NORTHEAST BANCORP /ME/
Form 10-Q
November 12, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2014

Commission File Number: 1-14588

Northeast Bancorp

(Exact name of registrant as specified in its charter)

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

(207) 786-3245

Registrant s telephone number, including area code

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

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

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

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

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date. As of October 31, 2014, the registrant had outstanding 9,349,587 shares of voting common stock, $1.00 par value per share and 880,963 shares of non-voting common stock, $1.00 par value per share.

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PART 1- FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

NORTHEAST BANCORP AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

(Unaudited)

(Dollars in thousands, except share data)

	September 30, 2014	June 30, 2014
Assets		
Cash and due from banks	$ 2,313	$ 3,372
Short-term investments	81,217	78,887
Total cash and cash equivalents	83,530	82,259
Available-for-sale securities, at fair value	110,347	113,881
Loans held for sale	9,069	11,945
Loans	541,799	516,416
Less: Allowance for loan losses	1,539	1,367
Loans, net	540,260	515,049
Premises and equipment, net	8,780	9,135
Real estate owned and other repossessed collateral, net	2,115	1,991
Federal Home Loan Bank stock, at cost	4,102	4,102
Intangible assets, net	2,632	2,798
Bank owned life insurance	14,945	14,836
Other assets	6,511	5,935
Total assets	$ 782,291	$ 761,931
Liabilities and Shareholders Equity		
Liabilities		
Deposits:		
Demand	$ 52,698	$ 50,140
Savings and interest checking	96,814	98,340
Money market	103,054	83,901
Time	341,229	341,948
Total deposits	593,795	574,329
Federal Home Loan Bank advances	42,773	42,824
Wholesale repurchase agreements	10,158	10,199
Short-term borrowings	3,804	2,984
Junior subordinated debentures issued to affiliated trusts	8,485	8,440

Capital lease obligation		1,511		1,558
Other liabilities		8,523		9,531
Total liabilities		669,049		649,865
Commitments and contingencies				
Shareholders equity				
Preferred stock, $1.00 par value, 1,000,000 shares authorized; no shares issued and outstanding at September 30, 2014 and June 30, 2014				
Voting common stock, $1.00 par value, 25,000,000 shares authorized; 9,367,071 and 9,260,331 shares issued and outstanding at September 30, 2014 and June 30, 2014, respectively		9,367		9,260
Non-voting common stock, $1.00 par value, 3,000,000 shares authorized; 880,963 shares issued and outstanding at September 30, 2014 and June 30, 2014		881		881
Additional paid-in capital		90,809		90,914
Retained earnings		13,836		12,294
Accumulated other comprehensive loss		(1,651)		(1,283)
Total shareholders equity		113,242		112,066
Total liabilities and shareholders equity	$	782,291	$	761,931

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

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NORTHEAST BANCORP AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

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

Interest and dividend income:		
Interest on loans	$ 10,922	$ 8,457
Interest on available-for-sale securities	244	282
Other interest and dividend income	66	52
Total interest and dividend income	11,232	8,791
Interest expense:		
Deposits	1,130	1,047
Federal Home Loan Bank advances	323	323
Wholesale repurchase agreements	73	95
Short-term borrowings	9	5
Junior subordinated debentures issued to affiliated trusts	206	192
Obligation under capital lease agreements	20	22
Total interest expense	1,761	1,684
Net interest and dividend income before provision for loan losses	9,471	7,107
Provision for loan losses	320	77
Net interest income after provision for loan losses	9,151	7,030
Noninterest income:		
Fees for other services to customers	394	439
Gain on sales of loans held for sale	584	539
Gain on sales of portfolio loans	80	216
Loss recognized on real estate owned and other repossessed collateral, net	(23)	(38)
Bank-owned life insurance income	109	118
Other noninterest income	10	14
Total noninterest income	1,154	1,288
Noninterest expense:		
Salaries and employee benefits	4,533	4,612
Occupancy and equipment expense	1,202	1,327
Professional fees	308	376
Data processing fees	345	277
Marketing expense	69	36
Loan acquisition and collection expense	274	473
FDIC insurance premiums	124	110
Intangible asset amortization	166	210
Legal settlement recovery		(250)
Other noninterest expense	716	681
Total noninterest expense	7,737	7,852
Income from continuing operations before income tax expense	2,568	466
Income tax expense	924	156
Net income from continuing operations	1,644	310
Income from discontinued operations before income tax expense		15
Income tax expense		5
Net income from discontinued operations		10

Net income	$	1,644	$	320
Net income available to common shareholders	$	1,644	$	320
Weighted-average shares outstanding:				
Basic		10,180,038		10,440,513
Diluted		10,180,038		10,440,513
Earnings per common share:				
Basic:				
Income from continuing operations	$	0.16	$	0.03
Income from discontinued operations		0.00		0.00
Net Income	$	0.16	$	0.03
Diluted:				
Income from continuing operations	$	0.16	$	0.03
Income from discontinued operations		0.00		0.00
Net Income	$	0.16	$	0.03
Cash dividends declared per common share	$	0.01	$	0.09

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

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NORTHEAST BANCORP AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(Dollars in thousands)

Net income	$	1,644	$	320
Other comprehensive income (loss), before tax:				
Available-for-sale securities:				
Change in net unrealized gain or loss on available-for-sale securities		(275)		517
Reclassification adjustment for net gains included in net income				
Total available-for-sale securities		(275)		517
Derivatives and hedging activities:				
Change in accumulated loss on effective cash flow hedges		(272)		19
Reclassification adjustments for net gains included in net income		(9)		(19)
Total derivatives and hedging activities		(281)		
Total other comprehensive income (loss), before tax		(556)		517
Income tax expense (benefit) related to other comprehensive (loss) income		(188)		176
Other comprehensive income (loss), net of tax		(368)		341
Total comprehensive income	$	1,276	$	661

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

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NORTHEAST BANCORP AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY

(Unaudited)

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

	Preferred Stock		Voting Common Stock		Non-voting Common Stock		Additional Paid-in	Retained	Accumulated Other Comprehensive	Total Shareholders
	Shares	Amount	Shares	Amount	Shares	Amount	Capital	Earnings	Income (Loss)	Equity
Balance at June 30, 2013		$	9,565,680	$ 9,566	880,963	$ 881	$ 92,745	$ 12,524	$ (1,914)	$ 113,802
Net income								320		320
Other comprehensive income, net of tax									341	341
Dividends on common stock at $0.09 per share								(940)		(940)
Stock-based compensation							323			323
Forfeiture of restricted common stock			(13,093)	(13)			13			
Balance at September 30, 2013		$	9,552,587	$ 9,553	880,963	$ 881	$ 93,081	$ 11,904	(1,573)	$ 113,846
Balance at June 30, 2014		$	9,260,331	$ 9,260	880,963	$ 881	$ 90,914	$ 12,294	$ (1,283)	$ 112,066
Net income								1,644		1,644
Other comprehensive income, net of tax									(368)	(368)
Common stock repurchased			(14,400)	(14)			(120)			(134)
Dividends on common stock at $0.01 per share								(102)		(102)
Stock-based compensation							136			136
Issuance of restricted common stock			128,000	128			(128)			
Forfeiture of restricted common stock			(6,860)	(7)			7			
Balance at September 30, 2014		$	9,367,071	$ 9,367	880,963	$ 881	$ 90,809	$ 13,836	$ (1,651)	$ 113,242

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

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NORTHEAST BANCORP AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(Dollars in thousands)

Operating activities:				
Net income	$	1,644	$	320
Adjustments to reconcile net income to net cash provided by operating activities:				
Provision for loan losses		320		77
(Gain) loss on sale and impairment of real estate owned and other repossessed collateral, net		(5)		102
Accretion of fair value adjustments on loans, net		(3,097)		(1,317)
Accretion of fair value adjustments on deposits, net		(64)		(201)
Accretion of fair value adjustments on borrowings, net		(47)		(67)
Originations of loans held for sale		(27,676)		(27,433)
Net proceeds from sales of loans held for sale		31,136		31,148
Gain on sales of loans held for sale		(584)		(539)
Gain on sales of portfolio loans		(80)		(216)
Amortization of intangible assets		166		210
Bank-owned life insurance income, net		(109)		(118)
Depreciation of premises and equipment		432		522
Loss (gain) on sale of premises and equipment		28		(1)
Stock-based compensation		136		323
Amortization of securities, net		262		335
Changes in other assets and liabilities:				
Other assets		(364)		(497)
Other liabilities		(1,284)		387
Net cash provided by operating activities		814		3,035
Investing activities:				
Purchases of available-for-sale securities				(3,004)
Proceeds from maturities and principal payments on available-for-sale securities		2,994		6,576
Loan purchases		(13,167)		(16,348)
Proceeds from sales of portfolio loans		793		205
Loan originations and principal collections, net		(10,213)		(31,961)
Purchases of premises and equipment		(105)		(284)
Proceeds from sales of premises and equipment				11
Proceeds from sales of real estate owned and other repossessed collateral		88		150
Net cash used in investing activities		(19,610)		(44,655)
Financing activities:				
Net increase in deposits		19,530		47,676
Net increase in short-term borrowings		820		1,345
Repurchase of common stock		(134)		
Dividends paid on common stock		(102)		(940)
Proceeds from FHLB advances				15,000
Repayment of wholesale repurchase agreements				(10,000)
Repayment of capital lease obligation		(47)		(44)
Net cash provided by financing activities		20,067		53,037
Net increase in cash and cash equivalents		1,271		11,417

Cash and cash equivalents, beginning of period		82,259		65,934
Cash and cash equivalents, end of period	$	83,530	$	77,351
Supplemental schedule of noncash investing and financing activities:				
Transfers from loans to real estate owned and other repossessed collateral	$	209	$	1,531
Transfers from real estate owned and other repossessed collateral to loans				

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

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NORTHEAST BANCORP AND SUBSIDIARY

Notes to Unaudited Consolidated Financial Statements

September 30, 2014

1. Basis of Presentation

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

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

2. Recent Accounting Pronouncements

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

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

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

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3. Securities Available-for-Sale

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

	September 30, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
U.S. Government agency securities	$ 48,359	$ 15	$ (23)	$ 48,351
Agency mortgage-backed securities	63,544	0	(1,548)	61,996
	$ 111,903	$ 15	$ (1,571)	$ 110,347

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

When securities are sold, the adjusted cost of the specific security sold is used to compute the gain or loss on sale. There were no securities sold during the three months ended September 30, 2014 or 2013. At September 30, 2014, investment securities with a fair value of approximately $32.3 million were pledged as collateral to secure outstanding borrowings.

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

	September 30, 2014					
	Less than 12 Months		More than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(Dollars in thousands)					
U.S. Government agency securities	$ 27,111	$ (23)	$	$	$ 27,111	$ (23)
Agency mortgage-backed securities	2,510	(6)	59,486	(1,542)	61,996	(1,548)
	$ 29,621	$ (29)	$ 59,486	$ (1,542)	$ 89,107	$ (1,571)

	June 30, 2014					
	Less than 12 Months		More than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses

	(Dollars in thousands)											
U.S. Government agency securities	$	24,141	$	(28)	$		$		$	24,141	$	(28)
Agency mortgage-backed securities						62,734		(1,284)		62,734		(1,284)
	$	24,141	$	(28)	$	62,734	$	(1,284)	$	86,875	$	(1,312)

There was no other-than-temporary impairment losses on securities during the three months ended September 30, 2014 or 2013.

At September 30, 2014, the Company had twenty-one securities in a continuous loss position for greater than twelve months. At September 30, 2014, all of the Company s available-for-sale securities were issued or guaranteed by either government agencies or government-sponsored enterprises. The decline in fair value of the Company s available-for-sale securities at September 30, 2014 is attributable to changes in interest rates.

Management of the Company, in addition to considering current trends and economic conditions that may affect the quality of individual securities within the Company s investment portfolio, also considers the Company s ability and intent to hold such securities to maturity or recovery of cost. Management does not believe any of the Company s available-for-sale securities are other-than-temporarily impaired at September 30, 2014.

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The amortized cost and fair values of available-for-sale debt securities by contractual maturity are shown below as of September 30, 2014. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
	(Dollars in thousands)	
Due within one year	$ 3,002	$ 3,009
Due after one year through five years	45,357	45,342
Due after five years through ten years	31,904	31,393
Due after ten years	31,640	30,603
	$ 111,903	$ 110,347

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4. Loans, Allowance for Loan Losses and Credit Quality

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

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

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

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

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

	September 30, 2014			June 30, 2014	
Originated	Purchased	Total	Originated	Purchased	Total
		(Dollars in thousands)			

Residential real estate	$	114,414	$	2,729	$	117,143	$	116,972	$	3,687	$	120,659
Home equity		26,818				26,818		27,975				27,975
Commercial real estate		108,709		202,922		311,631		116,617		199,481		316,098
Commercial business		76,663		277		76,940		41,518		282		41,800
Consumer		9,267				9,267		9,884				9,884
Total loans	$	335,871	$	205,928	$	541,799	$	312,966	$	203,450	$	516,416

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Allowance for Loan Losses and Impaired Loans

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

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

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

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

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

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

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

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

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

There were no significant changes in the Company s policies or methodology pertaining to the general component of the allowance for loan losses during the three months ended September 30, 2014 or 2013.

The allocated component of the allowance for loan losses relates to loans that are classified as impaired. Impairment is measured on a loan-by-loan basis for commercial business and commercial real estate loans by either the present value of expected future cash flows discounted at the loan s effective interest rate or the fair value of the collateral if the loan is collateral dependent. An allowance is established when the discounted cash flows or collateral value of the impaired loan is lower than the carrying value of that loan. Large

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groups of smaller-balance homogeneous loans, such as consumer and residential real estate loans are collectively evaluated for impairment based on the group s historical loss experience adjusted for qualitative factors. Accordingly, the Company does not separately identify individual consumer and residential loans for individual impairment and disclosure. However, all TDRs are individually reviewed for impairment.

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

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

	Three Months Ended September 30, 2014						
	Residential Real Estate	Commercial Real Estate	Commercial Business	Consumer	Purchased	Unallocated	Total
	(Dollars in thousands)						
Beginning balance	$ 580	$ 358	$ 48	$ 79	$ 267	$ 35	$ 1,367
Provision	358	(18)	1	(35)	4	10	320
Recoveries	5			10			15
Charge-offs	(160)			(3)			(163)
Ending balance	$ 783	$ 340	$ 49	$ 51	$ 271	$ 45	$ 1,539

	Three Months Ended September 30, 2013						
	Residential Real Estate	Commercial Real Estate	Commercial Business	Consumer	Purchased	Unallocated	Total
	(Dollars in thousands)						
Beginning balance	$ 594	$ 173	$ 70	$ 189	$ 76	$ 41	$ 1,143
Provision	115	(10)	(26)	(53)	25	26	77
Recoveries	6		6	18			30
Charge-offs	(20)			(6)			(26)
Ending balance	$ 695	$ 163	$ 50	$ 148	$ 101	$ 67	$ 1,224

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

	September 30, 2014						
	Residential Real Estate	Commercial Real Estate	Commercial Business	Consumer	Purchased	Unallocated	Total
	(Dollars in thousands)						
Allowance for loan losses:							
Individually evaluated	$ 389	$ 86	$	$ 4	$ 232	$	$ 711
Collectively evaluated	394	254	49	47		45	789
ASC 310-30					39		39
Total	$ 783	$ 340	$ 49	$ 51	$ 271	$ 45	$ 1,539
Loans:							
Individually evaluated	$ 3,501	$ 2,294	$	$ 221	$ 6,274	$	$ 12,290
Collectively evaluated	137,731	106,415	76,663	9,046			329,855
ASC 310-30					199,654		199,654
Total	$ 141,232	$ 108,709	$ 76,663	$ 9,267	$ 205,928	$	$ 541,799

	June 30, 2014						
	Residential Real Estate	Commercial Real Estate	Commercial Business	Consumer	Purchased	Unallocated	Total
	(Dollars in thousands)						
Allowance for loan losses:							
Individually evaluated	$ 190	$ 84	$	$ 6	$ 166	$	$ 446
Collectively evaluated	390	274	48	73		35	820

ASC 310-30					101		101
Total	$ 580	$ 358	$ 48	$ 79	$ 267	$ 35	$ 1,367
Loans:							
Individually evaluated	$ 2,314	$ 2,549	$	$ 240	$ 4,747	$	$ 9,850
Collectively evaluated	142,633	114,068	41,518	9,644			307,863
ASC 310-30					198,703		198,703
Total	$ 144,947	$ 116,617	$ 41,518	$ 9,844	$ 203,450	$	$ 516,416

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

	At September 30, 2014			At June 30, 2014		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
	(Dollars in thousands)					
Impaired loans without a valuation allowance:						
Originated:						
Residential real estate	$ 1,396	$ 1,468	$	$ 1,005	$ 1,081	$
Consumer	191	195		200	205	
Commercial real estate	808	814		1,368	1,371	
Commercial business		11				
Purchased:						
Commercial real estate	5,018	7,193		2,857	4,148	
Total	7,413	9,681		5,430	6,805	
Impaired loans with a valuation allowance:						
Originated:						
Residential real estate	2,105	2,036	389	1,309	1,278	190
Consumer	30	31	4	40	47	6
Commercial real estate	1,486	1,468	86	1,181	1,187	84
Commercial business						
Purchased:						
Commercial real estate	1,256	1,745	232	1,890	2,215	166
Total	4,877	5,280	711	4,420	4,727	446
Total impaired loans	$ 12,290	$ 14,961	$ 711	$ 9,850	$ 11,532	$ 446

	Three Months Ended September 30,			
	2014		2013	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(Dollars in thousands)			
Impaired loans without a valuation allowance:				
Originated:				
Residential real estate	$ 1,201	$ 17	$ 1,061	$ 6
Consumer	196	3	84	1
Commercial real estate	1,088	7	439	7
Commercial business		1	63	3
Purchased:				
Commercial real estate	3,938	75	1,637	7
Total	6,423	103	3,284	24
Impaired loans with a valuation allowance:				
Originated:				
Residential real estate	1,707	28	1,393	18
Consumer	35	1	91	1
Commercial real estate	1,334	20	1,121	26
Commercial business			54	
Purchased:				

Commercial real estate	1,573	3	200	2
Total	4,649	52	2,859	47
Total impaired loans	$ 11,072	$ 155	$ 6,143	$ 71

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Credit Quality

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

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

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

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

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

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

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

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

[redacted]

Loans rated 1- 6	$	102,725	$	76,427	$	11,686	$	191,367	$	382,207

Loans rated 7	4,783	42	1,014	9,815	15,654
Loans rated 8	1,201	194	665	4,746	6,806
Loans rated 9					
Loans rated 10					
	$ 108,709	$ 76,663	$ 13,365	$ 205,928	$ 404,667

[redacted]

Loans rated 1- 6	$ 110,044	$ 41,271	$ 11,941	$ 189,986	$ 353,242
Loans rated 7	4,880	46	940	8,619	14,485
Loans rated 8	1,693	201	670	4,845	7,409
Loans rated 9					
Loans rated 10					
	$ 116,617	$ 41,518	$ 13,551	$ 203,450	$ 375,136

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

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Past Due and Nonaccrual Loans

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

	September 30, 2014							
	30-59 Days	60-89 Days	Past Due 90 Days or More-Still Accruing	Past Due 90 Days or More-Nonaccrual	Total Past Due	Total Current	Total Loans	Non-Accrual Loans
	(Dollars in thousands)							
Originated portfolio:								
Residential real estate	$ 427	$ 508	$	$ 1,306	$ 2,241	$ 112,173	$ 114,414	$ 2,105
Home equity				11	11	26,807	26,818	28
Commercial real estate	733			432	1,165	107,544	108,709	721
Commercial business						76,663	76,663	
Consumer	308	83		57	448	8,819	9,267	145
Total originated portfolio	1,468	591		1,806	3,865	332,006	335,871	2,999
Purchased portfolio:								
Residential real estate						2,729	2,729	
Commercial business						277	277	
Commercial real estate		289		3,437	3,726	199,196	202,922	4,287
Total purchased portfolio		289		3,437	3,726	202,202	205,928	4,287
Total loans	$ 1,468	$ 880	$	$ 5,243	$ 7,591	$ 534,207	$ 541,799	$ 7,286

	June 30, 2014							
	30-59 Days	60-89 Days	Past Due 90 Days or More-Still Accruing	Past Due 90 Days or More-Nonaccrual	Total Past Due	Total Current	Total Loans	Non-Accrual Loans
	(Dollars in thousands)							
Originated portfolio:								
Residential real estate	$ 222	$ 728	$	$ 1,573	$ 2,523	$ 114,449	$ 116,972	$ 1,743
Home equity	109	7		120	236	27,739	27,975	160
Commercial real estate	126	136		629	891	115,726	116,617	1,162
Commercial business						41,518	41,518	5
Consumer	188	24		49	261	9,623	9,884	139
Total originated portfolio	645	895		2,371	3,911	309,055	312,966	3,209
Purchased portfolio:								
Residential real estate						3,687	3,687	
Commercial business						282	282	
Commercial real estate				1,995	1,995	197,486	199,481	4,116
Total purchased portfolio				1,995	1,995	201,455	203,450	4,116
Total loans	$ 645	$ 895	$	$ 4,366	$ 5,906	$ 510,510	$ 516,416	$ 7,325

Troubled Debt Restructurings

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

	Three Months Ended September 30,			
	2014		2013	
	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
	(Dollars in thousands)			
Extended maturity	2	$ 234	1	$ 14
Adjusted interest rate			1	82
Rate and maturity	4	246		
Principal deferment	1	461	2	341
Court ordered concession	4	85		
	11	$ 1,026	4	$ 437

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

	Three Months Ended September 30,					
	2014			2013		
	Number of Contracts	Recorded Investment Pre-Modification	Recorded Investment Post-Modification	Number of Contracts	Recorded Investment Pre-Modification	Recorded Investment Post-Modification
Originated portfolio:						
Residential real estate	9	$ 823	$ 823		$	$
Home equity				1	14	14
Commercial real estate	1	200	200	1	323	323
Commercial business				1	18	18
Consumer	1	3	3	1	82	82
Total originated portfolio	11	1,026	1,026	4	437	437
Purchased portfolio:						
Residential real estate						
Commercial real estate						
Total purchased portfolio						
Total	11	$ 1,026	$ 1,026	4	$ 437	$ 437

The Company considers TDRs past due 90 days or more to be in payment default. Two loans modified in a TDR in the last twelve months defaulted during the three months ended September 30, 2014; the recorded investment of such loans was $48 thousand. As of September 30, 2014, there were no further commitments to lend associated with loans modified in a TDR.

ASC 310-30 Loans

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

	Three Months Ended September 30, 2014 (Dollars in thousands)
Contractually required payments receivable	$ 21,108
Nonaccretable difference	(304)
Cash flows expected to be collected	20,804
Accretable yield	(7,960)
Fair value of loans acquired	$ 12,844

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

		As of and for the three months ended September 30, 2014
Loans acquired during the period	$	322
Loans at end of period		4,287

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

		Three Months Ended September 30, 2014 (Dollars in thousands)
Beginning balance	$	109,040
Acquisitions		7,960
Accretion		(4,443)
Reclassifications to (from) accretable yield		10
Disposals and other changes		(4,215)
End balance	$	108,352

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

		September 30, 2014		June 30, 2014
		(Dollars in thousands)		
Unpaid principal balance	$	241,675	$	239,376
Carrying amount	$	203,640	$	201,171

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5. Earnings Per Share (EPS)

EPS is computed by dividing net income allocated to common shareholders by the weighted average common shares outstanding. The following table shows the weighted average number of shares outstanding for the periods indicated. Shares issuable relative to stock options granted have been reflected as an increase in the shares outstanding used to calculate diluted EPS, after applying the treasury stock method. The number of shares outstanding for basic and diluted EPS is presented as follows:

	Three Months Ended September 30, 2014		2013	
	(Dollars in thousands, except share and per share data)			
Net income	$	1,644	$	320
Net income from continuing operations available to common shareholders	$	1,644	$	320
Weighted average shares used in calculation of basic earnings per share		10,180,038		10,440,513
Incremental shares from assumed exercise of dilutive securities				
Weighted average shares used in calculation of diluted earnings per share		10,180,038		10,440,513
Earnings per common share:				
Income from continuing operations	$	0.16	$	0.03
Income from discontinued operations		0.00		0.00
Earnings per common share	$	0.16	$	0.03
Diluted earnings per common share:				
Income from continuing operations	$	0.16	$	0.03
Income from discontinued operations		0.00		0.00
Diluted earnings per common share	$	0.16	$	0.03

Anti-dilutive options and warrants excluded from the calculation of dilutive earnings per share follow.

	Three Months Ended September 30, 2014	2013
Stock options	1,082,121	1,166,804
Warrants		
	1,082,121	1,166,804

6. Fair Value Measurements

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Fair Value of other Financial Instruments:

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

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

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

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

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

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

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

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

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

	September 30, 2014			
	Total	Level 1	Level 2	Level 3
	(Dollars in thousands)			
Assets				
Securities available-for-sale:				
U.S. Government agency securities	$ 48,351	$	$ 48,351	$
Agency mortgage-backed securities	61,996		61,996	
Other assets interest rate caps				