BAR HARBOR BANKSHARES
Form 10-Q
November 09, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2012

OR

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

Commission File Number: **01-13349**

BAR HARBOR BANKSHARES

(Exact name of registrant as specified in its charter)

Maine	**01-0393663**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
PO Box 400 **82 Main Street, Bar Harbor, ME**	**04609-0400**
(Address of principal executive offices)	(Zip Code)

(207) 288-3314

(Registrant's telephone number, including area code)

Inapplicable

(Former name, former address and former fiscal year, if changed since last report)

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

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

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 the definitions of large accelerated filer , accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act: Large accelerated filer ¨ Accelerated filer **þ** Non-accelerated filer (do not check if a smaller reporting company) ¨ Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act): YES: ¨ NO: **þ**

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date:

Class of Common Stock	Number of Shares Outstanding November 1, 2012
$2.00 Par Value	**3,921,427**

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PART I. FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

BAR HARBOR BANKSHARES AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

SEPTEMBER 30, 2012 AND DECEMBER 31, 2011

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

(*unaudited*)

	September 30, 2012	December 31, 2011
Assets		
Cash and cash equivalents	$ 10,045	$ 8,720
Securities available for sale, at fair value	421,826	381,880
Federal Home Loan Bank stock	18,189	16,068
Loans	808,412	729,003
Allowance for loan losses	(8,053)	(8,221)
Loans, net of allowance for loan losses	800,359	720,782
Premises and equipment, net	19,345	16,090
Goodwill	5,231	3,158
Bank owned life insurance	7,567	7,377
Other assets	12,868	13,391
TOTAL ASSETS	$1,295,430	$1,167,466
Liabilities		
Deposits:		
Demand and other non-interest bearing deposits	$ 80,372	$ 62,648
NOW accounts	115,113	99,120
Savings and money market deposits	220,843	206,704
Time deposits	397,299	354,418
Total deposits	813,627	722,890
Short-term borrowings	193,342	175,813
Long-term advances from Federal Home Loan Bank	145,491	139,470
Junior subordinated debentures	5,000	5,000
Other liabilities	8,735	6,043
TOTAL LIABILITIES	$1,166,195	$1,049,216
Shareholders' equity		
Capital stock, par value $2.00; authorized 10,000,000 shares; issued 4,525,635 shares at September 30, 2012, and December 31, 2011	9,051	9,051

Surplus	26,651	26,512
Retained earnings	92,277	86,198
Accumulated other comprehensive income:		
Prior service cost and unamortized net actuarial losses on employee benefit plans, net of tax of ($174) and ($9), at September 30, 2012 and December 31, 2011, respectively	(338)	(17)
Net unrealized appreciation on securities available for sale, net of tax of $5,547 and $3,845, at September 30, 2012 and December 31, 2011, respectively	10,768	7,464
Portion of OTTI attributable to non-credit gains(losses), net of tax of $78 and ($218), at September 30, 2012, and December 31, 2011, respectively	152	(423)
Total accumulated other comprehensive income	10,582	7,024
Less: cost of 606,741 and 646,742 shares of treasury stock at September 30, 2012 and December 31, 2011, respectively	(9,326)	(10,535)
TOTAL SHAREHOLDERS' EQUITY	129,235	118,250
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$1,295,430	$1,167,466

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

BAR HARBOR BANKSHARES AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2012 AND 2011

(Dollars in thousands, except per share data)

(unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2012	2011	2012	2011
Interest and dividend income:				
Interest and fees on loans	$ 9,422	$ 8,783	$27,155	$26,087
Interest on securities	3,432	3,926	10,663	12,192
Dividend on FHLB stock	22	11	63	35
Total interest and dividend income	12,876	12,720	37,881	38,314
Interest expense:				
Deposits	1,941	2,202	5,795	6,606
Short-term borrowings	105	55	319	199
Long-term debt	1,416	1,759	4,383	5,847
Total interest expense	3,462	4,016	10,497	12,652
Net interest income	9,414	8,704	27,384	25,662
Provision for loan losses	427	750	1,302	1,850
Net interest income after provision for loan losses	8,987	7,954	26,082	23,812
Non-interest income:				
Trust and other financial services	850	746	2,468	2,261
Service charges on deposit accounts	351	372	887	997
Credit and debit card service charges and fees	419	361	1,075	940
Net securities gains	597	993	1,834	2,313
Total other-than-temporary impairment ("OTTI") losses	(173)	(743)	(1,007)	(1,897)
Non-credit portion of OTTI losses (before taxes) (1)	72	171	226	171
Net OTTI losses recognized in earnings	(101)	(572)	(781)	(1,726)
Other operating income	182	164	489	496
Total non-interest income	2,298	2,064	5,972	5,281
Non-interest expense:				
Salaries and employee benefits	3,670	3,267	10,161	9,334
Occupancy expense	408	350	1,183	1,153
Furniture and equipment expense	387	416	1,294	1,261
Credit and debit card expenses	99	87	274	232
FDIC insurance assessments	237	242	609	870

Other operating expense	1,758	1,322	5,003	4,131
Total non-interest expense	6,559	5,684	18,524	16,981
Income before income taxes	4,726	4,334	13,530	12,112
Income taxes	1,358	1,324	3,894	3,460
Net income	$ 3,368	$ 3,010	$ 9,636	$ 8,652
Per Common Share Data:				
Basic earnings per share	$ 0.86	$ 0.78	$ 2.47	$ 2.25
Diluted earnings per share	$ 0.86	$ 0.77	$ 2.46	$ 2.23

(1)

Included in other comprehensive loss, net of tax

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

BAR HARBOR BANKSHARES AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2012 AND 2011

(Dollars in thousands)

(unaudited)

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011
Net income	$ 3,368	$ 3,010
Other comprehensive income:		
Net unrealized appreciation on securities available for sale, net of tax of $1,359 and $2,096, respectively	2,635	4,068
Less reclassification adjustment for net gains related to securities available for sale included in net income, net of tax of ($203) and ($338), respectively	(394)	(657)
Add other-than-temporary impairment adjustment, net of tax of $58 and $252, respectively	115	490
Less non-credit portion of other-than-temporary impairment losses, net of tax of ($25), and ($58), respectively	(47)	(113)
Net amortization of prior service cost and actuarial(gain)/loss for supplemental executive retirement plan, net of related tax of ($52) and $1, respectively	(100)	1
Actuarial gain on supplemental executive retirement plan, net of related tax of $114 and $0, respectively	(222)	---
Total other comprehensive income	1,987	3,789
Total comprehensive income	$ 5,355	$ 6,799

	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
Net income	$ 9,636	$ 8,652
Other comprehensive income:		
Net unrealized appreciation on securities available for sale, net of tax of $2,357 and $3,648,	4,573	7,082

respectively		
Less reclassification adjustment for net gains related to securities available for sale included in net		
income, net of tax of ($624) and ($787), respectively	(1,210)	(1,528)
Add other-than-temporary impairment adjustment, net of tax of $342 and $645, respectively	665	1,252
Less non-credit portion of other-than-temporary impairment losses, net of tax of ($77), and ($58),		
respectively	(149)	(113)
Net amortization of prior service cost and actuarial (gain)/loss supplemental executive retirement plan,		
net of related tax of ($51) and $1, respectively	(99)	2
Actuarial gain on supplemental executive retirement plan, net of related tax of $114 and $0, respectively	(222)	---
Total other comprehensive income	3,558	6,695
Total comprehensive income	$13,194	$15,347

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

BAR HARBOR BANKSHARES AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2012 AND 2011

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

(unaudited)

	Capital Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Total Shareholders' Equity
Balance December 31, 2010	$9,051	$26,165	$80,379	$ 284	$(12,271)	$103,608
Net income	---	---	8,652	---	---	8,652
Total other comprehensive income	---	---	---	6,695	---	6,695
Dividend declared:						
Common stock ($0.815 per share)	---	---	(3,142)	---		(3,142)
Purchase of treasury stock (10,794 shares)	---	---	---	---	(304)	(304)
Stock options exercised (77,033 shares), including related tax effects	---	246	(989)	---	2,330	1,587
Recognition of stock based compensation expense	---	77		---	---	77
Balance September 30, 2011	$9,051	$26,488	$84,900	$ 6,979	$(10,245)	$117,173

	Capital Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Total Shareholders' Equity
Balance December 31, 2011	$9,051	$26,512	$86,198	$ 7,024	$(10,535)	$118,250
Net income	---	---	9,636	---	---	9,636
Total other comprehensive income	---	---	---	3,558	---	3,558
Dividend declared:						
Common stock ($0.870 per share)	---	---	(3,388)	---		(3,388)
Stock options exercised (40,001 shares),	---	28	(197)	---	1,168	999

including related tax effects						
Recognition of stock based compensation expense	---	160	20	---	---	180
Restricted stock grants	---	(49)	8	---	41	---
Balance September 30, 2012	$9,051	$26,651	$92,277	$10,582	$(9,326)	$129,235

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

BAR HARBOR BANKSHARES AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2012 AND 2011

(Dollars in thousands)

(unaudited)

	2012	2011
Cash flows from operating activities:		
Net income	$ 9,636	$ 8,652
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of premises and equipment	905	891
Provision for loan losses	1,302	1,850
Net securities gains	(1,834)	(2,313)
Other-than-temporary impairment	781	1,726
Net amortization of bond premiums and discounts	2,869	1,039
Recognition of stock based expense	180	77
Net change in other assets	(390)	785
Net change in other liabilities	2,215	(183)
Net cash provided by operating activities	15,664	12,524
Cash flows from investing activities:		
Net cash received in acquisition	1,197	---
Purchases of securities available for sale	(134,170)	(113,677)
Proceeds from maturities, calls and principal paydowns of mortgage-backed securities	67,157	52,377
Proceeds from sales of securities available for sale	34,664	40,457
Purchase of FHLB stock	(1,351)	---
Net loans made to customers	(48,197)	(16,705)
Proceeds from sale of other real estate owned	356	116
Capital expenditures	(3,597)	(2,216)
Net cash used in investing activities	(83,941)	(39,648)
Cash flows from financing activities:		
Net increase in deposits	52,217	53,766
Net increase (decrease) in securities sold under repurchase agreements and fed funds purchased	3,988	(750)
Proceeds from Federal Home Loan Bank advances	53,999	26,000
Repayments of Federal Home Loan Bank advances	(38,213)	(54,302)
Purchases of Treasury Stock	---	(304)
Proceeds from stock option exercises, including excess tax benefits	999	1,587
Payments of dividends	(3,388)	(3,142)
Net cash provided by financing activities	69,602	22,855
Net decrease in cash and cash equivalents	1,325	(4,269)

Cash and cash equivalents at beginning of period	8,720	12,815
Cash and cash equivalents at end of period	$ 10,045	$ 8,546
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$ 10,574	$12,923
Income taxes	2,988	3,077
Schedule of noncash investing activities:		
Transfers from loans to other real estate owned	$ 912	$ 960
Acquisitions:		
Fair value of noncash assets acquired	$41,576	$ ---
Fair value of liabilities assumed	($42,773)	$ ---

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

BAR HARBOR BANKSHARES AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

SEPTEMBER 30, 2012

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

(*unaudited*)

Note 1: Basis of Presentation

The accompanying consolidated interim financial statements are unaudited. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. All inter-company transactions have been eliminated in consolidation. Amounts in the prior period financial statements are reclassified whenever necessary to conform to current period presentation. The net income reported for the three and nine months ended September 30, 2012, is not necessarily indicative of the results that may be expected for the year ending December 31, 2012, or any other interim periods.

The consolidated balance sheet at December 31, 2011, has been derived from audited consolidated financial statements at that date. The accompanying unaudited interim consolidated financial statements have been prepared in accordance with United States (U.S.) generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X (17 CFR Part 210). Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. For further information, please refer to the consolidated financial statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2011, and notes thereto.

Note 2: Management s Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of the allowance for loan losses, other-than-temporary impairments on securities, income tax estimates, and the valuation of intangible assets.

Allowance for Loan Losses: The allowance for loan losses (the allowance) is a significant accounting estimate used in the preparation of the Company s consolidated financial statements. The allowance is available to absorb losses on loans and is maintained at a level that, in management s judgment, is appropriate for the amount of risk inherent in the loan portfolio, given past and present conditions. The allowance is increased by provisions charged to operating expense and by recoveries on loans previously charged-off, and is decreased by loans charged-off as uncollectible.

Arriving at an appropriate level of allowance involves a high degree of judgment. The determination of the adequacy of the allowance and provisioning for estimated losses is evaluated regularly based on review of loans, with particular emphasis on non-performing or other loans that management believes warrant special consideration. The ongoing evaluation process includes a formal analysis, which considers among other factors: the character and size of the loan portfolio, business and economic conditions, real estate market conditions, collateral values, changes in product offerings or loan terms, changes in underwriting and/or collection policies, loan growth, previous charge-off experience, delinquency trends, non-performing loan trends, the performance of individual loans in relation to contract terms, and estimated fair values of collateral.

The allowance consists of allowances established for specific loans including impaired loans; allowances for pools of loans based on historical charge-offs by loan types; and supplemental allowances that adjust historical loss experience to reflect current economic conditions, industry specific risks, and other observable data.

While management uses available information to recognize losses on loans, changing economic conditions and the economic prospects of the borrowers may necessitate future additions or reductions to the allowance. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the allowance, which also may necessitate future additions or reductions to the allowance, based on information available to them at the time of their examination.

Other-Than-Temporary Impairments on Investment Securities**:** One of the significant estimates relating to securities is the evaluation of other-than-temporary impairment. If a decline in the fair value of a security is judged to be other-than-temporary, and management does not intend to sell the security and believes it is more-likely-than-not the Company will not be required to sell the security prior to recovery of cost or amortized cost, the portion of the total impairment attributable to the credit loss is recognized in earnings, and the remaining difference between the security s amortized cost basis and its fair value is included in other comprehensive income.

For impaired available for sale debt securities that management intends to sell, or where management believes it is more-likely-than-not that the Company will be required to sell, an other-than-temporary impairment charge is recognized in earnings equal to the difference between fair value and cost or amortized cost basis of the security. The fair value of the other-than-temporarily impaired security becomes its new cost basis.

The evaluation of securities for impairments is a quantitative and qualitative process, which is subject to risks and uncertainties and is intended to determine whether declines in the fair value of securities should be recognized in current period earnings. The risks and uncertainties include changes in general economic conditions, the issuer s financial condition and/or future prospects, the effects of changes in interest rates or credit spreads and the expected recovery period of unrealized losses. The Company has a security monitoring process that identifies securities that, due to certain characteristics, as described below, are subjected to an enhanced analysis on a quarterly basis.

Securities that are in an unrealized loss position, are reviewed at least quarterly to determine if an other-than-temporary impairment is present based on certain quantitative and qualitative factors and measures. The primary factors considered in evaluating whether a decline in value of securities is other-than-temporary include: (a) the cause of the impairment; (b) the financial condition, credit rating and future prospects of the issuer; (c) whether the debtor is current on contractually obligated interest and principal payments; (d) the volatility of the securities fair value; (e) performance indicators of the underlying assets in the security including default rates, delinquency rates, percentage of non-performing assets, loan to collateral value ratios, conditional payment rates, third party guarantees, current levels of subordination, vintage, and geographic concentration and; (f) any other information and observable data considered relevant in determining whether other-than-temporary impairment has occurred, including the expectation of the receipt of all principal and interest due.

In addition, for securitized financial assets with contractual cash flows, such as private label mortgage-backed securities, the Company periodically updates its best estimate of cash flows over the life of the security. The Company s best estimate of cash flows is based upon assumptions consistent with the current economic environment, similar to those the Company believes market participants would use. If the fair value of a securitized financial asset is less than its cost or amortized cost and there has been an adverse change in timing or amount of anticipated future cash flows since the last revised estimate to the extent that the Company does not expect to receive the entire amount of future contractual principal and interest, an other-than-temporary impairment charge is recognized in earnings representing the estimated credit loss if management does not intend to sell the security and believes it is more-likely-than-not the Company will not be required to sell the security prior to recovery of cost or amortized cost. Estimating future cash flows is a quantitative and qualitative process that incorporates information received from third party sources along with certain assumptions and judgments regarding the future performance of the underlying collateral. In addition, projections of expected future cash flows may change based upon new information regarding the performance of the underlying collateral.

Income Taxes: The Company uses the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. If current available information indicates that it is more-likely-than-not that deferred tax assets will not be realized, a valuation allowance is established. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Significant management judgment is required in determining income tax expense and deferred tax assets and liabilities. As of September 30, 2012 and December 31, 2011, there was no valuation allowance for deferred tax assets. Deferred tax assets are included in other assets on the consolidated balance sheet.

Goodwill and Identifiable Intangible Assets: In connection with acquisitions, the Company generally records as assets on its consolidated financial statements both goodwill and identifiable intangible assets, such as core deposit intangibles.

The Company evaluates whether the carrying value of its goodwill has become impaired, in which case the value is reduced through a charge to its earnings. Goodwill is evaluated for impairment at least annually, or upon a triggering event using certain fair value techniques. Goodwill impairment testing is performed at the segment (or reporting unit) level. Goodwill is assigned to reporting units at the date the goodwill is initially recorded. Once goodwill has been assigned to the reporting units, it no longer retains its association with a particular acquisition, and all of the activities within a reporting unit, whether acquired or organically grown, are available to support the value of the goodwill.

Goodwill represents the excess of the purchase price over the fair value of net assets acquired in accordance with the purchase method of accounting for business combinations. Goodwill is not amortized but, instead, is subject to impairment tests on at least an annual basis or more frequently if an event occurs or circumstances change that reduce the fair value of a reporting unit below its carrying amount. The Company completes its annual goodwill impairment test as of December 31 of each year. The impairment testing process is conducted by assigning assets and goodwill to each reporting unit. Currently, the Company s goodwill is evaluated at the entity level as there is only one reporting unit. The Company first assesses certain qualitative factors to determine if it is more likely than not that the fair value of the reporting unit is less than its carrying value. If it is more likely than not that the fair value of the reporting unit is less than the carrying value, then the fair value of each reporting unit is compared to the recorded book value step one. If the fair value of the reporting unit exceeds its carrying value, goodwill is not considered impaired and step two is not considered necessary. If the carrying value of a reporting unit exceeds its fair value, the impairment test continues (step two) by comparing the carrying value of the reporting unit s goodwill to the implied fair value of goodwill. The implied fair value is computed by adjusting all assets and liabilities of the reporting unit to current fair value with the offset adjustment to goodwill. The adjusted goodwill balance is the implied fair value of the goodwill.

An impairment charge is recognized if the carrying fair value of goodwill exceeds the implied fair value of goodwill. At December 31, 2011, there was no indication of impairment that led the Company to believe it needed to perform a two-step test.

Any changes in the estimates used by the Company to determine the carrying value of its goodwill, or which otherwise adversely affect their value or estimated lives, would adversely affect the Company s consolidated results of operations.

Note 3: Business Combinations

On August 10, 2012 , Bar Harbor Bank & Trust (the Bank), a wholly-owned first tier operating subsidiary of Bar Harbor Bankshares, completed its acquisition of the operations of the Border Trust Company (Border Trust), a state chartered bank headquartered in Augusta, Maine, by acquiring certain assets and assuming certain liabilities, including all deposits for a net purchase price of $133. This transaction represented a strategic extension of the Company s franchise with three branch locations located in Kennebec and Sagadahoc counties.

The Company has determined that the acquisition of the net assets of Border Trust constituted a business combination as defined by the FASB ASC Topic 805, *Business Combinations*. Accordingly, the assets acquired and liabilities assumed were recorded at their fair values. Fair values were determined based on the requirements of FASB ASC Topic 820, *Fair Value Measurements*. In many cases, the determination of these fair values required management to make estimates about discount rates, future expected cash flows, market conditions and other future events that are highly subjective in nature and subject to change. These fair value estimates are subject to change for up to one year after the closing date of the transaction as additional information relative to closing date fair values becomes available. In addition, the tax treatment is complex and subject to interpretations that may result in future adjustments of deferred taxes as of the acquisition date.

The results of Border Trust s operations are included in the Consolidated Statements of Income from the date of acquisition. In connection with this transaction, the consideration paid, the assets acquired, and the liabilities assumed were recorded at fair value on the date of acquisition, as summarized in the following table, as of August 10, 2012.

Fair value of total consideration paid:	
Cash consideration paid at closing to Border Trust	$ 133
Fair value of identifiable assets acquired:	
Cash and cash equivalents	$1,330
Securities	3,537
Federal Home Loan Bank Common stock	770
Loans	33,606
Premises and equipment	563
Core deposit intangible	783
Other assets	244
Total identifiable assets acquired	40,833
Fair value of liabilities assumed:	
Deposits	38,520

Borrowings	3,776
Other liabilities	477
Total liabilities assumed	42,773
Fair value of net identifiable assets acquired	1,940
Goodwill resulting from transaction	$2,073

Initial goodwill of $2,073 was recorded after adjusting for the fair value of net identifiable assets acquired. The estimated goodwill from the acquisition represents the inherent long-term value anticipated from the synergies and business opportunities expected to be achieved as a result of the transaction. The estimated core deposit intangible asset is being amortized over its estimated life, currently expected to be eight and one-half years.

Note 4: Earnings Per Share

Basic earnings per share excludes dilution and is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the Company, such as the Company s dilutive stock options.

The following is a reconciliation of basic and diluted earnings per share for the three and nine months ended September 30, 2012 and 2011:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	**2011**	**2012**	**2011**
Net income	$ 3,368	$ 3,010	$ 9,636	$ 8,652
Weighted average common shares outstanding				
Basic	3,912,237	3,876,647	3,894,653	3,853,030
Effect of dilutive employee stock options	20,965	12,610	19,787	21,660
Diluted	3,933,202	3,889,257	3,914,440	3,874,690
Anti-dilutive options excluded from earnings per share calculation	25,500	129,030	30,500	127,030
Per Common Share Data:				
Basic earnings per share	$ 0.86	$ 0.78	$ 2.47	$ 2.25
Diluted earnings per share	$ 0.86	$ 0.77	$ 2.46	$ 2.23

Note 5: Securities Available For Sale

The following tables summarize the securities available for sale portfolio as of September 30, 2012 and December 31, 2011:

September 30, 2012 **Available for Sale:**	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Estimated Fair Value**
Obligations of US Government sponsored enterprises	$ 1,000	$ 7	$ ---	$ 1,007
US Treasury securities	101	1	---	102
Mortgage-backed securities:				
US Government-sponsored enterprises	231,938	10,237	200	241,975
US Government agency	86,026	3,077	150	88,953
Private label	8,910	487	557	8,840
Obligations of states and political subdivisions thereof	77,306	4,075	432	80,949
Total	$405,281	$17,884	$1,339	$421,826

December 31, 2011 **Available for Sale:**	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Estimated Fair Value**
Obligations of US Government sponsored enterprises	$ 1,000	$ 23	$ ---	$ 1,023
Mortgage-backed securities:				
US Government-sponsored enterprises	225,962	9,414	127	235,249
US Government agency	72,585	2,932	23	75,494
Private label	13,504	201	1,492	12,213
Obligations of states and political subdivisions thereof	58,160	2,199	2,458	57,901
Total	$371,211	$14,769	$4,100	$381,880

Securities Maturity Distribution: The following table summarizes the maturity distribution of the amortized cost and estimated fair value of securities available for sale as of September 30, 2012. Actual maturities may differ from the final maturities noted below because issuers may have the right to prepay or call certain securities. In the case of mortgage-backed securities, actual maturities may also differ from expected maturities due to the amortizing nature of the underlying mortgage collateral, and the fact that borrowers have the right to prepay.

Securities Available for Sale	**Amortized Cost**	**Estimated Fair Value**

Due one year or less	$ 1,073	$ 1,081
Due after one year through five years	1,706	1,667
Due after five years through ten years	25,052	26,209
Due after ten years	377,450	392,869
	$405,281	$421,826

Securities Impairment: As a part of the Company s ongoing security monitoring process, the Company identifies securities in an unrealized loss position that could potentially be other-than-temporarily impaired (OTTI).

For the three and nine months ended September 30, 2012, the Company recorded total OTTI losses of $173 and $1,007, respectively, in the statement of income (before taxes), related to thirteen, available for sale, private-label mortgage-backed securities (MBS), all but one of which the Company had previously determined were other-than-temporarily impaired. Of the $1,007 in total year-to-date OTTI losses, $781 (before taxes) represented estimated credit losses on the collateral underlying the securities, while $226 (before taxes) represented unrealized losses for the same securities resulting from factors other than credit. The $781 in estimated credit losses were recorded in earnings (before taxes), with the $226 non-credit portion of the unrealized losses recorded within accumulated other comprehensive income. The additional credit losses principally reflected an increase in the future loss severity and constant default rate estimates resulting from depressed and still declining real estate markets, extended foreclosure and collateral liquidation timelines, and depressed economic conditions that affected the expected performance of the mortgage loans underlying these securities.

The OTTI losses recognized in earnings during the three and nine months ended September 30, 2012 represented management s best estimate of credit losses inherent in the securities based on discounted, bond-specific future cash flow projections using assumptions about cash flows associated with the pools of mortgage loans underlying each security. In estimating those cash flows the Company takes a variety of factors into consideration including, but not limited to, loan level credit characteristics, current delinquency and non-performing loan rates, current levels of subordination and credit support, recent default rates and future constant default rate estimates, original and current loan to collateral value ratios, recent collateral loss severities and future collateral loss severity estimates, recent and historical conditional prepayment rates and future conditional prepayment rate assumptions, and other estimates of future collateral performance.

Despite some rising levels of delinquencies, defaults and losses in the underlying residential mortgage loan collateral, given credit enhancements resulting from the structures of the individual securities, the Company currently expects that as of September 30, 2012 it will recover the amortized cost basis of its private label mortgage-backed securities as depicted in the table below and has therefore concluded that such securities were not other-than-temporarily impaired as of that date. Nevertheless, given recent market conditions, it is possible that adverse changes in repayment performance and fair value could occur in future periods that could impact the Company s current best estimates.

The following table displays the beginning balance of OTTI related to historical credit losses on debt securities held by the Company at the beginning of the current reporting period, as well as changes in credit losses recognized in pre-tax earnings for the three and nine months ending September 30, 2012, and 2011.

	2012	**2011**
Estimated credit losses as of June 30,	$4,958	$4,527
Additions for credit losses for securities on which		
OTTI has been previously recognized	101	503
Additions for credit losses for securities on which		
OTTI has not been previously recognized	---	69
Reductions for securities paid off during the period	---	---
Estimated credit losses as of September 30,	$5,059	$5,099
Estimated credit losses as of prior year-end,	$4,697	$3,373
Additions for credit losses for securities on which	675	1,313

OTTI has been previously recognized		
Additions for credit losses for securities on which		
OTTI has not been previously recognized	106	413
Reductions for securities paid off during the period	419	---
Estimated credit losses as of September 30,	$5,059	$5,099

Upon initial impairment of a security, total OTTI losses represent the excess of the amortized cost over the fair value. For subsequent impairments of the same security, total OTTI losses represent additional credit losses and or declines in fair value subsequent to the previously recorded OTTI losses, if applicable. Unrealized OTTI losses recognized in accumulated other comprehensive income (OCI) represent the non-credit component of OTTI losses on debt securities. Net impairment losses recognized in earnings represent the credit component of OTTI losses on debt securities.

As of September 30, 2012, the Company held fifteen private-label MBS (debt securities) with a total amortized cost (i.e. carrying value) of $4,046 for which OTTI losses have previously been recognized in pre-tax earnings (dating back to the fourth quarter of 2008). For eleven of these securities, the Company previously recognized credit losses in excess of the unrealized losses in accumulated OCI, creating an unrealized gain of $296, net of tax, as included in accumulated OCI as of September 30, 2012. For the remaining four securities, the total OTTI losses included in accumulated OCI amounted to $144, net of tax, as of September 30, 2012. As of September 30, 2012, the total net unrealized gains included in accumulated OCI for securities held where OTTI has been historically recognized in pre-tax earnings amounted to $152, net of tax, compared with net unrealized losses of $423, net of tax, at December 31, 2011.

As of September 30, 2012, based on a review of each of the remaining securities in the securities portfolio, the Company concluded that it expects to recover its amortized cost basis for such securities. This conclusion was based on the issuers continued satisfaction of the securities obligations in accordance with their contractual terms and the expectation that they will continue to do so through the maturity of the security, the expectation that the Company will receive the entire amount of future contractual cash flows, as well as the evaluation of the fundamentals of the issuers financial condition and other objective evidence. Accordingly, the Company concluded that the declines in the values of those securities were temporary and that any additional other-than-temporary impairment charges were not appropriate at September 30, 2012. As of that date, the Company did not intend to sell nor anticipated that it would more-likely-than-not be required to sell any of its impaired securities, that is, where fair value is less than the cost basis of the security.

The following table summarizes the fair value of securities with continuous unrealized losses for less than 12 months and those that have been in a continuous unrealized loss position for 12 months or longer as of September 30, 2012 and December 31, 2011. All securities referenced are debt securities. At September 30, 2012, and December 31, 2011, the Company did not hold any common stock or other equity securities in its securities portfolio.

September 30, 2012	Less than 12 months Estimated Fair Value	Number of Investments	Unrealized Losses	12 months or longer Estimated Fair Value	Number of Investments	Unrealized Losses	Total Estimated Fair Value	Number of Investments	Unrealized Losses
Description of Securities:									
Mortgage-backed securities:									
US Government-sponsored enterprises	$17,306	16	$200	$ ---	--	$ ---	$17,306	16	$ 200
US Government agency	8,409	10	150	6	1	---	8,415	11	150
Private label	1,122	3	35	3,717	18	522	4,839	21	557
Obligations of states and political subdivisions thereof	6,240	10	85	5,963	23	347	12,203	33	432
Total	$33,077	39	$470	$ 9,686	42	$ 869	$42,763	81	$1,339

December 31, 2011	Less than 12 months Estimated Fair Value	Number of Investments	Unrealized Losses	12 months or longer Estimated Fair Value	Number of Investments	Unrealized Losses	Total Estimated Fair Value	Number of Investments	Unrealized Losses
Description of Securities:									
Mortgage-backed securities:									
US Government-sponsored enterprises	$15,870	13	$127	$ 20	1	$ ---	$15,890	14	$ 127
US Government agency	9,934	10	22	59	3	1	9,993	13	23
Private label	1,613	8	219	6,807	26	1,273	8,420	34	1,492

Obligations of states and political subdivisions thereof	703	4	25	14,770	61	2,433	15,473	65	2,458
Total	$28,120	35	$393	$21,656	91	$3,707	$ 49,776	126	$4,100

For securities with unrealized losses, the following information was considered in determining that the impairments were not other-than-temporary:

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Mortgage-backed securities issued by U.S. Government-sponsored enterprises: As of September 30, 2012, the total unrealized losses on these securities amounted to $200, compared with $127 at December 31, 2011. All of these securities were credit rated AA+ by the major credit rating agencies. Company management believes these securities have minimal credit risk, as these Government-sponsored enterprises play a vital role in the nation s financial markets. Management s analysis indicates that the unrealized losses at September 30, 2012 were attributed to changes in current market yields and pricing spreads for similar securities since the date the underlying securities were purchased, and does not consider these securities to be other-than-temporarily impaired at September 30, 2012.

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Mortgage-backed securities issued by U.S. Government agencies: As of September 30, 2012, the total unrealized losses on these securities amounted to $150, compared with $23 at December 31, 2011. All of these securities were credit rated AA+ by the major credit rating agencies. Management s analysis indicates that these securities bear little or no credit risk because they are backed by the full faith and credit of the United States. The Company attributes the unrealized losses at September 30, 2012 to changes in current market yields and pricing spreads for similar securities since the date the underlying securities were purchased, and does not consider these securities to be other-than-temporarily impaired at September 30, 2012.

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Private label mortgage-backed securities: As of September 30, 2012, the total unrealized losses on the Bank s private label mortgage-backed securities amounted to $557, compared with $1,492 at December 31, 2011. The Company attributes the unrealized losses at September 30, 2012 to the current illiquid market for non-agency mortgage-backed securities, a seriously depressed and un-stabilized housing market, significantly elevated levels of home foreclosures, risk-related market pricing discounts for non-agency mortgage-backed securities and credit rating downgrades on certain private label mortgage-backed securities owned by the Company. Based upon the foregoing considerations and the expectation that the Company will receive all of the future contractual cash flows related to amortized cost on these securities, the Company does not consider there to be any additional other-than-temporary impairment with respect to these securities at September 30, 2012.

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Obligations of states of the U.S. and political subdivisions thereof: As of September 30, 2012, the total unrealized losses on the Bank s municipal securities amounted to $432, compared with $2,458 at December 31, 2011. The Bank s municipal securities primarily consist of general obligation bonds and to a lesser extent, revenue bonds. General obligation bonds carry less risk, as they are supported by the full faith, credit and taxing authority of the issuing government and in the cases of school districts, are additionally supported by state aid. Revenue bonds are generally backed by municipal revenue streams generated through user fees or lease payments associated with specific municipal projects that have been financed.

Municipal bonds are frequently supported with insurance, which guarantees that in the event the issuer experiences financial problems, the insurer will step in and assume payment of both principal and interest. Historically, insurance support has strengthened an issuer s underlying credit rating to AAA or AA status. Starting in 2008 and continuing through 2012, many of the insurance companies providing municipal bond insurance experienced financial difficulties and, accordingly, were downgraded by at least one of the major credit rating agencies. Consequently, since 2008 a portion of the Bank s municipal bond portfolio was downgraded by at least one of the major credit rating agencies. Notwithstanding the credit rating downgrades, at September 30, 2012, the Bank s municipal bond portfolio did not contain any below investment grade securities as reported by major credit rating agencies. In addition, at September 30, 2012 all municipal bond issuers were current on contractually obligated interest and principal payments.

The Company attributes the unrealized losses at September 30, 2012 to changes in credit ratings on certain securities and resulting changes in prevailing market yields and pricing spreads since the date the underlying securities were purchased. The Company also attributes the unrealized losses to ongoing media attention and market concerns about the prolonged recovery from the national economic recession and the impact it might have on the future financial stability of municipalities throughout the country. Accordingly, the Company does not consider these municipal securities to be other-than-temporarily impaired at September 30, 2012.

At September 30, 2012, the Company had no intent to sell nor believed it is more-likely-than-not that it would be required to sell any of its impaired securities as identified and discussed immediately above, and therefore did not consider these securities to be other-than-temporarily impaired as of that date.

Securities Gains and Losses: The following table summarizes realized gains and losses and other-than-temporary impairment losses on securities available for sale for the three and nine months ended September 30, 2012 and 2011.

	Proceeds from Sale of Securities Available	Realized Gains	Realized Losses	Other Than Temporary Impairment	Net

	for Sale			Losses	
Three months ended September 30,					
2012	$10,431	$ 614	$17	$ 101	$ 496
2011	$17,984	$ 993	$---	$ 572	$ 421
Nine months ended September 30,					
2012	$34,664	$1,857	$23	$ 781	$1,053
2011	$40,457	$2,313	$---	$1,726	$ 587

Note 6: Loans and Allowance for Loan Losses

Loans are carried at the principal amounts outstanding adjusted by partial charge-offs and net deferred loan origination costs or fees.

Interest on loans is accrued and credited to income based on the principal amount of loans outstanding. Residential real estate and home equity loans are generally placed on non-accrual status when reaching 90 days past due, or in process of foreclosure, or sooner if judged appropriate by management. Consumer loans are generally placed on non-accrual status when reaching 90 days or more past due, or sooner if judged appropriate by management. Secured consumer loans are written down to realizable value and unsecured consumer loans are charged-off upon reaching 120 days past due. Commercial real estate loans and commercial business loans that are 90 days or more past due are generally placed on non-accrual status, unless secured by sufficient cash or other assets immediately convertible to cash, and the loan is in the process of collection. Commercial real estate and commercial business loans may be placed on non-accrual status prior to the 90 days delinquency date if considered appropriate by management. When a loan has been placed on non-accrual status, previously accrued and uncollected interest is reversed against interest on loans. A loan can be returned to accrual status when principal is reasonably assured and the loan has performed for a period of time, generally six months.

Commercial real estate and commercial business loans are considered impaired when it becomes probable the Bank will not be able to collect all amounts due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status and collateral value. In considering loans for evaluation of impairment, management generally excludes smaller balance, homogeneous loans: residential mortgage loans, home equity loans, and all consumer loans, unless such loans were restructured in a troubled debt restructuring. These loans are collectively evaluated for risk of loss.

When a loan is classified as non-accrual or impaired, any payments received are typically applied to reduce the principal balance of the loan. In situations where the Company reasonably believes there is no longer doubt regarding the ultimate collectability of principal on a non-accrual or impaired loan, subsequent interest payments received are recorded as interest income on the cash basis in accordance with the contractual terms. For the three and nine months ended September 30, 2012, the Company recognized interest income of $54 and $105 on impaired loans using a cash-basis method of accounting, respectively, compared with none during the same periods in 2011.

Loan origination and commitment fees and direct loan origination costs are deferred, and the net amount is amortized as an adjustment of the related loans yield, using the level yield method over the estimated lives of the related loans.

The Company s lending activities are principally conducted in downeast, midcoast and central Maine. The following table summarizes the composition of the loan portfolio as of September 30, 2012 and December 31, 2011:

LOAN PORTFOLIO SUMMARY

	September 30, 2012	December 31, 2011
Commercial real estate mortgages	$298,784	$285,484
Commercial and industrial	78,623	62,450
Commercial construction and land development	25,106	30,060
Agricultural and other loans to farmers	26,206	26,580
Total commercial loans	428,719	404,574
Residential real estate mortgages	292,122	239,799
Home equity loans	53,044	51,462
Other consumer loans	19,678	22,906
Total consumer loans	364,844	314,167
Tax exempt loans	15,442	9,700
Net deferred loan costs and fees	(593)	562
Total loans	808,412	729,003
Allowance for loan losses	(8,053)	(8,221)
Total loans net of allowance for loan losses	$800,359	$720,782

Loan Origination/Risk Management: The Company has certain lending policies and procedures in place that are designed to maximize loan income within an acceptable level of risk. The Company s board of directors reviews and approves these policies and procedures on a regular basis. A reporting system supplements the review process by providing management and the board with frequent reports related to loan production, loan quality, concentrations of credit, loan delinquencies and non-performing loans and potential problem loans. The Company seeks to diversify the loan portfolio as a means of managing risk associated with fluctuations in economic conditions.

Commercial Real Estate Mortgages: The Bank s commercial real estate mortgage loans are collateralized by liens on real estate, typically have variable interest rates (or five year or less fixed rates) and amortize over a 15 to 20 year period. These loans are underwritten primarily as cash flow loans and secondarily as loans secured by real estate. Payments on loans secured by such properties are largely dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Accordingly, repayment of these loans may be subject to adverse economic conditions to a greater extent than other types of loans. The Company seeks to minimize these risks in a variety of ways, including giving careful consideration to the property s operating history, future operating projections, current and projected occupancy, location and physical condition in connection with underwriting these loans. The underwriting analysis also includes credit verification, analysis of global cash flows, appraisals and a review of the financial condition of the borrower. Reflecting the Bank s business region, at September 30, 2012 approximately 32.5% of the commercial real estate mortgage portfolio was represented by loans to the lodging industry. The Bank underwrites lodging industry loans as operating businesses, lending primarily to seasonal establishments with stabilized cash flows.

Commercial and Industrial Loans: Commercial and industrial loans are underwritten after evaluating and understanding the borrower s ability to operate profitability, and prudently expand its business. Commercial and industrial loans are primarily made in the Bank s market areas and are underwritten on the basis of the borrower s ability to service the debt from income. As a general practice, the Bank takes as collateral a lien on any available real estate, equipment or other assets owned by the borrower and obtains a personal guaranty of the borrower s or principal s. Working capital loans are primarily collateralized by short-term assets whereas term loans are primarily collateralized by long-term assets. In general, commercial and industrial loans involve more credit risk than residential mortgage loans and commercial mortgage loans and, therefore, usually yield a higher return. The increased risk in commercial and industrial loans is principally due to the type of collateral securing these loans. The increased risk also derives from the expectation that commercial and industrial loans generally will be serviced principally from the operations of the business, and, if not successful, these loans are primarily secured by tangible, non-real estate collateral. As a result of these additional complexities, variables and risks, commercial and industrial loans generally require more thorough underwriting and servicing than other types of loans.

Construction and Land Development Loans: The Company makes loans to finance the construction of residential and, to a lesser extent, non-residential properties. Construction loans generally are collateralized by first liens on real estate. The Company conducts periodic inspections, either directly or through an agent, prior to approval of periodic draws on these loans. Underwriting guidelines similar to those described immediately above are also used in the Company s construction lending activities. Construction loans involve additional risks attributable to the fact that loan funds are advanced against a project under construction and the project is of uncertain value prior to its completion. Because of uncertainties inherent in estimating construction costs, the market value of the completed project and the effects of governmental regulation on real property, it can be difficult to accurately evaluate the total funds required to complete a project and the related loan to value ratio. As a result of these uncertainties, construction lending often involves the disbursement of substantial funds with repayment dependent, in part, on the success of the ultimate project rather than the ability of a borrower or guarantor to repay the loan. In many cases the success of the project can also depend upon the financial support/strength of the sponsorship. If the Company is forced to foreclose on a project prior to completion, there is no assurance that the Company will be able to recover the entire unpaid portion of the loan. In addition, the Company may be required to fund additional amounts to complete a project and may have to hold the property for an indeterminate period of time. While the Company has underwriting procedures designed to identify what it believes to be acceptable levels of risks in construction lending, no assurance can be given that these procedures will prevent losses from the risks described above.

Residential Real Estate Mortgages: The Company originates first-lien, adjustable-rate and fixed-rate, one-to-four-family residential real estate loans for the construction, purchase or refinancing of a single family residential property. These loans are principally collateralized by owner-occupied properties, and are amortized over 10 to 30 years. From time to time the Company will sell longer-term, low rate, residential mortgage loans to the Federal Home Loan Mortgage Corporation (FHLMC) with servicing rights retained. This practice allows the Company to better manage interest rate risk and liquidity risk. In an effort to manage risk of loss and strengthen secondary market liquidity opportunities, management typically uses secondary market underwriting, appraisal, and servicing guidelines for all loans, including those held in its portfolio. Loans on one-to-four-family residential real estate are mostly originated in amounts of no more than 80% of appraised value or have private mortgage insurance. Mortgage title insurance and hazard insurance are required. Construction loans have a unique risk, because they are secured by an incomplete dwelling. This risk is reduced through more stringent underwriting standards, including regular inspections throughout the construction period.

Home Equity Loans: The Company originates home equity lines of credit and second mortgage loans (loans which are secured by a junior lien position on one-to-four-family residential real estate). These loans carry a higher risk than first mortgage residential loans as they are in a second position relating to collateral. Risk is reduced through underwriting criteria, which include credit verification, appraisals and evaluations, a review of the borrower's financial condition, and personal cash flows. A security interest, with title insurance when necessary, is taken in the underlying real estate.

Non-performing Loans: the following table sets forth information regarding non-accruing loans and accruing loans 90 days or more overdue at September 30, 2012 and December 31, 2011.

TOTAL NON-PERFORMING LOANS

	September 30, 2012	**December 31, 2011**
Commercial real estate mortgages	$ 2,929	$ 2,676
Commercial and industrial loans	589	1,078
Commercial construction and land development	2,599	3,753
Agricultural and other loans to farmers	596	595
Total commercial loans	6,713	8,102
Residential real estate mortgages	2,713	4,266
Home equity loans	306	266
Other consumer loans	61	273
Total consumer loans	3,080	4,805
Total non-accrual loans	9,793	12,907
Accruing loans contractually past due 90 days or more	954	---
Total non-performing loans	$10,747	$12,907
Allowance for loan losses to non-performing loans	75%	64%
Non-performing loans to total loans	1.33%	1.77%
Allowance to total loans	1.00%	1.13%

Troubled Debt Restructures: A Troubled Debt Restructure (TDR) results from a modification to a loan to a borrower who is experiencing financial difficulty in which the Bank grants a concession to the debtor that it would not otherwise consider but for the debtor s financial difficulties. Financial difficulty arises when a debtor is bankrupt or contractually past due, or is likely to become so, based upon its ability to pay. A concession represents an accommodation not generally available to other customers, which may include a below-market interest rate, deferment of principal payments, extension of maturity dates, etc. Such accommodations extended to customers who are not experiencing financial difficulty do not result in TDR classification.

Summary information pertaining to the TDRs that occurred during the three and nine months ended September 30, 2012 follows:

	For the Three Months Ended	**For the Nine Months Ended**

	September 30, 2012			September 30, 2012		
	Number of Loans	**Pre-Modification Outstanding Recorded Investment**	**Post-Modification Outstanding Recorded Investment**	**Number of Loans**	**Pre-Modification Outstanding Recorded Investment**	**Post-Modification Outstanding Recorded Investment**
Commercial and industrial loans	0	$ ---	$ ---	2	$ 67	$ 67
Total commercial loans	0	$ ---	$ ---	2	$ 67	$ 67
Residential real estate mortgages	0	$ ---	$ ---	1	$ 56	$ 56
Total consumer loans	0	$ ---	$ ---	1	$ 56	$ 56
Total	0	$ ---	$ ---	3	$123	$123

As of September 30, 2012, the Bank had four real estate secured loans and two commercial and industrial loans to three relationships totaling $928 that were classified as TDRs. At September 30, 2012, three TDRs totaling $123 were past due and classified as non-accrual.

As of December 31, 2011, the Bank had four real estate secured loans to two relationships totaling $913 that were classified as TDRs. At December 31, 2011, one TDR for $82 was past due and classified as non-accrual.

Past Due Loans: Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. The following tables set forth information regarding past due loans at September 30, 2012 and December 31, 2011. Amounts shown exclude deferred loan origination fees and costs.

September 30, 2012	**30-59 Days Past Due**	**60-89 Days Past Due**	**90 Days or Greater**	**Total Past Due**	**Current**	**Total Loans**	**>90 Days Past Due and Accruing**
Commercial real estate mortgages	$ 667	$ ---	$ 1,515	$ 2,182	$296,602	$298,784	$196
Commercial and industrial	512	27	692	1,231	77,392	78,623	154
Commercial construction and land development	---	---	2,599	2,599	22,507	25,106	---
Agricultural and other loans to farmers	67	109	401	577	25,629	26,206	---
Residential real estate mortgages	949	754	2,092	3,795	288,327	292,122	572
Home equity	440	8	257	705	52,339	53,044	29
Other consumer loans	51	94	43	188	19,490	19,678	3
Tax exempt	---	---	---	---	15,442	15,442	---
Total	$2,686	$ 992	$ 7,599	$11,277	$797,728	$809,005	$954

December 31, 2011	**30-59 Days Past Due**	**60-89 Days Past Due**	**90 Days or Greater**	**Total Past Due**	**Current**	**Total Loans**	**>90 Days Past Due and Accruing**
Commercial real estate mortgages	$ 264	$ 284	$ 2,504	$ 3,052	$282,432	$285,484	$ ---
Commercial and industrial	294	201	996	1,491	60,959	62,450	---
Commercial construction and land development	91	142	2,993	3,226	26,834	30,060	---
Agricultural and other loans to farmers	162	---	526	688	25,892	26,580	---
Residential real estate mortgages	1,690	644	2,553	4,887	234,912	239,799	---

Home equity	40	---	266	306	51,156	51,462	---
Other consumer loans	87	22	257	366	22,540	22,906	---
Tax exempt	---	---	---	---	9,700	9,700	---
Total	$2,628	$1,293	$10,095	$14,016	$714,425	$728,441	$ ---

Impaired Loans: Impaired loans are all commercial loans for which the Company believes it is probable that it will be unable to collect all amounts due according to the contractual terms of the loan agreement, as well as all loans modified into a TDR, if any. Allowances for losses on impaired loans are determined by the lower of the present value of the expected cash flows related to the loan, using the original contractual interest rate, and its recorded value, or in the case of collateral dependant loans, the lower of the fair value of the collateral, less costs to dispose, and the recorded amount of the loans. When foreclosure is probable, impairment is measured based on the fair value of the collateral less cost to sell.

Details of impaired loans as of September 30, 2012 and December 31, 2011 follows:

	September 30, 2012			**December 31, 2011**		
	Recorded Investment	**Unpaid Principal Balance**	**Related Allowance**	**Recorded Investment**	**Unpaid Principal Balance**	**Related Allowance**
With no related allowance:						
Commercial real estate mortgages	$3,709	$3,829	$ ---	$3,301	$ 3,431	$ ---
Commercial and industrial	514	579	---	973	1,043	---
Commercial construction and development	2,225	4,150	---	2,992	4,893	---
Agricultural and other loans to farmers	596	671	---	595	595	---
Residential real estate loans	57	79	---	82	82	---
Subtotal	$7,101	$9,308	$ ---	$7,943	$10,044	$ ---
With an allowance:						
Commercial real estate mortgages	$ ---	$ ---	$ ---	$ 176	$ 176	$100
Commercial and industrial	100	100	100	135	135	135
Commercial construction and development	374	374	30	761	761	100
Agricultural and other loans to farmers	---	---	---	---	---	---
Residential real estate loans	---	---	---	---	---	---
Subtotal	$ 474	$ 474	$130	$1,072	$ 1,072	$335
Total	$7,575	$9,782	$130	$9,015	$11,116	$335

Details of impaired loans for the three and nine months ended September 30, 2012 and 2011 follows:

	September 30, 2012		**September 30, 2011**	
	For the Three Months Ended	**For the Nine Months Ended**	**For the Three Months Ended**	**For the Nine Months Ended**

	Average Recorded Investment	Interest Recorded	Average Recorded Investment	Interest Recorded	Average Recorded Investment	Interest Recorded	Average Recorded Investment	Interest Recorded
With no related allowance:								
Commercial real estate mortgages	$3,814	$47	$3,589	$ 96	$ 1,740	$ ---	$ 1,199	$ ---
Commercial and industrial	603	6	702	6	972	---	638	---
Commercial construction and development	2,424	---	2,813	---	334	---	264	---
Agricultural and other loans to farmers	603	---	605	---	176	---	210	---
Residential real estate mortgages	135	1	138	3	---	---	---	---
Subtotal	$7,579	$54	$7,847	$105	$ 3,222	$ ---	$ 2,311	$ ---
With an allowance:								
Commercial real estate mortgages	$ ---	$---	$ ---	$---	$ 1,304	$ ---	$ 2,075	$ ---
Commercial and industrial	100	---	100	---	341	---	453	---
Commercial construction and development	593	---	704	---	4,608	---	4,735	---
Agricultural and other loans to farmers	---	---	---	---	---	---	---	---
Residential real estate mortgages	---	---	---	---	---	---	---	---
Subtotal	$ 693	$---	$ 804	$---	$ 6,253	$ ---	$ 7,263	$ ---
Total	$8,272	$54	$8,651	$105	$ 9,475	$ ---	$ 9,574	$ ---

Credit Quality Indicators/Classified Loans: In monitoring the credit quality of the portfolio, management applies a credit quality indicator to all categories of commercial loans. These credit quality indicators range from one through nine, with a higher number correlating to increasing risk of loss. These ratings are used as inputs to the calculation of the allowance for loan losses. Loans rated one through five are consistent with the regulators Pass ratings, and are generally allocated a lesser percentage allocation in the allowance for loan losses than loans rated from six through nine.

Consistent with regulatory guidelines, the Bank provides for the classification of loans which are considered to be of lesser quality as substandard, doubtful, or loss. The Bank considers a loan substandard if it is inadequately protected by the current net worth and paying capacity of the borrower or of the collateral pledged, if any. Substandard loans have a well defined weakness that jeopardizes liquidation of the debt. Substandard loans include those loans where there the distinct possibility of some loss of principal, if the deficiencies are not corrected.

Loans that the Bank classifies as doubtful have all of the weaknesses inherent in those loans that are classified as substandard but also have the added characteristic that the weaknesses present make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The possibility of loss is high but because of certain important and reasonably specific pending factors which may work to the advantage and strengthening of the loan, its classification as an estimated loss is deferred until its more exact status may be determined. Pending factors include proposed merger, acquisition, or liquidation procedures, capital injection, perfecting liens on additional collateral and refinancing plans. The entire amount of the loan might not be classified as doubtful when collection of a specific portion appears highly probable. Loans are generally not classified doubtful for an extended period of time (i.e., over a year).

Loans that the Bank classifies as loss are those considered uncollectible and of such little value that their continuance as an asset is not warranted and the uncollectible amounts are charged off. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be affected in the future. Losses are taken in the period in which they surface as uncollectible.

Loans that do not expose the Bank to risk sufficient to warrant classification in one of the aforementioned categories, but which possess some weaknesses, are designated special mention. A special mention loan has potential weaknesses that deserve management s close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the institution s credit position at some future date. This might include loans which the lending officer may be unable to supervise properly because of: lack of expertise, inadequate loan agreement, the poor condition of or lack of control over collateral, failure to obtain proper documentation or any other deviations from prudent lending practices. Economic or market conditions which may, in the future, affect the obligor may warrant special mention of the asset. Loans for which an adverse trend in the borrower's operations or an imbalanced position in the balance sheet which has not reached a point where the liquidation is jeopardized may be included in this classification. Special mention assets are not adversely classified and do not expose an institution to sufficient risks to warrant classification.

The following tables summarize the commercial loan portfolio as of September 30, 2012 and December 31, 2011 by credit quality indicator. Credit quality indicators are reassessed for each applicable commercial loan at least annually, or upon receipt and analysis of the borrower s financial statements, when applicable. Consumer loans, which principally consist of residential mortgage loans, are not rated, but are evaluated for credit quality after origination based on delinquency status (see past due loan aging table above).

September 30, 2012	Commercial real estate mortgages	Commercial and industrial	Commercial construction and land development	Agricultural and other loans to farmers	Total
Pass	$268,904	$65,401	$20,118	$25,128	$379,551
Other Assets Especially Mentioned	20,497	10,123	2,389	330	33,339
Substandard	9,383	3,099	2,599	748	15,829
Doubtful	---	---	---	---	---
Loss	---	---	---	---	---
Total	$298,784	$78,623	$25,106	$26,206	$428,719

December 31, 2011	Commercial real estate mortgages	Commercial and industrial	Commercial construction and land development	Agricultural and other loans to farmers	Total
Pass	$255,945	$50,866	$23,615	$25,295	$355,721
Other Assets Especially Mentioned	19,787	7,183	2,692	469	30,131
Substandard	9,752	4,401	3,520	816	18,489
Doubtful	---	---	233	---	233
Loss	---	---	---	---	---
Total	$285,484	$62,450	$30,060	$26,580	$404,574

Allowance for Loan Losses: The allowance for loan losses (the allowance) is a reserve established through a provision for loan losses (the provision) charged to expense, which represents management s best estimate of probable losses that have been incurred within the existing portfolio of loans. The allowance, in the judgment of management, is necessary to provide for estimated loan losses and risks inherent in the loan portfolio. The Company s allowance for loan loss methodology includes allowance allocations calculated in accordance with ASC Topic 310, Receivables and allowance allocations calculated in accordance with ASC Topic 450, Contingencies. Accordingly, the methodology is based on historical loss experience by type of credit and internal risk grade, specific homogeneous risk pools and specific loss allocations, with adjustments for current events and conditions. The Company s process for determining the appropriate level of the allowance is designed to account for credit deterioration as it occurs. The provision reflects loan quality trends, including the levels of and trends related to non-accrual loans, past due loans, potential problem loans, criticized loans and net charge-offs or recoveries, among other factors. The provision also reflects the totality of actions taken on all loans for a particular period. In other words, the amount of the provision reflects not only the necessary increases in the allowance related to newly identified criticized loans, but it also reflects actions taken related to other loans including, among other things, any necessary increases or decreases in required allowances for specific loans or loan pools.

The level of the allowance reflects management s continuing evaluation of industry concentrations, specific credit risks, loan loss experience, current loan portfolio quality, present economic, political and regulatory conditions and unidentified losses inherent in the current loan portfolio. While management utilizes its best judgment and information available, the ultimate adequacy of the allowance is dependent upon a variety of factors beyond the Company s control, including, among other things, the performance of the Company s loan portfolio, the economy, changes in interest rates and the view of the regulatory authorities toward loan classifications.

The Company s allowance for loan losses consists of three principal elements: (i) specific valuation allowances determined in accordance with ASC Topic 310 based on probable losses on specific loans; (ii) historical valuation allowances determined in accordance with ASC Topic 450 based on historical loan loss experience for similar loans with similar characteristics and trends, adjusted, as necessary, to reflect the impact of current conditions; and (iii) general valuation allowances determined in accordance with ASC Topic 450 based on general economic conditions and other qualitative risk factors both internal and external to the Company.

The allowances established for probable losses on specific loans are based on a regular analysis and evaluation of problem loans. Loans are classified based on an internal credit risk grading process that evaluates, among other things: (i) the obligor s ability to repay; (ii) the underlying collateral, if any; and (iii) the economic environment and industry in which the borrower operates. This analysis is performed at the relationship level for all commercial loans. When a loan has a classification of seven or higher, the Company analyzes the loan to determine whether the loan is impaired and, if impaired, the need to specifically allocate a portion of the allowance to the loan. Specific valuation allowances are determined by analyzing the borrower s ability to repay amounts owed, collateral deficiencies, the relative risk grade of the loan and economic conditions affecting the borrower s industry, among other observable considerations.

Historical valuation allowances are calculated based on the historical loss experience of specific types of loans and the internal risk grade of such loans at the time they were charged-off. The Company calculates historical loss ratios for pools of similar loans with similar characteristics based on the proportion of actual charge-offs experienced to the total population of loans in the pool. The historical loss ratios are periodically updated based on actual charge-off experience. A historical valuation allowance is established for each pool of similar loans based upon the product of the historical loss ratio and the total dollar amount of the loans in the pool, net of any loans for which reserves are already established. The Company s pools of similar loans include similarly risk-graded groups of, commercial real estate loans, commercial and industrial loans, consumer real estate loans and consumer and other loans.

General valuation allowances are based on general economic conditions and other qualitative risk factors both internal and external to the Company. In general, such valuation allowances are determined by evaluating, among other things: (i) the experience, ability and effectiveness of the Bank s lending management and staff; (ii) the effectiveness of the Bank s loan policies, procedures and internal controls; (iii) changes in asset quality; (iv) changes in loan portfolio volume; (v) the composition and concentrations of credit; (vi) the impact of competition on loan structuring and pricing; (vii) the effectiveness of the internal loan review function; (viii) the impact of environmental risks on portfolio risks; and (ix) the impact of rising interest rates on portfolio risk. Management evaluates the degree of risk that each one of these components has on the quality of the loan portfolio on a quarterly basis. The results are then used to determine an appropriate general valuation allowance.

Loans identified as losses by management, internal loan review and/or bank examiners, are charged-off. Furthermore, consumer loan accounts are charged-off based on regulatory requirements.

The following tables detail activity in the allowance for loan losses by portfolio segment for the three and nine months ended September 30, 2012 and 2011 and the twelve months ended December 31, 2011. The tables also provide details regarding the Company s recorded investment in loans related to each balance in the allowance for loan losses by portfolio segment and disaggregated on the basis of the Company s impairment methodology. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

Three Months Ended September 30, 2012	**Commercial Real Estate**	**Commercial and Industrial**	**Commercial Construction and land development**	**Agricultural**	**Residential Real Estate**	**Consumer**	**Home Equity**	**Tax Exempt**	**Total**
Beginning Balance	$ 4,044	$ 1,236	$ 533	$ 323	$1,466	$ 293	$ 344	$ 115	$ 8,354
Charged Off	(102)	(2)	(300)	(6)	(300)	(43)	---	---	(753)
Recoveries	1	1	---	1	14	8	---	---	25
Provision	100	118	187	(5)	119	4	(36)	(60)	427
Ending Balance	$ 4,043	$ 1,353	$ 420	$ 313	$ 1,299	$ 262	$ 308	$ 55	$ 8,053

Nine Months Ended September 30, 2012	**Commercial Real Estate**	**Commercial and Industrial**	**Commercial Construction and land development**	**Agricultural**	**Residential Real Estate**	**Consumer**	**Home Equity**	**Tax Exempt**	**Total**
Beginning Balance	$ 3,900	$ 1,321	$ 594	$ 332	$ 1,436	$ 286	$ 266	$ 86	$ 8,221
Charged Off	(252)	(42)	(300)	(148)	(514)	(263)	(92)	---	(1,611)
Recoveries	9	9	---	81	14	28	----	---	141
Provision	386	65	126	48	363	211	134	(31)	1,302
Ending Balance	$ 4,043	$ 1,353	$ 420	$ 313	$ 1,299	$ 262	$ 308	$ 55	$ 8,053
of which:									
Amount for loans individually evaluated for impairment	$ 102	$ 100	$ 100	$ ---	$ ---	$ ---	$ ---	$ ---	$ 302
Amount for Loans collectively									

evaluated for impairment	$ 3,941	$ 1,253	$ 320	$ 313	$ 1,299	$ 262	$ 308	$ 55	$ 7,751
Loans individually evaluated for Impairment	$ 2,929	$ 589	$ 2,599	$ 596	$ ---	$ ---	$ ---	$ ---	$ 6,713
Loans collectively evaluated for impairment	$ 295,855	$78,034	$ 22,507	$25,610	$292,122	$19,678	$53,044	$15,442	$802,292

Three Months Ended September 30, 2011	Commercial Real Estate	Commercial and Industrial	Commercial Construction and land development	Agricultural	Residential Real Estate	Consumer	Home Equity	Tax Exempt	Total
Beginning Balance	$3,699	$ 1,618	$ 1,655	$347	$ 1,436	$ 304	$ 330	$146	$ 9,535
Charged Off	---	(42)	(1,993)	---	(101)	(2)	(56)	---	(2,194)
Recoveries	6	2	---	---	40	14	---	---	62
Provision	277	(81)	738	(17)	(75)	(42)	(10)	(40)	750
Ending Balance	$3,982	$ 1,497	$ 400	$ 330	$ 1,300	$ 274	$ 264	$ 106	$ 8,153

Nine Months Ended September 30, 2011	Commercial Real Estate	Commercial and Industrial	Commercial Construction and land development	Agricultural	Residential Real Estate	Consumer	Home Equity	Tax Exempt	Total
Beginning Balance	$ 4,260	$ 1,237	$ 999	$ 223	$ 1,322	$ 73	$ 276	$ 110	$ 8,500
Charged Off	(99)	(48)	(1,993)	---	(178)	(30)	(56)	---	(2,404)
Recoveries	7	81	---	45	40	34	---	---	207
Provision	(186)	227	1,394	62	116	197	44	(4)	1,850
Ending Balance	$ 3,982	$ 1,497	$ 400	$ 330	$ 1,300	$ 274	$ 264	$ 106	$ 8,153

Twelve Months Ended December 31, 2011	Commercial Real Estate	Commercial and Industrial	Commercial Construction and land development	Agricultural	Residential Real Estate	Consumer	Home Equity	Tax Exempt	Total
Beginning Balance	$ 4,260	$ 1,237	$ 999	$ 223	$ 1,322	$ 73	$ 276	$ 110	$ 8,500
Charged Off	(423)	(123)	(1,943)	---	(254)	(90)	(94)	---	(2,927)
Recoveries	8	82	77	45	---	41	---	---	253
Provision	55	125	1,461	64	368	262	84	(24)	2,395
Ending Balance	$ 3,900	$ 1,321	$ 594	$ 332	$ 1,436	$ 286	$ 266	$ 86	$ 8,221
of which:									
Amount for loans									

individually evaluated for impairment	$ 100	$ 135	$ 100	$ ---	$ ---	$ ---	$ ---	$ ---	$ 335
Amount for loans collectively evaluated for impairment	$ 3,800	$ 1,186	$ 494	$ 332	$ 1,436	$ 286	$ 266	$ 86	$ 7,886
Loans individually evaluated for impairment	$ 2,676	$ 1,078	$ 3,753	$ 595	$ ---	$ ---	$ ----	$ ---	$ 8,102
Loans collectively evaluated for impairment	$282,808	$ 61,372	$26,307	$25,985	$239,799	$22,906	$ 51,462	$ 9,700	$720,339

Loan concentrations: Because of the Company s proximity to Acadia National Park, a large part of the economic activity in the Bank s area is generated from the hospitality business associated with tourism. At September 30, 2012 and December 31, 2011, loans to the lodging industry amounted to approximately $100,929 and $99,345, respectively.

Note 7: Retirement Benefit Plans

The Company has non-qualified supplemental executive retirement agreements with certain retired officers. The agreements provide supplemental retirement benefits payable in installments over a period of years upon retirement or death. The Company recognized the net present value of payments associated with the agreements over the service periods of the participating officers. Interest costs continue to be recognized on the benefit obligations.

The Company also has supplemental executive retirement agreements with certain current executive officers. These agreements provide a stream of future payments in accordance with individually defined vesting schedules upon retirement, termination, or upon a change of control.

The following table summarizes the net periodic benefit costs for the three and nine months ended September 30, 2012 and 2011:

Three Months Ended September 30,	**2012**	**2011**
Service cost	$ 84	$ 12
Interest cost	63	47
Net amortization of prior service cost and actuarial (gain) loss	(101)	1
Actuarial gain on supplemental executive retirement plan, net of related tax	222	---
Net periodic benefit cost	$ 268	$ 60

Nine Months Ended September 30,	**2012**	**2011**
Service cost	130	$ 36
Interest cost	98	142
Net amortization of prior service cost and actuarial (gain) loss	(99)	3
Actuarial gain on supplemental executive retirement plan, net of related tax	222	---
Net periodic benefit cost	$ 351	$ 181

The Company is expected to recognize $165 of expense for the foregoing plans for the year ended December 31, 2012. The Company is expected to contribute $206 to the foregoing plans in 2012. As of September 30, 2012, the Company had contributed $153.

Note 8: Commitments and Contingent Liabilities

The Company s wholly owned subsidiary, Bar Harbor Bank & Trust (the Bank), is a party to financial instruments in the normal course of business to meet financing needs of its customers. These financial instruments include commitments to extend credit, unused lines of credit, and standby letters of credit.

Commitments to originate loans, including unused lines of credit, are agreements to lend to a customer provided 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 Bank uses the same credit policy to make such commitments as it uses for on-balance-sheet items, such as loans. The Bank evaluates each customer s creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management s credit evaluation of the borrower.

The Bank guarantees the obligations or performance of customers by issuing standby letters of credit to third parties. These standby letters of credit are primarily issued in support of third party debt or obligations. The risk involved in issuing standby letters of credit is essentially the same as the credit risk involved in extending loan facilities to customers, and they are subject to the same credit origination, portfolio maintenance and management procedures in effect to monitor other credit and off-balance sheet instruments. Exposure to credit loss in the event of non-performance by the counter-party to the financial instrument for standby letters of credit is represented by the contractual amount of those instruments. Typically, these standby letters of credit have terms of five years or less and expire unused; therefore, the total amounts do not necessarily represent future cash requirements.

The following table summarizes the contractual amounts of commitments and contingent liabilities as of September 30, 2012 and December 31, 2011:

	September 30, 2012	**December 31, 2011**
Commitments to originate loans	$ 56,106	$23,220
Unused lines of credit	$102,851	$88,208
Un-advanced portions of construction loans	$ 12,108	$ 4,986
Standby letters of credit	$ 442	$ 350

As of September 30, 2012 and December 31, 2011, the fair value of the standby letters of credit was not significant to the Company s consolidated financial statements.

Note 9: Goodwill and Other Intangible Assets

Goodwill: Goodwill totaled $5,231 and $3,158 at September 30, 2012 and December 30, 2011, respectively. In the third quarter of 2012 the Company recorded $2,073 of goodwill in connection with the Bank s acquisition of substantially all of the assets and the assumption of certain liabilities including all deposits of the Border Trust Company.

Core Deposit Intangible Asset: The Company has a finite-lived intangible asset capitalized on its consolidated balance sheet in the form of a core deposit intangible asset related to the Border Trust Company acquisition. The core deposit intangible is being amortized over an estimated useful life of eight and one-half years and is included in other assets on the Company s consolidated balance sheet. At September 30, 2012 the balance of the core deposit intangible asset amounted to $770. Amortization of the core deposit intangible asset is expected to be $36 and $92 for 2012 and 2013, respectively.

Note 10: Fair Value Measurements

The Company measures fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets and liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are (i) independent, (ii) knowledgeable, (iii) able to transact, and (iv) willing to transact.

The Company s fair value measurements employ valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities. The income approach uses valuation techniques to convert future amounts, such as cash flows or earnings, to a single present amount on a discounted basis. The cost approach is based on the amount that currently would be required to replace the servicing capacity of an asset (replacement cost). Valuation techniques should be consistently applied. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. The Company uses a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets (Level 1 measurements) for identical assets or liabilities and the lowest priority to unobservable inputs (Level 3 measurements). The fair value hierarchy is as follows:

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Level 1 Valuation is based on unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

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

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

The level in the fair value hierarchy within which the fair value measurement in its entirety falls is determined based on the lowest level input that is significant to the fair value measurement in its entirety.

The most significant instruments that the Company values are securities, all of which fall into Level 2 in the fair value hierarchy. The securities in the available for sale portfolio are priced by independent providers. In obtaining such valuation information from third parties, the Company has evaluated their valuation methodologies used to develop the fair values in order to determine whether valuations are appropriately placed within the fair value hierarchy and whether the valuations are representative of an exit price in the Company s principal markets. The Company s principal markets for its securities portfolios are the secondary institutional markets, with an exit price that is predominantly reflective of bid level pricing in those markets. Additionally, the Company periodically tests the reasonableness of the prices provided by these third parties by obtaining fair values from other independent providers and by obtaining desk bids from a variety of institutional brokers.

A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below.

Securities Available for Sale: All securities and major categories of securities classified as available for sale are reported at fair value utilizing Level 2 inputs. For these securities, the Company obtains fair value measurements from independent pricing providers. The fair value measurements used by the pricing providers consider observable data that may include dealer quotes, market maker quotes and live trading systems. If quoted prices are not readily available, fair values are determined using matrix pricing models, or other model-based valuation techniques requiring observable inputs other than quoted prices such as market pricing spreads, credit information, callable features, cash flows, the U.S. Treasury yield curve, trade execution data, market consensus prepayment speeds, default rates, and the securities terms and conditions, among other things.

The foregoing valuation methodologies may produce fair value calculations that may not be fully indicative of net realizable value or reflective of future fair values. While Company management believes these valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

The following tables summarize financial assets and financial liabilities measured at fair value on a recurring basis as of September 30, 2012 and December 31, 2011, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

September 30, 2012	**Level 1 Inputs**	**Level 2 Inputs**	**Level 3 Inputs**	**Total Fair Value**
Securities available for sale:				
Obligations of US Government-sponsored enterprises	$ ---	$ 1,007	$ ---	$ 1,007
US Treasury securities	$ ---	$ 102	$ ---	$ 102
Mortgage-backed securities:				
US Government-sponsored enterprises	$ ---	$241,975	$ ---	$241,975
US Government agencies	$ ---	$ 88,953	$ ---	$ 88,953
Private label	$ ---	$ 8,840	$ ---	$ 8,840
Obligations of states and political subdivisions thereof	$ ---	$ 80,949	$ ---	$ 80,949

December 31, 2011	**Level 1 Inputs**	**Level 2 Inputs**	**Level 3 Inputs**	**Total Fair Value**
Securities available for sale:				
Obligations of US Government-sponsored enterprises	$ ---	$ 1,023	$ ---	$ 1,023
Mortgage-backed securities:				
US Government-sponsored enterprises	$ ---	$235,249	$ ---	$235,249
US Government agencies	$ ---	$ 75,494	$ ---	$ 75,494
Private label	$ ---	$ 12,213	$ ---	$ 12,213
Obligations of states and political subdivisions thereof	$ ---	$ 57,901	$ ---	$ 57,901

The following tables summarize financial assets and financial liabilities measured at fair value during the periods indicated, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value.

Three Months Ended September 30, 2012	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Fair Value as of 9/30/12	Loss
Other real estate owned	$ ---	$---	$ 388	$ 388	$ 2
Collateral dependent impaired loans	$ ---	$---	$2,674	$2,644	$ ---

Nine Months Ended September 30, 2012	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Fair Value as of 9/30/12	Loss
Other real estate owned	$ ---	$---	$1,533	$1,387	$ 170
Collateral dependent impaired loans	$ ---	$---	$2,674	$2,644	$ ---

Year Ended December 31, 2011	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Fair Value as of 12/31/11	Loss
Other real estate owned	$ ---	$ ---	$2,094	$2,094	$ 12
Collateral dependent impaired loans	$ ---	$ ---	$ 937	$ 737	$ ---

The estimated fair value of OREO is based on market appraisals less estimated costs to dispose and the Company s internal analysis. Certain inputs used in the appraisals and the Company's internal analysis are not always observable and therefore, the fair value of OREO is categorized as Level 3 within the fair value hierarchy.

The Company measures the value of collateral dependent impaired loans using level 3 inputs. Specifically, the Company uses the appraised value of the collateral, which is then discounted for estimated costs to dispose and other considerations. These discounts generally range from 10% to 30% of appraised value.

There were no transfers between levels during the periods presented.

At September 30, 2012 and December 31, 2011 the Company had total collateral dependent impaired loans with a carrying value of $3,500 and $4,827, which had specific reserves included in the allowance of $130 and $200, respectively.

Note 11: Fair Value of Financial Instruments

The Company discloses fair value information about financial instruments for which it is practicable to estimate fair value. Fair value estimates are made as of a specific point in time based on the characteristics of the financial instruments and relevant market information. Where available, quoted market prices are used. In other cases, fair values are based on estimates using present value or other valuation techniques. These techniques involve uncertainties and are significantly affected by the assumptions used and judgments made regarding risk characteristics of various financial instruments, discount rates, estimates of future cash flows, future expected loss experience and other factors. Changes in assumptions could significantly affect these estimates. Derived fair value estimates cannot be substantiated by comparison to independent markets and, in certain cases, could not be realized in an immediate sale of the instrument.

Fair value estimates are based on existing financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Accordingly, the aggregate fair value amounts presented do not purport to represent the underlying market value of the Company.

The following describes the methods and significant assumptions used by the Company in estimating the fair values of significant financial instruments:

Cash and Cash Equivalents: For cash and cash equivalents, including cash and due from banks and other short-term investments with maturities of 90 days or less, the carrying amounts reported on the consolidated balance sheet approximate fair values.

Federal Home Loan Bank stock: For Federal Home Loan Bank stock, the carrying amounts report on the consolidated balance sheet approximate fair values.

Loans: For variable rate loans that re-price frequently and have no significant change in credit risk, fair values are based on carrying values. The fair value of other loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.

Deposits*:* The fair value of deposits with no stated maturity is equal to the carrying amount. The fair value of time deposits is based on the discounted value of contractual cash flows, applying interest rates currently being offered on wholesale funding products of similar maturities. The fair value estimates for deposits do not include the benefit that results from the low-cost funding provided by the deposit liabilities compared to the cost of alternative forms of funding (deposit base intangibles).

Borrowings: For borrowings that mature or re-price in 90 days or less, carrying value approximates fair value. The fair value of the Company s remaining borrowings is estimated by using discounted cash flows based on current rates available for similar types of borrowing arrangements taking into account any optionality.

Accrued Interest Receivable and Payable: The carrying amounts of accrued interest receivable and payable approximate their fair values.

Off-Balance Sheet Financial Instruments*:* The Company s off-balance sheet instruments consist of loan commitments and standby letters of credit. Fair values for standby letters of credit and loan commitments were insignificant.

A summary of the carrying values and estimated fair values of the Company s significant financial instruments at September 30, 2012, and December 31, 2011, follows:

September 30, 2012	Carrying Value	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
Cash and cash equivalents	$ 10,045	$10,045	$ ---	$ ---	$ 10,045
Federal Home Loan Bank stock	$ 18,189	$ ---	$18,189	$ ---	$ 18,189
Loans, net	$800,359	$ ---	$ ---	$808,914	$808,914
Interest receivable	$ 4,668	$ 4,668	$ ---	$ ---	$ 4,668
Financial liabilities:					
Deposits (with no stated maturity)	$416,328	$ ---	$416,328	$ ---	$416,328
Time deposits	$397,299	$ ---	$404,826	$ ---	$404,826
Borrowings	$343,833	$ ---	$351,032	$ ---	$351,032
Interest payable	$ 751	$ 751	$ ---	$ ---	$ 751

December 31, 2011	Carrying Value	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
Cash and cash equivalents	$ 8,720	$ 8,720	$ ---	$ ---	$ 8,720
Federal Home Loan Bank stock	$ 16,068	$ ---	$16,068	$ ---	$ 16,068
Loans, net	$720,782	$ ---	$ ---	$728,985	$728,985
Interest receivable	$ 4,385	$ 4,385	$ ---	$ ---	$ 4,385
Financial liabilities:					
Deposits (with no stated maturity)	$368,472	$ ---	$368,472	$ ---	$368,472
Time deposits	$354,418	$ ---	$362,933	$ ---	$362,933
Borrowings	$320,283	$ ---	$329,801	$ ---	$329,801
Interest payable	$ 828	$ 828	$ ---	$ ---	$ 828

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Management s discussion and analysis, which follows, focuses on the factors affecting the Company s consolidated results of operations for the three and nine months ended September 30, 2012 and 2011, and financial condition at September 30, 2012, and December 31, 2011, and where appropriate, factors that may affect future financial performance. The following discussion and analysis of financial condition and results of operations of the Company and its subsidiaries should be read in conjunction with the consolidated financial statements and notes thereto, and selected financial and statistical information appearing elsewhere in this report on Form 10-Q.

Amounts in the prior period financial statements are reclassified whenever necessary to conform to current period presentation.

Unless otherwise noted, all dollars are expressed in thousands except share data.

Use of Non-GAAP Financial Measures: Certain information discussed below is presented on a fully taxable equivalent basis. Specifically, included in interest income in the third quarter of 2012 and 2011 was $836 and $743, respectively, of tax-exempt interest income from certain investment securities and loans. For the nine months ended September 30, 2012 and 2011, the amount of tax-exempt income included in interest income was $2,364 and $2,312, respectively.

An amount equal to the tax benefit derived from this tax exempt income has been added back to the interest income totals discussed in certain sections of this Management s Discussion and Analysis, representing tax equivalent adjustments of $407 and $359 in the third quarter of 2012 and 2011, respectively, and $1,151 and $1,113 for the nine months ended September 30, 2012 and 2011, respectively, which increased net interest income accordingly. The analysis of net interest income tables included in this report on Form 10-Q provide a reconciliation of tax equivalent financial information to the Company's consolidated financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles.

Management believes the disclosure of tax equivalent net interest income information improves the clarity of financial analysis, and is particularly useful to investors in understanding and evaluating the changes and trends in the Company's results of operations. Other financial institutions commonly present net interest income on a tax equivalent basis. This adjustment is considered helpful in the comparison of one financial institution's net interest income to that of another institution, as each will have a different proportion of tax-exempt interest from their earning asset portfolios. Moreover, net interest income is a component of a second financial measure commonly used by financial institutions, net interest margin, which is the ratio of net interest income to average earning assets. For purposes of this measure as well, other financial institutions generally use tax equivalent net interest income to provide a better basis of comparison from institution to institution. The Company follows these practices.

FORWARD LOOKING STATEMENTS DISCLAIMER

Certain statements, as well as certain other discussions contained in this quarterly report on Form 10-Q, or incorporated herein by reference, contain statements which may be considered to be forward-looking 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. Readers can identify these forward-looking statements by the use of words like "strategy," "expects," "plans," "believes," "will," "estimates," "intends," "projects," "goals," "targets," and other words of similar meaning. Readers can also identify them by the fact that they do not relate strictly to historical or current facts.

Investors are cautioned that forward-looking statements are inherently uncertain. Forward-looking statements include, but are not limited to, those made in connection with estimates with respect to the future results of operation, financial condition, and the business of the Company which are subject to change based on the impact of various factors that could cause actual results to differ materially from those projected or suggested due to certain risks and uncertainties. Those factors include but are not limited to:

(i) The Company's success is dependent to a significant extent upon general economic conditions in Maine, and Maine's ability to attract new business, as well as factors that affect tourism, a major source of economic activity in the Company s immediate market areas;

(ii) The Company's earnings depend to a great extent on the level of net interest income (the difference between interest income earned on loans and investments and the interest expense paid on deposits and borrowings) generated by the Company s wholly-owned banking subsidiary, Bar Harbor Bank & Trust (the Bank), and thus the Company s results of operations may be adversely affected by increases or decreases in interest rates;

(iii) The banking business is highly competitive and the profitability of the Company depends on the Bank's ability to attract loans and deposits in Maine, where the Bank competes with a variety of traditional banking and non-traditional institutions, such as credit unions and finance companies;

(iv) A significant portion of the Bank's loan portfolio is comprised of commercial loans and loans secured by real estate, exposing the Company to the risks inherent in financings based upon analysis of credit risk, the value of underlying collateral, and other intangible factors which are considered in making commercial loans and, accordingly, the Company's profitability may be negatively impacted by judgment errors in risk analysis, by loan defaults, and the ability of certain borrowers to repay such loans during a downturn in general economic conditions;

(v) Adverse changes in repayment performance and fair value of underlying residential mortgage loan collateral, that differ from the Company s current estimates, could change the Company s expectations that it will recover the amortized cost of its private label mortgage backed securities portfolio and/or its conclusion that such securities were not other-than temporarily impaired as of the date of this report;

(vi) Our allowance for loan losses may be adversely impacted by a variety of factors, including, but not limited to, the performance of the Company s loan portfolio, the economy, changes in interest rates, and the view of regulatory authorities toward loan classifications;

(vii) Significant changes in the Company s internal controls, or internal control failures;

(viii) Acts or threats of terrorism and actions taken by the United States or other governments as a result of such threats, including military action, could further adversely affect business and economic conditions in the United States generally and in the Company s markets, which could have an adverse effect on the Company s financial performance and that of borrowers and on the financial markets and the price of the Company s common stock;

(ix) Significant changes in the extensive laws, regulations, and policies governing bank holding companies and their subsidiaries could alter the Company's business environment or affect its operations;

(x) Changes in general, national, international, regional or local economic conditions and credit markets which are less favorable than those anticipated by Company management that could impact the Company's securities portfolio, quality of credits, or the overall demand for the Company's products or services; and

(xi) The Company s success in managing the risks involved in all of the foregoing matters.

Readers should carefully review all of these factors as well as the risk factors set forth in Item 1A- Risk Factors, contained in the Company s Annual Report on Form 10-K for the year ended December 31, 2011. There may be other risk factors that could cause differences from those anticipated by management.

The forward-looking statements contained herein represent the Company's judgment as of the date of this quarterly report on Form 10-Q and the Company cautions readers not to place undue reliance on such statements. The Company disclaims any obligation to publicly update or revise any forward-looking statement contained in the succeeding discussion, or elsewhere in this quarterly report on Form 10-Q, except to the extent required by federal securities laws.

APPLICATION OF CRITICAL ACCOUNTING POLICIES

The Company s significant accounting policies are more fully enumerated in Note 1 to the Consolidated Financial Statements included in Item 8 of its December 31, 2011, report on Form 10-K. The reader of the financial statements should review these policies to gain a greater understanding of how the Company s financial performance is reported.

Management s discussion and analysis of the Company s financial condition and results of operations are based on the Consolidated Financial Statements, which are prepared in accordance with U.S. generally accepted accounting principles. The preparation of such financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. Management evaluates its estimates on an ongoing basis. Management bases its estimates on historical experience and various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis in making judgments about the carrying values of assets that are not readily apparent from other sources. Actual results could differ from the amount derived from management s estimates and assumptions under different assumptions or conditions. Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of the allowance for loan losses, other than temporary impairment on securities, income tax estimates, and the evaluation of intangible assets. The use of these estimates is more fully described in Part I, Item 1, Note 2 of the consolidated financial statements in this quarterly report on Form 10-Q.

SUMMARY FINANCIAL RESULTS

For the three months ended September 30, 2012, the Company reported net income of $3,368, compared with $3,010 in the third quarter of 2011, representing an increase of $358, or 11.9%. The Company s diluted earnings per share amounted to $0.86 for the quarter compared with $0.77 in the third quarter of 2011, representing an increase of $0.09, or 11.7%.

The Company s annualized return on average shareholders equity (ROE) amounted to 10.49% for the quarter, compared with 10.45% in the third quarter of 2011. The Company s third quarter return on average assets (ROA) amounted to 1.05%, compared with 1.04% in the third quarter of 2011.

For the nine months ended September 30, 2012, the Company s net income amounted to $9,636, compared with $8,652 for the same period in 2011, representing an increase of $984, or 11.4%. Diluted earnings per share amounted to $2.46 for the nine months ended September 30, 2012, compared with $2.23 for the same period in 2011, representing an increase of $0.23, or 10.3%.

For the nine months ended September 30, 2012, the Company s ROE amounted to 10.37%, compared with 10.60% for the same period in 2011. The Company s ROA amounted to 1.04% for the nine months ended September 30, 2012, compared with 1.01% for the first nine months of 2011.

As previously announced, on August 10, 2012 the Bank acquired substantially all assets and assumed certain liabilities including all deposits of Border Trust Company (Border Trust), a subsidiary of Border Bancshares, Inc., headquartered in Augusta, Maine. The Bank acquired $38,520 of deposits and $33,606 in loans, as well as three branch offices (two of which were leased) located in Kennebec and Sagadahoc Counties. The Bank paid a core deposit premium of 3.85%, or $1,115, and purchased the loan portfolio, excluding selected non-performing loans, at a discount of 2.16%, or $749. In connection with this transaction, the Bank recorded estimated goodwill of $2,073 and an estimated core deposit intangible of $783, or 2.7% of core deposits. The Bank also recorded $829 in non-recurring year-to-date expenses, of which $657 were incurred in the third quarter, including employee severance, professional fees, and other conversion related items.

RESULTS OF OPERATIONS

Net Interest Income

Net interest income is the principal component of the Company's income stream and represents the difference or spread between interest generated from earning assets and the interest expense paid on deposits and borrowed funds. Net interest income is entirely generated by the Bank. Fluctuations in market interest rates as well as volume and mix changes in earning assets and interest bearing liabilities can materially impact net interest income.

Total Net Interest Income: For the three months ended September 30, 2012, net interest income on a tax equivalent basis amounted to $9,821, compared with $9,063 in the third quarter of 2011, representing an increase of $758, or 8.4%. The increase in third quarter 2012 tax-equivalent net interest income compared with the third quarter of 2011 was attributed to average earning asset growth of $114,080 or 10.3%, as the net interest margin declined four basis points.

For the nine months ended September 30, 2012, net interest income on a tax-equivalent basis amounted to $28,535, compared with $26,775 for the same period in 2011, representing an increase of $1,760, or 6.6%. The increase in net interest income was principally attributed to average earning asset growth of $74,581, or 6.7%, as the tax-equivalent net interest margin declined one basis point.

Factors contributing to the changes in net interest income and the net interest margin are more fully enumerated in the following discussion and analysis.

Net Interest Income Analysis: The following tables summarize the Company s average balance sheets and components of net interest income, including a reconciliation of tax equivalent adjustments, for the three and nine months ended September 30, 2012 and 2011:

AVERAGE BALANCE SHEET AND

ANALYSIS OF NET INTEREST INCOME

THREE MONTHS ENDED

SEPTEMBER 30, 2012 AND 2011

	2012			**2011**		
	Average Balance	**Interest**	**Weighted Average Rate**	**Average Balance**	**Interest**	**Weighted Average Rate**
Interest Earning Assets:						
Loans (1,3)	$ 798,095	$ 9,464	**4.72%**	$ 723,219	$ 8,813	**4.83%**
Securities (2,3)	406,563	3,797	**3.72%**	368,579	4,255	**4.58%**
Federal Home Loan Bank stock	17,825	22	**0.49%**	16,068	11	**0.27%**
Fed funds sold, money market funds, and time deposits with other banks	1	---	**0.00%**	538	---	**0.00%**
Total Earning Assets	1,222,484	13,283	**4.32%**	1,108,404	13,079	**4.68%**
Non-Interest Earning Assets:						
Cash and due from banks	3,375			8,974		
Allowance for loan losses	(8,482)			(9,698)		
Other assets (2)	64,469			44,719		
Total Assets	$1,281,846			$1,152,399		
Interest Bearing Liabilities:						
Deposits	$ 721,831	$ 1,941	**1.07%**	$ 687,541	$ 2,202	**1.27%**
Borrowings	350,953	1,521	**1.72%**	279,903	1,814	**2.57%**
Total Interest Bearing Liabilities	1,072,784	3,462	**1.28%**	967,444	4,016	**1.65%**

Rate Spread			**3.04%**			**3.03%**
Non-Interest Bearing Liabilities:						
Demand and other non-interest bearing deposits	74,798			65,455		
Other liabilities	6,476			5,202		
Total Liabilities	1,154,058			1,038,101		
Shareholders' equity	127,788			114,298		
Total Liabilities and Shareholders' Equity	$ 1,281,846			$1,152,399		
Net interest income and net interest margin (3)		9,821	**3.20%**		9,063	**3.24%**
Less: Tax Equivalent adjustment		(407)			(359)	
Net Interest Income		$ 9,414	**3.06%**		$ 8,704	**3.12%**

(1)

For purposes of these computations, non-accrual loans are included in average loans.

(2)

For purposes of these computations, unrealized gains (losses) on available for sale securities are recorded in other assets.

(3)

For purposes of these computations, interest income, net interest income and net interest margin are reported on a tax equivalent basis.

AVERAGE BALANCE SHEET AND

ANALYSIS OF NET INTEREST INCOME

NINE MONTHS ENDED

SEPTEMBER 30, 2012 AND 2011

	2012			2011		
	Average Balance	Interest	Weighted Average Rate	Average Balance	Interest	Weighted Average Rate
Interest Earning Assets:						
Loans (1,3)	$ 770,998	$27,267	**4.72%**	$ 718,633	$26,188	**4.87%**
Securities (2,3)	394,669	11,702	**3.96%**	373,335	13,204	**4.73%**
Federal Home Loan Bank stock	17,089	63	**0.49%**	16,068	35	**0.29%**
Fed funds sold, money market funds, and time deposits with other banks	43	---	**0.00%**	182	---	**0.00%**
Total Earning Assets	1,182,799	39,032	**4.41%**	1,108,218	39,427	**4.76%**
Non-Interest Earning Assets:						
Cash and due from banks	3,169			7,540		
Allowance for loan losses	(8,428)			(9,313)		
Other assets (2)	59,223			41,474		
Total Assets	$1,236,763			$1,147,919		
Interest Bearing Liabilities:						
Deposits	$ 687,991	$ 5,795	**1.13%**	$ 674,400	$ 6,606	**1.31%**
Borrowings	354,392	4,702	**1.77%**	300,036	6,046	**2.69%**
Total Interest Bearing Liabilities	1,042,383	10,497	**1.35%**	974,436	12,652	**1.74%**
Rate Spread			**3.06%**			**3.02%**
Non-Interest Bearing Liabilities:						
Demand and other non-interest bearing deposits	64,294			59,270		
Other liabilities	5,967			5,112		
Total Liabilities	1,112,644			1,038,818		
Shareholders' equity	124,119			109,101		
Total Liabilities and Shareholders' Equity	$1,236,763			$ 1,147,919		
Net interest income and net interest margin (3)		28,535	**3.22%**		26,775	**3.23%**
Less: Tax Equivalent adjustment		(1,151)			(1,113)	

Net Interest Income	$27,384	**3.09%**	$25,662	**3.10%**

(4)

For purposes of these computations, non-accrual loans are included in average loans.

(5)

For purposes of these computations, unrealized gains (losses) on available for sale securities are recorded in other assets.

(6)

For purposes of these computations, interest income, net interest income and net interest margin are reported on a tax equivalent basis.

Net Interest Margin: The net interest margin, expressed on a tax equivalent basis, represents the difference between interest and dividends earned on interest-earning assets and interest paid to depositors and other creditors, expressed as a percentage of average earning assets.

The net interest margin is determined by dividing tax equivalent net interest income by average interest-earning assets. The interest rate spread represents the difference between the average tax equivalent yield earned on interest earning-assets and the average rate paid on interest bearing liabilities. The net interest margin is generally higher than the interest rate spread due to the additional income earned on those assets funded by non-interest bearing liabilities, primarily demand deposits and shareholders equity.

For the three months ended September 30, 2012, the tax equivalent net interest margin amounted to 3.20%, compared with 3.24% in the third quarter of 2011, representing a decline of four basis points. The decline in the net interest margin was principally attributed to the volume of interest earning assets added to the Company s balance sheet, as the interest rate spread improved one basis point. The yield on earning assets declined 36 basis points to 4.32% while the rate paid on interest bearing liabilities declined 37 basis points to 1.28%.

For the nine months ended September 30, 2012, the tax-equivalent net interest margin amounted to 3.22%, compared with 3.23% for the same period in 2011, representing a decline of one basis point. The decline in the net interest margin was principally attributed to the volume of interest earning assets added to the Company s balance sheet, as the interest rate spread improved four basis points. The yield on earning assets declined 35 basis points to 4.41% while the rate paid on interest bearing liabilities declined 39 basis points to 1.35%.

The following table summarizes the net interest margin components, on a quarterly basis, over the past two years. Factors contributing to the changes in the net interest margin are further enumerated in the following discussion and analysis.

NET INTEREST MARGIN ANALYSIS

FOR QUARTER ENDED

WEIGHTED AVERAGE RATES	**2012**				**2011**			**2010**
Quarter:	**3**	**2**	**1**	**4**	**3**	**2**	**1**	**4**
Interest Earning Assets:								
Loans (1,3)	4.72%	4.64%	4.82%	4.88%	4.83%	4.86%	4.93%	5.00%
Securities (2,3)	3.72%	3.96%	4.22%	4.29%	4.58%	4.78%	4.79%	4.73%
Federal Home Loan Bank stock	0.49%	0.49%	0.50%	0.30%	0.27%	0.30%	0.30%	0.00%
Fed Funds sold, money market funds, and time deposits with other banks	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Total Earning Assets	4.32%	4.35%	4.56%	4.61%	4.68%	4.77%	4.81%	4.83%
Interest Bearing Liabilities:								
Deposits	1.07%	1.13%	1.18%	1.25%	1.27%	1.30%	1.36%	1.50%
Borrowings	1.72%	1.69%	1.91%	2.38%	2.57%	2.69%	2.81%	3.22%
Total Interest Bearing Liabilities	1.28%	1.33%	1.43%	1.58%	1.65%	1.74%	1.82%	2.03%
Rate Spread	3.04%	3.02%	3.13%	3.03%	3.03%	3.03%	2.99%	2.80%
Net Interest Margin (3)	3.20%	3.17%	3.30%	3.23%	3.24%	3.23%	3.21%	3.06%
Net Interest Margin without	3.06%	3.04%	3.17%	3.11%	3.12%	3.09%	3.07%	2.92%

Tax Equivalent Adjustments

(1) For purposes of these computations, non-accrual loans are included in average loans.

(2) For purposes of these computations, unrealized gains (losses) on available for sale securities are recorded in other assets.

(3) For purposes of these computations, interest income, net interest income and net interest margin are reported on a tax equivalent basis.

For the three and nine months ended September 30, 2012, the weighted average yield on average earning assets amounted to 4.32% and 4.41%, compared with 4.68% and 4.76% for the same periods in 2011, representing declines of 36 and 35 basis points, respectively. These declines largely resulted from the replacement of accelerated cash flows from the Bank s mortgage-backed securities portfolio along with the purchase of additional securities during a period of historically low interest rates. The declines were also attributed to the origination and competitive re-pricing of certain commercial loans, as well as residential mortgage loan refinancing activity during a period of historically low interest rates.

For the three and nine months ended September 30, 2012, the weighted average cost of interest bearing liabilities amounted to 1.28% and 1.35%, compared with 1.65% and 1.74% for the same periods in 2011, representing declines of 37 and 39 basis points, respectively. These declines principally reflected the ongoing re-pricing of maturing time deposits and borrowings, combined with the lowering of interest rates on certain of the Bank s core deposit products.

Interest and Dividend Income: For the three months ended September 30, 2012, total interest and dividend income on a tax-equivalent basis amounted to $13,283, compared with $13,079 in the third quarter of 2011, representing an increase of $204, or 1.6%. The increase in interest and dividend income was principally attributed to average earning asset growth of $114,080 or 10.3%, but was largely offset by a 36 basis point decline in the weighted average earning asset yield.

For the three months ended September 30, 2012, tax-equivalent interest income from the securities portfolio amounted to $3,797, representing a decline of $458, or 10.8%, compared with the third quarter of 2011. The decline in interest income from securities was principally attributed to an 86 basis point decline in the weighted average securities portfolio yield to 3.72%, offset in part by a $37,984, or 10.3% increase in total average securities, compared with the third quarter of 2011. The decline in the weighted average securities yield was largely attributed to the ongoing replacement of accelerated mortgage-backed securities cash flows in a historically low interest rate environment combined with incremental securities purchases at low prevailing market yields. Accelerated cash flows were principally attributed to increased securitized loan refinancing activity driven by historically low interest rates, a variety of government stimulus programs, quantitative easing efforts by the Federal Reserve, as well as continuing credit defaults.

For the three months ended September 30, 2012, tax-equivalent interest income from the loan portfolio amounted to $9,464, representing an increase of $651, or 7.4% compared with the third quarter of 2011. The increased income from the loan portfolio was attributed to a $74,876 or 10.4% increase in total average loans, but was largely offset by an 11 basis point decline in the weighted average yield to 4.72%, compared with the third quarter of 2011. The decline in the weighted average loan yield principally reflected the origination and competitive re-pricing of certain commercial loans, as well as elevated levels of residential mortgage loan refinancing activity during a period of historically low interest rates.

For the nine months ended September 30, 2012, total tax-equivalent interest and dividend income amounted to $39,032, compared with $39,427 for the same period in 2011, representing a decline of $395, or 0.1%. The decline in interest and dividend income was principally attributed to a 35 basis point decline in the weighted average earning asset yield, largely offset by earning asset growth of $74,581, or 6.7%.

For the nine months ended September 30, 2012, tax-equivalent interest income from the securities portfolio amounted to $11,702, representing a decline of $1,502, or 11.4%, compared with the same period in 2011. The decline in interest income from securities was principally attributed to a 77 basis point decline in the weighted average securities portfolio yield to 3.96%, partially offset by average securities portfolio growth of $21,334, or 5.7%. As more fully discussed immediately above, the decline in the weighted average securities yield was largely attributed to the ongoing replacement of accelerated portfolio cash flows in a historically low interest rate environment, combined with incremental securities purchases at low prevailing market yields.

For the nine months ended September 30, 2012, tax-equivalent interest income from the loan portfolio amounted to $27,267, representing an increase of $1,079 or 4.1% compared with the same period in 2011. The increase in interest income from the loan portfolio was attributed to average loan portfolio growth of $52,365 or 7.3%, as the weighted average yield declined 15 basis points to 4.72%. The decline in yield principally reflected the origination and competitive re-pricing of certain commercial loans, as well as an elevated level of residential mortgage loan refinancing activity during a period of historically low interest rates.

Interest Expense: For the three months ended September 30, 2012, total interest expense amounted to $3,462, compared with $4,016 in the third quarter of 2011, representing a decline of $554, or 13.8%. The decline in interest expense was principally attributed to a 37 basis point decline in the weighted average cost of interest bearing liabilities, the impact of which was largely offset by a $105,340 or 10.9% increase in total average interest bearing liabilities, compared with the third quarter of 2011.

The decline in the third quarter weighted average cost of interest bearing liabilities compared with the same quarter in 2011 was principally attributed to prevailing, historically low short-term and long-term market interest rates, with maturing time deposits and borrowings being added or replaced at a lower cost and other interest bearing deposits re-pricing into the lower interest rate environment. For the three months ended September 30, 2012, the total weighted average cost of interest bearing liabilities amounted to 1.28%, compared with 1.65% for the same quarter in 2011, representing a decline of 37 basis points. The weighted average cost of interest bearing deposits declined 20 basis points to 1.07%, compared with the third quarter of 2011, while the weighted average cost of borrowed funds declined 85 basis points to 1.72%.

For the nine months ended September 30, 2012, total interest expense amounted to $10,497, compared with $12,652 for the same period in 2011, representing a decline of $2,155, or 17.0%. The decline in interest expense was principally attributed to a 39 basis point decline in the weighted average cost of interest bearing liabilities, the impact of which was partially offset by a $67,947 or 7.0% increase in total average interest bearing liabilities, compared with the nine months ended September 30, 2011.

The decline in the weighted average cost of interest bearing liabilities for the nine months ended September 30, 2012 compared with the same period in 2011 was principally attributed to prevailing, historically low short-term and long-term market interest rates, with maturing time deposits and borrowings being added or replaced at a lower cost and other interest bearing deposits re-pricing into the lower interest rate environment. For the nine months ended September 30, 2012, the total weighted average cost of interest bearing liabilities amounted to 1.35%, compared with 1.74% for the same period in 2011, representing a decline of 39 basis points. The weighted average cost of interest bearing deposits declined 18 basis points to 1.13%, while the weighted average cost of borrowed funds declined 92 basis points to 1.77%.

Rate/Volume Analysis: The following tables set forth a summary analysis of the relative impact on net interest income of changes in the average volume of interest earning assets and interest bearing liabilities, and changes in average rates on such assets and liabilities. The income from tax-exempt assets has been adjusted to a fully tax equivalent basis, thereby allowing uniform comparisons to be made. Because of the numerous simultaneous volume and rate changes during the periods analyzed, it is not possible to precisely allocate changes to volume or rate. For presentation purposes, changes which are not solely due to volume changes or rate changes have been allocated to these categories in proportion to the relationships of the absolute dollar amounts of the change in each.

ANALYSIS OF VOLUME AND RATE CHANGES ON NET INTEREST INCOME

THREE MONTHS ENDED SEPTEMBER 30, 2012 AND 2011

INCREASES (DECREASES) DUE TO:

	Average Volume	Average Rate	Total Change
Loans (1,3)	$ 912	$ (261)	$ 651
Securities (2,3)	439	(897)	(458)
Federal Home Loan Bank stock	1	10	11
Fed funds sold, money market funds, and time deposits with other banks	---	---	---
TOTAL EARNING ASSETS	**$1,352**	**$(1,148)**	**$ 204**
Interest bearing deposits	110	(371)	(261)
Borrowings	465	(758)	(293)
TOTAL INTEREST BEARING LIABILITIES	**$ 575**	**$(1,129)**	**$(554)**
NET CHANGE IN NET INTEREST INCOME	**$ 777**	**$ (19)**	**$ 758**

(1)

For purposes of these computations, non-accrual loans are included in average loans.

(2)

For purposes of these computations, unrealized gains (losses) on available for sale securities are recorded in other assets.

(3)

For purposes of these computations, net interest income and net interest margin are reported on a tax equivalent basis.

ANALYSIS OF VOLUME AND RATE CHANGES ON NET INTEREST INCOME

NINE MONTHS ENDED SEPTEMBER 30, 2012 AND 2011

INCREASES (DECREASES) DUE TO:

	Average Volume	**Average Rate**	**Total Change**
Loans (1,3)	$1,908	$ (829)	$ 1,079
Securities (2,3)	755	(2,257)	(1,502)
Federal Home Loan Bank stock	2	26	28
Fed funds sold, money market funds, and time deposits with other banks	---	---	---
TOTAL EARNING ASSETS	**$2,665**	**$(3,060)**	**$ (395)**
Interest bearing deposits	133	(944)	(811)
Borrowings	1,100	(2,444)	(1,344)
TOTAL INTEREST BEARING LIABILITIES	**$1,233**	**$(3,388)**	**$(2,155)**
NET CHANGE IN NET INTEREST INCOME	**$1,432**	**$ 328**	**$ 1,760**

(1)

For purposes of these computations, non-accrual loans are included in average loans.

(2)

For purposes of these computations, unrealized gains (losses) on available for sale securities are recorded in other assets.

(3)

For purposes of these computations, net interest income and net interest margin are reported on a tax equivalent basis.

Provision for Loan Losses

The provision for loan losses (the provision) reflects the amount necessary to maintain the allowance for loan losses at a level that, in management s judgment, is appropriate for the amount of inherent risk of probable loss in the Bank s current loan portfolio.

The credit quality of the Bank s loan portfolio continued to improve during the three and nine months ended September 30, 2012. This improvement was highlighted by a $2,160 or 16.7% decline in non-performing loans and a $1,423 or 14.2% decline in potential problem loans, compared with December 31, 2011. During the three and nine months ended September 30, 2012 the Bank experienced a moderate level of loan loss experience, with total net loan charge-offs amounting to $728 and $1,470, or annualized net charge-offs to average loans outstanding of 0.36% and 0.25%, respectively.

For the three and nine months ended September 30, 2012, the Bank recorded provisions of $427 and $1,302, compared with $750 and $1,850 for the same periods in 2011, representing declines of $323 and $548, or 43.1% and 29.6%, respectively. The provisions recorded during the three and nine months ended September 30, 2012 were largely driven by the Bank s charge-off experience, growth in the loan portfolio, and still depressed real estate values. The three and nine month declines in the provision largely reflected improved credit quality metrics which continued to stabilize during the first nine months of 2012.

Refer below to Item 2 of this Part I, Financial Condition, Loans, *Non-Performing Loans, Potential Problem Loans* and *Allowance for Loan Losses,* in this report on Form 10-Q for further discussion and analysis related to the provision for loan losses.

Non-interest Income

For the three and nine months ended September 30, 2012, total non-interest income amounted to $2,298 and $5,972, compared with $2,064 and $5,281 for the same periods in 2011, representing increases of $234 and $691, or 11.3% and 13.1%, respectively.

Factors contributing to the changes in non-interest income are enumerated in the following discussion and analysis.

Trust and Other Financial Services: Income from trust and other financial services is principally derived from fee income based on a percentage of the fair market value of client assets under management and held in custody and, to a lesser extent, revenue from brokerage services conducted through Bar Harbor Financial Services, an independent third-party broker.

For the three and nine months ended September 30, 2012, trust and other financial service fees amounted to $850 and $2,468, compared with $746 and $2,261 for the same periods in 2011, representing increases of $104 and $207, or 13.9% and 9.2%, respectively. Reflecting new client relationships and some stability in the equity markets, quarter-end assets under management stood at $358,201, compared with $322,451 at September 30, 2011, representing an increase of $35,750 or 11.1%.

Service Charges on Deposit Accounts: For the three and nine months ended September 30, 2012, income from service charges on deposit accounts amounted to $351 and $887, compared with $372 and $997 for the same periods in 2011, representing declines of $21 and $110, or 5.7% and 11.0%, respectively. The declines in service charges on deposit accounts were principally attributed to declines in deposit account overdraft fees, reflecting reduced overdraft activity and the impact of new regulations that limit the ability of a bank to offer overdraft protection to customers without their specific consent and to derive fees from overdraft protection programs in general.

Credit and Debit Card Service Charges and Fees: For the three and nine months ended September 30, 2012, income generated from credit and debit card service charges and fees amounted to $419 and $1,075, compared with $361 and $940 for the same periods in 2011, representing increases of $58 and $135 or 16.1% and 14.4%, respectively. These increases were principally attributed to continued growth of the Bank s retail deposit base, higher levels of merchant credit card processing volumes, and continued success with a program that offers rewards for certain debit card transactions.

Net Securities Gains: For the three months ended September 30, 2012, total net securities gains amounted to $597, compared with $993 in the third quarter of 2011, representing a decline of $396, or 39.9%. The net realized securities gains recorded in the third quarter of 2012 were comprised of realized gains of $600, offset by realized losses of $3. The net realized securities gains recorded in the third quarter of 2011 were comprised entirely of realized gains on the sale of securities.

For nine months ended September 30, 2012, total net securities gains amounted to $1,834, compared with $2,313 for the same period in 2011, representing a decline of $479, or 20.7%. The net realized securities gains recorded during the nine months ended September 30, 2012 were comprised of realized gains of $1,857, offset by realized losses of $23. The net realized gains recorded during the nine months ended September 30, 2011 were comprised entirely of realized gains on the sale of securities.

Net Other-than-temporary Impairment Losses Recognized in Earnings: For the three and nine months ended September 30, 2012, net OTTI losses recognized in earnings amounted to $101 and $781 compared with $572 and $1,726 for the same periods in 2011, representing declines of $471 and $945, or 82.3% and 54.8%, respectively.

During the three and nine months ended September 30, 2012 the Company determined that certain available-for-sale, private-label mortgage-backed securities were other-than-temporarily impaired, because the Company could no longer conclude that it was probable it would recover all of the principal and interest on these securities. The continuance of credit losses principally reflected an increase in the loss severity and constant default rate estimates of the underlying residential mortgage loan collateral, resulting from seriously depressed real estate values, extended foreclosure and collateral liquidation timelines, and depressed economic conditions overall.

The OTTI losses recorded during the nine months ended September 30, 2012 related to ten, available for sale, private-label MBS, all but one of which the Company had previously determined to be other-than-temporarily impaired. These OTTI losses represented management s best estimate of credit losses or additional credit losses on the residential mortgage loan collateral underlying these securities. The $781 in estimated year-to-date credit losses were previously recorded, net of taxes, in unrealized gains or losses on securities available for sale within accumulated other comprehensive income or loss, a component of total shareholders equity on the Company s consolidated balance sheet.

Further information regarding impaired securities, other-than-temporarily impaired securities, and evaluation of securities for impairment is incorporated by reference to Notes 2 and 5 of the unaudited consolidated financial statements in Part I, Item 1 of this quarterly report on Form 10-Q.

Non-interest Expense

For the three months ended September 30, 2012, total non-interest expense amounted to $6,559, compared with $5,684 in the third quarter of 2011, representing an increase of $875, or 15.4%. As more fully discussed below, the increase in third quarter non-interest expense was largely attributed to $657 in non-recurring expenses associated with the Border Trust acquisition.

For the nine months ended September 30, 2012, total non-interest expense amounted to $18,524, compared with $16,981 for the same period in 2011, representing an increase of $1,543, or 9.1%. As more fully discussed below, the increase in year-to-date non-interest expense was largely attributed to $829 in non-recurring expenses associated with the Border Trust acquisition.

Factors contributing to the changes in non-interest expense are more fully enumerated in the following discussion and analysis.

Salaries and Employee Benefits: For the three months ended September 30, 2012, total salaries and employee benefits expense amounted to $3,670, compared with $3,267 in the third quarter of 2011, representing an increase of $403, or 12.3%. The increase in salaries and employee benefits was largely attributed to $263 of employee severance payments in connection with the Border Trust acquisition, higher levels of employee incentive accruals, as well as changes in staffing levels and mix.

For the nine months ended September 30, 2012, total salaries and employee benefits amounted to $10,161, compared with $9,334 for the same period in 2011, representing an increase of $827, or 8.9%. The increase in salaries and employee benefits was largely attributed to employee severance payments, including those incurred in connection with the Border Trust acquisition as enumerated immediately above. The increase was also attributed to higher levels of employee incentive, as well as normal increases in base salaries and changes in staffing levels and mix. The year-over-year increase in salaries and employee benefits expense also reflected the recording of $130 in employee health insurance credits, based on favorable claims experience, in the second quarter of 2011.

Occupancy Expense: For the three and nine months ended September 30, 2012 total occupancy expense amounted to $408 and $1,183, compared with $350 and $1,153 for the same periods in 2011, representing increases of $58 and $30, or 16.6% and 2.6%, respectively. The increase in third quarter occupancy expense compared with the third quarter of 2011 largely resulted from the three new branch office locations acquired in connection with the Border Trust acquisition, which was consummated in the third quarter of 2012. The increase in occupancy expense was also attributed to the Bank s substantial reconfiguration of its Ellsworth campus, including the replacement of its Ellsworth retail banking office, which was put in service in the third quarter of 2012.

FDIC Assessments: For the three and nine months ended September 30, 2012, total FDIC insurance assessments amounted to $237 and $609 compared with $242 and $870 for the same periods in 2011, representing declines of $5 and $261, or 2.1% and 30.0%, respectively. These declines were largely attributed to a new as