

FIRST NATIONAL LINCOLN CORP /ME/  
Form 10-K/A  
September 28, 2007  
UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

**FORM 10-K/A**

**X Annual Report Pursuant to Section 13 or 15(d) of The Securities Exchange Act of 1934**

**For the Fiscal Year ended December 31, 2006**

**Commission File Number 0-26589**

**FIRST NATIONAL LINCOLN CORPORATION**

(Exact name of Registrant as specified in its charter)

**MAINE 01-0404322**

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

**MAIN STREET, DAMARISCOTTA, MAINE**

**04543**

(Address of principal executive offices)

(Zip code)

**(207) 563-3195**

Registrant's telephone number, including area code

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

**Common Stock, \$.01 par value per share**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes  No **x**

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes  No **x**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes **x** No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

**Large accelerated filer**  **Accelerated filer** **x** **Non-accelerated filer**

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes  No **x**

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter.

**Common Stock, \$.01 par value per share: \$147,751,000**

Indicate the number of shares outstanding of each of the registrant's classes of common stock as of March 15, 2007

**Common Stock: 9,782,975 shares**

**Explanatory Note to Form 10-K Amendment No. 1**

**First National Lincoln Corporation**

**Annual Report on Form 10-K/A**

**For the Year Ended December 31, 2006**

This Amendment No. 1 on Form 10-K/A amends the Company's Annual Report on Form 10-K for the year ended December 31, 2006, as filed with the Securities and Exchange Commission on March 16, 2007, for the following:

(a) in Item 8 of Part II of the Form 10-K, to amend the Report of Independent Registered Public Accounting Firm on page 27. This is to correct the date in the reference to the audit firm's report on effectiveness of First National Lincoln Corporation and Subsidiary's internal control over financial reporting on page 29; and

(b) in Item 9A of Part II of the Form 10-K, to amend the Report of Independent Registered Public Accounting Firm on page 29. This is to correct the date in the reference to the audit firm's report on page 27 which expressed an unqualified opinion.

No other changes have been made to Items 8 and 9A.

Except for the items describes above, this Amendment continues to speak as of the date of the Original Form 10-K, and does not modify, amend or update in any way the financial statements or any other item or disclosures in the Original Form 10-K.

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**ITEM 8. Financial Statements and Supplemental Data****Consolidated Balance Sheets***First National Lincoln Corporation and Subsidiary*

<i>As of December 31,</i>	<b>2006</b>	<b>2005</b>
<b><u>Assets</u></b>		
Cash and cash equivalents	<b>\$ 24,188,000</b>	\$ 25,982,000
Securities available for sale	<b>44,815,000</b>	54,743,000
Securities to be held to maturity, fair value of \$134,649,000 at December 31, 2006, and \$128,563,000 at December 31, 2005	<b>135,734,000</b>	129,238,000
Loans held for sale	<b>460,000</b>	-
Loans	<b>838,145,000</b>	772,338,000
Less allowance for loan losses	<b>6,364,000</b>	6,086,000
Net loans	<b>831,781,000</b>	766,252,000
Accrued interest receivable	<b>6,140,000</b>	5,005,000
Premises and equipment, net	<b>15,845,000</b>	16,712,000
Other real estate owned	<b>1,144,000</b>	-
Goodwill	<b>27,684,000</b>	27,684,000
Other assets	<b>17,078,000</b>	16,593,000
<b>Total assets</b>	<b>\$ 1,104,869,000</b>	\$ 1,042,209,000
<b><u>Liabilities</u></b>		
Demand deposits	<b>\$62,157,000</b>	\$62,109,000
NOW deposits	<b>99,612,000</b>	109,124,000
Money market deposits	<b>137,163,000</b>	127,630,000
Savings deposits	<b>98,131,000</b>	109,615,000
Certificates of deposit under \$100,000	<b>164,770,000</b>	125,741,000
Certificates of deposit \$100,000 or more	<b>243,402,000</b>	179,745,000
Total deposits	<b>805,235,000</b>	713,964,000
Borrowed funds	<b>179,862,000</b>	215,189,000
Other liabilities	<b>12,445,000</b>	9,604,000
<b>Total liabilities</b>	<b>997,542,000</b>	938,757,000
Commitments and contingent liabilities (notes 13, 14 and 18)		
<b><u>Shareholders' equity</u></b>		
Common stock, one cent par value	<b>98,000</b>	99,000
Additional paid-in capital	<b>45,587,000</b>	47,718,000
Retained earnings	<b>61,298,000</b>	54,901,000
Accumulated other comprehensive income		
Net unrealized gain on securities available for sale,		
net of tax of \$370,000 in 2006 and \$373,000 in 2005	<b>696,000</b>	734,000
Net unrealized loss on postretirement benefit costs,		
net of tax benefit of \$190,000	<b>(352,000)</b>	-
<b>Total shareholders' equity</b>	<b>107,327,000</b>	103,452,000
<b>Total liabilities and shareholders' equity</b>	<b>\$ 1,104,869,000</b>	\$ 1,042,209,000
<b><u>Common stock</u></b>		
Number of shares authorized	<b>18,000,000</b>	18,000,000
Number of shares issued	<b>9,770,792</b>	9,832,777
Number of shares outstanding	<b>9,770,792</b>	9,832,777
Book value per share	<b>\$10.98</b>	\$10.52

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



**Consolidated Statements of Income***First National Lincoln Corporation and Subsidiary*

<i>Years ended December 31,</i>	<b>2006</b>	2005	2004
<b>Interest and dividend income</b>			
Interest and fees on loans (includes tax-exempt income of \$975,000 in 2006, \$879,000 in 2005, and \$356,000 in 2004)	<b>\$54,585,000</b>	\$42,623,000	\$23,982,000
Interest on deposits with other banks	<b>64,000</b>	13,000	4,000
Interest and dividends on investments (includes tax-exempt income of \$2,703,000 in 2006, \$2,482,000 in 2005, and \$1,802,000 in 2004)	<b>9,555,000</b>	7,795,000	6,542,000
Total interest and dividend income	<b>64,204,000</b>	50,431,000	30,528,000
<b>Interest expense</b>			
Interest on deposits	<b>25,804,000</b>	13,489,000	5,175,000
Interest on borrowed funds	<b>7,785,000</b>	5,359,000	3,849,000
Total interest expense	<b>33,589,000</b>	18,848,000	9,024,000
Net interest income	<b>30,615,000</b>	31,583,000	21,504,000
Provision for loan losses	<b>1,325,000</b>	200,000	880,000
Net interest income after provision for loan losses	<b>29,290,000</b>	31,383,000	20,624,000
<b>Non-interest income</b>			
Fiduciary and investment management income	<b>1,951,000</b>	1,686,000	874,000
Service charges on deposit accounts	<b>2,752,000</b>	2,438,000	1,177,000
Net securities gains	<b>18,000</b>	-	-
Mortgage origination and servicing income	<b>503,000</b>	616,000	419,000
Other operating income	<b>5,082,000</b>	4,294,000	2,197,000
Total non-interest income	<b>10,306,000</b>	9,034,000	4,667,000
<b>Non-interest expense</b>			
Salaries and employee benefits	<b>10,826,000</b>	11,099,000	7,071,000
Occupancy expense	<b>1,421,000</b>	1,395,000	850,000
Furniture and equipment expense	<b>2,124,000</b>	2,136,000	1,431,000
Amortization of core deposit intangible	<b>283,000</b>	271,000	-
Other operating expenses	<b>7,785,000</b>	7,617,000	4,019,000
Total non-interest expense	<b>22,439,000</b>	22,518,000	13,371,000
Income before income taxes	<b>17,157,000</b>	17,899,000	11,920,000
Income tax expense	<b>4,862,000</b>	5,056,000	3,411,000
<b>Net income</b>	<b>\$12,295,000</b>	\$12,843,000	\$ 8,509,000
<b>Earnings per common share</b>			
Basic earnings per share	<b>\$ 1.25</b>	\$ 1.32	\$ 1.16
Diluted earnings per share	<b>1.25</b>	1.30	1.14
Cash dividends declared per share	<b>0.61</b>	0.53	0.45
Weighted average number of shares outstanding	<b>9,816,307</b>	9,745,456	7,330,434
Incremental shares	<b>49,476</b>	114,751	149,721

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

**Consolidated Statements of Changes in Shareholders' Equity***First National Lincoln Corporation and Subsidiary*

	Number of common shares outstanding	Common stock	Additional paid-in capital	Retained earnings	Net unrealized gain on securities available for sale	Treasury stock	Total Shareholders equity
Balance at December 31, 2003	7,264,140	\$ 74,000	\$ 4,650,000	\$ 42,988,000	\$ 2,497,000	\$ (2,491,000)	\$ 47,718,000
Net income	-	-	-	8,509,000	-	-	8,509,000
Net unrealized loss on securities available for sale, net of tax benefit of \$277,000	-	-	-	-	(538,000)	-	(538,000)
Comprehensive income	-	-	-	8,509,000	(538,000)	-	7,971,000
Cash dividends declared	-	-	-	(3,292,000)	-	-	(3,292,000)
Payment to repurchase common stock	(25,543)	-	-	-	-	(404,000)	(404,000)
Proceeds from sale of common stock	118,239	-	(625,000)	-	-	1,447,000	822,000
Retirement of treasury stock	-	-	(52,000)	(1,396,000)	-	1,448,000	-
Balance at December 31, 2004	7,356,836	74,000	3,973,000	46,809,000	1,959,000	-	52,815,000
Net income	-	-	-	12,843,000	-	-	12,843,000
Net unrealized loss on securities available for sale, net of tax benefit of \$631,000	-	-	-	-	(1,225,000)	-	(1,225,000)
Comprehensive income	-	-	-	12,843,000	(1,225,000)	-	11,618,000
Cash dividends declared	-	-	-	(5,212,000)	-	-	(5,212,000)
Payment to repurchase common stock	(176,247)	(2,000)	(3,030,000)	-	-	-	(3,032,000)
Proceeds from sale of common stock	187,590	2,000	1,414,000	-	-	-	1,416,000
Tax benefit of disqualifying disposition of incentive stock option shares	-	-	-	461,000	-	-	461,000
Acquisition of FNB Bankshares	2,464,598	25,000	45,361,000	-	-	-	45,386,000
Balance at December 31, 2005	9,832,777	\$ 99,000	\$ 47,718,000	\$ 54,901,000	\$ 734,000	\$ -	\$103,452,000

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	Number of common shares outstanding	Common stock	Additional paid-in capital	Retained earnings	Net unrealized gain on securities available for sale	Net unrealized loss on post- retirement benefits	Total Shareholders equity
Balance at December 31, 2005	9,832,777	\$ 99,000	\$ 47,718,000	\$ 54,901,000	\$ 734,000	\$ -	\$103,452,000
Net income	-	-	-	12,295,000	-	-	12,295,000
Net unrealized loss on securities available for sale, net of tax benefit of \$3,000	-	-	-	-	(38,000)	-	(38,000)
Adjustment to initially apply Statement No. 158, net of tax benefit of \$190,000	-	-	-	-	-	(352,000)	(352,000)
Comprehensive income	-	-	-	12,295,000	(38,000)	(352,000)	11,905,000
Cash dividends declared	-	-	-	(5,983,000)	-	-	(5,983,000)
Equity compensation expense	-	-	60,000	-	-	-	60,000
Payment to repurchase common stock	(179,176)	(1,000)	(3,051,000)	-	-	-	(3,052,000)
Proceeds from sale of common stock	117,191	-	860,000	-	-	-	860,000
Tax benefit of disqualifying disposition of incentive stock option shares	-	-	-	85,000	-	-	85,000
<b>Balance at December 31, 2006</b>	<b>9,770,792</b>	<b>\$ 98,000</b>	<b>\$ 45,587,000</b>	<b>\$ 61,298,000</b>	<b>\$ 696,000</b>	<b>\$ (352,000)</b>	<b>\$107,327,000</b>

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



**Consolidated Statements of Cash Flows***First National Lincoln Corporation and Subsidiary*

<i>For the years ended December 31,</i>	2006	2005	2004
<b>Cash flows from operating activities</b>			
Net income	\$12,295,000	\$12,843,000	\$ 8,509,000
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	1,400,000	1,469,000	1,009,000
Deferred income taxes	(424,000)	392,000	(3,000)
Provision for loan losses	1,325,000	200,000	880,000
Loans originated for resale	(17,435,000)	(24,524,000)	(15,375,000)
Proceeds from sales of loans	16,975,000	25,115,000	16,357,000
Net gain on sale of other real estate owned	(10,000)	-	-
Equity compensation expense	60,000	-	-
Net (gain)/loss on sale or call of securities available for sale	(18,000)	-	4,000
Net change in other assets and accrued interest receivable	(1,444,000)	(2,721,000)	100,000
Net change in other liabilities	2,542,000	2,257,000	455,000
Net amortization of premiums on investments	(253,000)	68,000	88,000
Net acquisition amortization	252,000	319,000	-
Provision for losses on other real estate owned	269,000	-	-
Net cash provided by operating activities	15,534,000	15,418,000	12,024,000
<b>Cash flows from investing activities</b>			
Proceeds from maturities, payments, calls of securities available for sale	10,019,000	4,723,000	6,245,000
Proceeds from maturities, payments, calls of securities held to maturity	20,040,000	22,590,000	48,494,000
Proceeds from sales of other real estate owned	561,000	-	47,000
Purchases of securities available for sale	(58,000)	(7,423,000)	(1,529,000)
Purchases of securities to be held to maturity	(26,339,000)	(52,405,000)	(44,251,000)
Net increase in loans	(68,961,000)	(109,943,000)	(79,803,000)
Capital expenditures	(872,000)	(1,353,000)	(974,000)
Proceeds from sale of real estate	339,000	-	-
Cash for acquisition, net of cash received	-	3,493,000	-
Net cash used in investing activities	(65,271,000)	(140,318,000)	(71,771,000)
<b>Cash flows from financing activities</b>			
Net increase (decrease) in demand deposits, savings,			
and money market accounts	(11,415,000)	30,102,000	11,838,000
Net increase (decrease) in certificates of deposit	102,837,000	121,383,000	(1,071,000)
Advances on long-term borrowings	30,000,000	-	8,215,000
Repayments on long-term borrowings	-	(47,118,000)	(27,331,000)
Net increase (decrease) in short-term borrowings	(65,304,000)	38,088,000	68,500,000
Payments to repurchase common stock	(3,052,000)	(3,032,000)	(404,000)
Proceeds from sale of common stock	860,000	1,416,000	822,000
Dividends paid	(5,983,000)	(4,727,000)	(3,139,000)
Net cash provided by financing activities	47,943,000	136,112,000	57,430,000
Net increase (decrease) in cash and cash equivalents	(1,794,000)	11,212,000	(2,317,000)
Cash and cash equivalents at beginning of year	25,982,000	14,770,000	17,087,000
<b>Cash and cash equivalents at end of year</b>	<b>\$24,188,000</b>	<b>\$25,982,000</b>	<b>\$14,770,000</b>
Interest paid	\$32,934,000	\$18,386,000	\$ 9,086,000
Income taxes paid	4,443,000	4,957,000	3,529,000
Non-cash transactions:			
Non-cash assets acquired with common stock	-	254,984,000	-
Less liabilities assumed	-	213,091,000	-
Transfer from loans to other real estate owned	1,964,000	-	-
Net change in unrealized gain on securities available for sale	41,000	1,856,000	815,000

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

**Notes to Consolidated Financial Statements**

***Nature of Operations***

First National Lincoln Corporation (the Company) through its wholly-owned subsidiary, The First, N.A. ( the Bank ), provides a full range of banking services to individual and corporate customers from fourteen offices in Mid-Coast and Down East Maine. First Advisors, a division of the Bank, provides investment management, private banking and financial planning services. First Advisors has three offices in Mid-Coast and Down East Maine. On January 14, 2005, the Company completed the acquisition of FNB Bankshares ( FNB ) of Bar Harbor, Maine, and 2005 operating results include the effect of the FNB acquisition only after the closing date (see Note 21 Pro-Forma Financial Information).

**Note 1. Summary of Significant Accounting Policies**

***Principles of Consolidation***

The consolidated financial statements include the accounts of the Company and the Bank. All intercompany accounts and transactions have been eliminated in consolidation.

***Use of Estimates in Preparation of Financial Statements***

In preparing the financial statements in accordance with accounting principles generally accepted in the United States of America, Management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities as of the date of the balance sheet and revenues and expenses for the reporting period. Actual results could differ significantly 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, the valuation of mortgage servicing rights, and goodwill.

***Investment Securities***

Investment securities are classified as available for sale or held to maturity when purchased. There are no trading account securities.

Securities available for sale consist primarily of debt securities which Management intends to hold for indefinite periods of time. They may be used as part of the Bank's funds management strategy, and may be sold in response to changes in interest rates or prepayment risk, changes in liquidity needs, to increase capital, or for other similar reasons. These assets are accounted for at fair value, with unrealized gains or losses adjusted through shareholders' equity, net of related income taxes.

Securities to be held to maturity consist primarily of debt securities which Management has acquired solely for long-term investment purposes, rather than for purposes of trading or future sale. For securities to be held to maturity, Management has the intent and the Bank has the ability to hold such securities until their respective maturity dates. Such securities are carried at cost adjusted for the amortization of premiums and accretion of discounts.

Investment securities transactions are accounted for on a settlement date basis; reported amounts would not be materially different from those accounted for on a trade date basis. Gains and losses on the sales of investment securities are determined using the amortized cost of the specific security sold.

***Loans Held for Sale***

Loans held for sale consist of residential real estate mortgage loans and are carried at the lower of aggregate cost or market value, as determined by current investor yield requirements.

***Loans***

Loans are generally reported at their outstanding principal balances, adjusted for chargeoffs, the allowance for loan losses and any deferred fees or costs to originate loans. Loan commitments are recorded when funded.

***Loan Fees and Costs***

Loan origination fees and certain direct loan origination costs are deferred and recognized in interest income as an adjustment to the loan yield over the life of the related loans. The unamortized net deferred fees and costs are included on the balance sheets with the related loan balances, and the amortization is included with the related interest income.

***Allowance for Loan Losses***

Loans considered to be uncollectible are charged against the allowance for loan losses. The allowance for loan losses is maintained at a level determined by Management to be adequate to absorb probable losses. This allowance is increased by provisions charged to operating expenses and recoveries on loans previously charged off. Arriving at an appropriate level of allowance for loan losses necessarily involves a high degree of judgment. In determining the appropriate level

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of allowance for loan losses, Management takes into consideration several factors, including reviews of individual non-performing loans and performing loans listed on the watch report requiring periodic evaluation, loan portfolio size by category, recent loss experience, delinquency trends and current economic conditions. Loans more than 30 days past due are considered delinquent.

Impaired loans, including restructured loans, are measured at the present value of expected future cash flows discounted at the loan's effective interest rate or at the fair value of the collateral if the loan is collateral dependent. Management takes into consideration impaired loans in addition to the above mentioned factors in determining the appropriate level of allowance for loan losses.

### ***Goodwill & Identified Intangible Assets***

Intangible assets include the excess of the purchase price over the fair value of net assets acquired (goodwill) from the acquisition of FNB Bankshares as well as the core deposit intangible related to the same acquisition. The core deposit intangible is amortized on a straight-line basis over ten years. Amortization expense for 2006 was \$283,000 and the amortization expense for each year until fully amortized will be \$283,000. The straight-line basis is used because the Company does not expect significant run off in the core deposits which were acquired. The Company periodically evaluates intangible assets for impairment on the basis of whether these assets are fully recoverable from projected, undiscounted net cash flows of the acquired company. At December 31, 2006, the Company determined that goodwill was not impaired.

### ***Income Taxes***

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between financial statement carrying amounts of assets and liabilities and their respective tax bases. 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 of a change in tax rates on deferred tax assets and liabilities is recognized in income in the period the change is enacted.

### ***Accrual of Interest Income and Expense***

Interest on loans and investment securities is taken into income using methods which relate the income earned to the balances of loans and investment securities outstanding. Interest expense on liabilities is derived by applying applicable interest rates to principal amounts outstanding. Recording of interest income on problem loans, which includes impaired loans, ceases when collectibility of principal and interest within a reasonable period of time becomes doubtful. Cash payments received on non-accrual loans, which includes impaired loans, are applied to reduce the loan's principal balance until the remaining principal balance is deemed collectible, after which interest is recognized when collected. As a general rule, a loan may be restored to accrual status when payments are current and repayment of the remaining contractual amounts is expected or when it otherwise becomes well secured and in the process of collection.

### ***Premises and Equipment***

Premises, furniture and equipment are stated at cost, less accumulated depreciation. Depreciation expense is computed by straight-line and accelerated methods over the asset's estimated useful life.

### ***Other Real Estate Owned (OREO)***

Real estate acquired by foreclosure or deed in lieu of foreclosure is transferred to OREO and recorded at the lower of cost or fair market value, less estimated costs to sell, based on appraised value at the date actually or constructively received. Loan losses arising from the acquisition of such property are charged against the allowance for loan losses. Subsequent provisions to reduce the carrying value of a property are recorded to the allowance for OREO losses and a charge to operations on a specific property basis.

***Earnings Per Share***

Basic earnings per share data are based on the weighted average number of common shares outstanding during each year. Diluted earnings per share gives effect to the stock options outstanding, determined by the treasury stock method.

***Post-Retirement Benefits***

The cost of providing post-retirement benefits is accrued during the active service period of the employee or director.

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### ***Segments***

First National Lincoln Corporation, through the branches of its subsidiary, The First, N.A., provides a broad range of financial services to individuals and companies in Mid-Coast and Down East Maine. These services include demand, time, and savings deposits; lending; credit card servicing; ATM processing; and investment management and trust services. Operations are managed and financial performance is evaluated on a corporate-wide basis. Accordingly, all of the Company's banking operations are considered by Management to be aggregated in one reportable operating segment.

### ***Comprehensive Income***

Comprehensive income includes both net income and other comprehensive income. Other comprehensive income, which includes the change in unrealized gains and losses on securities available for sale, net of tax, and unrealized loss related to postretirement benefit costs, net of tax, is disclosed in the consolidated statements of changes in shareholders' equity.

### ***Loan Servicing***

Servicing rights are recognized when they are acquired through sale of loans. Capitalized servicing rights are reported in other assets and are amortized into non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets. Servicing rights are evaluated for impairment based upon the fair value of the rights as compared to amortized cost. Impairment is determined by stratifying rights by predominant characteristics, such as interest rates and terms. Impairment is recognized through a valuation allowance for an individual stratum, to the extent that fair value is less than the capitalized amount for the stratum.

### ***Stock Options***

The Company established a shareholder-approved stock option plan in 1995, under which the Company may grant options to its employees for up to 600,000 shares of common stock. The Company believes that such awards align the interests of its employees with those of its shareholders. Only incentive stock options may be granted under the plan. The option price of each option grant is determined by the Options Committee of the Board of Directors, and in no instance shall be less than the fair market value on the date of the grant. An option's maximum term is ten years from the date of grant, with 50% of the options granted vesting two years from the date of grant and the remaining 50% vesting five years from date of grant. As of January 16, 2005, all options under this plan had been granted.

In addition, options to acquire 40,630 FNB shares were converted into options to acquire an aggregate of 95,479 common shares of the Company at a purchase price of \$3.80 per share as a result of the FNB acquisition. As of December 31, 2006, all options converted as a result of the FNB acquisition had been exercised.

The Company applies the fair value recognition provisions of Statement of Financial Accounting Standards (SFAS) No. 123 (Revised 2004), *Share-Based Payment*, to stock-based employee compensation for fiscal years beginning on or after January 1, 2006. As a result, \$60,000 in compensation cost is included in the Company's financial statements for 2006. The unrecognized compensation cost to be amortized over a weighted average remaining vesting period of 3.2 years is \$171,000, which is comprised of \$23,000 for 16,500 options granted in 2002 and \$148,000 for 42,000 options granted in 2005.

The weighted average fair market value per share was \$2.77 for options granted in 2002 and \$4.41 for options granted in 2005. The fair market value was estimated using the Black-Scholes option pricing model and the following assumptions: quarterly dividends of \$0.07 in 2002 and \$0.12 in 2005, risk-free interest rate of 1.58% in 2002 and 4.20% in 2005, volatility of 37.73% in 2002 and 25.81% in 2005, and an expected life of 10 years for both years, the options' maximum term. Volatility is based on the actual volatility of the Company's stock during the quarter in which the options were granted. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve at the time of the option grant.

The following table summarizes the status of the Company's non-vested options as of December 31, 2006.

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	Number of Shares	Weighted Average Grant Date Fair Value
Non-vested at December 31, 2005	58,500	\$3.95
Granted in 2006	-	-
Vested in 2006	-	-
Forfeited in 2006	-	-
Non-vested at December 31, 2006	58,500	\$3.95

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During 2006, 82,750 options were exercised, with total proceeds paid to the Company of \$271,000. The excess of the fair value of the stock issued upon option exercise over the exercise price was \$1,138,000. The Company recognized a tax benefit of \$85,000 on disqualifying dispositions related to stock option exercises during 2006.

A summary of the status of the Company's Stock Option Plan as of December 31, 2006, and changes during the year then ended, is presented below.

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (In thousands)
Outstanding at December 31, 2005	205,750	\$ 7.61		
Granted in 2006	-	-		
Vested in 2006	-	-		
Exercised in 2006	(82,750)	3.28		
Forfeited in 2006	-	-		
Outstanding at December 31, 2006	123,000	\$10.53	4.7	\$ 815,000
Exercisable at December 31, 2006	64,500	\$ 5.97	2.5	\$ 693,000

In prior years, the Company applied Accounting Principles Board Opinion No. 25 and related interpretations in accounting for the stock option plan(s). Accordingly, no compensation cost was recognized in prior years. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS No. 123 in prior years.

<i>For the years ended December 31,</i>	<b>2006</b>	2005	2004
<b>Net income</b>			
As reported	<b>\$ 12,295,000</b>	\$ 12,843,000	\$ 8,509,000
Value of option grants, net of tax	-	115,000	-
Pro forma	<b>\$ 12,295,000</b>	\$ 12,728,000	\$ 8,509,000
<b>Basic earnings per share</b>			
As reported	<b>\$ 1.25</b>	\$ 1.32	\$ 1.16
Value of option grants, net of tax	-	0.01	-
Pro forma	<b>\$ 1.25</b>	\$ 1.31	\$ 1.16
<b>Diluted earnings per share</b>			
As reported	<b>\$ 1.25</b>	\$ 1.30	\$ 1.14
Value of option grants, net of tax	-	0.01	-
Pro forma	<b>\$ 1.25</b>	\$ 1.29	\$ 1.14

**Note 2. Cash and Cash Equivalents**

For the purposes of reporting consolidated cash flows, cash and cash equivalents include cash on hand, amounts due from banks and federal funds sold. At December 31, 2006 the Company had a contractual clearing balance of \$500,000 and a reserve balance requirement of \$12,091,000 at the Federal Reserve Bank, which are satisfied by both cash on hand at branches and balances held at the Federal Reserve Bank of Boston. The Company maintains a portion of its cash in bank deposit accounts which, at times, may exceed federally insured limits. The Company has not experienced any losses in such accounts. The Company believes it is not exposed to any significant risk with respect to these accounts.



**Note 3. Investment Securities**

The following tables summarize the amortized cost and estimated fair value of investment securities at December 31, 2006 and 2005:

<i>As of December 31, 2006</i>	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value (Estimated)
<b>Securities available for sale</b>				
U.S. Treasury and agency	\$ 5,001,000	\$ -	\$ (34,000)	\$ 4,967,000
Mortgage-backed securities	1,573,000	36,000	(38,000)	1,571,000
State and political subdivisions	10,729,000	344,000	-	11,073,000
Corporate securities	17,600,000	810,000	(61,000)	18,349,000
Federal Home Loan Bank stock	7,586,000	-	-	7,586,000
Federal Reserve Bank stock	662,000	-	-	662,000
Other equity securities	594,000	18,000	(5,000)	607,000
	\$ 43,745,000	\$ 1,208,000	\$ (138,000)	\$ 44,815,00
<b>Securities to be held to maturity</b>				
U.S. Treasury and agency	\$ 46,192,000	\$ 12,000	\$ (787,000)	\$ 45,417,000
Mortgage-backed securities	33,379,000	99,000	(787,000)	32,691,000
State and political subdivisions	47,549,000	535,000	(169,000)	47,915,000
Corporate securities	8,614,000	12,000	-	8,626,000
	\$ 135,734,000	\$ 658,000	\$ (1,743,000)	\$ 134,649,000
<i>As of December 31, 2005</i>	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value (Estimated)
<b>Securities available for sale</b>				
U.S. Treasury and agency	\$ 9,161,000	\$ -	\$ (60,000)	\$ 9,101,000
Mortgage-backed securities	1,943,000	39,000	(2,000)	1,980,000
State and political subdivisions	11,340,000	442,000	-	11,782,000
Corporate securities	19,675,000	1,193,000	(515,000)	20,353,000
Federal Home Loan Bank stock	10,294,000	-	-	10,294,000
Federal Reserve Bank stock	653,000	-	-	653,000
Other equity securities	565,000	19,000	(4,000)	580,000
	\$ 53,631,000	\$ 1,693,000	\$ (581,000)	\$ 54,743,000
<b>Securities to be held to maturity</b>				
U.S. Treasury and agency	\$ 42,274,000	\$ 88,000	\$ (495,000)	\$ 41,867,000
Mortgage-backed securities	33,670,000	100,000	(697,000)	33,073,000
State and political subdivisions	44,685,000	526,000	(221,000)	44,990,000
Corporate securities	8,609,000	24,000	-	8,633,000
	\$ 129,238,000	\$ 738,000	\$ (1,413,000)	\$ 128,563,000

The following table summarizes the contractual maturities of investment securities at December 31, 2006:

	<b><u>Securities available for sale</u></b>		<b><u>Securities to be held to maturity</u></b>	
	<b>Amortized Cost</b>	<b>Fair Value (Estimated)</b>	<b>Amortized Cost</b>	<b>Fair Value (Estimated)</b>
Due in 1 year or less	\$ 3,199,000	\$ 3,228,000	\$ 515,000	\$ 517,000
Due in 1 to 5 years	12,626,000	13,207,000	8,490,000	8,419,000
Due in 5 to 10 years	16,684,000	17,127,000	26,614,000	26,476,000
Due after 10 years	2,394,000	2,398,000	100,115,000	99,237,000
Equity securities	8,842,000	8,855,000	-	-
	\$ 43,745,000	\$ 44,815,000	\$ 135,734,000	\$ 134,649,000



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At December 31, 2006, securities with a fair value of \$137,253,000 were pledged to secure borrowings from the Federal Home Loan Bank of Boston, public deposits, repurchase agreements, and for other purposes as required by law. This compares to securities with a fair value of \$155,156,000, as of December 31, 2005 pledged for the same purpose.

Gains and losses on the sale of securities available for sale are computed by subtracting the amortized cost at the time of sale from the security's selling price, net of accrued interest to be received. The Company's gross securities gain in 2006, which originated from the call of a security by its issuer at a premium, was \$18,000, with \$6,000 of related tax expense. There were no realized gains or losses in 2005 or 2004.

Management reviews securities with unrealized losses for other than temporary impairment. Federal Home Loan Bank stock and Federal Reserve Bank stock have been evaluated for impairment. As of December 31, 2006, there were 103 securities with unrealized losses held in the Company's portfolio. These securities were temporarily impaired as a result of changes in interest rates reducing their fair market value, of which 64 had been temporarily impaired for 12 months or more. At the present time, there have been no material changes in the credit quality of these securities resulting in other than temporary impairment. Information regarding securities temporarily impaired as of December 31, 2006 and 2005 is summarized below:

	<u>Less than 12 months</u>		<u>12 months or more</u>		<u>Total</u>	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<i>As of December 31, 2006</i>						
U.S. Treasury and agency	\$ 11,596,000	\$ (195,000)	\$ 31,776,000	\$ (626,000)	\$ 43,372,000	\$ (821,000)
Mortgage-backed securities	4,198,000	(55,000)	23,580,000	(770,000)	27,778,000	(825,000)
State and political subdivisions	6,244,000	(36,000)	4,273,000	(133,000)	10,517,000	(169,000)
Corporate securities	-	-	1,004,000	(61,000)	1,004,000	(61,000)
Other equity securities	101,000	(2,000)	73,000	(3,000)	174,000	(5,000)
	\$ 22,139,000	\$ (288,000)	\$ 60,706,000	\$ (1,593,000)	\$ 82,845,000	\$ (1,881,000)

	<u>Less than 12 months</u>		<u>12 months or more</u>		<u>Total</u>	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<i>As of December 31, 2005</i>						
U.S. Treasury and agency	\$ 37,022,000	\$ (409,000)	\$ 6,854,000	\$ (146,000)	\$ 43,876,000	\$ (555,000)
Mortgage-backed securities	22,454,000	(367,000)	9,383,000	(332,000)	31,837,000	(699,000)
State and political subdivisions	18,521,000	(142,000)	824,000	(79,000)	19,345,000	(221,000)
Corporate securities	2,118,000	(513,000)	475,000	(2,000)	2,593,000	(515,000)
Other equity securities	84,000	(4,000)	-	-	84,000	(4,000)
	\$ 80,199,000	\$ (1,435,000)	\$ 17,536,000	\$ (559,000)	\$ 97,735,000	\$ (1,994,000)

### Note 4. Loan Servicing

At December 31, 2006 and 2005, the Bank serviced loans for others totaling \$162,151,000 and \$164,226,000, respectively. Net gains from the sale of loans totaled \$222,000 in 2006, \$300,000 in 2005, and \$201,000 in 2004.

In 2006, mortgage servicing rights of \$579,000 were capitalized or acquired, and amortization for the year totaled \$705,000. After deducting for an impairment reserve of \$3,000 at December 31, 2006, mortgage servicing rights had a fair value of \$985,000, which is included in other assets. In 2005, mortgage servicing rights of \$1,074,000 were capitalized or acquired, and amortization for the year totaled \$669,000. After deducting for an impairment reserve of \$6,000 at December 31, 2005, mortgage servicing rights had a fair value of \$1,109,000, which is included in other assets.

**Note 5. Loans**

The following table shows the composition of the Company's loan portfolio as of December 31, 2006 and 2005:

<i>As of December 31,</i>	<b>2006</b>	2005
Real estate loans		
Residential	<b>\$ 421,967,000</b>	\$ 390,995,000
Commercial	<b>94,765,000</b>	79,135,000
Commercial and industrial loans	<b>236,637,000</b>	233,806,000
State and municipal loans	<b>23,724,000</b>	20,270,000
Consumer loans	<b>55,658,000</b>	39,135,000
Residential construction loans	<b>5,394,000</b>	8,997,000
Total loans	<b>\$ 838,145,000</b>	\$ 772,338,000

Loan balances include net deferred loan costs of \$1,261,000 in 2006 and \$1,125,000 in 2005. Pursuant to collateral agreements, qualifying first mortgage loans, which were valued at \$341,702,000 and \$286,522,000 in 2006 and 2005, respectively, were used to collateralize borrowings from the Federal Home Loan Bank of Boston.

At December 31, 2006 and 2005, loans on non-accrual status totaled \$3,485,000 and \$3,095,000, respectively. Interest income which would have been recognized on these loans, if interest had been accrued, was \$396,000 for 2006, \$202,000 for 2005, and \$189,000 for 2004. Loans past due greater than 90 days which are accruing interest totaled \$748,000 at December 31, 2006 and \$402,000 at December 31, 2005. The Company continues to accrue interest on these loans because it believes collection of principal and interest is reasonably assured.

Transactions in the allowance for loan losses for the years ended December 31, 2006, 2005 and 2004 were as follows:

<i>For the years ended December 31,</i>	<b>2006</b>	2005	2004
Balance at beginning of year	<b>\$ 6,086,000</b>	\$ 4,714,000	\$ 4,200,000
Acquisition of FNB Bankshares	-	2,066,000	-
Provision charged to operating expenses	<b>1,325,000</b>	200,000	880,000
	<b>7,411,000</b>	6,980,000	5,080,000
Loans charged off	<b>(1,313,000)</b>	(1,052,000)	(440,000)
Recoveries on loans	<b>266,000</b>	158,000	74,000
Net loans charged off	<b>(1,047,000)</b>	(894,000)	(366,000)
Balance at end of year	<b>\$ 6,364,000</b>	\$ 6,086,000	\$ 4,714,000

Information regarding impaired loans is as follows:

<i>As of December 31,</i>	<b>2006</b>	2005	2004
Average investment in impaired loans	<b>\$ 3,391,000</b>	\$ 2,690,000	1,617,000
Interest income recognized on impaired loans, all on cash basis	<b>99,000</b>	56,000	39,000

<i>As of December 31,</i>	<b>2006</b>	2005
Balance of impaired loans	<b>\$ 3,485,000</b>	\$ 3,081,000
Less portion for which no allowance for loan losses is allocated	<b>(2,400,000)</b>	(2,072,000)
Portion of impaired loan balance for which an allowance for loan losses is allocated	<b>\$ 1,085,000</b>	\$ 1,009,000
Portion of allowance for loan losses allocated to the impaired loan balance	<b>\$ 211,000</b>	\$ 392,000

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Loans to directors, officers and employees totaled \$30,907,000 at December 31, 2006 and \$28,468,000 at December 31, 2005. A summary of loans to directors and executive officers, which in the aggregate exceed \$60,000, is as follows:

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<i>For the years ended December 31,</i>	<b>2006</b>	2005
Balance at beginning of year	<b>\$ 17,016,000</b>	\$ 10,539,000
New loans	<b>3,389,000</b>	14,471,000
Repayments	<b>(1,710,000)</b>	(7,994,000)
Balance at end of year	<b>\$ 18,695,000</b>	\$ 17,016,000

**Note 6. Premises and Equipment**

Premises and equipment are carried at cost and consist of the following:

<i>As of December 31,</i>	<b>2006</b>	2005
Land	<b>\$ 3,635,000</b>	\$ 3,784,000
Land improvements	<b>602,000</b>	602,000
Buildings	<b>12,115,000</b>	12,186,000
Equipment	<b>11,503,000</b>	11,206,000
	<b>27,855,000</b>	27,778,000
Less accumulated depreciation	<b>12,010,000</b>	11,066,000
	<b>\$ 15,845,000</b>	\$ 16,712,000

**Note 7. Other Real Estate Owned**

The following summarizes other real estate owned:

<i>As of December 31,</i>	<b>2006</b>	2005
Real estate acquired in settlement of loans	<b>\$ 1,144,000</b>	\$ -

Changes in the allowance for losses from other real estate owned were as follows:

<i>For the years ended December 31,</i>	<b>2006</b>	2005	2004
Balance at beginning of year	<b>\$ -</b>	\$ -	\$ -
Losses charged to allowance	-	-	-
Provision charged to operating expenses	<b>269,000</b>	-	-
Balance at end of year	<b>\$ 269,000</b>	\$ -	\$ -

**Note 8. Goodwill**

On August 25, 2004, the Company entered into an agreement to acquire FNB Bankshares of Bar Harbor, Maine, and its subsidiary, The First National Bank of Bar Harbor. This acquisition was completed on January 14, 2005. In its 2004 Strategic Plan, the Company identified certain markets in which it would consider future growth opportunities, including the area served by FNB Bankshares. Management expects that the products and services available in the FNB Bankshares market area will be enhanced as a result of the combination of the two companies, and this will also provide a larger capacity to lend money and a stronger overall funding base. It is expected that the combined entity will realize cost savings from redundant expenses, such as regulatory fees, audit costs, legal costs, and outsourced costs.

As part of the acquisition, the Company issued 2.35 shares of its common stock to the shareholders of FNB in exchange for each of the 1,048,814 shares of the common stock outstanding of FNB. Cash in lieu of fractional shares of the Company's stock was paid at the rate of \$17.87 per share, which was the average high/low price of the Company's stock for the 30-day period ending January 9, 2005, under terms specified in the Merger Agreement. At the time of the acquisition, there were options to purchase 126,208 shares of FNB common stock under the FNB Bankshares Stock Option Plan. Of these, options to acquire 40,630 FNB shares were converted into options to acquire 95,479 common shares of the Company at a purchase price of \$3.80 per share. Holders of unexercised options to purchase FNB shares that were not converted were paid cash to retire their options at the rate of \$42.00 for each share subject to the option, less the option exercise price per share. The total amount paid to retire the remaining options was \$2.6 million.

The total value of the transaction was \$47,955,000, and all of the voting equity interest of FNB was acquired in the transaction. The Company assumed all outstanding liabilities of FNB, including liabilities under certain Employment Continuity Agreements and Split Dollar Agreements with executive officers of FNB. The acquisition was intended to qualify as a reorganization for federal income tax purposes and provide for a tax-free exchange of shares.

The transaction was accounted for as a purchase and, accordingly, the operations of FNB are included in the Company's consolidated financial statements from the date of acquisition. The purchase price was allocated to assets acquired and liabilities assumed at the date of acquisition. The excess of purchase price over the fair value of net tangible assets acquired equaled \$27,835,000 and was recorded as goodwill, none of which is expected to be deductible for tax purposes. During the fourth quarter of 2005, this amount was reduced \$276,000, net of tax, as a result of pending changes in employment continuity agreements with FNB employees who became employees of the Bank, which resulted in lower reserves for these agreements. The portion of the purchase price related to the core deposit intangible is being amortized over its expected economic life, and goodwill is evaluated annually for possible impairment under the provisions of SFAS No. 142, Goodwill and Other Intangible Assets.

**Note 9. Income Taxes**

The current and deferred components of income tax expense (benefit) were as follows:

<i>For the years ended December 31,</i>	<b>2006</b>	2005	2004
<b>Federal income tax</b>			
Current	<b>\$ 5,075,000</b>	\$ 4,452,000	\$ 3,278,000
Deferred	<b>(424,000)</b>	392,000	(3,000)
	<b>4,651,000</b>	4,844,000	3,275,000
State franchise tax	<b>211,000</b>	212,000	136,000
	<b>\$ 4,862,000</b>	\$ 5,056,000	\$ 3,411,000

The actual tax expense differs from the expected tax expense (computed by applying the applicable U.S. Federal corporate income tax rate to income before income taxes) as follows:

<i>For the years ended December 31,</i>	<b>2006</b>	2005	2004
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Expected tax expense	<b>\$ 6,005,000</b>	\$ 6,265,000	\$ 4,053,000
Non-taxable income	<b>(1,209,000)</b>	(1,168,000)	(734,000)
State franchise tax, net of federal tax benefit	<b>137,000</b>	139,000	90,000
Other	<b>(71,000)</b>	(180,000)	2,000
	<b>\$ 4,862,000</b>	\$ 5,056,000	\$ 3,411,000

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Deferred tax assets and liabilities are classified as other assets and other liabilities in the consolidated balance sheets. No valuation allowance is deemed necessary for the deferred tax asset. Items that give rise to the deferred income tax assets and liabilities and the tax effect of each at December 31, 2006 and 2005 are as follows:

	<b>2006</b>	2005
Allowance for loan losses	<b>\$2,136,000</b>	\$1,969,000
Other real estate owned	<b>94,000</b>	-
Assets related to FNB acquisition	<b>61,000</b>	342,000
Accrued pension and post-retirement	<b>1,073,000</b>	756,000
Other assets	<b>162,000</b>	-
Total deferred tax asset	<b>3,526,000</b>	3,067,000
Net deferred loan costs	<b>(524,000)</b>	(498,000)
Depreciation	<b>(1,539,000)</b>	(1,460,000)
Unrealized gain on securities available for sale	<b>(374,000)</b>	(378,000)
Mortgage servicing rights	<b>(346,000)</b>	(341,000)
Core deposit intangible	<b>(798,000)</b>	(897,000)
Liabilities related to FNB acquisition	<b>(93,000)</b>	(219,000)
Other liabilities	<b>(18,000)</b>	(108,000)
Total deferred tax liability	<b>(3,692,000)</b>	(3,901,000)
Net deferred tax liability	<b>\$(166,000)</b>	\$(834,000)

### **Note 10. Certificates of Deposit**

At December 31, 2006, the scheduled maturities of certificates of deposit are as follows:

Year of Maturity	Less than \$100,000	Greater than \$100,000	All Certificates of Deposit
2007	\$122,292,000	\$213,562,000	\$335,854,000
2008	32,833,000	20,420,000	53,253,000
2009	4,404,000	1,688,000	6,092,000
2010	3,083,000	7,190,000	10,273,000
2011	2,158,000	542,000	2,700,000
	\$164,770,000	\$243,402,000	\$408,172,000

Interest on certificates of deposit of \$100,000 or more was \$11,210,000, \$4,829,000, and \$1,732,000 in 2006, 2005 and 2004, respectively.

### **Note 11. Borrowed Funds**

Borrowed funds consist of advances from the Federal Home Loan Bank of Boston (FHLB), Treasury Tax & Loan Notes, and securities sold under agreements to repurchase with municipal and commercial customers.

Pursuant to collateral agreements, FHLB advances are collateralized by all stock in FHLB, qualifying first mortgage loans, U.S. Government and Agency securities not pledged to others, and funds on deposit with FHLB. As of December 31, 2006, the Bank's total FHLB borrowing capacity was \$256,276,000, of which \$118,772,000 was unused and available for additional borrowings. All FHLB advances as of December 31, 2006 had fixed rates of interest until their respective maturity dates, except for the FHLB overnight line of credit, which has an interest rate

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which can fluctuate daily. Under the Treasury Tax & Loan Note program, the Bank accumulates tax deposits made by customers and is eligible to receive Treasury Direct investments up to an established maximum balance. Securities sold under agreements to repurchase include U.S. Treasury and Agency securities and other securities. Repurchase agreements have maturity dates ranging from one to 365 days. The Bank also has in place \$10.0 million in credit lines with correspondent banks which are currently not in use.

Borrowed funds at December 31, 2006 and 2005 have the following range of interest rates and maturity dates:

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*As of December 31, 2006*

Federal Home Loan Bank Advances				
2007	3.99%	-	5.61%	\$ 90,357,000
2008	4.86%	-	4.94%	30,000,000
2009		-	4.98%	2,000,000
2010	4.95%	-	5.41%	15,000,000
2012 and thereafter		-	0.00%	198,000
				137,555,000
Treasury Tax & Loan Notes (rate at December 31, 2006 was 5.04%)			variable	2,512,000
Repurchase agreements	2.71%	-	5.07%	39,795,000
				\$179,862,000

*As of December 31, 2005*

Federal Home Loan Bank Advances				
2006	1.85%	-	4.38%	\$140,865,000
2007	3.99%	-	4.47%	12,000,000
2009		-	4.98%	2,000,000
2010	4.95%	-	5.41%	15,000,000
2011 and thereafter		-	4.50%	2,782,000
				172,647,000
Treasury Tax & Loan Notes (rate at December 31, 2005 was 4.00%)			variable	2,691,000
Repurchase agreements	1.98%	-	4.40%	39,851,000
				\$215,189,000

**Note 12. Employee Benefit Plans**

***401(k) Plan***

The Bank has a defined contribution plan available to substantially all employees who have completed six months of service. Employees may contribute up to 50.0% of their compensation (not to exceed \$15,000 if under age 50 and \$20,000 if over age 50), and the Bank may provide a match of up to 3.0% of compensation. Subject to a vote of the Board of Directors, the Bank may also make a profit-sharing contribution to the Plan. Such contribution equaled 2.0% of each eligible employee's compensation in 2006, 2.0% in 2005, and 2.5% in 2004. The expense related to the 401(k) plan was \$315,000, \$298,000, and \$220,000 in 2006, 2005, and 2004, respectively.

***Supplemental Retirement Plan***

The Bank also sponsors an unfunded, non-qualified supplemental retirement plan for certain officers. The agreement provides supplemental retirement benefits payable in installments over 20 years upon retirement or death. The costs for this plan are recognized over the service periods of the participating officers. The expense of this supplemental plan was \$149,000 in 2006, \$166,000 in 2005, and \$147,000 in 2004. As of December 31, 2006 and 2005, the accrued liability of this plan was \$1,060,000 and \$967,000, respectively.

***Post-Retirement Benefit Plans***

The Bank sponsors two post-retirement benefit plans. One plan currently provides a subsidy for health insurance premiums to certain retired employees and a future subsidy for seven active employees who were age 50 and over in 1996. These subsidies are based on years of service and range between \$40 and \$1,200 per month per person. The other plan provides life insurance coverage to certain retired employees. The Bank also provides health insurance for retired directors. None of these plans are pre-funded.

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In December 2003, the federal Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act) was signed into law. The Act included two features to Medicare (Medicare Part D) that could affect the measurement of the accumulated post-retirement benefit obligation and net periodic postretirement benefit costs: a subsidy to plan sponsors that is based on 28% of an individual beneficiary's annual prescription drug costs between \$250 and \$5,000, and the opportunity for a retiree to obtain a prescription drug benefit under Medicare. During 2004, the Financial Accounting Standards Board ( FASB ) Staff issued FASB Staff Position ( FSP ) FAS 106-2, Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003. The FSP addresses employers' accounting for the effects of the Act and was effective for the Company in 2004. The

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accounting for the Act will depend on the Company's assessment as to whether the prescription drug benefits available under its plan are actuarially equivalent to Medicare Part D, among other factors. Currently, due to the lack of clarifying regulations related to the Act, the Company cannot determine if the benefit it provides would be considered actuarially equivalent to the benefit provided under the Act. Accordingly, the potential impact of applying the FSP is not known.

The following tables set forth the accumulated post-retirement benefit obligation, funded status, and net periodic benefit cost:

<i>At December 31,</i>	<b>2006</b>	2005	2004
<b>Change in benefit obligations</b>			
Benefit obligation at beginning of year:	<b>\$ 1,705,000</b>	\$ 531,000	\$ 542,000
Service cost	<b>13,000</b>	11,000	4,000
Interest cost	<b>125,000</b>	119,000	33,000
Benefits paid	<b>(157,000)</b>	(121,000)	(45,000)
Actuarial (gain) loss	<b>319,000</b>	(24,000)	(3,000)
Plan change from FNB acquisition	-	1,189,000	-
Benefit obligation at end of year:	<b>\$ 2,005,000</b>	\$ 1,705,000	\$ 531,000
<b>Funded status</b>			
Benefit obligation at end of year	<b>\$ (2,005,000)</b>	\$ (1,705,000)	\$ (531,000)
Unamortized prior service cost	-	(11,000)	(14,000)
Unamortized net actuarial loss	-	56,000	40,000
Unrecognized transition obligation	-	208,000	237,000
Accrued benefit cost	<b>\$ (2,005,000)</b>	\$ (1,452,000)	\$ (268,000)

<i>For the years ended December 31,</i>	<b>2006</b>	2005	2004
<b>Components of net periodic benefit cost</b>			
Service cost	<b>\$ 13,000</b>	\$ 11,000	\$ 4,000
Interest cost	<b>125,000</b>	119,000	33,000
Amortization of unrecognized transition obligation	<b>29,000</b>	29,000	29,000
Amortization of prior service cost	<b>(3,000)</b>	(3,000)	3,000
Amortization of accumulated losses	<b>4,000</b>	6,000	5,000
Net periodic benefit cost	<b>\$ 168,000</b>	\$ 162,000	\$ 74,000
<b>Weighted average assumptions as of December 31</b>			
Discount rate	<b>7.0%</b>	7.0%	7.0%

The above discount rate assumption was used in determining both the accumulated benefit obligation as well as the net benefit cost. The measurement date for benefit obligations was as of year-end for all years presented. The estimated amount of benefits to be paid in 2007 is \$153,000. For years ending 2008 through 2011 the estimated amount of benefits to be paid is \$150,000, \$154,000, \$161,000 and \$165,000 respectively, and the total estimated amount of benefits to be paid for years ended 2012 through 2016 is \$788,000. Plan expense for 2007 is estimated to be \$175,000.

In 2006, the Company adopted SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*. On initial application, a \$352,000 adjustment was recognized in the Statement of Changes in Shareholders' Equity as a component of other comprehensive income. Amounts not yet reflected in net periodic benefit cost and included in accumulated other comprehensive income are as follows:

<i>At December 31,</i>	<b>2006</b>	Portion to Be Recognized in Income in 2007
Unamortized prior service cost	<b>\$ 8,000</b>	\$ -
Unamortized net actuarial loss	<b>(371,000)</b>	-
Unrecognized transition obligation	<b>(179,000)</b>	29,000
	<b>(542,000)</b>	-
Deferred tax benefit at 35%	<b>190,000</b>	(10,000)
Net unrecognized postretirement benefits included in comprehensive income	<b>\$(352,000)</b>	\$ 19,000



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The incremental effect of applying SFAS No. 158 on individual line items in the balance sheets as of December 31, 2006, are as follows:

	Before Application	SFAS No. 158 Adjustment	After Application
Other assets	\$ 16,888,000	\$ 190,000	\$ 17,078,000
Total assets	1,104,679,000	190,000	1,104,869,000
Other liabilities	11,903,000	542,000	12,445,000
Total liabilities	997,000,000	542,000	997,542,000
Accumulated other comprehensive income	696,000	(352,000)	344,000
Total shareholders' equity	\$ 107,679,000	\$ (352,000)	\$ 107,327,000

The unrecognized transition obligation arose from the Bank's election to recognize the accumulated post-retirement benefit obligation as of January 1, 1993 of \$578,000 as a component of net periodic post-retirement benefit cost over a 20-year period.

### **Note 13. Shareholders' Equity**

The Company has reserved 700,000 shares of its common stock to be made available to directors and employees who elect to participate in the stock purchase or savings and investment plans. During 2006, the number of shares set aside for these plans was increased by the Board of Directors from 480,000 to 700,000. As of December 31, 2006, 428,129 shares had been issued pursuant to these plans, leaving 271,871 shares available for future use. The issuance price is based on the market price of the stock at issuance date. Sales of stock to directors and employees amounted to 17,410 shares in 2006, 36,727 shares in 2005, and 16,950 shares in 2004.

In 2001, the Company established a dividend reinvestment plan to allow shareholders to use their cash dividends for the automatic repurchase of shares in the Company. When the plan was established, 600,000 shares were registered with the Securities and Exchange Commission, and as of December 31, 2006, 91,912 shares have been issued, leaving 508,088 shares for future use. Participation in this plan is optional and at the individual discretion of each shareholder. Shares are purchased for the plan from the Company at a price per share equal to the average of the daily bid and asked prices reported on the NASDAQ System for the five trading days immediately preceding, but not including, the dividend payment date. Sales of stock under the Dividend Reinvestment Plan amounted to 17,031 shares in 2006, 13,633 shares in 2005, and 15,186 shares in 2004.

### **Note 14. Off-Balance-Sheet Financial Instruments and Concentrations of Credit Risk**

The Bank is party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to originate loans, commitments for unused lines of credit, and standby letters of credit. The instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the consolidated balance sheets. The contract amounts of those instruments reflect the extent of involvement the Bank has in particular classes of financial instruments.

Commitments for unused lines 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 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 did not incur any losses on its commitments in 2006, 2005 or 2004.

Standby letters of credit are conditional commitments issued by the Bank to guarantee a customer's performance to a third party, with the customer being obligated to repay (with interest) any amounts paid out by the Bank under the letter of credit. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers.

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The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for loan commitments and standby letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. At December 31, the Bank had the following off-balance-sheet financial instruments, whose contract amounts represent credit risk:

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<i>As of December 31,</i>	<b>2006</b>	2005
Unused lines, collateralized by residential real estate	<b>\$ 57,212,000</b>	\$ 68,062,000
Other unused commitments	<b>54,896,000</b>	62,979,000
Standby letters of credit	<b>1,659,000</b>	1,486,000
Commitments to extend credit	<b>14,809,000</b>	16,060,000
Total	<b>\$ 128,576,000</b>	\$ 148,587,000

The Bank grants residential, commercial and consumer loans to customers principally located in the Mid-Coast region of Maine. Collateral on these loans typically consists of residential or commercial real estate, or personal property. Although the loan portfolio is diversified, a substantial portion of borrowers' ability to honor their contracts is dependent on the economic conditions in the area, especially in the real estate sector.

### **Note 15. Earnings Per Share**

The following tables provide detail for basic earnings per share (EPS) and diluted earnings per share for the years ended December 31, 2006, 2005 and 2004:

	Income (Numerator)	Shares (Denominator)	Per-Share Amount
<b>For the year ended December 31, 2006</b>			
Net income as reported	\$12,295,000		
Basic EPS: Income available to common shareholders	12,295,000	9,816,307	\$ 1.25
Effect of dilutive securities: incentive stock options		49,476	
Diluted EPS: Income available to common shareholders plus assumed conversions	\$12,295,000	9,865,783	\$ 1.25
<b>For the year ended December 31, 2005</b>			
Net income as reported	\$12,843,000		
Basic EPS: Income available to common shareholders	12,843,000	9,745,456	\$ 1.32
Effect of dilutive securities: incentive stock options		114,751	
Diluted EPS: Income available to common shareholders plus assumed conversions	\$12,843,000	9,860,207	\$ 1.30
<b>For the year ended December 31, 2004</b>			
Net income as reported	\$ 8,509,000		
Basic EPS: Income available to common shareholders	8,509,000	7,330,434	\$ 1.16
Effect of dilutive securities: incentive stock options		149,721	
Diluted EPS: Income available to common shareholders plus assumed conversions	\$ 8,509,000	7,480,155	\$ 1.14

All earnings per share calculations have been made using the weighted average number of shares outstanding for each year. All of the dilutive securities are incentive stock options granted to certain key members of Management. The dilutive number of shares has been calculated using the treasury method, assuming that all granted options were exercisable at each year end.

### **Note 16. Fair Value of Financial Instruments**

Fair value estimates, methods, and assumptions are set forth below for the Company's financial instruments.

*Cash and Cash Equivalents*

The carrying values of cash, cash equivalents, due from banks and federal funds sold approximate their relative fair values.

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### ***Investment Securities***

The fair values of investment securities are estimated based on bid prices published in financial newspapers or bid quotations received from securities dealers. The fair value of certain state and municipal securities is not readily available through market sources other than dealer quotations, so fair value estimates are based on quoted market prices of similar instruments, adjusted for differences between the quoted instruments and the instruments being valued. Fair values are calculated based on the value of one unit without regard to any premium or discount that may result from concentrations of ownership of a financial instrument, possible tax ramifications, or estimated transaction costs. If these considerations had been incorporated into the fair value estimates, the aggregate fair value could have been changed. The carrying values of restricted equity securities approximate fair values.

### ***Loans***

Fair values are estimated for portfolios of loans with similar financial characteristics. The fair values of performing loans are calculated by discounting scheduled cash flows through the estimated maturity using estimated market discount rates that reflect the credit and interest 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 and lending conditions, and the effects of estimated prepayments. Fair values for significant non-performing loans are based on estimated cash flows and are discounted using a rate commensurate with the risk associated with the estimated cash flows. Assumptions regarding credit risk, cash flows, and discount rates are judgmentally determined using available market information and specific borrower information. Management has made estimates of fair value using discount rates that it believes to be reasonable. However, because there is no market for many of these financial instruments, Management has no basis to determine whether the fair value presented above would be indicative of the value negotiated in an actual sale.

### ***Cash Surrender Value of Life Insurance***

The fair value is based on the actual cash surrender value of life insurance policies.

### ***Accrued Interest Receivable***

The fair value estimate of this financial instrument approximates the carrying value as this financial instrument has a short maturity. It is the Company's policy to stop accruing interest on loans for which it is probable that the interest is not collectible. Therefore, this financial instrument has been adjusted for estimated credit loss.

### ***Deposits***

The fair value of deposits is 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 deposits 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.

### ***Borrowed Funds***

The fair value of borrowed funds is based on the discounted value of contractual cash flows. The discount rate is estimated using the rates currently available for borrowings of similar remaining maturities.

***Accrued Interest Payable***

The fair value estimate approximates the carrying amount as this financial instrument has a short maturity.

***Off-Balance-Sheet Instruments***

Off-balance-sheet instruments include loan commitments. Fair values for loan commitments have not been presented as the future revenue derived from such financial instruments is not significant.

***Limitations***

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These values do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based on Management's judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates. Fair value estimates are based on existing on- and off-balance-sheet financial instruments without attempting to estimate the

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value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Other significant assets and liabilities that are not considered financial instruments include the deferred tax asset, premises and equipment, and other real estate owned. In addition, tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of the estimates.

The estimated fair values for the Company's financial instruments as of December 31, 2006 and 2005 were as follows:

	<u>December 31, 2006</u>		<u>December 31, 2005</u>	
	Carrying amount	Estimated fair value	Carrying amount	Estimated fair value
<b>Financial assets</b>				
Cash and cash equivalents	\$ 24,188,000	\$ 24,188,000	\$ 25,982,000	\$ 25,982,000
Securities available for sale	44,815,000	44,815,000	54,743,000	54,743,000
Securities to be held to maturity	135,734,000	134,649,000	129,238,000	128,563,000
Loans (net of allowance for loan losses)	831,781,000	814,049,000	766,252,000	759,244,000
Cash surrender value of life insurance	8,495,000	8,495,000	8,212,000	8,212,000
Accrued interest receivable	6,140,000	6,140,000	5,005,000	5,005,000
<b>Financial liabilities</b>				
Deposits	\$ 805,235,000	\$ 735,741,000	\$ 713,964,000	\$ 676,462,000
Borrowed funds	179,862,000	181,321,000	215,189,000	216,554,000
Accrued interest payable	1,592,000	1,592,000	937,000	937,000

### Note 17. Other Operating Income and Expense

Other operating income and other operating expense include the following items greater than 1% of revenues.

<i>For the years ended December 31,</i>	2006	2005	2004
<b>Other operating income</b>			
Merchant discount fees	\$ 2,507,000	\$ 2,250,000	\$ 1,039,000
ATM income	771,000	684,000	-
<b>Other operating expense</b>			
Merchant interchange fees	\$ 2,393,000	\$ 2,278,000	\$ 898,000

### Note 18. Regulatory Capital Requirements

The ability of the Company to pay cash dividends to its shareholders depends primarily on receipt of dividends from its subsidiary, the Bank. The subsidiary may pay dividends to its parent out of so much of its net income as the Bank's directors deem appropriate, subject to the limitation that the total of all dividends declared by the Bank in any calendar year may not exceed the total of its net income of that year combined with its retained net income of the preceding two years and subject to minimum regulatory capital requirements. The amount available for dividends in 2007 will be 2007 earnings plus retained earnings of \$10,208,000 from 2006 and 2005.

The payment of dividends by the Company is also affected by various regulatory requirements and policies, such as the requirements to maintain adequate capital. In addition, if, in the opinion of the applicable regulatory authority, a bank under its jurisdiction is engaged in or is about to engage in an unsafe or unsound practice (which, depending on the financial condition of the bank, could include the payment of dividends), that authority may require, after notice and hearing, that such bank cease and desist from that practice. The Federal Reserve Bank and the

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Comptroller of the Currency have each indicated that paying dividends that deplete a bank's capital base to an inadequate level would be an unsafe and unsound banking practice. The Federal Reserve Bank, the Comptroller and the Federal Deposit Insurance Corporation have issued policy statements which provide that bank holding companies and insured banks should generally only pay dividends out of current operating earnings.

In addition to the effect on the payment of dividends, failure to meet minimum capital requirements can also result in mandatory and discretionary actions by regulators that, if undertaken, could have an impact on the Company's operations. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank

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must meet specific capital guidelines that involve quantitative measurements of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of Tier 1 capital and Tier 2 or total capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of December 31, 2006, that the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2006, the most recent notification from the Office of the Comptroller of the Currency classified the Bank as well-capitalized under the regulatory framework for prompt corrective action. To be categorized as well-capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table. There are no conditions or events since this notification that Management believes have changed the institution's category.

The actual and minimum capital amounts and ratios for the Bank are presented in the following table:

	Actual	For capital adequacy purposes	To be well-capitalized under prompt corrective action provisions
<b>As of December 31, 2006</b>			
Tier 2 capital to risk-weighted assets	\$82,455,000 11.21%	\$58,827,000 8.00%	\$73,534,000 10.00%
Tier 1 capital to risk-weighted assets	\$76,091,000 10.35%	\$29,414,000 4.00%	\$44,120,000 6.00%
Tier 1 capital to average assets	\$76,091,000 7.19%	\$42,347,000 4.00%	\$52,934,000 5.00%
<b>As of December 31, 2005</b>			
Tier 2 capital to risk-weighted assets	\$76,963,000 11.05%	\$55,664,000 8.00%	\$69,581,000 10.00%
Tier 1 capital to risk-weighted assets	\$70,877,000 10.18%	\$27,832,000 4.00%	\$41,748,000 6.00%
Tier 1 capital to average assets	\$70,877,000 7.28%	\$38,890,000 4.00%	\$48,612,000 5.00%

The actual and minimum capital amounts and ratios for the Company, on a consolidated basis, are presented in the following table:

	Actual	For capital adequacy purposes	To be well-capitalized under prompt corrective action provisions
<b>As of December 31, 2006</b>			
Tier 2 capital to risk-weighted assets	\$82,849,000 11.26%	\$58,862,000 8.00%	n/a n/a
Tier 1 capital to risk-weighted assets	\$76,485,000 10.40%	\$29,431,000 4.00%	n/a n/a
Tier 1 capital to average assets	\$76,485,000 7.22%	\$42,395,000 4.00%	n/a n/a
<b>As of December 31, 2005</b>			
Tier 2 capital to risk-weighted assets	\$81,019,000 11.61%	\$55,694,000 8.00%	n/a n/a
Tier 1 capital to risk-weighted assets	\$74,933,000 10.74%	\$27,847,000 4.00%	n/a n/a





Tier 1 capital to average assets	\$74,933,000 7.66%	\$39,149,000 4.00%	n/a n/a
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**Note 19. Condensed Financial Information of Parent**

Condensed financial information for First National Lincoln Corporation exclusive of its subsidiary is as follows:

**Balance Sheets**

<i>As of December 31,</i>	2006	2005
<b><u>Assets</u></b>		
Cash and cash equivalents	\$ 142,000	\$ 1,087,000
Dividends receivable	1,500,000	400,000
Investments	443,000	445,000
Investment in subsidiary	78,931,000	74,340,000
Premises and equipment	224,000	226,000
Goodwill	27,559,000	27,559,000
Other assets	183,000	1,669,000
<b>Total assets</b>	<b>\$ 108,982,000</b>	<b>\$ 105,726,000</b>
<b><u>Liabilities and shareholders equity</u></b>		
Dividends payable	\$ 1,563,000	\$ 1,374,000
Other liabilities	92,000	900,000
Total liabilities	1,655,000	2,274,000
Shareholders equity		
Common stock	98,000	99,000
Additional paid-in capital	45,587,000	47,718,000
Retained earnings	61,634,000	55,625,000
Net unrealized gains on available-for-sale securities	8,000	10,000
Total shareholders equity	107,327,000	103,452,000
<b>Total liabilities and shareholders equity</b>	<b>\$ 108,982,000</b>	<b>\$ 105,726,000</b>

**Statements of Income**

<i>For the years ended December 31,</i>	2006	2005	2004
Investment income	\$ 36,000	\$ 33,000	\$ 56,000
Other expense	120,000	58,000	74,000
Loss before Bank earnings	(84,000)	(25,000)	(18,000)
Equity in earnings of Bank			
Remitted	7,485,000	7,400,000	3,276,000
Unremitted	4,894,000	5,468,000	5,251,000
Net income	\$ 12,295,000	\$ 12,843,000	\$ 8,509,000

*Statements of Cash Flows*

<i>For the years ended December 31,</i>	<b>2006</b>	2005	2004
<b>Cash flows from operating activities:</b>			
<b>Net income</b>	<b>\$ 12,295,000</b>	\$ 12,843,000	\$ 8,509,000
<b>Adjustments to reconcile net income to net cash provided by operating activities:</b>			
Depreciation	<b>2,000</b>	2,000	2,000
Equity compensation expense	<b>60,000</b>	-	-
(Increase) decrease in other assets	<b>386,000</b>	(999,000)	(83,000)
Increase (decrease) in other liabilities	<b>(619,000)</b>	1,749,000	19,000
Unremitted earnings of Bank	<b>(4,894,000)</b>	(5,468,000)	(5,251,000)
<b>Net cash provided by operating activities</b>	<b>7,230,000</b>	8,127,000	3,196,000
<b>Cash flows from investing activities:</b>			
Proceeds from maturities and calls of investments	-	-	250,000
Net cash used in acquisition	-	(2,348,000)	-
<b>Net cash provided by (used in) investing activities</b>	<b>-</b>	(2,348,000)	250,000
<b>Cash flows from financing activities:</b>			
Payments to purchase common stock	<b>(3,052,000)</b>	(3,032,000)	(404,000)
Proceeds from sale of common stock	<b>860,000</b>	1,416,000	822,000
Dividends paid	<b>(5,983,000)</b>	(4,727,000)	(3,135,000)
<b>Net cash used in financing activities</b>	<b>(8,175,000)</b>	(6,343,000)	(2,717,000)
Net increase (decrease) in cash and cash equivalents	<b>(945,000)</b>	(564,000)	729,000
Cash and cash equivalents at beginning of year	<b>1,087,000</b>	1,651,000	922,000
<b>Cash and cash equivalents at end of year</b>	<b>\$ 142,000</b>	\$ 1,087,000	\$ 1,651,000

**Note 20. Quarterly Information**

The following tables provide unaudited financial information by quarter for each of the past two years:

<i>Dollars in thousands</i>	2005Q1	2005Q2	2005Q3	2005Q4	2006Q1	2006Q2	2006Q3	2006Q4
<b>Balance Sheets</b>								
Cash	\$22,206	\$22,080	\$32,007	\$25,982	\$21,052	\$22,606	\$26,512	\$24,188
Investments	156,182	160,041	163,439	183,981	187,930	189,718	178,954	180,549
Net loans	676,091	712,270	733,163	766,252	785,184	819,918	822,318	831,781
Other assets	63,739	64,181	64,712	65,994	66,207	68,341	67,656	68,351
Total assets	918,218	958,572	993,321	1,042,209	1,060,373	1,100,583	1,095,440	1,104,869
Deposits	606,180	672,254	755,324	713,964	750,714	786,961	848,048	805,235
Borrowed funds	202,856	177,729	126,647	215,189	194,172	196,649	130,300	179,862
Other liabilities	9,467	8,017	9,506	9,604	10,908	11,343	10,428	12,445
Stockholders' equity	99,715	100,572	101,844	103,452	104,579	105,630	106,664	107,327
Total liabilities & equity	918,218	958,572	993,321	1,042,209	1,060,373	1,100,583	1,095,440	1,104,869
<b>Income Statements</b>								
Interest income	10,896	12,294	13,138	14,103	14,812	15,833	16,829	16,730
Interest expense	3,453	4,400	5,149	5,846	7,064	8,338	9,091	9,096
Net interest income	7,443	7,894	7,989	8,257	7,748	7,495	7,738	7,634
Provision for loan losses	-	100	-	100	250	350	300	425
Net interest income after provision for loan losses	7,443	7,794	7,989	8,157	7,498	7,145	7,438	7,209
Non-interest income	1,663	2,228	2,954	2,189	2,073	2,360	3,246	2,627
Non-interest expense	4,906	5,666	6,254	5,692	5,434	5,081	6,235	5,689
Income before taxes	4,200	4,356	4,689	4,654	4,137	4,424	4,449	4,147
Income taxes	1,205	1,223	1,342	1,286	1,159	1,252	1,272	1,179
Net income	2,995	3,133	3,347	3,368	2,978	3,172	3,177	2,968
Basic earnings per share	0.32	0.32	0.34	0.34	0.30	0.32	0.32	0.31
Diluted earnings per share	0.31	0.31	0.34	0.34	0.30	0.32	0.32	0.31

**Note 21. Pro-Forma Financial Information**

On August 25, 2004, the Company entered into an agreement to acquire FNB Bankshares of Bar Harbor, Maine, and its subsidiary, The First National Bank of Bar Harbor. This acquisition was completed on January 14, 2005, and in the table which follows, pro forma financial information is presented.

The pro forma statements of income in the following table show how the Company's results of operations would have been presented if the Company and FNB had operated as one entity for the entire periods presented. Management has made adjustments to reflect the amortization of the premium on loans acquired, increased depreciation on premises, and amortization of the core deposit intangible. Average shares outstanding and incremental shares used in earnings per share calculations are based upon the exchange ratio of 2.35 shares of the Company for each share of FNB.

	<b>For the years ended December 31,</b>		
	<b>2006</b>	2005	2004
Interest income	<b>\$ 64,204,000</b>	\$ 50,812,000	\$41,356,000
Interest expense	<b>33,589,000</b>	18,956,000	11,304,000
Net interest income	<b>30,615,000</b>	31,856,000	30,052,000
Provision for loan losses	<b>1,325,000</b>	200,000	1,060,000
Net interest income after provision for loan losses	<b>29,290,000</b>	31,656,000	28,992,000
Other operating income	<b>10,306,000</b>	9,179,000	8,748,000
Other operating expenses	<b>22,439,000</b>	23,212,000	22,831,000
Income before income taxes	<b>17,157,000</b>	17,623,000	14,909,000
Applicable income taxes	<b>4,862,000</b>	4,954,000	4,163,000
Net income	<b>\$ 12,295,000</b>	\$ 12,669,000	\$ 10,746,000
<b>Operating Statistics</b>			
Basic earnings per share	<b>\$1.25</b>	\$1.30	\$1.10
Diluted earnings per share	<b>\$1.25</b>	\$1.28	\$1.08
Cash dividends declared per share	<b>\$0.61</b>	\$0.53	\$0.45
Dividend payout ratio	<b>48.80%</b>	40.77%	39.14%
Return on average assets	<b>1.14%</b>	1.32%	1.31%
Return on average equity	<b>11.63%</b>	12.72%	16.47%
Return on average tangible equity	<b>15.75%</b>	17.41%	16.51%
Efficiency ratio (tax equivalent)	<b>52.12%</b>	53.97%	55.98%

**Report of Independent Registered Public Accounting Firm**

*Berry, Dunn, McNeil & Parker*

The Board of Directors and Shareholders

First National Lincoln Corporation

We have audited the accompanying consolidated balance sheets of First National Lincoln Corporation and Subsidiary as of December 31, 2006 and 2005, and the related consolidated statements of income, changes in shareholders' equity and cash flows for each of the three years in the three-year period ended December 31, 2006. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by Management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of First National Lincoln Corporation and Subsidiary as of December 31, 2006 and 2005, and the consolidated results of their operations and their consolidated cash flows for each of the three years in the three-year period ended December 31, 2006 in conformity with accounting principles generally accepted in the United States of America.

As disclosed in Notes 1 and 12 to the consolidated financial statements, the Company adopted the provisions of Statement of Financial Accounting Standards No. 123(R), Share-Based Payment, on January 1, 2006 and Statement of Financial Accounting Standards No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements No. 87, 88, 106, and 132(R) on December 31, 2006.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of First National Lincoln Corporation and Subsidiary's internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 16, 2007 expressed an unqualified opinion on Management's assessment of internal control over financial reporting and an unqualified opinion on the effectiveness of internal control over financial reporting.

/s/ BERRY, DUNN, McNEIL & PARKER

Portland, Maine

March 16, 2007

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**ITEM 9A. Controls and Procedures**

As required by Rule 13a-15 under the Securities Exchange Act of 1934 (the Exchange Act), as of December 31, 2006, the end of the period covered by this report, the Company carried out an evaluation under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures. In designing and evaluating the Company's disclosure controls and procedures, the Company and its management recognize that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and the Company's management necessarily was required to apply its judgment in evaluating and implementing possible controls and procedures. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective to provide reasonable assurance that information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Also, based on Management's evaluation, there was no change in the Company's internal control over financial reporting that occurred during the fiscal quarter ended December 31, 2006 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting. The Company reviews its disclosure controls and procedures, which may include its internal controls over financial reporting, on an ongoing basis, and may from time to time make changes aimed at enhancing their effectiveness and to ensure that the Company's systems evolve with its business.

**Management's Annual Report on Internal Control over Financial Reporting**

The Management of the Company is responsible for the preparation and fair presentation of the financial statements and other financial information contained in this Form 10-K. Management is also responsible for establishing and maintaining adequate internal control over financial reporting and for identifying the framework used to evaluate its effectiveness. Management has designed processes, internal control and a business culture that foster financial integrity and accurate reporting. The Company's comprehensive system of internal control over financial reporting was designed to provide reasonable assurances regarding the reliability of financial reporting and the preparation of the consolidated financial statements of the Company in accordance with generally accepted accounting principles. The Company's accounting policies and internal control over financial reporting, established and maintained by Management, are under the general oversight of the Company's Board of Directors, including the Board of Directors' Audit Committee.

Management has made a comprehensive review, evaluation, and assessment of the Company's internal control over financial reporting as of December 31, 2006. The standard measures adopted by Management in making its evaluation are the measures in Internal Control - Integrated Framework published by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO). Based upon its review and evaluation, Management concluded that, as of December 31, 2006, the Company's internal control over financial reporting was effective and that there were no material weaknesses.

Berry, Dunn, McNeil & Parker, an independent registered public accounting firm, which has audited and reported on the consolidated financial statements contained in this Form 10-K, has issued its written attestation report on Management's assessment of the Company's internal control over financial reporting which follows this report.

**Report of the Independent Registered Public Accounting Firm**

To the Board of Directors and Shareholders

First National Lincoln Corporation

We have audited Management's assessment, included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting, that First National Lincoln Corporation ( Company ) maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). First National Lincoln Corporation's Management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on Management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating Management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Management's assessment that First National Lincoln Corporation maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also in our opinion, First National Lincoln Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of First National Lincoln Corporation as of December 31, 2006, and the related consolidated statements of income, changes in shareholders' equity and cash flows for the year then ended, and our report dated March 16, 2007 expressed an unqualified opinion.

/s/ Berry, Dunn, McNeil & Parker



Portland, Maine

March 16, 2007

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**SIGNATURE**

Pursuant to the requirements of section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

FIRST NATIONAL LINCOLN COPORATION

By

/s/ DANIEL R. DAIGNEAULT

Daniel R. Daigneault

President and Chief Executive Officer

September 28, 2007

/s/ F. STEPHEN WARD

F. Stephen Ward

Treasurer & Chief Financial Officer

September 28, 2007

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