basis, or more often if needed, the Company formally reviews the ratings of all loans subject to risk ratings. Semi-annually, the Company engages an independent third-party to review a significant portion of loans within these segments. Management uses the results of these reviews as part of its annual review process. Risk ratings on purchased loans, with and without evidence of credit deterioration at acquisition, are determined relative to the Company s recorded investment in that loan, which may be significantly lower than the loan s unpaid principal balance.

The following tables present the Company s loans by risk rating.

	December 31, 2014				
	Originated Portfolio				
	Commercial Real Estate	Commercial Business	Residential(1)	Purchased Portfolio	Total
	(Dollars in thousands)				
Loans rated 1- 6	$ 119,210	$ 82,490	$ 9,795	$ 208,566	$ 420,061

Loans rated 7	4,758	38	997	8,481	14,274
Loans rated 8	1,599	144	657	3,345	5,745
Loans rated 9					
Loans rated 10					
	$ 125,567	$ 82,672	$ 11,449	$ 220,392	$ 440,080

	June 30, 2014				
	Originated Portfolio				
	Commercial Real Estate	Commercial Business	Residential(1)	Purchased Portfolio	Total
	(Dollars in thousands)				
Loans rated 1- 6	$ 110,044	$ 41,271	$ 11,941	$ 189,986	$ 353,242
Loans rated 7	4,880	46	940	8,619	14,485
Loans rated 8	1,693	201	670	4,845	7,409
Loans rated 9					
Loans rated 10					
	$ 116,617	$ 41,518	$ 13,551	$ 203,450	$ 375,136

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(1) Certain of the Company s loans made for commercial purposes, but secured by residential collateral, are rated under the Company s risk-rating system.

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Past Due and Nonaccrual Loans

The following is a summary of past due and non-accrual loans:

	December 31, 2014							
	30-59 Days	60-89 Days	Past Due 90 Days or More-Still Accruing	Past Due 90 Days or More-Nonaccrual	Total Past Due	Total Current	Total Loans	Non-Accrual Loans
	(Dollars in thousands)							
Originated portfolio:								
Residential real estate	$ 314	$ 614	$	$ 1,509	$ 2,437	$ 109,835	$ 112,272	$ 2,706
Home equity	48			11	59	25,475	25,534	11
Commercial real estate	212			1,040	1,252	124,315	125,567	1,166
Commercial business		19			19	82,653	82,672	
Consumer	222	31		124	377	8,521	8,898	237
Total originated portfolio	796	664		2,684	4,144	350,799	354,943	4,120
Purchased portfolio:								
Residential real estate						2,211	2,211	
Commercial business						267	267	
Commercial real estate	2,758	853		7,411	11,022	206,892	217,914	8,129
Total purchased portfolio	2,758	853		7,411	11,022	209,370	220,392	8,129
Total loans	$ 3,554	$ 1,517	$	$ 10,095	$ 15,166	$ 560,169	$ 575,335	$ 12,249

	June 30, 2014							
	30-59 Days	60-89 Days	Past Due 90 Days or More-Still Accruing	Past Due 90 Days or More-Nonaccrual	Total Past Due	Total Current	Total Loans	Non-Accrual Loans
	(Dollars in thousands)							
Originated portfolio:								
Residential real estate	$ 222	$ 728	$	$ 1,573	$ 2,523	$ 114,449	$ 116,972	$ 1,743
Home equity	109	7		120	236	27,739	27,975	160
Commercial real estate	126	136		629	891	115,726	116,617	1,162
Commercial business						41,518	41,518	5
Consumer	188	24		49	261	9,623	9,884	139
Total originated portfolio	645	895		2,371	3,911	309,055	312,966	3,209
Purchased portfolio:								
Residential real estate						3,687	3,687	
Commercial business						282	282	
Commercial real estate				1,995	1,995	197,486	199,481	4,116
Total purchased portfolio				1,995	1,995	201,455	203,450	4,116

Total loans	$	645	$	895	$		$	4,366	$	5,906	$	510,510	$	516,416	$	7,325

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Troubled Debt Restructurings

The following table shows the Company s post-modification balance of TDRs by type of modification.

	Three Months Ended December 31,				Six Months Ended December 31,			
	2014		2013		2014		2013	
	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
	(Dollars in thousands)							
Extended maturity	1	$ 356	3	$ 1,763	3	$ 590	4	$ 1,777
Adjusted interest rate	3	157			4	195	1	82
Rate and maturity					3	201		
Principal deferment					1	453	2	341
Court ordered concession					4	84		
	4	$ 513	3	$ 1,763	15	$ 1,523	7	$ 2,200

The following table shows loans modified in a TDR and the change in the recorded investment subsequent to the modifications occurring.

Originated portfolio:						
Residential real estate	2	$ 125	$ 125		$	$
Home equity						
Commercial real estate						
Commercial business						
Consumer	1	32	32	1	39	39
Total originated portfolio	3	157	157	1	39	39
Purchased portfolio:						
Residential real estate						
Commercial real estate	1	356	356	2	1,685	1,724
Total purchased portfolio	1	356	356	2	1,685	1,724
Total	4	$ 513	$ 513	3	$ 1,724	$ 1,763

Originated portfolio:						
Home equity				1	14	14
Commercial business				1	18	18
Total originated portfolio	14	1,167	1,167	5	476	476
Residential real estate						
Total purchased portfolio	1	356	356	2	1,685	1,724

The Company considers TDRs past due 90 days or more to be in payment default. Three loans modified in a TDR in the last twelve months defaulted during the six months ended December 31, 2014; the recorded investment of such loans was $50 thousand. One loan modified in a TDR in the last twelve months defaulted during the three months ended December 31, 2014; the recorded investment of the loans was zero. As of December 31, 2014, there were no further commitments to lend associated with loans modified in a TDR.

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ASC 310-30 Loans

The following table presents a summary of loans accounted for under ASC 310-30 that were acquired by the Company during the period indicated.

	Three Months Ended December 31, 2014	Six Months Ended December 31, 2014
	(Dollars in thousands)	
Contractually required payments receivable	$ 66,662	$ 87,770
Nonaccretable difference	(1,625)	(1,929)
Cash flows expected to be collected	65,037	85,841
Accretable yield	(25,405)	(33,365)
Fair value of loans acquired	$ 39,632	$ 52,476

Certain of the loans accounted for under ASC 310-30 that were acquired by the Company are not accounted for using the income recognition model because the Company cannot reasonably estimate cash flows expected to be collected. The carrying amounts of such loans are as follows.

	As of and for the Three Months Ended December 31, 2014	As of and for the Six Months Ended December 31, 2014
	(Dollars in thousands)	
Loans acquired during the period	$ 35	$ 357
Loans at end of period	7,697	11,984

The following table summarizes the activity in the accretable yield for loans accounted for under ASC 310-30.

	Three Months Ended December 31, 2014	Six Months Ended December 31, 2014
	(Dollars in thousands)	
Beginning balance	$ 108,352	$ 109,040
Acquisitions	25,405	33,365
Accretion	(4,286)	(8,729)
Reclassifications to accretable yield		10
Disposals and other changes	(6,196)	(10,411)
End balance	$ 123,275	$ 123,275

The following table provides information related to the unpaid principal balance and carrying amounts of ASC 310-30 loans.

	December 31, 2014	June 30, 2014
	(Dollars in thousands)	
	$ 259,588	$ 239,376

Unpaid principal balance				
Carrying amount	$	218,049	$	201,171

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5. Earnings Per Share (EPS)

EPS is computed by dividing net income allocated to common shareholders by the weighted average common shares outstanding (including participating securities). The Company s only participating securities are unvested restricted stock awards that contain non-forfeitable rights to dividends. The following table shows the weighted average number of shares outstanding for the periods indicated. Shares issuable relative to stock options granted have been reflected as an increase in the shares outstanding used to calculate diluted EPS, after applying the treasury stock method. The number of shares outstanding for basic and diluted EPS is presented as follows:

	Three months Ended December 31,				Six months Ended December 31,			
	2014		2013		2014		2013	
	(Dollars in thousands, except share and per share data)							
Net income	$	1,580	$	1,393	$	3,224	$	1,713
Weighted average shares used in calculation of basic EPS		10,132,349		10,432,833		10,155,598		10,436,673
Incremental shares from assumed exercise of dilutive securities								
Weighted average shares used in calculation of diluted EPS		10,132,349		10,432,833		10,155,598		10,436,673
Earnings per common share:								
Income from continuing operations	$	0.16	$	0.13	$	0.32	$	0.16
Income from discontinued operations								
Earnings per common share	$	0.16	$	0.13	$	0.32	$	0.16
Diluted earnings per common share:								
Income from continuing operations	$	0.16	$	0.13	$	0.32	$	0.16
Income from discontinued operations								
Diluted earnings per common share	$	0.16	$	0.13	$	0.32	$	0.16

For the three and six months ended December 31, 2014, the following stock options and warrants were excluded from the calculation of diluted EPS due to the exercise price of these options exceeding the average market price of the Company s common stock for the period. These options, which were not dilutive at that date, may potentially dilute EPS in the future.

	Three Months Ended December 31,		Six Months Ended December 31,	
	2014	2013	2014	2013
Stock options	1,086,599	1,136,080	1,105,694	1,151,442
Warrants				
	1,086,599	1,136,080	1,105,694	1,151,442

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6. Fair Value Measurements

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. The Company uses prices and inputs that are current as of the measurement date, including during periods of market dislocation. In periods of market dislocation, the observability of prices and inputs may be reduced for many instruments. This condition could cause an instrument to be reclassified from one level to another. When market assumptions are not readily available, the Company s own assumptions are set to reflect those that market participants would use in pricing the asset or liability at the measurement date. If there has been a significant decrease in the volume and level of activity for the asset or liability, regardless of the valuation technique(s) used, the objective of a fair value measurement remains the same.

ASC 820 defines fair value and establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under ASC 820 are described below:

Level 1 Inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2 Valuations based on significant observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3 Prices or valuations that require inputs that are both significant to the fair value measurement and unobservable.

To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgment. Accordingly, the degree of judgment exercised by the Company in determining fair value is greatest for instruments categorized in Level 3. A financial instrument s level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

*Valuation technique*s - There have been no changes in the valuation techniques used during the current period.

Transfers- There were no transfers of assets and liabilities measured at fair value on a recurring or nonrecurring basis during the current period .

Assets and Liabilities Measured at Fair Value on a Recurring Basis:

Available-for-sale securities - Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Examples of such instruments include publicly-traded common and preferred stocks. If quoted prices are not available, then fair values are estimated by using pricing models (*i.e.* , matrix pricing) and market interest rates and credit assumptions or quoted prices of securities with similar characteristics and are classified within Level 2 of the valuation hierarchy. Examples of such instruments include government agency and government sponsored agency mortgage-backed securities, as well as certain preferred and trust preferred stocks. Level 3 securities are securities for which significant unobservable inputs are utilized.

Derivative financial instruments - The valuation of the Company s interest rate swaps and caps are determined using widely accepted valuation techniques including discounted cash flow analyses on the expected cash flows of derivatives. These analyses reflect the contractual terms of the derivatives, including the period to maturity, and use observable market-based inputs, including interest rate curves and implied volatilities. Unobservable inputs, such as credit valuation adjustments are insignificant to the overall valuation of the Company s derivative financial instruments. Accordingly, the Company has determined that its interest rate derivatives fall within Level 2 of the fair value hierarchy.

The fair value of derivative loan commitments and forward loan sale agreements are estimated using the anticipated market price based on pricing indications provided from syndicate banks. These commitments and agreements are categorized as Level 2. The fair value of such instruments was nominal at each date presented.

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis:

Collateral Dependent Impaired Loans- Valuations of impaired loans measured at fair value are determined by a review of collateral values. Certain inputs used in appraisals are not always observable, and therefore impaired loans are generally categorized as Level 3 within the fair value hierarchy.

Real Estate Owned and Other Repossessed collateral - The fair values of real estate owned and other repossessed collateral are estimated based upon appraised values less estimated costs to sell. Certain inputs used in appraisals are not always observable, and therefore may be categorized as Level 3 within the fair value hierarchy. When inputs used in appraisals are primarily observable, they are classified as Level 2.

Fair Value of other Financial Instruments:

Cash and cash equivalents - The fair value of cash, due from banks, interest bearing deposits and FHLB overnight deposits approximates their relative book values, as these financial instruments have short maturities.

FHLB stock - The carrying value of FHLB stock approximates fair value based on redemption provisions of the FHLB.

Loans- Fair values are estimated for portfolios of loans with similar financial characteristics. The fair value of performing loans is calculated by discounting scheduled cash flows through the estimated maturity using estimated market discount rates that reflect the credit and interest rate risk inherent in the loan. The estimates of maturity are based on the Company s historical experience with repayments for each loan classification, modified, as required, by an estimate of the effect of current economic conditions, lending conditions and the effects of estimated prepayments.

Loans held for sale - The fair value of loans held-for-sale is estimated based on bid quotations received from loan dealers.

Interest receivable - The fair value of this financial instrument approximates the book value as this financial instrument has a short maturity. It is the Company s policy to stop accruing interest on loans past due by more than 90 days. Therefore, this financial instrument has been adjusted for estimated credit loss.

Deposits - The fair value of deposits with no stated maturity, such as noninterest-bearing demand deposits, savings, NOW accounts and money market accounts, is equal to the amount payable on demand. The fair values of time deposits are based on the discounted value of contractual cash flows. The discount rate is estimated using the rates currently offered for deposits of similar remaining maturities. The fair value estimates do not include the benefit that results from the low-cost funding provided by the deposit liabilities compared to the cost of borrowing funds in the market. If that value were considered, the fair value of the Company s net assets could increase.

Borrowings - The fair value of the Company s borrowings with the FHLB is estimated by discounting the cash flows through maturity or the next re-pricing date based on current rates available to the Company for borrowings with similar maturities. The fair value of the Company s short-term borrowings, capital lease obligations, wholesale repurchase agreements and other borrowings is estimated by discounting the cash flows through maturity based on current rates available to the Company for borrowings with similar maturities.

Off-Balance Sheet Credit-Related Instruments -Fair values for off-balance-sheet, credit-related financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties credit standing. The fair value of such instruments was nominal at each date presented.

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Assets and liabilities measured at fair value on a recurring basis are summarized below.

	December 31, 2014			
	Total	Level 1	Level 2	Level 3
	(Dollars in thousands)			
Assets				
Securities available-for-sale:				
U.S. Government agency securities	$ 48,317	$	$ 48,317	$
Agency mortgage-backed securities	59,524		59,524	
Other assets interest rate caps	102		102	
Liabilities				
Other liabilities interest rate swaps	$ 1,411	$	$ 1,411	$

	June 30, 2014			
	Total	Level 1	Level 2	Level 3
	(Dollars in thousands)			
Assets				
Securities available-for-sale:				
U.S. Government agency securities	$ 48,418	$	$ 48,418	$
Agency mortgage-backed securities	65,463		65,463	
Other assets interest rate caps				
Liabilities				
Other liabilities interest rate swap	$ 714	$	$ 714	$

Assets measured at fair value on a nonrecurring basis are summarized below.

	December 31, 2014			
	Total	Level 1	Level 2	Level 3
	(Dollars in thousands)			
Collateral dependent impaired loans	$ 978	$	$	$ 978
Real estate owned and other repossessed collateral	2,058			2,058

	June 30, 2014			
	Total	Level 1	Level 2	Level 3
	(Dollars in thousands)			
Collateral dependent impaired loans	$ 1,467	$	$	$ 1,467
Real estate owned and other repossessed collateral	1,991			1,991

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The following table presents the estimated fair value of the Company s financial instruments.

	Carrying Amount	Fair Value Measurements at December 31, 2014 Total	Level 1	Level 2	Level 3
	(Dollars in thousands)				
Financial assets:					
Cash and cash equivalents	$ 83,269	$ 83,269	$ 83,269	$	$
Available-for-sale securities	107,841	107,841		107,841	
Federal Home Loan Bank stock	4,102	4,102		4,102	
Loans held for sale	5,154	5,159		5,159	
Loans, net	573,671	575,858			575,858
Accrued interest receivable	1,136	1,136		1,136	
Interest rate caps	102	102		102	
Financial liabilities:					
Deposits	631,720	632,098		632,098	
FHLB advances	35,244	36,031		36,031	
Wholesale repurchase agreements	10,177	10,292		10,292	
Short-term borrowings	2,775	2,775		2,775	
Capital lease obligation	1,464	1,563		1,563	
Subordinated debentures	8,530	8,521			8,521
Interest rate swaps	1,411	1,411		1,411	

	Carrying Amount	Fair Value Measurements at June 30, 2014 Total	Level 1	Level 2	Level 3
	(Dollars in thousands)				
Financial assets:					
Cash and cash equivalents	$ 82,259	$ 82,259	$ 82,259	$	$
Available-for-sale securities	113,881	113,881		113,881	
Federal Home Loan Bank stock	4,102	4,102		4,102	
Loans held for sale	11,945	11,945		11,945	
Loans, net	515,049	522,154			522,154
Accrued interest receivable	1,216	1,216		1,216	
Interest rate caps					
Financial liabilities:					
Deposits	574,329	574,868		574,868	
FHLB advances	42,824	43,843		43,843	
Wholesale repurchase agreements	10,199	10,484		10,484	
Short-term borrowings	2,984	2,984		2,984	
Capital lease obligation	1,558	1,701		1,701	
Subordinated debentures	8,440	7,858			7,858
Interest rate swaps	714	714		714	

7. Derivatives and Hedging Activities

The Company has stand-alone derivative financial instruments in the form of interest rate caps that derive their value from a fee paid and are adjusted to fair value based on index and strike rate, and swap agreements that derive their value from the underlying interest rate. These transactions involve both credit and market risk. The notional amounts are amounts on which calculations, payments and the value of the derivative are based. Notional amounts do not represent direct credit exposures. Direct credit exposure arises in the event of nonperformance by the counterparties to these agreements, and is limited to the net difference between the calculated amounts to be received and paid, if any. Such differences, which represent the fair value of the derivative instruments, are reflected on the Company s balance sheet as derivative assets and derivative liabilities. The Company seeks to manage the credit risk of its financial contracts through credit approvals, limits and monitoring procedures, and does not expect any counterparties to fail to meet their obligations.

The Company currently holds derivative instruments that contain credit-risk related features that are in a net liability position, which may require that collateral be assigned to dealer banks. At December 31, 2014, the Company had posted cash collateral totaling $3.3 million with dealer banks related to derivative instruments in a net liability position.

The Company does not offset fair value amounts recognized for derivative instruments. The Company does not net the amount recognized for the right to reclaim cash collateral against the obligation to return cash collateral arising from derivative instruments executed with the same counterparty under a master netting arrangement.

Risk Management Policies Derivative Instruments

The Company evaluates the effectiveness of entering into any derivative instrument agreement by measuring the cost of such an agreement in relation to the reduction in net income volatility within an assumed range of interest rates.

Interest Rate Risk Management Cash Flow Hedging Instruments

The Company uses variable rate debt as a source of funds for use in the Company s lending and investment activities and other general business purposes. These debt obligations expose the Company to variability in interest payments due to changes in interest rates. If

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interest rates increase, interest expense increases. Conversely, if interest rates decrease, interest expense decreases. Management believes it is prudent to limit the variability of a portion of its interest payments and, therefore, generally hedges a portion of its variable-rate interest payments.

Information pertaining to outstanding interest rate caps and swap agreements used to hedge variable rate debt is as follows.

				December 31, 2014					
Notional Amount	Inception Date	Termination Date	Index	Receive Rate	Pay Rate	Strike Rate	Unrealized Gain (Loss)	Fair Value	Balance Sheet Location
				(Dollars in thousands)					
Interest rate swaps:									
$ 10,000	February 2010	February 2015	3 Mo. LIBOR	2.14%	4.69%	n/a	$ (22)	$ (37)	Other Liabilities
5,000	July 2013	July 2033	3 Mo. LIBOR	0.25%	3.38%	n/a	(639)	(639)	Other Liabilities
5,000	July 2013	July 2028	3 Mo. LIBOR	0.25%	3.23%	n/a	(485)	(485)	Other Liabilities
5,000	July 2013	July 2023	3 Mo. LIBOR	0.25%	2.77%	n/a	(250)	(250)	Other Liabilities
Interest rate caps:									
6,000	October 2014	September 2019	3 Mo. LIBOR	n/a	n/a	2.50%	(75)	102	Other Assets
$ 31,000							$ (1,471)	$ (1,309)	

				June 30, 2014					
Notional Amount	Inception Date	Termination Date	Index	Receive Rate	Pay Rate	Strike Rate	Unrealized Loss	Fair Value	Balance Sheet Location
				(Dollars in thousands)					
Interest rate swaps:									
$ 10,000	February 2010	February 2015	3 Mo. LIBOR	2.12%	4.69%	n/a	$ (99)	$ (165)	Other Liabilities
5,000	July 2013	July 2033	3 Mo. LIBOR	0.23%	3.38%	n/a	$ (216)	$ (216)	Other Liabilities
5,000	July 2013	July 2028	3 Mo. LIBOR	0.23%	3.23%	n/a	$ (200)	$ (200)	Other Liabilities
5,000	July 2013	July 2023	3 Mo. LIBOR	0.23%	2.77%	n/a	$ (133)	$ (133)	Other Liabilities
Interest rate caps:									
6,000	September 2009	September 2014	3 Mo. LIBOR	n/a	n/a	2.51%	(16)		Other Assets
$ 31,000							$ (664)	$ (714)	

During the three and six months ended December 31, 2014 and 2013, no interest rate cap or swap agreements were terminated prior to maturity. Changes in the fair value of interest rate caps and swaps designated as hedging instruments of the variability of cash flows associated with variable rate debt are reported in other comprehensive income. These amounts subsequently are reclassified into interest expense as a yield adjustment in the same period in which the related interest on the debt affects earnings. Risk management results for the three and six months ended December 31, 2014 and 2013 related to the balance sheet hedging of variable rate debt indicates that the hedges were effective.

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8. Other Comprehensive Income

The components of other comprehensive income (loss) follow.

	Three Months Ended December 31,					
	2014			2013		
	Pre-tax Amount	Tax Expense (Benefit)	After-tax Amount	Pre-tax Amount	Tax Expense (Benefit)	After-tax Amount
	(Dollars in thousands)					
Change in net unrealized gain or loss on available-for-sale securities	$ 538	$ 183	$ 355	$ (647)	$ (220)	$ (427)
Reclassification adjustment for net gains included in net income						
Total available-for-sale securities	538	183	355	(647)	(220)	(427)
Change in accumulated loss on effective cash flow hedges	(500)	(171)	(329)	565	192	373
Reclassification adjustment for net gains included in net income	(24)	(8)	(16)	(17)	(6)	(11)
Total derivatives and hedging activities	(524)	(179)	(345)	548	186	362
Total other comprehensive income (loss)	$ 14	$ 4	$ 10	$ (99)	$ (34)	$ (65)

	Six Months Ended December 31,					
	2014			2013		
	Pre-tax Amount	Tax Expense (Benefit)	After-tax Amount	Pre-tax Amount	Tax Expense (Benefit)	After-tax Amount
	(Dollars in thousands)					
Change in net unrealized gain or loss on available-for-sale securities	$ 263	$ 90	$ 173	$ (130)	$ (44)	$ (86)
Reclassification adjustment for net gains included in net income						
Total available-for-sale securities	263	90	173	(130)	(44)	(86)
Change in accumulated loss on effective cash flow hedges	(770)	(261)	(509)	584	198	386
Reclassification adjustment for net gains included in net income	(34)	(12)	(22)	(36)	(12)	(24)
Total derivatives and hedging activities	(804)	(273)	(531)	548	186	362
Total other comprehensive income (loss)	$ (541)	$ (183)	$ (358)	$ 418	$ 142	$ 276

Accumulated other comprehensive loss is comprised of the following.

	December 31, 2014	June 30, 2014
	(Dollars in thousands)	
Unrealized loss on available-for-sale securities	$ (1,016)	$ (1,278)
Tax effect	345	434
Net-of-tax amount	(671)	(844)
Unrealized loss on cash flow hedges	(1,471)	(664)
Tax effect	501	225
Net-of-tax amount	(970)	(439)
Accumulated other comprehensive loss	$ (1,641)	$ (1,283)

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9. Commitments and Contingencies

Commitments

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 and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets. The contract amounts of those instruments reflect the extent of involvement the Company has 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 and standby letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

Financial instruments with contract amounts which represent credit risk are as follows:

	December 31, 2014	June 30, 2014
	(Dollars in thousands)	
Commitments to originate loans	$ 17,656	$ 14,282
Unused lines of credit	32,543	34,657
Standby letters of credit	116	166

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 commitment 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 deemed necessary by the Company upon extension of credit, is based on management s credit evaluation of the counter party. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment, and income-producing commercial properties. The Company has recorded an allowance for possible losses on commitments and unfunded loans totaling $30 thousand recorded in other liabilities at both December 31, 2014 and June 30, 2014

Contingencies

The Company and its subsidiary are parties to litigation and claims arising in the normal course of business. Management believes that the liabilities, if any, arising from such litigation and claims will not be material to the Company s consolidated financial position or results of operations.

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10. Discontinued Operations

The Company concluded all investment brokerage activities in the second quarter of Fiscal 2014. Accordingly, operations associated with these activities have been classified as discontinued operations in the accompanying consolidated statements of income. The following summarizes the operations of the Company s investment brokerage division for the three and six months ended December 31, 2014 and 2013.

	Three Months Ended December 31,		Six Months Ended December 31,	
	2014	2013	2014	2013
	(Dollars in thousands)			
Noninterest income:				
Investment commissions	$	$ 296	$	$ 971
Other noninterest income				
Total noninterest income		296		971
Noninterest expense:				
Salaries and employee benefits		261		793
Occupancy and equipment expense		20		60
Data processing fees		25		82
Marketing expense				8
Other noninterest expense		17		40
Total noninterest expense		323		983
(Loss) income before tax		(27)		(12)
Income tax (benefit) expense		(9)		(4)
Net (loss) income	$	$ (18)	$	$ (8)

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with the consolidated financial statements, notes and tables included in Northeast Bancorp s Annual Report on Form 10-K for the fiscal year ended June 30, 2014, filed with the Securities and Exchange Commission.

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, as amended and Section 21E of the Securities Exchange Act of 1934, as amended, such as statements relating to the Company s financial condition, prospective results of operations, future performance or expectations, plans, objectives, prospects, loan loss allowance adequacy, simulation of changes in interest rates, capital spending and finance sources 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 , approximately , intend , objective , goal , project , or other similar terms or variations the future or conditional verbs such as will , may , should , could , and would . Although the Company believes 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, the Company cannot give you any assurance that its expectations will, in fact, occur or that its estimates or assumptions will be correct. The Company cautions you that actual results could differ materially from those expressed or implied by such forward-looking statements as a result of, among other factors, changes in interest rates and real estate values; competitive pressures from other financial institutions; the effects of continuing weakness in general economic conditions on a national basis or in the local markets in which the Company operates, including changes which adversely affect borrowers ability to service and repay the Company s loans; changes in loan defaults and charge-off rates; changes in the value of securities and other assets, adequacy of loan loss reserves, or deposit levels necessitating increased borrowing to fund loans and investments; changes in government regulation; the risk that the Company may not be successful in the implementation of its business strategy; the risk of compromises or breaches to our security systems; the risk that intangibles recorded in the Company s financial statements will become impaired; changes in assumptions used in making such forward-looking statements; and the other risks and uncertainties detailed in the Company s Annual Report on Form 10-K for the fiscal year ended June 30, 2014 as updated in the Company s Quarterly Reports on Form 10-Q and other filings submitted to the Securities and Exchange Commission. These forward-looking statements speak only as of the date of this report and the Company does 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.

Description of Business and Strategy

Business Overview

Northeast Bancorp (we, our, us, Northeast or the Company), incorporated under Maine law in 1987, is a bank holding company registered w the Board of Governors of the Federal Reserve System (the Federal Reserve). As a bank holding company registered under the Bank Holding Company Act of 1956, as amended (the BHCA), the Company is subject to regulation and supervision by the Federal Reserve. The Company s primary subsidiary and principal asset is its wholly-owned banking subsidiary, Northeast Bank (the Bank or Northeast Bank), a Maine state-chartered bank originally organized in 1872. As a Federal Deposit Insurance Corporation (FDIC) insured Maine-chartered bank, the Bank is subject to regulation and supervision by the Maine Bureau of Financial Institutions (the Bureau) and the FDIC.

On December 29, 2010, the merger of the Company and FHB Formation LLC, a Delaware limited liability company (FHB), was consummated. As a result of the merger, the surviving company received a capital contribution of $16.2 million (in addition to the approximately $13.1 million in cash consideration paid to former shareholders), and the former members of FHB collectively acquired approximately 60% of the Company s outstanding common stock. The Company applied the acquisition method of accounting, as described in Accounting Standards Codification (ASC) 805, *Business Combinations* (ASC 805) to the merger, which represents an acquisition by FHB of Northeast, with Northeast as the surviving company.

In connection with the transaction, as part of the regulatory approval process, the Company and the Bank made certain commitments to the Federal Reserve, the most significant of which are (i) to maintain a Tier 1 leverage ratio of at least 10%, (ii) to maintain a total risk-based capital ratio of at least 15%, (iii) to limit purchased loans to 40% of total loans, (iv) to fund 100% of the Company s loans with core deposits (defined as non-maturity deposits and non-brokered insured time deposits), and (v) to hold commercial real estate loans (including owner-occupied commercial real estate) to within 300% of total risk-based capital. On June 28, 2013, the Federal Reserve approved the amendment to exclude owner-occupied commercial real estate loans from the commitment to hold commercial real estate loans to within 300% of total risk-based capital. All other commitments made to the Federal Reserve in connection with the merger remain unchanged. The Company and the Bank are currently in compliance with all commitments to the Federal Reserve. Company s compliance ratios at December 31, 2014 follow.

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Condition	Ratios at December 31, 2014
(i) Tier 1 leverage ratio	14.81%
(ii) Total risk-based capital ratio	21.44%
(iii) Ratio of purchased loans to total loans, including loans held for sale	37.97%
(iv) Ratio of loans to core deposits (1)	91.79%
(v) Ratio of commercial real estate loans to total risk-based capital (2)	190.05%

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(1) Core deposits include all non-maturity deposits and maturity deposits less than $250 thousand

(2) For purposes of calculating this ratio, commercial real estate includes all those loans defined as such by regulatory guidance, including all land development and construction loans.

As of December 31, 2014, the Company, on a consolidated basis, had total assets of $810.0 million, total deposits of $631.7 million, and shareholders equity of $110.9 million. The Company gathers retail deposits through its banking offices in Maine and its online affinity deposit program, ableBanking; originates loans through the Bank s Community Banking Division; and purchases and originates commercial loans through the Bank s Loan Acquisition and Servicing Group (LASG). The Community Banking Division, with ten full-service branches and two loan production offices, operates from the Bank s headquarters in Lewiston, Maine. The Company operates ableBanking and the LASG from its offices in Boston, Massachusetts.

Unless the context otherwise requires, references herein to the Company include the Company and its subsidiary on a consolidated basis.

Strategy

The Company s goal is to prudently grow its franchise, while maintaining sound operations and risk management, by implementing the following strategies:

Measured growth of our national commercial loan portfolio. The Company purchases performing commercial real estate loans, on a nationwide basis, typically at a discount from their outstanding principal balances, producing yields higher than those normally achieved on our originated loan portfolio. These loans are purchased from a variety of sources, including banks, insurance companies, investment funds and government agencies, either directly or indirectly through a loan sale advisor. We also originate commercial real estate and commercial business loans on a nationwide basis. We expect national originations to become an area of increasing focus for the Company, and in particular the origination of loans guaranteed by the Small Business Administration (SBA). As of December 31, 2014, the Company serviced SBA loans with an unpaid principal balance of $52.6 million, of which $37.3 million was held by third parties.

Focus on core deposits. The Company offers a full line of deposit products to customers in the Community Banking Division s market area through its ten-branch network. In addition, we utilize our online deposit program, ableBanking, a division of Northeast Bank, to provide an additional channel through which to raise core deposits to fund the Company s asset strategy.

Continuing our community banking tradition. The Community Banking Division retains a high degree of local autonomy and operational flexibility to better serve its customers. The Community Banking Division s focus on sales and service allows us to attract and retain core deposits in support of balance sheet growth, and to continue to generate new commercial and residential mortgage loans.

Critical Accounting Policies

Critical accounting policies are those that involve significant judgments and assessments by management, and which could potentially result in materially different results under different assumptions and conditions. The reader is encouraged to review each of the policies included in Form 10-K for the year ended June 30, 2014 to gain a better understanding of how Northeast s financial performance is measured and reported. There has been no material change in critical accounting policies during the six months ended December 31, 2014.

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Overview

Net income from continuing operations was $1.6 million, or $0.16 per diluted common share, for the quarter ended December 31, 2014, compared to $1.4 million, or $0.13 per diluted common share, for the quarter ended December 31, 2013. The current quarter included $55 thousand of expenses related to severance, and excluding these items, which the Company considers to be non-core, net operating earnings were $1.6 million, or $0.16 per diluted common share.

Net income from continuing operations was $3.2 million, or $0.32 per diluted common share, for the six months ended December 31, 2014, compared to $1.7 million, or $0.16 per diluted common share, for the six months ended December 31, 2013. The current six month period included $166 thousand of expenses related to severance, and excluding these items, which the Company considers to be non-core, net operating earnings were $3.3 million, or $0.33 per diluted common share.

Net interest and dividend income before provision increased by $409 thousand, or 4.5%, to $9.4 million for the quarter ended December 31, 2014 compared to the quarter ended December 31, 2013, due primarily to higher transactional interest income from purchased loan payoffs and the positive effect of balance sheet growth..

Noninterest income increased by $535 thousand for the quarter ended December 31, 2014, compared to the quarter ended December 31, 2013, principally due to the following:

- An increase of $432 thousand in gain on sales of portfolio loans, realized primarily on the sale of the guaranteed portion of SBA loans. The Company recognized $445 thousand in gains on SBA loans sold for the three months ended December 31, 2014, compared to no SBA gain for the quarter ended December 31, 2013; and

- An increase of $106 thousand in gains realized on sale of residential loans originated for sale in the secondary market, due principally to an increase in purchase-related mortgage loan activity in the current period.

Noninterest expense increased by $596 thousand for the quarter ended December 31, 2014, compared to the quarter ended December 31, 2013, principally due to the following:

- An increase of $484 thousand in salaries and employee benefits, principally due to increased employee head count and incentive compensation, offset by a decrease in group insurance expense and employee stock options expense;

- An increase of $177 thousand in professional fees, due primarily to fees for temporary consulting services;

- An increase of $123 thousand in loan acquisition and collection expenses, due in part to an increased level of loan purchases in the quarter ended December 31, 2014 when compared to the quarter ended December 31, 2013; and

- A decrease of $130 thousand in occupancy and equipment expense, the result of a reduction in software maintenance and depreciation expense following the conversion of the Bank s core systems platform to an outsourced model in May 2014. The decrease in equipment expense was offset in part by higher data processing fees, which increased by $70 thousand.

Financial Condition

<u>*Overview*</u>

Total assets increased by $48.1 million, or 6.3%, to $810.0 million at December 31, 2014, compared to June 30, 2014. The principal components of the change in the balance sheet were as follows:

- The loan portfolio excluding loans held for sale grew by $58.9 million, or 11.4%, compared to June 30, 2014, the result of net growth of $65.9 million in commercial loans purchased or originated by the Bank s Loan Acquisition and Servicing Group (LASG), offset by a $7.0 million decrease in the Bank s Community Banking Division loan portfolio.

New loans generated by the LASG totaled $68.2 million and $121.7 million for the three and six-month periods, respectively, ending December 31, 2014. The quarterly growth in LASG loans consisted of $39.7 million in purchases, at an average price of 85.7%, and $28.5 million in originations. Residential and consumer loan production sold in the secondary market totaled $26.0 million for the quarter.

As noted above in the *Business Overview* the Company made certain commitments to the Board of Governors of the Federal Reserve System in connection with the merger of FHB Formation LLC with and into the Company in December 2010. The Company s loan purchase and commercial real estate loan availability under these conditions follow.

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Basis for Regulatory Condition	Condition	Availability at December 31, 2014 (Dollars in millions)	
Total Loans	Purchased loans may not exceed 40% of total loans	$	19.7
Regulatory Capital	Commercial real estate loans may not exceed 300% of total risk-based capital	$	132.6

An overview of the LASG portfolio follows.

	LASG Portfolio Three Months Ended December 31,					
	2014			2013		
	Purchased	Originated	Total LASG	Purchased	Originated	Total LASG
	(Dollars in thousands)					
Loans purchased or originated during the period:						
Unpaid principal balance	$ 46,307	$ 28,579	$ 74,886	$ 15,663	$ 17,138	$ 32,801
Net investment basis	39,667	28,565	68,232	13,619	17,138	30,757
Loan returns during the period:						
Yield	13.27%	4.00%	10.17%	13.82%	5.14%	11.38%
Total Return (1)	13.72%	4.57%	10.67%	13.76%	5.14%	11.35%

	Six Months Ended December 31,					
	2014			2013		
	Purchased	Originated	Total LASG	Purchased	Originated	Total LASG
	(Dollars in thousands)					
Loans purchased or originated during the period:						
Unpaid principal balance	$ 62,425	$ 68,915	$ 131,340	$ 33,994	$ 43,564	$ 77,558
Net investment basis	52,834	68,904	121,738	29,967	43,564	73,531
Loan returns during the period:						
Yield	13.02%	5.08%	10.53%	12.00%	5.37%	10.35%
Total Return (1)	13.24%	5.58%	10.85%	12.20%	5.37%	10.51%
Total loans as of period end:						
Unpaid principal balance	$ 262,445	$ 126,620	$ 389,065	$ 212,767	$ 78,828	$ 291,595
Net investment basis	$ 220,391	$ 126,563	$ 346,954	$ 177,435	$ 78,868	$ 256,303

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(1) The total return on purchased loans represents scheduled accretion, accelerated accretion, gains on asset sales, and other noninterest income recorded during the period divided by the average invested balance, on an annualized basis.

Assets

Cash, Short-term Investments and Securities

Cash and short-term investments were $83.3 million as of December 31, 2014, an increase of $1.0 million, or 1.2%, from $82.3 million at June 30, 2014.

Available-for-sale securities, consisting of securities issued by government agencies and government-sponsored enterprises, totaled $107.8 million as of December 31, 2014 as compared to $113.9 million as of June 30, 2014, representing a decrease of $6.0 million or 5.3%. At December 31, 2014, securities with a fair value of $34.7 million were pledged for outstanding borrowings.

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Loans

The following represents the composition of the Company s loan portfolio.

	Community Banking Division	LASG	Total	Percent of Total
Originated loans:				
Residential real estate	$ 111,963	$ 309	$ 112,272	19.51%
Home equity	25,534		25,534	4.44%
Commercial real estate: non-owner occupied	49,355	39,392	88,747	15.43%
Commercial real estate: owner occupied	23,181	13,264	36,445	6.33%
Construction	375		375	0.07%
Commercial business	9,074	73,598	82,672	14.37%
Consumer	8,898		8,898	1.55%
Subtotal	228,380	126,563	354,943	61.69%
Purchased loans:				
Residential real estate		2,211	2,211	0.38%
Commercial business		267	267	0.05%
Commercial real estate: non-owner occupied		171,975	171,975	29.89%
Commercial real estate: owner occupied		45,939	45,939	7.98%
Subtotal		220,392	220,392	38.31%
Total	$ 228,380	$ 346,955	$ 575,335	100.00%

	June 30, 2014			
	Community Banking Division	LASG	Total	Percent of Total
	(Dollars in thousands)			
Originated loans:				
Residential real estate	$ 116,660	$ 312	$ 116,972	22.66%
Home equity	27,975		27,975	5.42%
Commercial real estate: non-owner occupied	46,191	33,969	80,160	15.52%
Commercial real estate: owner occupied	24,519	11,907	36,426	7.05%
Construction	31		31	0.01%
Commercial business	10,145	31,373	41,518	8.04%
Consumer	9,884		9,884	1.91%
Subtotal	235,405	77,561	312,966	60.61%
Purchased loans:				
Residential real estate		3,687	3,687	0.71%
Commercial business		282	282	0.05%
		133,581	133,581	25.87%

Commercial real estate: non-owner occupied				
Commercial real estate: owner occupied		65,900	65,900	12.76%
Subtotal		203,450	203,450	39.39%
Total	$ 235,405	$ 281,011	$ 516,416	100.00%

Classification of Assets

Loans are classified as non-performing when 90 days past due, unless a loan is well-secured and in the process of collection. Loans less than 90 days past due, for which collection of principal or interest is considered doubtful, also may be designated as non-performing. In both situations, accrual of interest ceases. The Company typically maintains such loans as non-performing until the respective borrowers have demonstrated a sustained period of payment performance.

In cases where a borrower experiences financial difficulties and the Company makes certain concessionary modifications, the loan is classified as a troubled debt restructuring (TDR). Concessionary modifications may include adjustments to interest rates, extensions of maturity, or other actions intended to minimize economic loss and avoid foreclosure or repossession of collateral. Nonaccrual loans that are restructured generally remain on nonaccrual status for a minimum period of six months to demonstrate that the borrower can meet the restructured terms. If the restructured loan is on accrual status prior to being modified, it is reviewed to determine if the modified loan should remain on accrual status. If the borrower s ability to meet the revised payment schedule is not reasonably assured, the loan is classified as a nonaccrual loan. With limited exceptions, loans classified as TDRs remain classified as such until the loan is paid off.

Other nonperforming assets include other real estate owned (OREO) and other personal property securing loans repossessed by the Bank. The real estate and personal property collateral for commercial and consumer loans is written down to its estimated realizable value upon repossession. Revenues and expenses are recognized in the period when received or incurred on OREO and in substance foreclosures. Gains and losses on disposition are recognized in noninterest income.

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The following table details the Company s nonperforming assets and other credit quality indicators as of December 31, 2014 and June 30, 2014. Management believes that, based on their carrying amounts, nonperforming assets are well secured based on the estimated fair value of underlying collateral.

	Non-Performing Assets at December 31, 2014		
	Community Banking Division	LASG	Total
	(Dollars in thousands)		
Loans:			
Residential real estate	$ 2,535	$ 171	$ 2,706
Home equity	11		11
Commercial real estate	1,166	8,129	9,295
Construction			
Commercial business			
Consumer	237		237
Subtotal	3,949	8,300	12,249
Real estate owned and other repossessed collateral	2,058		2,058
Total	$ 6,007	$ 8,300	$ 14,307
			2.13%
Ratio of nonperforming loans to total loans			1.77%
Ratio of nonperforming assets to total assets			2.64%
Ratio of loans past due to total loans			$ 1,904
Nonperforming loans that are current			$ 1,746
Commercial loans risk rated substandard or worse			
Troubled debt restructurings:			$ 5,351
On accrual status			$ 1,863
On nonaccrual status			

	Non-Performing Assets at June 30, 2014		
	Community Banking Division	LASG	Total
	(Dollars in thousands)		
Loans:			
Residential real estate	$ 1,572	$ 171	$ 1,743
Home equity	160		160
Commercial real estate	1,162	4,116	5,278
Construction			
Commercial business	5		5
Consumer	139		139
Subtotal	3,038	4,287	7,325
Real estate owned and other repossessed collateral	1,991		1,991
Total	$ 5,029	$ 4,287	$ 9,316
Ratio of nonperforming loans to total loans			1.42%
Ratio of nonperforming assets to total assets			1.22%
			1.14%

Ratio of loans past due to total loans		
Nonperforming loans that are current	$	651
Commercial loans risk rated substandard or worse	$	1,894
Troubled debt restructurings:		
On accrual status	$	4,057
Nonaccrual status	$	2,117

At December 31, 2014, nonperforming assets totaled $14.3 million, or 1.8% of total assets, as compared to $9.3 million, or 1.2% of total assets at June 30, 2014. The increase in nonperforming assets during the six months ended December 31, 2014 was mainly due to the addition of one recently-purchased loan relationship.

Allowance for Loan Losses

In connection with the application of the acquisition method of accounting for the merger on December 29, 2010, the allowance for loan losses was reduced to zero when the loan portfolio was marked to its then current fair value. Since that date, the Company has provided for an allowance for loan losses as new loans are originated or in the event that credit exposure in the pre-merger loan portfolio or other acquired loans exceeds the exposure estimated when initial fair values were determined.

The Company s allowance for loan losses was $1.7 million as of December 31, 2014, which represents an increase of $297 thousand from $1.4 million as of June 30, 2014. The increase during the period was principally due to increases in reserves necessary for loans accounted for under ASC 310-30 and due to increased volume of newly originated loans.

The following table details ratios related to the allowance for loan losses for the periods indicated.

	December 31, 2014	June 30, 2014	December, 2013
Allowance for loan losses to nonperforming loans	13.58%	18.66%	21.95%
Allowance for loan losses to total loans	0.29%	0.26%	0.27%
Last twelve months of net-charge offs to average loans	0.08%	0.06%	0.09%

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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 provision for loan losses in the future as a result of changing economic conditions, adverse markets for real estate or other factors.

Other Assets

The cash surrender value of the Company s bank-owned life insurance (BOLI) assets increased $219 thousand, or 1.5% to $15.1 million at December 31, 2014, compared to $14.8 million at June 30, 2014. Increases in cash surrender value are recognized in other income and are not subject to income taxes. Borrowing on, or surrendering a policy, may subject the Company to income tax expense on the increase in cash surrender value. For these reasons, management considers BOLI an illiquid asset. BOLI represented 12.5% of the Company s total risk-based capital at December 31, 2014.

Intangible assets totaled $2.5 million and $2.8 million at December 31, 2014 and June 30, 2014, respectively. The $332 thousand decrease was the result of core deposit intangible asset amortization during the period.

Deposits, Borrowed Funds, Capital Resources and Liquidity

Deposits

The Company s principal source of funding is its core deposit accounts. At December 31, 2014, non-maturity accounts and certificates of deposit with balances less than $250 thousand represented 99.8% of total deposits.

Total deposits increased $57.4 million to $631.7 million as of December 31, 2014 from $574.3 million as of June 30, 2014. The increase, which funded growth in the Company s loan portfolio, was centered mainly in money market accounts attracted through the Bank s ableBanking division. The composition of total deposits at December 31, 2014 and June 30, 2014 follows.

	December 31, 2014		June 30, 2014	
	Amount	Percent of Total	Amount	Percent of Total
	(Dollars in thousands)			
Demand deposits	$ 51,920	8.22%	$ 50,140	8.73%
NOW accounts	61,644	9.76%	63,648	11.08%
Regular and other savings	33,729	5.34%	34,692	6.04%
Money market deposits	144,523	22.88%	83,901	14.61%
Total non-certificate accounts	291,816	46.19%	232,381	40.46%
Term certificates less than $250 thousand	338,751	53.62%	339,616	59.13%

Term certificates of $250 thousand or more		1,153	0.18%		2,332	0.41%
Total certificate accounts		339,904	53.81%		341,948	59.54%
Total deposits	$	631,720	100.00%	$	574,329	100.00%

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Borrowed Funds

Advances from the FHLB were $35.2 million and $42.8 million at December 31, 2014 and June 30, 2014, respectively; the decrease was due to $7.5 million of maturing advances during the period. At December 31, 2014, the Company had pledged investment securities with a fair value of $21.2 million, as well as certain residential real estate loans, commercial real estate loans, and FHLB deposits free of liens or pledges to secure outstanding advances and available additional borrowing capacity.

Wholesale repurchase agreements were $10.1 million and $10.2 million at December 31, 2014 and June 30, 2014, respectively. At December 31, 2014, the Company had pledged investment securities with a fair value of $13.5 million as collateral for outstanding wholesale repurchase agreements.

Short-term borrowings, consisting of sweep accounts and repurchase agreements, were $2.8 million and $3.0 million as of December 31, 2014 and June 30, 2014, respectively.

Liquidity

The following table is a summary of unused borrowing capacity of the Company at December 31, 2014, in addition to traditional retail deposit products (dollars in thousands).

Brokered time deposits	$	201,646	Subject to policy limitation of 25% of total assets
Federal Home Loan Bank of Boston		86,769	Subject to eligible and qualified collateral
Federal Reserve Discount Window Borrower-in-Custody		1,414	Subject to the pledge of indirect auto loans
Total unused borrowing capacity		289,829	
Unencumbered investment securities		73,116	
Total sources of liquidity	$	362,945	

Retail deposits and other core deposit sources including deposit listing services are used by the Company to manage its overall liquidity position. While the Company typically does not seek wholesale funding such as brokered deposits, the ability to raise them remains an important part of its liquidity contingency planning. While management closely monitors and forecasts the Company s liquidity position, it is affected by asset growth, deposit withdrawals and other contractual obligations and commitments. The accuracy of management s forecast assumptions may increase or decrease the Company s overall available liquidity.

At December 31, 2014, the Company had $362.9 million of immediately accessible liquidity, defined as additional cash that could be raised within seven days through collateralized borrowings, brokered deposits or security sales. This position represented 44.8% of total assets. The Company also had $83.3 million of cash and cash equivalents at December 31, 2014.

Management believes that there are adequate funding sources to meet its liquidity needs for the foreseeable future. Primary funding sources are the repayment of principal and interest on loans, the renewal of time deposits, the potential for growth in the deposit base, and the credit availability from the FHLB. Management does not believe that the terms and conditions that will be present at the renewal of these funding sources will significantly impact the Company s operations, due to its management of the maturities of its assets and liabilities.

Capital

The carrying amount and unpaid principal balance of junior subordinated debentures totaled $8.5 million and $16.5 million, respectively, as of December 31, 2014. This debt represents qualifying Tier 1 capital for the Company, up to a maximum of 25% of total Tier 1 capital. At December 31, 2014, the carrying amounts of the junior subordinated notes, net of the Company s $496 thousand investment in the affiliated trusts, qualified as Tier 1 capital.

At December 31, 2014, shareholders equity was $110.9 million, a decrease of $1.2 million, or 1.1% from June 30, 2014. Book value per outstanding common share was $11.27 at December 31, 2014 and $11.05 at June 30, 2014. Tier 1 capital to total average assets of the Company was 14.81% as of December 31, 2014 and 15.89% at June 30, 2014.

In addition to the risk-based capital requirements, under the rules in effect through December 31, 2014, the Federal Reserve required top-rated bank holding companies to maintain a minimum leverage capital ratio of Tier 1 capital (defined by reference to the risk-based capital guidelines) to its average total consolidated assets of at least 3.0%. For most other bank holding companies (including the Company), the minimum leverage capital ratio was 4.0%. Bank holding companies with supervisory, financial, operational or managerial weaknesses, as well as bank holding companies that are anticipating or experiencing significant growth, were expected to maintain capital ratios well above the minimum levels.

Prior to the effectiveness of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), the FDIC had adopted a statement of policy regarding the capital adequacy of state-chartered banks and promulgated regulations to implement the system of prompt corrective action established by Section 38 of the Federal Deposit Insurance Act (FDIA). Under the FDIC regulations, a bank was considered well capitalized if it had: (i) a total risk-based capital ratio of 10.0% or greater; (ii) a Tier 1 risk-based capital ratio of 6.0% or greater; (iii) a leverage capital ratio of 5.0% or greater; and (iv) was not subject to any written agreement, order, capital directive or prompt corrective action directive to meet and maintain a specific capital level for any capital measure.

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In 2010, the Basel Committee on Banking Supervision released new capital requirements, known as Basel III, setting forth higher capital requirements, enhanced risk coverage, a global leverage ratio, provisions for counter-cyclical capital, and liquidity standards. In 2013, the Federal Reserve, along with the other federal banking agencies, issued final rules implementing the Basel III capital standards and establishing the minimum capital requirements for banks and bank holding companies required under the Dodd-Frank Act. These rules, which became effective January 1, 2015, establish a minimum common equity Tier 1 capital ratio requirement of 4.5%, a minimum Tier 1 capital ratio requirement of 6%, a minimum total capital requirement of 8.0% and a minimum leverage ratio requirement of 4%. Additionally, subject to a transition schedule, these rules require that an institution establish a capital conservation buffer of common equity Tier 1 capital in an amount above the minimum risk-based capital requirements for adequately capitalized institutions equal to 2.5% of total risk weighted assets, or face restrictions on the ability to pay dividends, pay discretionary bonuses, and to engage in share repurchases.

Under rules effective January 1, 2015, a bank holding company, such as the Company, is considered well capitalized if the bank holding company (i) has a total risk based capital ratio of at least 10%, (ii) has a Tier 1 risk-based capital ratio of at least 6%, and (iii) is not subject to any written agreement order, capital directive or prompt corrective action directive to meet and maintain a specific capital level for any capital measure. In addition, the FDIC has amended its prompt corrective action rules to reflect the revisions made by the new capital rules implementing Basel III. Under the FDIC s revised rules, which became effective January 1, 2015, an FDIC supervised institution is considered well capitalized if it (i) has a total risk-based capital ratio of 10.0% or greater; (ii) a Tier 1 risk-based capital ratio of 8.0% or greater; (iii) a common Tier 1 equity ratio of at least 6.5% or greater, (iv) a leverage capital ratio of 5.0% or greater; and (iv) is not subject to any written agreement, order, capital directive, or prompt corrective action directive to meet and maintain a specific capital level for any capital measure.

The Company and Bank are considered well capitalized under all regulatory definitions.

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The Company s and the Bank s regulatory capital ratios are set forth below.

	Actual		Minimum Capital Requirements		Minimum To Be Well Capitalized Under Prompt Correction Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollars in thousands)					
December 31, 2014:						
Total capital to risk weighted assets:						
Company	$ 120,629	21.44%	$ 45,007	≥8.0%	$ N/A	N/A
Bank	107,010	18.98%	45,110	≥8.0%	56,387	≥10.0%
Tier 1 capital to risk weighted assets:						
Company	118,935	21.14%	22,504	≥4.0%	N/A	N/A
Bank	103,235	18.31%	22,555	≥4.0%	33,832	≥6.0%
Tier 1 capital to average assets:						
Company	118,935	14.81%	32,114	≥4.0%	N/A	N/A
Bank	103,235	12.88%	32,067	≥4.0%	40,084	≥5.0%
June 30, 2014:						
Total capital to risk weighted assets:						
Company	$ 120,818	23.69%	$ 40,808	≥8.0%	$ N/A	N/A
Bank	103,160	20.12%	41,027	≥8.0%	51,284	≥10.0%
Tier 1 capital to risk weighted assets:						
Company	119,421	23.41%	20,404	≥4.0%	N/A	N/A
Bank	99,256	19.35%	20,514	≥4.0%	30,771	≥6.0%
Tier 1 capital to average assets:						
Company	119,421	15.90%	30,049	≥4.0%	N/A	N/A
Bank	99,256	13.22%	30,028	≥4.0%	37,536	≥5.0%

Off-balance Sheet Financial Instruments

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.

See Part I. Item I. Notes to Unaudited Consolidated Financial Statements Note 9: Commitments and Contingencies for further discussion.

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Results of Operations

General

Net income increased by $187 thousand to $1.6 million for the quarter ended December 31, 2014, compared to $1.4 million for the quarter ended December 31, 2013. Net income increased by $1.5 million to $3.2 million for the six months ended December 31, 2014, compared to $1.7 million for the six months ended December 31, 2013. When compared to the prior year, increases in net income for both the three and six months ended December 31, 2014 resulted principally from higher transactional income on purchased loans, positive balance sheet growth due to increased volume, and higher gains on sales of residential mortgages and gains on portfolio loans.

The following table details the total return on purchased loans, which includes transactional interest income of $2.6 million for the quarter ended December 31, 2014, an increase of $515 thousand from the quarter ended December 31, 2013. Transactional interest income for the six months ended December 31, 2014 was $4.6 million, an increase of $1.8 million from the six months ended December 31, 2013 principally due to higher payoffs in the first two quarters of fiscal 2015.

Total Return on Purchased Loans

	Three Months Ended December 31,			
	2014		2013	
	Income	Return (1)	Income	Return (1)
	(Dollars in thousands)			
Regularly scheduled interest and accretion	$ 4,376	8.31%	$ 4,014	9.02%
Transactional income:				
Gains on loan sales	194	0.37%	11	0.02%
Gain on sale of real estate owned	40	0.08%		0.00%
Other noninterest income		0.00%		0.00%
Accelerated accretion and loan fees	2,613	4.96%	2,098	4.72%
Total transactional income	2,847	5.41%	2,109	4.74%
Total	$ 7,223	13.72%	$ 6,123	13.76%

	Six Months Ended December 31,			
	2014		2013	
	Income	Return (1)	Income	Return (1)
	(Dollars in thousands)			
Regularly scheduled interest and accretion	$ 8,873	8.55%	$ 7,753	8.78%
Transactional income:				
Gains on loan sales	190	0.18%	227	0.26%
Gain on sale of real estate owned	40	0.04%		0.00%
Other noninterest income		0.00%		0.00%
Accelerated accretion and loan fees	4,638	4.47%	2,794	3.16%
Total transactional income	4,868	4.69%	3,021	3.42%

Total	$	13,741	13.24%	$	10,774	12.20%

(1) The total return on purchased loans represents scheduled accretion, accelerated accretion, gains on asset sales, and other noninterest income recorded during the period divided by the average invested balance, on an annualized basis.

Net Interest Income

Three Months Ended December 31, 2014 and 2013

Net interest and dividend income before provision for the three months ended December 31, 2014 and 2013 was $9.4 million and $9.0 million, respectively. The increase of $409 thousand was largely attributable to growth in the LASG loan portfolio, which earned a yield of 10.2% for the quarter ended December 31, 2014 on an average outstanding balance of $314.1 million. The following table summarizes interest income and related yields recognized on the Company s loans for the three months ended December 31, 2014 and 2013.

	Three Months Ended December 31,					
	2014			2013		
	Average Balance	Interest Income	Yield	Average Balance	Interest Income	Yield
	(Dollars in thousands)					
Community Banking Division	$ 236,127	$ 2,899	4.87%	$ 247,057	$ 3,284	5.27%
LASG:						
Originated	105,167	1,060	4.00%	68,449	886	5.14%
Purchased	208,935	6,989	13.27%	175,469	6,112	13.82%
Total LASG	314,102	8,049	10.17%	243,918	6,998	11.38%
Total	$ 550,229	$ 10,948	7.89%	$ 490,975	$ 10,282	8.31%

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In the quarter ended December 31, 2014, net interest income was negatively affected by a lower level of noncash accretion of fair value adjustments resulting from the 2010 merger than in the quarter ended December 31, 2013. The effect of such accretion will continue to diminish as financial instruments held at the merger mature or prepay. The following table summarizes the effects of such accretion.

	Three Months Ended December 31,									
	2014					2013				
		Average Balance		Income (Expense)	Effect on Yield / Rate		Average Balance		Income (Expense)	Effect on Yield / Rate
	(Dollars in thousands)									
Interest-earning assets:										
Investment securities	$	109,498	$		0.00%	$	116,888	$		0.00%
Loans		550,229		51	0.04%		490,975		47	0.04%
Other interest-earning assets		108,924			0.00%		84,770			0.00%
Total interest-earning assets	$	768,651	$	51	0.03%	$	692,633	$	47	0.03%
Interest-bearing liabilities:										
Interest-bearing deposits		571,419		56	0.04%		488,562		214	0.18%
Short-term borrowings		2,869			0.00%		2,397			0.00%
Borrowed funds		45,587		70	0.61%		59,941		107	0.72%
Junior subordinated debentures		8,508		(45)	(2.10)%		8,331		(42)	(2.04)%
Total interest-bearing liabilities	$	628,383	$	81	0.05%	$	559,231	$	279	0.20%
Total effect of noncash accretion on:										
Net interest income			$	132				$	326	
Net interest margin				0.07%					0.19%	

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The Company s interest rate spread and net interest margin both decreased by 29 basis points for the quarter ended December 31, 2014 compared to the quarter ended December 31, 2013. These decreases were principally rate driven with a slight decrease in yield on interest-earning assets and a slight increase in yield on interest-earning deposits. The following sets forth the average balance sheets, interest income and interest expense, and average yields and costs for the three months ended December 31, 2014 and 2013.

NORTHEAST BANCORP AND SUBSIDIARY

CONSOLIDATED AVERAGE BALANCE SHEETS AND ANNUALIZED YIELDS

(Unaudited)

(Dollars in thousands)

	Three Months Ended December 31,					
	2014			2013		
	Average Balance	Interest Income/ Expense	Average Yield/ Rate	Average Balance	Interest Income/ Expense	Average Yield/ Rate
Assets:						
Interest-earning assets:						
Investment securities (1)	$ 109,498	$ 232	0.84%	$ 116,888	$ 262	0.89%
Loans (2) (3)	550,229	10,948	7.89%	490,975	10,282	8.31%
Regulatory stock	4,102	15	1.45%	5,721	48	3.33%
Short-term investments (4)	104,822	64	0.24%	79,049	48	0.24%
Total interest-earning assets	768,651	11,259	5.81%	692,633	10,640	6.09%
Cash and due from banks	2,637			3,053		
Other non-interest earning assets	32,500			36,222		
Total assets	$ 803,788			$ 731,908		
Liabilities & Stockholders Equity:						
Interest-bearing liabilities:						
NOW accounts	$ 62,259	$ 40	0.25%	$ 58,987	$ 40	0.27%
Money market accounts	127,394	241	0.75%	86,245	114	0.52%
Savings accounts	33,648	12	0.14%	33,540	12	0.14%
Time deposits	348,118	988	1.13%	309,790	813	1.04%
Total interest-bearing deposits	571,419	1,281	0.89%	488,562	979	0.80%
Short-term borrowings	2,869	7	0.97%	2,397	6	0.99%
Borrowed funds	45,587	357	3.11%	59,941	446	2.95%
Junior subordinated debentures	8,508	188	8.77%	8,331	192	9.14%
Total interest-bearing liabilities	628,383	1,833	1.16%	559,231	1,623	1.15%
Non-interest bearing liabilities:						
Demand deposits and escrow accounts	55,131			53,184		
Other liabilities	7,130			5,677		

Total liabilities	690,644			618,092		
Stockholders equity	113,144			113,816		
Total liabilities and stockholders equity	$ 803,788			$ 731,908		
Net interest income		$ 9,426			$ 9,017	
Interest rate spread			4.65%			4.94%
Net interest margin (5)			4.87%			5.16%

(1) Interest income and yield are stated on a fully tax-equivalent basis using a 34% tax rate.
(2) Includes loans held for sale.
(3) Nonaccrual loans are included in the computation of average, but unpaid interest has not been included for purposes of determining interest income.
(4) Short term investments include FHLB overnight deposits and other interest-bearing deposits.
(5) Net interest margin is calculated as net interest income divided by total interest-earning assets.

The following table presents the extent to which changes in volume and interest rates of interest earning assets and interest bearing liabilities have affected the Company s interest income and interest expense during the periods indicated. Information is provided in each category with respect to (i) changes attributable to changes in volume (changes in volume multiplied by prior period rate), (ii) changes attributable to changes in rates (changes in rates multiplied by prior period volume) and (iii) change attributable to a combination of changes in rate and volume (change in rates multiplied by the changes in volume). Changes attributable to the combined impact of volume and rate have been allocated proportionately to the changes due to volume and the changes due to rate.

	Three Months Ended December 31, 2014 compared to 2013		
	Change Due to Volume	Change Due to Rate	Total Change
	(Dollars in thousands)		
Interest earning assets:			
Investment securities	$ (16)	$ (14)	$ (30)
Loans	1,197	(531)	666
Regulatory stock	(11)	(22)	(33)
Short-term investments	16		16
Total interest-earning assets	1,186	(567)	619
Interest-bearing liabilities:			
Interest-bearing deposits	176	126	302
Short-term borrowings	1		1
Borrowed funds	(111)	22	(89)
Junior subordinated debentures	4	(8)	(4)
Total interest-bearing liabilities	70	140	210
Total change in net interest income	$ 1,116	$ (707)	$ 409

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Six Months Ended December 31, 2014 and 2013

Net interest and dividend income before provision for the six months ended December 31, 2014 and 2013 was $18.9 million and $16.1 million, respectively. The increase of $2.8 million was largely attributable to growth in the LASG loan portfolio, which earned a yield of 10.5% for the six ended December 31, 2014 on an average outstanding balance of $299.6 million. The following table summarizes interest income and related yields recognized on the Company s loans for the six months ended December 31, 2014 and 2013.

	Six Months Ended December 31,									
	2014					2013				
		Average Balance		Interest Income	Yield		Average Balance		Interest Income	Yield
	(Dollars in thousands)									
Community Banking Division	$	238,646	$	5,960	4.95%	$	244,880	$	6,626	5.37%
LASG:										
Originated		93,751		2,399	5.08%		57,828		1,566	5.37%
Purchased		205,896		13,511	13.02%		174,318		10,547	12.00%
Total LASG		299,647		15,910	10.53%		232,146		12,113	10.35%
Total	$	538,293	$	21,870	8.06%	$	477,026	$	18,739	7.79%

In the six months ended December 31, 2014, net interest income was negatively affected by a lower level of noncash accretion of fair value adjustments resulting from the 2010 merger than in the six months ended December 31, 2013. The effect of such accretion will continue to diminish as financial instruments held at the merger mature or prepay. The following table summarizes the effects of such accretion.

	Six Months Ended December 31,									
	2014					2013				
		Average Balance		Income (Expense)	Effect on Yield / Rate		Average Balance		Income (Expense)	Effect on Yield / Rate
	(Dollars in thousands)									
Interest-earning assets:										
Investment securities	$	110,874	$		0.00%	$	118,093	$		0.00%
Loans		538,293		127	0.05%		477,026		83	0.03%
Other interest-earning assets		97,894			0.00%		83,949			0.00%
Total interest-earning assets	$	747,061	$	127	0.03%	$	679,068	$	83	0.02%
Interest-bearing liabilities:										
Interest-bearing deposits		548,025		120	0.04%		475,845		415	0.17%
Short-term borrowings		3,095			0.00%		2,337			0.00%
Borrowed funds		49,283		162	0.65%		59,964		215	0.71%
Junior subordinated debentures		8,484		(90)	(2.10)%		8,309		(84)	(2.01)%
Total interest-bearing liabilities	$	608,887	$	192	0.09%	$	546,455	$	546	0.20%
Total effect of noncash accretion on:										
Net interest income			$	319				$	629	
Net interest margin				0.08%					0.18%	

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The Company s interest rate spread and net interest margin increased by 32 basis points and 31 basis points, respectively, for the six months ended December 31, 2014 compared to the six months ended December 31, 2013. These increases were principally the result of the aforementioned increase in loan volume and average yield. The following sets forth the average balance sheets, interest income and interest expense, and average yields and costs for the six months ended December 31, 2014 and 2013.

	Six Months Ended December 31,					
	2014			2013		
	Average Balance	Interest Income/ Expense	Average Yield/ Rate	Average Balance	Interest Income/ Expense	Average Yield/ Rate
	(Dollars in thousands)					
Assets:						
Interest-earning assets:						
Investment securities	$ 110,874	$ 475	0.85%	$ 118,093	$ 544	0.91%
Loans (1) (2)	538,293	21,870	8.06%	477,026	18,739	7.79%
Regulatory stock	4,102	31	1.50%	5,721	52	1.80%
Short-term investments (3)	93,792	115	0.24%	78,228	95	0.24%
Total interest-earning assets	747,061	22,491	5.97%	679,068	19,430	5.68%
Cash and due from banks	2,674			3,045		
Other non-interest earning assets	33,326			35,117		
Total assets	$ 783,061			$ 717,230		
Liabilities & Stockholders Equity:						
Interest-bearing liabilities:						
NOW accounts	$ 62,934	$ 81	0.26%	$ 59,055	$ 80	0.27%
Money market accounts	106,844	365	0.68%	85,967	226	0.52%
Savings accounts	34,004	23	0.13%	33,733	24	0.14%
Time deposits	344,243	1,941	1.12%	297,090	1,696	1.13%
Total interest-bearing deposits	548,025	2,410	0.87%	475,845	2,026	0.84%
Short-term borrowings	3,095	16	1.03%	2,337	11	0.93%
Borrowed funds	49,283	771	3.10%	59,964	886	2.93%
Junior subordinated debentures	8,484	394	9.21%	8,309	385	9.19%
Total interest-bearing liabilities	608,887	3,591	1.17%	546,455	3,308	1.20%
Non-interest bearing liabilities:						
Demand deposits and escrow accounts	54,187			51,788		
Other liabilities	7,220			5,619		
Total liabilities	670,294			603,862		
Stockholders equity	112,767			113,368		
Total liabilities and stockholders equity	$ 783,061			$ 717,230		
Net interest income		$ 18,900			$ 16,122	
Interest rate spread			4.80%			4.48%
Net interest margin (4)			5.02%			4.71%

(1) Includes loans held for sale.
(2) Nonaccrual loans are included in the computation of average, but unpaid interest has not been included for purposes of determining interest income.
(3) Short term investments include FHLB overnight deposits and other interest-bearing deposits.
(4) Net interest margin is calculated as net interest income divided by total interest-earning assets.

The following table presents the extent to which changes in volume and interest rates of interest earning assets and interest bearing liabilities have affected the Company s interest income and interest expense during the periods indicated. Information is provided in each category with respect to (i) changes attributable to changes in volume (changes in volume multiplied by prior period rate), (ii) changes attributable to changes in rates (changes in rates multiplied by prior period volume) and (iii) changes attributable to a combination of changes in rate and volume (change in rates multiplied by the changes in volume). Changes attributable to the combined impact of volume and rate have been allocated proportionately to the changes due to volume and the changes due to rate.

	Six Months Ended December 31, 2014 compared to 2013		
	Change Due to Volume	Change Due to Rate (Dollars in thousands)	Total Change
Interest earning assets:			
Investment securities	$ (32)	$ (37)	$ (69)
Loans	2,472	659	3,131
Regulatory stock	(13)	(8)	(21)
Short-term investments	19	1	20
Total interest-earning assets	2,446	615	3,061
Interest-bearing liabilities:			
Interest-bearing deposits	341	43	384
Short-term borrowings	4	1	5
Borrowed funds	(165)	50	(115)
Junior subordinated debentures	8	1	9
Total interest-bearing liabilities	188	95	283
Total change in net interest income	$ 2,258	$ 520	$ 2,778

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Provision for Loan Losses

Quarterly, the Company determines the amount of the allowance for loan losses that is appropriate to provide for losses inherent in the Company s loan portfolios, with the provision for loan losses determined by the net change in the allowance for loan losses. For loans acquired with deteriorated credit quality, a provision for loan a loss is recorded when estimates of future cash flows are lower than had been previously expected. See Part I. Item I. Notes to Unaudited Consolidated Financial Statements Note 4: Loans, Allowance for Loan losses and Credit Quality for further discussion.

The provision for loan losses for periods subsequent to the merger with FHB Formation LLC reflects the impact of adjusting loans to their then fair values, as well as the elimination of the allowance for loan losses in accordance with the acquisition method of accounting. Subsequent to the merger, the provision for loan losses has been recorded based on estimates of inherent losses in newly originated loans and for incremental reserves required for pre-merger loans based on estimates of deteriorated credit quality post-merger.

Three Months Ended December 31, 2014 and 2013

The provision for loan losses for the quarter ended December 31, 2014 and 2013 was $113 thousand and $151 thousand, respectively. The decrease in the Company s loan loss provision resulted principally from favorable impairment trends in the purchased and originated loan portfolios.

Six Months Ended December 31, 2014 and 2013

The provision for loan losses for the six months ended December 31, 2014 and 2013 was $433 thousand and $227 thousand, respectively. The increase is principally due to increases in reserves necessary for loans accounted for under ASC 310-30 and due to increased volume of newly originated loans.

Noninterest Income

Three Months Ended December 31, 2014 and 2013

Noninterest income decreased by $535 thousand for the current quarter, compared to the quarter ended December 31, 2013, principally due to the following:

- An increase of $432 thousand in gain on sales of portfolio loans, realized primarily on the sale of the guaranteed portion of SBA loans. The Company recognized $445 thousand in gains on SBA loans sold for the three months ended December 31, 2014, compared to no SBA gain for the quarter ended December 31, 2013; and

- An increase of $106 thousand in gains realized on sale of residential loans originated for sale in the secondary market, due principally to an increase in purchase-related mortgage loan activity in the current period.

Six Months Ended December 31, 2014 and 2013

Noninterest income increased by $400 thousand for the six months ended December 31, 2014, compared to the six months ended December 31, 2013, principally due to the following:

- An increase of $295 thousand in gain on sales of portfolio loans, realized primarily on the sale of the guaranteed portion of SBA loans. The Company recognized $529 thousand in gains on SBA loans sold for the six months ended December 31, 2014, compared to no SBA gain for the quarter ended December 31, 2013; and

- An increase of $149 thousand in gains realized on sale of residential loans originated for sale in the secondary market, due principally to an increase in purchase-related mortgage loan activity in the current period.

Noninterest Expense

Three Months Ended December 31, 2014 and 2013

Noninterest expense increased by $596 thousand for the current quarter, compared to the quarter ended December 31, 2013, principally due to the following:

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- An increase of $484 thousand in salaries and employee benefits, principally due to increased employee head count and incentive compensation, offset by a decrease in group insurance expense and employee stock options expense;

- An increase of $177 thousand in professional fees, due primarily to fees for temporary consulting services;

- An increase of $123 thousand in loan acquisition and collection expenses, due in part to an increased level of loan purchases in the quarter ended December 31, 2014 when compared to the quarter ended December 31, 2013; and

- A decrease of $130 thousand in occupancy and equipment expense, the result of a reduction in software maintenance and depreciation expense following the conversion of the Bank s core systems platform to an outsourced model in May 2014. The decrease in equipment expense was offset in part by higher data processing fees, which increased by $70 thousand.

Six Months Ended December 31, 2014 and 2013

Noninterest expense increased by $483 thousand for the six months ended December 31, 2014, compared to the six months ended December 31, 2013, principally due to the following:

- An increase of $405 thousand in salaries and employee benefits, principally due to an increase in average headcount, as well as higher employee benefits and stock-based compensation;

- An increase of $109 thousand in professional fees, principally due to increased temporary consulting fees;

- An increase of $138 thousand in data processing fees, primarily due to increased expense associated with the Bank s core systems conversion in May 2014;

- An increase of $250 thousand in legal settlement expense resulting from an insurance recovery in the quarter ended September 30, 2013.

- A decrease of $217 thousand in occupancy and equipment expense, primarily due to a reduction in software maintenance and depreciation expense due to the Bank s core conversion in May 2014. This decrease was offset in part by a $179 thousand increase in data processing fees.

- A decrease of $89 thousand in intangible asset amortization. The Company s core deposit intangible amortizes on an accelerated basis.

Income Taxes

Three Months Ended December 31, 2014 and 2013

The Company s effective tax rate for the quarter ended December 31, 2014 was 36.1%, compared to 32.4% for the quarter ended December 31, 2013. The increase in the quarter was primarily the result of a change in estimated state tax apportionment.

Six Months Ended December 31, 2014 and 2013

The Company s income tax expense was $1.8 million or an effective rate of 36.1%, for the six months ended December 31, 2014, as compared to $832 thousand, or an effective rate of 32.6%, for the six months ended December 30, 2013. The increased effective rate in six months ended December 31, 2014 principally resulted from a change in estimated state tax apportionment.

Results of Operations Discontinued Operations

The Company concluded all investment brokerage activities in the second quarter of fiscal 2014. Accordingly, operations associated with these activities have been classified as discontinued operations.

The Company reported a net loss from discontinued operations of $18 thousand in the quarter ended December 31, 2013.

The Company reported a net loss from discontinued operations of $8 thousand for the six months ended December 31, 2013.

The net loss in both the quarter and six months ended December 31, 2013 was due to the discontinuance of brokerage activities in November 2013.

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Item 3. Quantitative and Qualitative Disclosure about Market Risk

Not required for smaller reporting companies.

Item 4. Controls and Procedures

The Company maintains controls and procedures designed to ensure that information required to be disclosed in the reports the Company files or submits under the Securities Exchange Act of 1934 (Exchange Act) is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission, and that such information is accumulated and communicated to the Company s management, including the Chief Executive Officer and Chief Financial Officer (the Company s principal executive officer and principal financial officer, respectively), as appropriate to allow for timely decisions regarding timely disclosure. In designing and evaluating disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost/benefit relationship of possible controls and procedures.

The Company s management, with the participation of the Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of its disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this Quarterly Report on Form 10-Q.

Based on this evaluation of the Company s disclosure controls and procedures, the Chief Executive Officer and Chief Financial Officer have concluded that these disclosure controls and procedures were effective as of December 31, 2014.

There were no changes in the Company s internal controls over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) that occurred during the quarter ended December 31, 2014 that have materially affected, or is reasonably likely to materially affect, the Company s internal controls over financial reporting.

PART II OTHER INFORMATION

Item 1. Legal Proceedings

None.

Item 1A. Risk Factors

Not required for smaller reporting companies.

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

On April 23, 2014, the Company announced that its Board of Directors authorized the Company to purchase up to 870,000 shares of its common stock, representing 8.3% of the Company s outstanding common shares and approximately $8.4 million based on the Company s closing stock price on April 22, 2014. Such purchases will be made in open market or in privately negotiated transactions from time to time and in such amounts as market conditions warrant. The timing and actual number of shares repurchased will depend on a variety of factors including price, corporate and regulatory requirements, market conditions, and other corporate liquidity requirements and priorities. The stock repurchase program may be suspended or terminated at any time without prior notice, and will expire on April 23, 2016.

The following table sets forth information with respect to purchases made by us of our common stock during the three months ended December 31, 2014.

Period	Total Number of Shares Purchased (1)		Average Price Per share	Total Number of Shares Purchased as Part of Publicly Announced Programs	Maximum Number of Shares that May Yet Be Purchased Under the Program
Jul. 1 Jul. 31	2,100	$	9.23	293,300	576,700
Aug. 1 Aug. 31	12,300	$	9.34	305,600	564,400
Sep. 1 Sep. 30				305,600	564,400
Oct. 1 Oct. 21	1,800		9.03	307,400	562,600
Nov. 1 Nov. 30	36,900		9.05	344,300	525,700
Dec. 1 - Dec. 31	395,586		9.14	739,886	130,114

(1) Based on trade date, not settlement date

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Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

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Item 6. Exhibits

Exhibits No.	Description
31.1	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Rule 13a-14(a)). *
31.2	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Rule 13a-14(a)). *
32.1	Certificate of the Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Rule 13a-14(b)). **
32.2	Certificate of the Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Rule 13a-14(b)). **
101	The following materials from Northeast Bancorp s Quarterly Report on Form 10-Q for the quarter ended December 31, 2014 formatted in XBRL: (i) Consolidated Balance Sheets at December 31, 2014 and June 30, 2014; (ii) Consolidated Statements of Income for the three and six months ended December 31, 2014 and 2013; (iii) Consolidated Statements of Comprehensive Income for the three and six months ended December 30, 2014 and 2013; (iv) Consolidated Statements of Changes in Shareholders Equity for the six months ended December 31, 2014 and 2013; (v) Consolidated Statements of Cash Flows for the six months ended December 31, 2014 and 2013; and (v) Notes to Unaudited Consolidated Financial Statements.

* Filed herewith

** Furnished herewith

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SIGNATURES

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

Date: February 13, 2015

NORTHEAST BANCORP

By: /s/ Richard Wayne

Richard Wayne
President and CEO

By: /s/ Brian Shaughnessy

Brian Shaughnessy
Chief Financial Officer

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NORTHEAST BANCORP

Index to Exhibits

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